

creases built in. These were probably larger than might have been negotiated under the circumstances.

Representative WIDNALL. You spoke of this practice in the first year having the heaviest impact, and then subsequent 2- and 3-year contracts having a lesser amount as "front loading." Do you think this tendency to front load should be encouraged or discouraged?

Secretary SHULTZ. I don't really have a view on that, I guess. But in addition, I suspect the parties are going to do what looks right to them, whatever we urge. That is, you can see what goes on. If you want to get an agreement, people properly value immediate income above future income, and the union and the company may desire, in order to get an agreement, to take the cost and put some of it up front. That tends to dramatize what is available immediately and helps to secure acceptance of the contract. I think it is that sort of process that is going on. We can look at this as steely eyed economists, and that is one thing. But at the same time, there are a lot of practical labor relations problems to be considered. I personally tend to have the philosophy that the experts are the people immediately involved. They know more about what they want and how they want to arrange their affairs than we do, and we basically should respect their judgment.

Representative WIDNALL. Mr. Chairman, my time is up. I would like to ask one more question.

Senator PROXMIRE (presiding). Go ahead.

Representative WIDNALL. At the end of the current war I think, as we all recognize, that we may face some serious unemployment problems, and also the problems of dislocation where some industries may have to shut down and cut down material. What planning is now being done in this area by your department?

Secretary SHULTZ. We are participating in an effort led by Dr. Herbert Stein, a member of the Council of Economic Advisers, to tackle just this issue. And I might say that in having Herb Stein lead this effort the administration has, I think, undoubtedly the country's leading expert on this kind problem. It goes back to a prize-winning essay that he wrote about the readjustment from World War II. He has worked on this subject off and on since then, and has worked on it in connection with the current hostilities.

In my own view of economists who have worked in this area, I would have to put Herb down as the absolute No. 1 person.

So we not only are making an effort, but have been fortunate enough to have the effort led by a man of great knowledge and insight and depth of analysis in this area.

Representative WIDNALL. Thank you, Mr. Shultz.

Senator PROXMIRE. Mr. Secretary, it is my understanding that the President's Committee, or Cabinet committee, on Price Stability has been killed; is that right?

Secretary SHULTZ. I am not certain as to how these things work. I haven't gone to any meetings of such a committee, and I notice that the Secretary of Labor was on the original committee.

Senator PROXMIRE. There is quite a difference between the approach to inflation on the part of the Nixon administration and the preceding administration, in that you are going to concentrate exclusively, really, on monetary and fiscal policy. And of course we have these longer range factors of antitrust, which we agree with. And you recognize that there is some difference now in employment stability,

but really you are going to concentrate on fiscal and monetary policy very largely as your anti-inflationary tools.

Secretary SHULTZ. I don't think that the relative committee structures have any particular implication of that kind.

Senator PROXMIRE. You are not going to use presidential jaw boning, or guidelines, or price controls, or anything of that sort. That doesn't leave much.

Secretary SHULTZ. I would say that the creation of the Cabinet Committee on Economic Policy—and certainly economic policy includes the problems of inflation, unemployment, and so forth—is a very positive step by the new administration to deal with these problems on a broad basis.

Senator PROXMIRE. You certainly have an interest in this committee in advising on inflation and anti-inflation policy. But you have many other responsibilities, as does this committee. But it is hard to say—it is hard to substitute that committee for a committee expressly and exclusively concerned with inflation, with price stability. It seems to me it is backing away from the institutional setup. Now, it may be right to do it. But all I am saying is that that seems to be a conclusion that I draw.

Secretary SHULTZ. I can't believe, from all the discussion that has taken place, in the light of the interest of this committee, and the people who have testified here, that there is any diminution of interest in this problem.

Senator PROXMIRE. No, but there is a concentration—and of course this is debatable as to whether this is why—there is a concentration on using particular policies, and the policies are fewer, the methods are fewer, than the methods before.

Secretary SHULTZ. I haven't tried in my testimony to outline a complete strategy for the administration, but I have concentrated on the manpower aspects of the program. I felt that was probably proper for me.

Senator PROXMIRE. About the manpower program, one definition of the target for these manpower programs, as I understand it, are those who have been employed for 15 weeks or more whose incomes are less than the poverty level. Do you have any data on how large a group this is?

Secretary SHULTZ. There are data on that, the so-called target group. And defining the group is a somewhat difficult problem.

Senator PROXMIRE. And how large a proportion of this group does the 1970 budget provide that the manpower program will meet?

Secretary SHULTZ. Well, that is something that we are digging into very hard to try to estimate.

Senator PROXMIRE. It is a small proportion, 15 or 20 percent?

Secretary SHULTZ. It is related to the question that Mr. Reuss asked me to report on earlier.

Senator PROXMIRE. At any rate, I understand it is a relatively small proportion. It certainly is not half, it is less than a quarter, it is a small part of the total problem.

Secretary SHULTZ. Yes.

Senator PROXMIRE. This brings me to the question of why you have, as I understand it, a flat opposition—if you do not let me know—to increasing the minimum wage. As I understand it, the minimum wage is designed to help bring more out of poverty those who have received

the bare minimum wage, the \$1.60, who would be on the fringe of poverty, depending on your definition, or very close to it.

What is your logic behind your taking this position, in view of the fact that we are not going to be able to help them through manpower policies, in the near future anyway?

Secretary SHULTZ. I support the general concept of the minimum wage. I think it has done some good things in our economy. The question, however, is whether or not it would be wise to raise the current minimum wage by some amount—and we talk about various amounts—this year. I think there is also a question that was raised about the impact of a flat minimum wage covering all people.

Senator PROXMIRE. It is always a bad time to raise the minimum wage, isn't it? When you have an unemployment situation you say that to raise the minimum wage is going to make the unemployment situation worse. We have had some very dramatic increase in the minimum wage, 15 cents up to 50, and 75 cents to a dollar, and then to \$1.20, and now we are up to \$1.60. And every time we were warned that this was going to increase unemployment and was going to be inflationary. And to the best of my knowledge, there is no data—and there has been plenty of opportunity to develop data—there has been no data to show that this is true.

You raise a very understandable question as to how this will affect teenagers. As I understand it, 20 to 25 percent of the labor force isn't covered by the minimum wage. And by and large—of course, there are many exceptions—but by and large teenagers are employed in areas that are not covered. So I think that without data it is hard to conclude that this would necessarily be restrictive on teenage employment.

Secretary SHULTZ. I do not believe that I made a flat statement of my view about the teenage employment problem.

Senator PROXMIRE. You did not, that it true. You raised that as a problem.

Secretary SHULTZ. I raised that as a problem, sir. And I do think that it is a legitimate problem and the contrast between our experience and the experience in other countries which handled this differently is quite striking.

The rise in teenage unemployment is much more of a problem now, relatively speaking, than it was, say, 10 years or so ago. It makes you wonder. Maybe it has some connection with the fairly rapid increases that have taken place, and the expansion of coverage. I am not ready to reach a conclusion on that either way. But I am certainly not going to sit here and say that I agree that the minimum wage has no impact on employment. I think it does.

But the question is whether or not, despite that, it can be desirable.

Senator PROXMIRE. You see, what this seems to spell out to some extent is that these policies of putting the whole burden of restraining inflation on monetary and fiscal policy—if you accept the Phillips concept of a trade-off between unemployment on the one hand and price stability on the other—and there seems to be a very logical argument in favor of that—it seems that the whole burden is put on the people with low income, the people who are likely to be out of work. And in a year in which Congress has increased its pay by 40 percent, it is

pretty hard for us to go out and explain the logic of this to people in my State who have very low incomes.

Secretary SHULTZ. I think the question you have to face—

Senator PROXMIRE. How would you explain it? Suppose you were confronted by a group of people working in a low-income industry, and they want to know how you explain that our salaries were increased—I voted against it, but that is not my point—at any rate, our salaries are increased by a big margin, and we are telling them that we can't give them an increase in the minimum wage so that they can live.

Secretary SHULTZ. I think the question is, does an increase in the minimum wage produce an increase in income for the people who are the most disadvantaged insofar as their ability to produce on the job is concerned? If we were to find and could stipulate that the way to get all of the unemployed, poverty-stricken people of this country, a good income was to require employers to pay a \$5 minimum wage, I would be all for it.

But what concerns me is that by raising the minimum wage to a level that is higher than the value that many people can produce on the job, we wind up with those people not having a job at the minimum wage or any other wage. So that really doesn't get them out of the problem.

Senator PROXMIRE. There has always been a question of the minimum wage. When we had sweatshops that were so conspicuous, and the people were paid less than 25 cents an hour, there was always the complaint, they are not worth more than 25 cents an hour. We found that this was not something that prevented the poor people from getting a better income, it was helpful. Wouldn't you conclude that minimum wage in the past has been a useful method of improving the income of low-income people?

Secretary SHULTZ. For some, I agree. And I agree that it can be a useful device in the future. The position I took was that this year, after the fairly substantial increases that we have seen very recently, it seemed to me that a pause was called for, and that we shouldn't push this too hard.

Senator PROXMIRE (presiding). My time is up. I want to come back. Senator Miller?

Senator MILLER. On this point, might it not be that—following the last round of minimum wage increases—a byproduct of unemployment, which, while normally resulting, did not take place because of the war, because of there being many more in the armed services, for example?

Secretary SHULTZ. I think it is quite clear from the employment figures presented that the armed services and the war-related industries were responsible for a great increase in male employment.

Senator MILLER. So that if it hadn't been for the war, this recent round of minimum wage increases might have shown up in the form of unemployment increases?

Secretary SHULTZ. It might have.

Senator MILLER. One other question. Do you have any plans to make any changes, substantial changes, in the CPI?

Secretary SHULTZ. This is a technical question. There is work going on to increase the usefulness of computer science as applied to the processing of the data. And that is underway. I believe that the re-

sults of the experience in terms of switching over to that method to a greater extent will bear fruit probably within the next 6 months. The CPI is periodically worked over from the standpoint of whether or not the weighting of particular goods and services is a true reflection of the market basket for various levels of income.

Preparations for the next comprehensive revision of the CPI are underway. There has also been continuing work—and I am not certain of the exact status of this now—continuing work and some concern about the problem of reflecting quality increases in the measurement process. For example, we say that medical costs are rising rapidly. And this is one of the big plus areas in the CPI.

It is certainly true that the daily price of a room in a hospital has been going up at a terrific clip. At the same time, one might ask what has happened to the cost of curing pneumonia, over a period of time? It may be that the cost of curing pneumonia has declined because of the advances in medical science. This means that the individual pneumonia patient does not remain as long in the hospital. However, the cost of curing pneumonia is a hard end product to get a handle on in a technical sense.

Now, I know there have been advances in price measurement techniques, and efforts are being made to continue these advances.

This is not a true technical response to your question.

If you would like a detailed one, I will see that you are supplied one.

Senator MILLER. For this time, that is all right. I am glad to know that you are very much aware of it, and you are working on it, and that computers will play a part in it.

On that point, however, is there any thought being given to possibly changing the area of sampling? As I understand it, the CPI is based upon sampling of wage earners in cities. And I have often wondered why we didn't take a broader look at this CPI to not only include wage earners in cities but wage earners in small communities, even retired people, so that we might have a little broader brush on what this looks like.

Maybe we might have to have two or three CPI's to reflect different segments of the social stratum. But do you know whether there is any thought being given to that?

Secretary SHULTZ. This involves sampling the varying market baskets that people in different communities have as distinct from the problem of pricing them out. The data come from surveys of individual consumers, rather than from the people who are selling the products. I am not prepared to answer that question completely.

Senator MILLER. I hope you will take a look at it and see what the possibilities are on that point, too.

Thank you, Mr. Secretary.

Senator PROXMIER (presiding). It is my understanding that we have always legislated the minimum wage by steps, and we have always been moderate in doing so, and we have tried to tie it to some index of productivity, and so forth. And presumably we will do that in the future. I haven't heard anyone propose \$5. I have heard some \$2 proposals. And maybe that is too high. But what I am suggesting is that this is an instrument that we just shouldn't put aside and say

we are not going to consider this this year, we are going to wait for a few years and see what has happened.

In the past we have had a lot of progressive systems for increasing the minimum wage. I don't say that we should increase it this year. We could act this year as we have to provide for step increases. Do you disagree that this can be another approach, and do you expect a moderate approach?

Secretary SHULTZ. I think a moderate approach to the subject is a desirable approach. And I would agree with you on that point.

Senator PROXMIRE. Now, as I understand it, you have stated that you favor the direct contract method for obtaining adequate public manpower programs as preferable to the tax-incentive approach, you have said so, I understand, in an interview. And you are also a member of the National Manpower Policy Task Force, which has cautioned against implementation of tax-incentive measures.

Is this a correct interpretation of your position?

Secretary SHULTZ. No, sir. The National Manpower Policy Task Force did put out a report. It took a very strong position on this question. I had left that task force before the report was prepared, and did not participate in the preparation of it, and didn't sign it, and had nothing to do with it.

I am not in any way derogating the report of that group, which I consider to be a very good group of people, and an able group of people, it is just that it isn't proper to infer any views of mine from this report.

Senator PROXMIRE. What is your position?

Secretary SHULTZ. My position is that the contracting approach as illustrated, I think, most prominently by the National Alliance of Businessmen JOBS Program, has worked quite well, and should be supported, and used aggressively. And we have plans to do so. I have referred to some of them in my testimony.

I think that the tax-incentive approach also has merit, and that the way we should conceive of this problem is not in terms of that approach or this approach, or some other approach. The way to go about this would be to realize that different ways will be useful in different segments of the economy, and that we need a kind of multi-dimensional approach to many of these problems.

So that I don't see that we can't have both of these things going on to some extent at the same time.

Now, so far as the use of tax-incentive is concerned in terms of specifics, I should think among other things that we ought to be conducting some efforts to learn by doing, and see if there aren't some areas where we could set up some experiments and see how well they work.

Senator PROXMIRE. What concerns me, and I think a lot of Members of Congress, is the erosion of the tax structure. Our rates are already very high, and we have already provided for many incentives such as the investment credit. And there are areas that we could do it in, in housing, and in so many areas. I am just concerned that this is going to give us a very awkward and unfortunate tax structure, even worse than it is now.

Secretary SHULTZ. I share the concern about the erosion of the tax base. And I think that when you talk about a tax incentive that there is

a special burden of proof on the advocate because of the importance of preserving the integrity of the tax base. I agree with that.

Senator PROXMIRE. One other question in this connection. Isn't it true that every employer has to train the people he hires in most cases? This is a very big and important cost for an employer. Now, if you are going to start subsidizing that enormous cost—you have to do it in a very careful and discriminating way. You have to provide that he is going to be given a tax credit only for those who otherwise would not be employable for training programs. You have to limit it to those with a limited education or with some limited skill.

Isn't this going to be very hard to administer? Isn't it going to involve a degree of bureaucratic interference that would be quite substantial?

Secretary SHULTZ. I think the points that you make also must be made with respect to any contracting program. And it is certainly true enough that a tax incentive program in this field, unless you wanted to change the concept of it quite drastically, is not a sort of automatic, self-administering device.

Senator PROXMIRE. That is my point. You put it better. I am not saying that the contract employment doesn't also have these limitations. I am saying that the notion that you get away from bureaucracy by simply providing a tax credit and you take care of it in the private market is not valid, it will still have a very careful review by the Internal Revenue Service, and a good deal of governmental judgment.

Secretary SHULTZ. One of the problems with it, I think is that you might wind up with the Internal Revenue Service administering human relations problems. And with all due respect to them, I don't think that is at all desirable.

Senator PROXMIRE. Your friendly tax collector.

Secretary SHULTZ. Well, we used to train some in our business school.

But it probably is the case that a tax-incentive approach would lessen the amount of administrative detail that you would have to engage in. So it is a matter of degree.

Senator PROXMIRE. If it did, you would very likely have a lot of leakage.

Secretary SHULTZ. I think probably you would rely on stipulations of what people are doing, and also on the references from, say, the Employment Service to an employer of an individual what would qualify for this tax break. With these kinds of stipulations you could proceed, and if people violated the trust involved, they would be prosecuted.

That approach to the administration in this area has grown, and in general it is a good approach.

I might just say one other word. And it takes this problem back to the minimum wage discussion that we had. The contracting approach, the tax-incentive approach, any of these approaches to stimulating greater employment for the disadvantaged, are in the nature of special subsidies for their employment. The reason they are needed—and I support them—is that the person that you are talking about is not able to produce the value of his pay immediately.

So you have a method of, in effect, having the Government make up the difference. I think that it is a perfectly good method. But I think what it suggests is that there is a relationship between the amount

of pay a person is required to get on a job and the decision about whether that person is employable at that pay. That just seems to me to be a pretty obvious proposition.

Senator PROXMIRE. Isn't one of the problems, too, the attitude of the supervisory personnel? These are the people who will weed out those who are inefficient and fire them. And that is one of the reasons that they are supervisory personnel, that is one of their jobs, they have to do that. But at the same time, unless they understand the problem here, and have the understanding of the requirement for patience and for seeing that these people do need particular help for a period of time, it is going to—the program isn't going to work well. Isn't it likely that this kind of approach is more sustainable with a contract method rather than with a tax-incentive method?

Secretary SHULTZ. No. I think the problem is the same in either case. But I agree with you that it is a central problem.

Senator PROXMIRE. Are you working on that aspect, too?

Secretary SHULTZ. It depends on the supervisor. But it is also the union steward and the work group in the particular place where the man or woman comes in to work that you have to work with. I think there have been some great and interesting strides taken by industry in this regard. And the Department of Labor programs support this effort.

But it is interesting that very explicit, special training programs for supervisors have emerged within industry on just this point. I think they have learned a few things of rather general interest to themselves as a result. They have learned that their hiring standards are not necessarily fitted to job requirements.

They have learned that by giving a lot of attention to the process by which a person comes into employment, they probably can have a considerable impact on the rate of turnover of people and keep them on the job longer. This is something not only applicable to the so-called disadvantaged person, but much more broadly.

So I think there is coming to be a little more emphasis on the so-called vestibule aspects of employment than there has been before.

Senator PROXMIRE. Just a couple more brief questions. Would you say that much of the inflationary pressure is caused by wage increases in the defense industry? Wage increases in the defense industry, I understand, were faster and more substantial than elsewhere. We have received a lot of evidence before this committee that the increase in expenditures in procurement have been just enormous, and that part of this is because of the rapid increases in wages to get labor to do a job, and do it in a hurry. Do you have any information on this?

Secretary SHULTZ. I don't have any special new information to contribute on that.

(The following letter was subsequently received from Secretary Shultz:)

U.S. DEPARTMENT OF LABOR,
OFFICE OF THE SECRETARY,
Washington, March 6, 1969.

Hon. WILLIAM PROXMIRE,
U.S. Senate,
Washington, D.C.

DEAR SENATOR PROXMIRE: On February 20, in the course of my testimony before the Joint Economic Committee, you referred to high wage rates in the defense industry and their relation to high defense procurement costs. Although I com-

mented only in part at that time, I have since had the opportunity to research this matter more fully.

Aerospace is predominant in defense procurement and aerospace wage averages do tend to be somewhere higher than general industry averages. The apparent explanation is not that the aerospace industry has experienced an escalating wage spiral but that the industry has a significantly greater percentage of higher paid professional workers—mainly engineers and scientists. Today only 59 percent of aerospace employees are blue collar in contrast to 73 percent for all other manufacturing industries. In the last several years there has been a shift within the aerospace industry from blue-collar to white-collar jobs. In 1959, for instance, 64 percent of aerospace employees were blue collar.

The average white-collar professional or technician earns \$3,000 more per year than his blue-collar counterpart, so it is clear that this larger white-collar segment accounts for much of the differential in gross wages paid. In 1966, out of about 1 million employees in ordnance and aircraft, 143,000 were scientists and engineers and 54,000 were classified as technicians. In manufacturing as a whole, only about 3.5 percent were scientists and engineers and 2 percent technicians.

The foregoing doesn't fully depict differences between the pattern of job distribution in aerospace and other industries. Even within the aerospace blue-collar ranks, for example, an extensive shift of jobs from unskilled to skilled craft levels has occurred.

As I am sure you know this upward shift in job levels in aerospace has been caused by the rapidly advancing technological state of its products. Industry methods, materials, and designs have become increasingly sophisticated and complex. A heavy component of advanced electronics and instrumentation adds to this picture.

For further comparison purposes we examined wage rates of the machinist job, a representative job found in several industries, and noted the wages for that job in aerospace along with machinist's pay scales in three other major industries—steel, automotive, and shipbuilding. Aerospace machinists earned approximately \$4 per hour as compared with \$3.95 per hour average in the other industries.

Comparisons of this nature are always difficult to make. Variations in pay provisions, use of piece rates, recency of labor bargaining and region are all factors which complicate exact comparisons. However, on a job-for-job basis aerospace does not appear to differ greatly from other major industries.

I hope this information is more fully responsive to your question on this subject.

Sincerely,

GEORGE P. SHULTZ,
Secretary of Labor.

Senator PROXMIRE. It would be interesting to know this, because this is something that is to some extent within Government control. And it seems to me that we have done a poor job of limiting this kind of inflationary factor. It is a great big thing in the economy, \$43 billion a year of Defense procurement.

One final question. And this relates to the very helpful statement that you make with regard to the need for training people in construction. I am delighted to see you emphasize that. Governor Romney, when he was before our Senate Banking Committee, pointed out that this was one of the bottlenecks that we have. I understand that there is a tough union problem here, and an understandable union problem.

What kind of progress do you anticipate you can make in this area?

Secretary SHULTZ. I think that part of the union problem is connected with the fears of job scarcity. So I keep emphasizing in my own mind and my own thinking the strategic importance for practically any questions you discuss of high employment.

Senator PROXMIRE. Especially in the housing industry, where they have this 10-year goal, that ought to help a lot.

Secretary SHULTZ. The efforts to estimate overall demand for labor in this industry, getting that known and understood well, are an important part here. The efforts to work at the seasonality problem seem to be an important aspect of reassurance to the union group. And I think that there have been successes, and I hope these will continue, in the use of various governmental programs, combining contract agreements with training, bringing in of apprentices, and so on.

So I agree that this is an important area, and there are various ways of working at it. It is not the easiest thing in the world to do, I am sure that is true, too.

Senator PROXMIRE (presiding). Senator Miller?

Senator MILLER. On this minimum wage again, at a time when you are concerned about inflation, would not the bumping effect of an increase in the minimum wage have a tendency to accelerate that inflationary problem?

Secretary SHULTZ. You mean, if you increase the minimum is there a pass through on up the line?

Senator MILLER. That is right.

Secretary SHULTZ. Yes, it would tend to have that impact.

Senator MILLER. But the tax-incentive or contract approach would not?

Secretary SHULTZ. I think I may have confused matters by bringing that in. I was trying to come back, I guess, to an analytical point in my discussion with the Chairman about whether or not there is any connection between the wage paid and the demand for labor of various kinds. The use of the contracting approach or tax approach—the distinction between the two is not important for this point—but the fact that contracting approach has worked to bring people who weren't otherwise there onto payrolls suggests that there is this connection.

One of the things that has happened in the contracting approach is filling this gap by the money that flows from the contract. That is what the contract is really all about. And this is one piece of evidence, I submit, on the question we were discussing. I will put it that way.

Senator MILLER. Finally, with this computer technology that is now becoming available to us, would it be feasible to have minimum wages according to regions around the country? What I am getting at is, a minimum wage of \$1.50 in New York certainly would be very little. But in the State of Mississippi it would be very great.

I can see where it could cause a loss of industry in the State of Mississippi because of the economics involved. And what we want to do is, we want to keep industry and increase industry in some of these rural areas. And I am just wondering if this would be a feasible way of possibly modifying the aggravation of the migration of people by having a minimum wage on a reasonable basis according to the cost of living in the region.

Secretary SHULTZ. Well, wage differentials do exist between different regions in the country.

Senator MILLER. Not only minimum wage.

Secretary SHULTZ. And they do have the impact of stimulating the flow of economic developments. I suppose the concept of the statutory minimum wage covering all parts of the country at once would be that that is a minimum, and then States where there are very high wages can put up a higher minimum wage if they want. But at the same

time you create some base that avoids competition among regions on the basis of, let's say, very low-wage labor.

And so I think that to a degree the approach you are suggesting takes place naturally in the economic workings of the economy. The fact that we have a minimum wage that covers the country as a whole means that in thinking about it, one does have to think about it in terms of the low-wage regions as well as the high-wage regions.

Senator MILLER. That is right. And that is why I am wondering if it might be feasible to go this route.

In any event, could you have that looked into as a possibility?

Secretary SHULTZ. Yes, sir.

Senator MILLER. Thank you.

Senator PROXMIRE. Thank you very much, Mr. Shultz. You have been a fine witness. And you talked about taking your orals again. Certainly, we are not as well qualified as you on any score, but if we were, we certainly would give you a high distinction in the job you did here this morning.

The committee will reconvene on Monday, February 24, at 10 a.m., to hear four distinguished professors, who will look in their crystal balls and tell us what is going to happen in the economic outlook. That hearing will be held in room 318, Old Senate Office Building.

(Whereupon, at 12:25 p.m., the committee recessed, to reconvene at 10 a.m., Monday, February 24, 1969.)

THE 1969 ECONOMIC REPORT OF THE PRESIDENT

MONDAY, FEBRUARY 24, 1969

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The Joint Economic Committee met, pursuant to recess, at 10 a.m., in room 318, Old Senate Office Building, Hon. Wright Patman (chairman of the joint committee) presiding.

Present: Representatives Patman, Bolling, Brock, and Conable; and Senators Proxmire, Sparkman, Miller, and Percy.

Also present: John R. Stark, executive director; and Douglas C. Frechtling, minority economist.

Chairman PATMAN. The committee will please come to order.

This morning the Joint Economic Committee continues its hearings on the state of the economy and the administration's program.

Our leadoff witness last week was the new Chairman of the Council of Economic Advisers. He was followed by the Budget Director of the new administration, and the secretaries of the Treasury and Labor.

Today we are privileged to have a panel of four outstanding professors who are experts on the analysis of the economic situation in our country. We are delighted to welcome you, gentlemen, and we are grateful to you for your advice.

Our panel today consists of Prof. Lawrence R. Klein of the University of Pennsylvania; Prof. George L. Perry, University of Minnesota; Prof. Daniel B. Suits, University of Michigan; and Prof. Robert M. Williams, University of California at Los Angeles.

We hope that each of you can summarize your individual views within 10 minutes to permit us ample time for questions. You may always extend your remarks to include anything that is germane to your discussion that you would like to have included in the printed record.

After you have presented your views the committee will interrogate the panel under the 10-minute rule.

Professor Klein, we will begin with the discussion of your statement. You may start off in your own way.

STATEMENT OF LAWRENCE R. KLEIN, PROFESSOR OF ECONOMICS, UNIVERSITY OF PENNSYLVANIA

Mr. KLEIN. Thank you, Mr. Chairman.

Some of the main conclusions in the 1969 Economic Report of the President and the amended presentation of the new Council of Economic Advisers about the 1969 prognosis and the effects of recent

fiscal and monetary policies are generally in line with the predictions made by the Econometric Forecasting Unit of the Wharton School of Finance and Commerce, University of Pennsylvania, but there are differences of detail that I would like to point out for the committee.

First, permit me to explain the method and background of my calculations on the present and projected state of the economy. The Wharton EFU predictions are made from a mathematical-statistical model of the U.S. economy consisting of some 70 simultaneous equations. This is a dynamic, nonlinear system of equations from which economic projections are computed every quarter for a period extending eight quarters into the future. Every quarter, data on the economy are assembled and updated for new projections. The Wharton EFU has been doing this since 1963 in cooperation with economists from many of the Nation's largest corporations. We meet regularly every quarter and assess the main assumptions of the projection solutions. This is not a mechanical, arithmetic process. Late information and judgment of all the participating members of our group are brought to bear on the final solutions used. The present calculations reached were decided upon at our regular quarterly meeting held February 14, 1969, in Los Angeles, Calif. They are made for a base case which reflects our best considered judgment on policy variables and unique events. We also make contingency calculations for policy alternatives or other events that may occur.

The principal assumptions that underlie our most recent calculations are:

1. The Federal income tax surcharge will be retained at a full 10-percent level for another year after July 1, 1969.

2. The war in Vietnam will continue at a slower tempo. This will enable national defense outlays to grow at their recent slow rate. Other Federal expenditures will grow at a restrained pace, but both sets of Federal outlays will re-reflect a pay increase in 1969.

3. State and local expenditures will continue to grow approximately as they have in recent quarters. I will read from my figures. The overall totals start out at 206.4 billion in 1969, first quarter, and increase to 210, 215, 219, 223, 227, 230, and 234 as of the eighth quarter the series gives the annual rate of Government expenditures, GNP account basis.

ANNUAL RATE
[In billions of dollars]

	1968		1969				1970			
	4	1	2	3	4	1	2	3	4	
Defense.....	80.0	80.4	80.9	82.4	82.8	83.3	83.7	84.1	84.6	
Other Federal.....	21.7	22.0	22.4	23.1	23.5	23.9	24.3	24.7	25.1	
State and local.....	101.2	104.0	106.8	109.7	112.7	115.7	118.7	121.7	124.7	
Total.....	203.0	206.4	210.1	215.2	219.0	222.9	226.7	230.5	234.4	

The assumption No. 3 is that monetary policy will continue to be restrictive for the first three quarters of 1969 and will become somewhat easier. We are assuming a discount rate of 5.5 percent for three quarters and then a rate of 5 percent. We place net free reserves at minus \$500 million for the next two quarters and then raise them gradually toward zero.

4. Farm prices and income decline slightly during 1969.

5. World trade continues its slow growth of recent months.

6. The dock strike in the first quarter of 1969, the increase in social security payments, and the payment of the retroactive portion of the surtax, are all accounted for in our calculations.

The model calculations with these assumptions yields slow growth in output during the first quarter of 1969. The quarterly increment in GNP is placed at \$10-\$11 billion in the present quarter, rising to about \$12 billion in the next quarter, and slightly more than \$12 billion in the third quarter, these are all annual rates.

For the remainder of the projection, quarterly growth is held to less than \$14 billion.

In this slower economy, unemployment is expected to rise to levels as high as 4.5 percent and price inflation, measured by the GNP inflator, should be reduced by something between one-half and a whole percentage point. Wage rates are projected at approximately 7 percent per annum. Profits should recede from their present high levels and recover somewhat after mid-1969.

The slow performance indicated by the Wharton EFU model in early 1969 is below the rate implied by the Economic Report and the yearly average growth in total output is smaller. Our estimate of GNP for all 1969, given the reported value for 1968, is \$916 billion. This is lower than the estimate of the Economic Report and of many other economic forecasters.

It is our opinion that the American economy changed its rate of expansion considerably in late 1968, as we had previously forecast, although our projections had been to low for the third quarter, that the pressures of restrictive measures are being felt more severely now, and will continue to be felt in the next quarter of 1969. We do not foresee a recession in this pattern of slowdown, but when the economy performs this slowly, unemployment should eventually increase because of normal labor force and productivity growth. A possible reason why we have not yet seen an effect of the slowdown in the unemployment rate is that there has been some labor hoarding. Hours worked per week have been falling for a few months, while the number of persons laid off has been kept small.

The turn-around of consumers under the pressures of higher taxes and social security payments is reflected in modest calculations of increases in consumer outlays of approximately \$7 billion per quarter. This is much smaller than 1968 increments prior to the fourth quarter.

In the first quarter of 1969, we have built the effects of the dock strike into our solutions to yield a poor showing of net exports that is partially made up in the second quarter. We probably differ from the Economic Report in this respect. We also project modest rises in business fixed investment. The Economic Report is largely guided by the results of surveys on investment intentions. These have been unusually optimistic recently, while our equations for predicting investment show more modest rates of expansion.

A result of these differences in specific aspects of the economic outlook, together with our overall slower growth rate for GNP in 1969, produces a different budgetary assessment. Our projections of the deficit—NIA accounting basis; Federal, State, and local—are that it will be in surplus in the first two quarters of 1969 and then will turn

negative, at increasing rates, again. The lower income base implied by our projections yields a smaller stream of receipts. Also, payments must be made for benefits at our projected higher rates of unemployment, and, of course, the higher interest rates are a big burden on interest payments by the Federal Government.

I have submitted some very late calculations that I wasn't able to include in my written statement, which is a table of the GNP account as it came off our computer output run. These are started in the left column as being the last quarter of 1968, and then projected ahead for the next 8 quarters. These figures have been slightly revised over the weekend but they are very close to the numbers that we are releasing for our first quarter forecast you can see in this table in line 17 the gross national product estimate in current prices. It starts at about \$897 billion as an estimate for the present quarter and grows in smaller increments than we have recently seen during the next few quarters.

To explain the notation in the tabulation, line 4 is total consumer expenditures. Line 9 is investment in fixed plant and equipment. Line 10 is housing investment. Line 11 is inventory change. Line 15 is the net foreign balance. Line 16 is Government expenditures. Line 18 is GNP at constant prices. Line 19 is the GNP price deflator. Line 20 is corporate profits before tax. Line 21 is disposable income at current prices and line 22 is the unemployment rate.

You can see that we project an almost level pattern of output in the very near term and then a slight pickup. The unemployment rate is expected to grow slightly in the first quarter. The January figure is in but we would be projecting a higher figure for February and March in order to come out with the quarter's average that we have here.

Thank you.

(Tables follow:)

WHARTON ECONOMETRIC FORECAST, FEB. 24, 1969

	1968				1969				1970			
	4th quarter	1st quarter	2d quarter	3d quarter	4th quarter	1st quarter	2d quarter	3d quarter	4th quarter	1st quarter	2d quarter	3d quarter
Nondurables and services.....	\$461.7000	\$469.2329	\$476.6960	\$484.2117	\$490.7451	\$497.3452	\$504.0398	\$512.8838	\$520.2512			
Durables (excluding cars).....	46.9000	46.8933	47.7060	47.7086	48.2767	48.3135	48.4366	49.7366	51.7045			
Cars.....	38.2000	37.5940	37.7318	37.7960	38.1185	37.9175	37.9341	39.6634	40.4212			
Consumption.....	\$546.7998	\$553.5862	\$561.4736	\$570.0090	\$577.1382	\$582.5769	\$590.4104	\$603.2837	\$612.3767			
Manufacturing investment.....	\$28.1000	\$28.8081	\$29.0664	\$29.4294	\$29.8141	\$29.9972	\$29.9960	\$29.7928	\$29.9671			
Regulated investment.....	\$26.3000	\$26.3608	\$26.4396	\$26.4868	\$26.5441	\$26.6075	\$27.0337	\$27.3614	\$27.7210			
Commercial investment.....	\$33.7000	\$33.7453	\$33.2376	\$32.8904	\$32.5200	\$32.6649	\$32.3570	\$32.0358	\$33.2962			
Farm investment.....	\$6.8000	\$7.1884	\$7.2427	\$6.9453	\$6.7184	\$6.8011	\$6.8787	\$6.9453	\$6.9988			
Fixed investment.....	\$94.9000	\$96.0926	\$96.0064	\$95.7490	\$95.3151	\$96.1597	\$96.2694	\$96.1352	\$97.9831			
Housing.....	\$31.0000	\$32.2922	\$31.7559	\$32.1415	\$31.7495	\$31.1818	\$30.8769	\$32.6609	\$33.5632			
Inventory change.....	\$10.6000	\$6.6630	\$7.1036	\$7.5623	\$6.6412	\$5.0300	\$4.8224	\$5.1040	\$6.4919			
Investment.....	\$136.5000	\$135.0477	\$134.8659	\$135.4530	\$134.3517	\$135.3505	\$131.9598	\$133.9001	\$138.0382			
Exports.....	\$50.1000	\$51.6607	\$53.8961	\$53.8481	\$54.2116	\$54.5967	\$55.5358	\$56.0649	\$56.7509			
Imports.....	\$94.1000	\$93.7845	\$93.7065	\$93.8665	\$93.2117	\$93.5966	\$93.9278	\$92.7155	\$93.3566			
Net foreign balance.....	\$1.0000	\$1.8762	\$3.1896	\$2.8816	\$2.5389	\$1.3111	\$3.6090	\$3.3494	\$3.4193			
Government expenditures.....	\$203.0000	\$206.4066	\$210.0974	\$215.2065	\$219.1062	\$222.6908	\$226.6994	\$230.4983	\$234.3933			
Gross national product.....	\$387.3999	\$396.9163	\$399.6240	\$393.5498	\$393.4353	\$392.0732	\$395.8753	\$391.0313	\$398.2271			
GNP (1958 dollars).....	\$718.3999	\$719.1951	\$722.2512	\$726.0913	\$727.5593	\$728.7039	\$730.6090	\$730.5337	\$746.6763			
GNP deflator.....	1.2350.	1.2471	1.2594	1.2719	1.2830	1.2924	1.3000	1.3130	1.3270			
Profits.....	\$91.9000	\$87.9647	\$89.4088	\$92.5178	\$91.3145	\$90.0724	\$92.0135	\$96.4537	\$98.3272			
Disposable income.....	\$602.3999	\$605.6800	\$613.8730	\$624.9122	\$632.7712	\$639.6542	\$646.0117	\$666.7300	\$677.7019			
Unemployment rate.....	3.4000	3.4008	3.6119	4.0076	4.0571	4.1775	4.3729	4.2998	3.9249			

RECURSIVE SYSTEM 2—SUMMARY TABLE

1. CNS	.....	\$469 2329	\$476 6960	\$484 2117	\$490 7451	\$497 3452	\$504 0398	\$512 8938	\$520 251
2. CNA	.....	\$46 7993	\$47 0460	\$47 596	\$48 2767	\$48 3125	\$48 4366	\$50 7366	\$51 7045
3. CA	.....	\$37 5540	\$37 7318	\$37 9380	\$38 1165	\$37 9175	\$37 9341	\$39 7664	\$40 4212
4. C	.....	\$553 5862	\$561 4736	\$570 0090	\$577 1382	\$583 5769	\$590 4104	\$603 2837	\$612 3767
5. IFM	.....	\$28 8081	\$29 0664	\$29 4294	\$29 8117	\$29 8972	\$29 9860	\$29 7928	\$29 9671
6. IPR	.....	\$26 3808	\$26 4566	\$26 4868	\$26 5341	\$26 6975	\$27 0337	\$27 7614	\$27 7910
7. IPC	.....	\$33 7453	\$33 2376	\$32 8904	\$32 8209	\$32 6639	\$32 3510	\$32 0358	\$32 2662
8. IFF	.....	\$7 1584	\$7 2427	\$6 9425	\$6 7487	\$6 8011	\$6 8787	\$6 9453	\$6 9888
9. IP	.....	\$96 0926	\$96 0064	\$95 7190	\$95 9151	\$96 1597	\$96 2594	\$96 1362	\$97 9837
10. IH	.....	\$32 2922	\$31 7559	\$32 1415	\$31 7955	\$31 1618	\$30 8769	\$32 6509	\$33 5622
11. C-II	.....	\$6 6630	\$7 1036	\$7 5625	\$6 6412	\$5 0380	\$4 8724	\$5 0000	\$6 4912
12. I	.....	\$135 0477	\$134 8659	\$135 4530	\$134 9517	\$132 3595	\$131 9558	\$133 0001	\$138 0382
13. FE	.....	\$51 6607	\$53 8961	\$53 8481	\$54 2116	\$54 8007	\$55 5358	\$56 0649	\$56 7549
14. FL	.....	\$49 7845	\$50 7065	\$50 9665	\$51 2717	\$51 5596	\$51 9278	\$52 7155	\$53 3769
15. NFB	.....	\$1 8762	\$3 1896	\$2 8816	\$3 2411	\$3 2111	\$3 6000	\$3 1494	\$3 4193
16. G	.....	\$206 4066	\$210 0974	\$215 2065	\$219 0062	\$222 8989	\$226 6904	\$231 4933	\$234 3933
17. GNP	.....	\$866 9163	\$909 6260	\$923 5498	\$933 4362	\$942 0762	\$950 6763	\$958 2771	\$968 2771
18. X	.....	\$719 1451	\$722 2512	\$726 0913	\$727 5593	\$728 7130	\$730 6089	\$733 5537	\$746 3763
19. P	.....	1 2471	1 2594	1 2719	1 2830	1 2928	1 3130	1 3370	1 3700
20. PCB	.....	\$87 9647	\$89 4088	\$92 5178	\$91 3145	\$90 0724	\$92 0135	\$96 4537	\$98 7272
21. DI	.....	\$605 6909	\$613 8730	\$624 9172	\$632 7712	\$639 8342	\$646 0117	\$666 7300	\$677 7019
22. UN	.....	3.4808	3.6119	4.0076	4.0571	4.1775	4.3729	4.2988	3.9232
Number of iterations to converge.	.....	43	41	39	39	39	40	34	32

Chairman PATMAN. Thank you very much, sir.
 Professor Perry, we will be very glad to hear from you, sir.

**STATEMENT OF GEORGE L. PERRY, PROFESSOR OF ECONOMICS,
 UNIVERSITY OF MINNESOTA**

Mr. PERRY. Thank you, Mr. Chairman.

In order to be brief, I shall limit this statement to a summary of my forecast for output, prices, employment, and the budget surplus, plus a couple of observations on some policy implications of this forecast.

I can fill in some more detail of the forecast if you would like during the question period.

The forecast assumes the surtax rates are extended and projects Federal expenditures at very near the levels estimated in the January budget. Also, in the forecast, interest rates do not rise significantly from present levels and are expected to ease, but only a little, as the year progresses. Under these conditions:

I expect the gross national product to increase by 7.2 percent or \$62 billion, from \$861 billion now indicated for 1968 to \$923 billion this year.

I am not as optimistic as the Government in 1969 President's Economic Report about the likelihood of a substantial slowdown in prices this year. There should be some deceleration of prices as the year progresses. But more than half of my forecast GNP increase for 1969 is due to the rise of almost 4 percent that I expect in the GNP deflator. With real output increasing more slowly than the economy's potential, I expect the unemployment rate to average a little above last year's 3.6 percent and to approach 4 percent before the end of this year.

Consistent with outlook for GNP, I expect a 7½-percent growth in personal incomes and very little change in corporate profits in 1969.

I expect the Federal budget, on the national income accounts basis, will show a modest surplus for the year.

While the pattern of GNP advance in the forecast can be characterized as somewhat faster in the second half of the year than in the first, I do not expect a dramatic shift in the growth rate of real output. In particular, I would not characterize the year as another 1967 when a big change in the rate of inventory building resulted in a sharply different rate of advance between the first and second halves. This year, the modest pickup expected in the second half is due to the Government pay increase, which contributes to GNP but not directly to real output; and to other Government policy actions, both budgetary and monetary, which could well change from present projections.

Finally, if I had to project what now seem the most likely places where this forecast might go wrong, I would list the most policy-sensitive sectors of demand, particularly—

Residential construction, where I now forecast a 1.5 to 1.6 million rate of housing starts for the year, a figure that could prove too high if determinedly tighter monetary policy were pursued; and

Purchases by all levels of Government, where the decidedly larger increases I expect in the second half of the year compared to the first could be pared if present budget plans are revised.

I am old-fashioned enough in my economics to believe that fiscal policy has a large influence on the level of GNP. And, in particular, the surtax as well as the level of budget expenditures matter in today's outlook. In contrast to so many remarks we have been hearing, I believe the evidence since the passage of the surtax shows that it has been important in slowing the economy. The right place to look for surtax effects is in consumer spending. And over the last 5 or 6 months, retail sales have not moved up at all.

An early announcement that the surtax will be extended would be useful, not only through its possible effects on consumer demands, but through its desirable influence on inflationary expectations. It might help avoid a substantial disintermediation in financial markets which would once again seriously depress the residential construction industry. Generally, I favor flexibility and believe it is desirable to keep policy options open. But in this case, the probability that the Government will want to extend the surtax next summer seems high enough and the advantages to an early announcement significant enough, that a prompt call for full extension is warranted now.

With inflation recently accelerating, our foreign trade surplus virtually gone, and the average unemployment rate at 3.3 percent, economists today are as nearly unanimous as they will ever be in calling for some slowdown from recent rates of GNP growth. When it comes to how much of a slowdown will be needed to achieve any given improvement in the inflation record and how extended a slowdown policy should aim for, differences begin to appear.

The policy of trying to slow inflation gradually and over an extended period that was outlined in their testimony by the President's Council of Economic Advisers seems easily the best approach to take at this time. I am not an optimist on the inflation problem. I do not think it will slow down quickly, so I hope the Government is patient in pursuing its policy of gradual adjustment. And while we can improve on the most recent record, we may, in the end, still have to tolerate a noticeable degree of inflation if we are to maintain high employment in the longer run. This outcome is made more likely to the extent that the potential evils of something like the old guidepost policy are thought to outweigh its possible benefits—a conclusion that is hard either to verify or to refute—so that we take no new initiatives on these lines. Other policies that can help, particularly those directed at manpower training and labor market problems, have become less controversial. They seem to be limited mainly by our ability to agree on the details of implementing and administering them and, more fundamentally, by our willingness to pay for them on a large enough scale. Desirable as they may be, I doubt that they can fully reconcile low unemployment with price stability, and especially doubt that they can be counted on for much help in the near-term transition from present inflation rates.

While stabilization policy thus may have to take higher unemployment as the cure for today's inflation, steps can be taken to minimize the costs of taking the cure. Even a modest rise in unemployment has substantial costs for many individuals. As the Council showed in its testimony, when the average unemployment rate fell 14 percent during the past year, from a (seasonally unadjusted) rate of 3.7 to 3.2 percent between the fourth quarters of 1967 and 1968, the unemployment

rate in urban poverty areas fell by 25 percent and the rate for blacks in these areas fell by nearly 30 percent.

By the fourth quarter of 1969, these changes may have been reversed, indeed will have been according to the kind of forecasts that are being made today. And before inflation is slowed much, unemployment is likely to be considerably higher in these groups. While this may be an inevitable result of a necessary slowdown, the amount of individual cost that has typically been involved in rising unemployment, especially to those in the high unemployment groups, is neither inevitable nor necessary. Anything that can be done to minimize this cost will make the anti-inflation program far more acceptable. This certainly justifies adequate access to programs with additional, longer run pay-offs, such as education and training programs, for those unemployed who could benefit from them. In my opinion, it also calls for strengthening programs that openly transfer income to those who lose jobs and who do not get sufficient assistance in other ways—either because existing training or employment programs are inadequate, because they do not qualify for them, or because the existing system of unemployment compensation does not cover them or provides inadequate coverage.

Chairman PATMAN. Thank you, Professor Perry.

Professor Suits, we should be very glad to hear from you, sir. You may proceed in your own way.

STATEMENT OF DANIEL B. SUITS, PROFESSOR OF ECONOMICS, UNIVERSITY OF MICHIGAN

Mr. Suits. Mr. Chairman, the economic outlook that I shall present today was compiled by the research seminar in quantitative economics at the University of Michigan as part of a research project supported by the National Science Foundation. I wish, in particular, to thank my able colleague Prof. Saul H. Hymans for his contribution to its preparation.

BASIC FACTORS IN THE OUTLOOK

The outlook is predicated on the projections of several basic elements.

1. The 10-percent surcharge on personal and corporate income taxes is projected to be renewed and continued in effect.

2. Total Federal Government purchases of goods and services are projected to hold at the level of the last quarter 1968 until the beginning of the fiscal year 1970, when they will rise modestly in response to prospective pay increases.

3. State and local purchases of goods and services are projected to rise at a trend rate of \$2.8 billion per quarter.

4. Monetary policy is projected at about the present level of tightness.

5. Projections of business fixed investment during the first two quarters are made consistent with investment intentions reported in recent surveys, and only small increases have been allowed for the last two quarters of the year.

6. Exports are projected to rise at a trend rate of \$.8 billion per quarter.

ECONOMY TO SLOW DOWN

The resulting economic outlook is presented in the accompanying table. Gross national product is forecast to rise from the \$887.4 billion level of the fourth quarter of 1968, to reach \$932.2 billion by the end of 1969. This would represent an average of \$914.9 billion for the year as a whole compared to \$860.7 billion for 1968.

ECONOMIC OUTLOOK FOR 1969

	1968, IV	1969				Year
		I	II	III	IV	
Gross national product.....	887.4	897.4	906.1	924.0	932.2	914.9
Consumption expenditure.....	546.8	552.8	558.2	568.5	573.0	563.1
Gross private domestic investment.....	136.5	137.3	137.3	138.9	139.1	138.2
Business fixed investment.....	94.3	96.2	97.6	98.6	99.6	98.0
Residential.....	31.6	32.2	32.4	32.4	32.8	32.5
Inventory accumulation.....	10.6	8.9	7.3	7.9	6.7	7.7
Net exports.....	1.0	1.4	1.8	1.8	2.2	1.8
Exports.....	50.1	50.9	51.7	52.5	53.3	52.1
Imports.....	49.1	49.5	49.9	50.7	51.1	50.3
Government purchases of goods and services.....	203.1	205.9	208.7	214.8	217.9	211.8
Federal.....	101.6	101.6	101.6	104.9	105.2	103.3
Defense.....	80.0	80.0	80.0	82.2	82.2	81.1
Other.....	21.6	21.6	21.6	22.7	23.0	22.2
State and local.....	101.5	104.3	107.1	109.9	112.7	108.6
Addenda:						
Unemployment rate (percent of civilian labor force).....	3.4	3.4	4.0	4.1	4.5	4.0
Implicit deflator for GNP (1958=100).....	123.5	124.5	125.5	126.9	127.8	126.2
Gross national product in 1958 prices.....	718.5	720.8	722.0	728.1	729.4	725.1

The quarterly pattern of the forecast reveals a very flat first half of the year followed by more rapid growth during the second half. This follows partly from the pattern of taxes. The forecast first half of the year is held down by the increase in social security taxes already in effect, and by the addition to final income tax settlements associated with the tax surcharge, but coupled with the \$10 billion inventory accumulation during the last quarter of 1968. The greater buoyancy of the second half is partly the result of the termination of these final settlements, and the addition of the pay increase to Government purchases.

The components of total output do not grow uniformly. Consumer spending is forecast to rise almost 5 percent, but the growth in gross private domestic investment is only 2 percent, partly because of the slower rate of inventory accumulation at the end of the year. Net exports, on the other hand, are forecast to double as imports grow more slowly than the projected rise in exports. Government purchases of goods and services rise 9 percent.

Overall, the forecast represents a substantial reduction in the growth rate of the U.S. economy. In contrast to the gain of almost 10 percent registered during the year just past, the GNP forecast for the end of 1969 is only 5 percent above the fourth quarter of 1968. When adjusted for an expected 3.5-percent increase in prices, this amounts to a gain of less than 2 percent in physical volume of output, compared to 5.5 percent for the corresponding period last year.

RIISING UNEMPLOYMENT BUT PRICE INCREASES TO CONTINUE

The forecast growth in gross national product is too slow to absorb the expected new entrants into the labor force and still compensate for rising productivity, and will be accompanied by rising unemployment that we expect to reach 4.5 percent of the labor force by the end of the year.

Despite slower growth and rising unemployment, however, prices will continue to rise at almost the same pace as during 1968. The reason for this is the backlog of undigested costs now in the economy. Producers cannot respond instantly to changed conditions, and there is necessarily a delay between the time a firm finds its costs rising and the time it can make appropriate price adjustments. Moreover, higher output prices of material producing firms represent higher input costs to their customers, and there is further delay before prices rise at the next stage of production. Our calculations indicate that it takes an average of 3 years before an initial increase in unit cost fully emerges in prices of final output, and for this reason any slowdown in the rate of economic growth has its first impact on jobs rather than on non-farm prices.

UNDERLYING COST PRESSURES REDUCED

Although the rate of price increase will be largely maintained through the year, underlying cost pressures will diminish and less inflationary steam will be generated beneath the surface than has been true in the recent past. Employee compensation per man-hour is forecast to rise only 5.5 percent this year, in contrast to recent rates of increase of almost 7 percent. With normal productivity increases, this implies a rise in unit labor cost of only 3.5 percent, a decline from rates of increase of 4 and 5 percent recently experienced. In other words, although rapid price increases can be expected to continue through this year, we are slowing the buildup of costs on which prices during 1970 and 1971 are going to depend. If slow growth in total output is maintained, the rate of inflation will be substantially abated by that time.

DIRECT MEASURES ARE NEEDED TO CHANGE THE TRADEOFF BETWEEN INFLATION AND UNEMPLOYMENT

Although maintaining slow growth through 1970 can bring the rate of price increase back to something like 2 percent per year, our analysis indicates that this slow growth will be accompanied by rising unemployment which will take us back to the rates of joblessness in excess of 5 percent that characterized the years from 1958 to 1964. During that period, prices as measured by the implicit deflator for the gross national product rose from their 1958 base of 100 to only 108.8, an average annual growth of only 1.4 percent. But this price stability was purchased at the cost of unemployment that never involved fewer than 5 percent of the labor force, and during 2 years averaged over 6 percent.

To put the matter another way, the present rate of price inflation is not the result of special economic "distortions" that can somehow be untangled to yield stable prices without loss of jobs. Rapid price infla-

tion and low unemployment are ultimately tied together in our economy. We cannot eliminate one without ultimately losing the other.

This poses a serious policy dilemma that we have so far failed to face up to. Purely global policy measures—whether fiscal or monetary, and in whatever combination—merely buy price stability with high unemployment, or pay for more jobs with higher inflation rates. Either way, somebody gets hurt for the protection of somebody else. Either way the divisive social forces evident today are further irritated. The real policy question is not how to choose among the alternatives offered by the existing trade-off between unemployment and inflation, but how to change the terms of the tradeoff itself. This cannot be done by global action, but only by specific programs designed to increase the education, skill mobility, employment potential, and employment opportunity of the unemployed worker.

Chairman PATMAN. Thank you, Professor Suits.

Professor Williams, we are glad to have you, sir, and you may proceed in your own way.

STATEMENT OF ROBERT M. WILLIAMS, PROFESSOR, GRADUATE SCHOOL OF BUSINESS ADMINISTRATION, UNIVERSITY OF CALIFORNIA AT LOS ANGELES

MR. WILLIAMS. Thank you, Mr. Chairman.

It is indeed an honor and a pleasure to appear before this committee. I have been asked to focus my testimony on the economic outlook. In carrying out this suggestion I shall present the UCLA business forecast for the Nation in 1969, which was the first presented on December 3, 1968, and recently was revised on the basis of more recent information, particularly data for the fourth quarter of 1968.¹

Since 1952, a panel of economists at UCLA Graduate School of Business Administration has prepared an annual forecast of GNP and its components and other national economic series. More recently, when national forecasts became more common, we began to make additional forecasts for California and subregions of the State.

Our forecast presented today does not differ materially from our preliminary forecast for 1969 made last September, which in turn was much like that made in early December. I mention this to point out that we have believed for some time that the American economy would continue to expand through 1969, although at a slower rate than prevailed in 1968. We never subscribed to the concept of "fiscal overkill" feared by some following adoption last June of the Revenue and Expenditure Control Act of 1968.

Before discussing the details of our 1969 forecast, let me state two basic assumptions. First, we expect that war in Vietnam will gradually diminish in intensity. We believe, however, that total manpower commitments in Southeast Asia will not decline significantly this year, and that total defense expenditures will increase somewhat. The second assumption is that the 10-percent tax surcharge on personal and corporate income will be extended at least through 1969. Moreover, speaking

¹ See the UCLA Business Forecast for the Nation and California in 1969, Robert M. Williams, editor; contributors include: T. A. Andersen, F. B. Case, D. Eiteman, C. Ervin, W. A. Fogel, M. Granfield, C. Huizenga, E. C. Miller, F. G. Mittelbach, R. E. Moor, F. E. Norton, S. L. Rabin, D. Ratajczak, J. V. Schmidt, J. P. Shelton, P. L. Smith, J. F. Weston, and R. M. Williams.

for myself, I believe that the surtax should be extended to reduce upward pressures on demand and prices and to reduce or eliminate the Federal budget deficit, thereby making it possible for the Federal Reserve System to conduct a more flexible monetary policy.

A FORECAST OF 13 SELECTED ECONOMIC SERIES

Turning now to the details of our forecast, table 1 shows annual data for the last 5 years and the 1969 forecast for 13 selected economic series.

TABLE 1.—SELECTED ECONOMIC SERIES, 1964-1968 AND THE UCLA FORECAST FOR 1969

	1964	1965	1966	1967	1968	Forecast 1969
1. Gross national product (billion current dollars).....	632	685	748	790	860.7	921.0
2. Federal Reserve Board Index of Industrial Products (1957-59=100).....	132	143	156	158	165.3	170
3. Private housing starts (million).....	1.53	1.47	1.16	1.29	1.50	1.60
4. Automobile production (million).....	7.8	9.3	8.6	7.4	8.8	8.5
5. Wholesale Price Index (Bureau of Labor Statistics 1957-59=100).....	100.5	102.5	105.9	106.1	108.7	111.0
6. Consumer Price Index (Bureau of Labor Statistics, 1957-59=100).....	108.1	109.9	113.1	116.3	120.9	125.0
7. Civilian employment (million).....	69.3	71.1	72.9	74.4	75.9	76.9
8. Unemployment as percent of civilian labor force.....	5.2	4.5	3.8	3.8	3.6	3.9
9. Average hourly earnings, manufacturing industries (dollars).....	2.53	2.61	2.72	2.83	3.01	3.15
10. Interest rate on 3-month Treasury bills, percent.....	3.55	3.95	4.88	4.32	5.34	5.15
11. Corporate bond yield (Moody's Aaa) percent.....	4.40	4.49	5.13	5.51	6.18	6.15
12. Corporate profits before taxes (billion dollars) ¹	66.3	76.1	83.9	80.4	89.2	92.0
13. Dow-Jones average of 30 industrial stock prices:						
High.....	892	969	995	943	985	1,060
Low.....	766	841	744	786	825	900

¹ With inventory valuation adjustment.

The first is "Gross National Product," which is discussed in some detail later. Suffice to say here that, although our forecast of GNP of \$921 billion is higher than that of some other private forecasts, it is the same as that presented in the 1969 Economic Report of the President and adopted by Dr. Paul McCracken, Chairman of the present Council of Economic Advisers, in his statement to this committee last week.

"Industrial Production," which includes output of manufacturing, mining, and utilities industries, is expected to increase by 4.7 points in the Federal Reserve Board Index in contrast to 7.2 points in 1968. This reduced rate of growth is about in proportion to that expected in "real" GNP.

"Residential Construction" is expected to continue the expansion which began in 1967, with the number of new private housing starts advancing to 1,600,000 in 1969 from 1,500,000 in 1968. In support of this optimistic forecast, the basic demand for housing in terms of existing vacancies is extremely strong, and we believe that the supply of mortgage credit, building materials, and skilled labor will be adequate to do the job.

"Automobile Production" is forecast to decline somewhat from the high level of 8.8 million reached in 1968 to 8.5 million in 1969.

"Wholesale Prices" are expected to increase by 2.3 index points or 2.1 percent in 1969, or slightly less than the 2.4-percent rise in 1968.

"Consumer Prices" are predicted to increase by 4.1 index points or 3.4 percent in 1969, or slightly less than the nearly 4.0-percent rise in 1968.

"Civilian Employment" is forecast to increase by 1 million in 1969 compared with 1,500,000 in 1968.

"Unemployment," as a percent of the civilian labor force, is expected to increase from the low level of 3.6 percent in 1968 to an average level of 3.9 percent in 1969.

"Average Hourly Earnings in Manufacturing Industries" are predicted to increase by 14 cents per hour in 1969 compared with 18 cents in 1968. This reduced rate of increase in wages in 1969 results from two factors. First, several important wage contracts made in 1968 provide for smaller increases this year than last. Second, premium payments for overtime worked will be lower in 1969 because of the shorter average work week expected.

"Short-term Interest Rates," as measured by the yield on 3-month Treasury bills, are expected to decline slightly from the high average level of 5.34 percent in 1968 to 5.15 in 1969. These rates are high now but are expected to decline in the second half of the year.

"Long-term Interest Rates," as measured by the yield on Moody's Aaa corporate bonds, are forecast to decline very slightly from 6.18 percent in 1968 to 6.15 percent in 1969.

"Corporate Profits," before taxes and adjusted for inventory valuation, increased by nearly \$9 billion to a record level of \$89.2 billion in 1968 and are expected to increase to \$92 billion in 1969.

"Stock prices," as measured by the Dow-Jones Average of 30 industrial stocks, are expected to break 1,000 before the end of 1969. This barrier was approached early in 1966, when the DJIA reached 995, and again in November 1968, when the average reached 985. Early last week the stock market declined, allegedly in reaction to some of the testimony and discussions in this committee. At present, the DJIA is near the lower end of the range between 900 and 1,060 which we expect in 1969.

THE FORECAST OF GNP IN 1969

Table 2 shows the forecast of GNP and its major components for 1969. GNP stated in current dollars is expected to increase 60.3 billion or 7 percent in 1969, compared with an increase of \$71 billion or 9 percent in 1968. In real terms, the expected increase is 3.4 percent in 1969 compared with 5 percent in 1968. The price increase in 1969, as reflected in the implicit price deflator for total GNP, is expected to be 3.5 percent, slightly less than the 3.8-percent increase recorded in 1968.

All components of GNP shown in table 2 are expected to increase except two, change in inventories—line 10—and net exports of goods and services—line 11—which are expected to decline slightly. Personal consumption expenditures are expected to increase \$36.1 billion or 6.8 percent, gross private domestic investment by \$8.5 billion or 6.7 percent, and total government purchases of goods and services by \$16.1 billion or 8.2 percent.

TABLE 2.—GROSS NATIONAL PRODUCT 1965-68 AND THE UCLA FORECAST FOR 1969

[In billions of current dollars]

Line	Actual				Forecast, 1969
	1965	1966	1967	1968	
1 Personal consumption expenditures.....	432.8	465.5	492.2	533.7	569.8
2 Autos and parts.....	30.3	30.4	30.4	36.5	37.0
3 Other durable goods.....	36.0	40.1	42.2	46.0	49.5
4 Nondurable goods.....	191.1	206.7	215.8	230.2	245.0
5 Services.....	175.5	188.3	203.8	221.0	238.3
6 Gross private domestic investment.....	108.1	120.8	114.3	127.5	136.0
7 Residential construction.....	27.2	24.8	24.6	30.0	34.0
8 Other construction.....	25.5	28.5	27.9	29.2	31.0
9 Producers' durable equipment.....	45.8	52.8	55.7	60.8	65.0
10 Change in inventories.....	9.6	14.7	6.1	7.6	6.0
11 Net exports of goods and services.....	6.9	5.1	4.8	2.4	2.0
12 Government purchase of goods and services.....	137.0	156.2	178.4	197.1	213.2
13 Federal.....	66.9	77.4	90.6	100.0	106.8
14 (National defense).....	(50.1)	(60.6)	(72.4)	(78.9)	(82.8)
15 (Other, including NASA).....	(16.8)	(16.8)	(18.2)	(21.1)	(24.0)
16 State and local.....	70.1	78.8	87.8	97.1	106.4
17 Gross national product.....	684.9	747.6	789.7	860.7	921.0
18 Amount of increase.....	52.5	62.7	42.1	71.0	60.3
19 Percent increase.....	8.3	9.2	5.6	9.0	7.0
20 Percent "real" increase.....	6.3	6.4	2.4	5.0	3.4
21 Percent price increase.....	1.9	2.6	3.1	3.8	3.5

[Dollar amounts in billions]

	1968	1969	Percent increase
Personal income.....	\$685.8	\$730.0	6.4
Disposable personal income.....	589.0	626.0	6.3
Personal saving.....	40.8	41.2	1.0
Personal saving as a percent of disposable personal income.....	6.9	6.6	

Included in our forecast are the following changes in personal income and related variables.

As stated above, we expect a growth in real GNP of 3.4 percent in 1969. On the supply side, this assumes the following changes from 1968:

	Percent change
Productivity per man hour.....	¹ 2.2
Average hours worked per year.....	-0.45
Employment rate.....	-0.3
Labor force participation rate.....	0.05
Population 16 years of age and over.....	1.9

¹ This is down from 2.9 percent in 1968.

Table 3 shows the quarterly profile of GNP and its components for 1968 and 1969. Data through 1968, of course, are from published data now available. We forecast that GNP will increase by \$11.2 billion in the first quarter of 1969, substantially less than in any quarter in 1968. GNP is expected to increase by \$12.5 billion in the second quarter and by \$17.5 billion and \$15.5 billion in the third and fourth quarters, respectively.

TABLE 3.—THE QUARTERLY PROFILE IN GNP IN 1968 AND 1969

[In billions of current dollars at seasonally adjusted annual rates]

Line	Item	1968				1969			
		1	2	3	4	1	2	3	4
1	Personal consumption expenditures...	519.4	527.9	541.1	546.3	555.5	564.5	574.5	584.5
2	Autos and parts.....	34.6	35.4	38.1	38.0	37.0	37.5	36.5	37.0
3	Other durable goods.....	44.4	45.6	47.0	46.8	48.0	49.0	50.0	51.0
4	Nondurable goods.....	226.5	228.2	232.7	233.5	238.0	242.0	247.5	252.5
5	Services.....	213.9	218.7	223.4	228.0	232.5	236.0	240.5	244.0
6	Gross private domestic investment.....	119.7	127.3	127.1	136.1	136.5	135.0	136.0	136.5
7	Residential construction.....	28.5	28.9	28.9	31.2	33.0	33.5	34.5	35.0
8	Other construction.....	29.6	28.5	28.8	29.8	30.5	30.5	31.0	32.0
9	Producers' durable equipment.....	59.0	58.5	61.3	64.4	65.5	65.0	65.0	64.5
10	Change in inventories.....	2.1	10.8	7.5	10.0	7.5	6.0	5.5	5.0
11	Net exports of goods and services.....	1.5	2.0	3.3	3.0	1.5	2.5	2.0	2.0
19	Government purchases of goods and services.....	19.50	195.7	199.6	202.5	205.5	209.5	216.5	221.5
13	Federal.....	97.1	100.0	101.2	101.6	102.5	104.5	109.0	111.5
14	(National defense).....	(76.8)	(79.0)	(79.6)	(80.0)	(80.0)	(81.5)	(84.0)	(85.5)
15	(Other, including NASA).....	(20.3)	(21.0)	(21.6)	(21.6)	(22.5)	(23.0)	(25.0)	(26.0)
16	State and local.....	93.4	95.6	98.4	100.8	103.0	105.0	107.5	110.0
17	Gross National product.....	832.1	852.9	871.0	887.8	899.0	911.5	929.0	944.5
18	Amount of increase.....	20.2	21.7	18.1	16.8	11.2	12.5	17.5	15.5
19	Implicit price deflator, 1958=100.....	120.0	121.2	122.3	123.5	124.5	125.5	126.7	127.6

Source: Survey of Current Business, January 1969, for data through 4th quarter, 1968

It should be pointed out that the accurate distribution of annual national output by quarters is difficult. We believe, however, that our forecast of GNP for the year is reasonable and that the second half of the year will see more rapid growth than the first half. If this prediction is accurate, then it is very important that the tax surcharge be returned through 1969. If the tax surcharge is not continued past June 30, 1969, we believe that prices and interest rates will be higher than we have predicted. Also, if the surcharge is not extended, total production, employment, and corporate profits will be somewhat higher but residential construction will be lower.

In conclusion, assuming that the tax surcharge is extended through 1969, we believe that the economy will grow at the respectable rate of 3.4 percent in real terms and that a start will be made toward reducing the rate of inflation. It is not possible in this brief statement to defend all the numbers presented in the three tables, so at the proper time I shall be glad to attempt to answer any questions you may have.

Thank you.

Chairman PATMAN. Thank you, Professor Williams. Senator Sparkman?

Senator SPARKMAN. Doctor, in your statement, just before you start on your conclusion, you inserted something there.

Mr. WILLIAMS. Yes, I did.

Senator SPARKMAN. Would you read it, please?

Mr. WILLIAMS. The sentence inserted was as follows:

Also if the surcharge is not extended total production, employment and corporate profits will be somewhat higher, but residential construction will be lower.

Senator SPARKMAN. Thank you.

Chairman PATMAN. I notice you said that "if the tax surcharge is not continued past June 30, 1969, we believe that interest rates will be higher than we have predicted."

Now, it has been amazing to a lot of people why housing starts have gone up in the recent past when interest rates and cost of closing loans generally have been very, very high.

The information I get from over the country is that it is based upon one argument to buyers or prospective homebuyers that if they don't buy now although interest rates are excessive you will have to pay more later.

Do you agree with that, Professor Klein?

MR. KLEIN. I think the inflationary psychology has been with us, certainly, and very much of an issue in the last 6 months.

We have found, however, in the case of home buyers that when credit is available, even though rates are high, house purchasing still goes on.

The one instance in which we found high interest rates and a marked reaction downward in the housing market was in 1966 when the tight money conditions were associated with lack of funds for mortgage lending.

I think if we are in a situation where interest rates are high and construction costs are high but funds are still available for mortgage lending then we won't see such a strong reaction in the housing market as we did in 1966.

Chairman PATMAN. I believe the argument that if you don't buy now, it will cost you a lot more later is a very persuasive one, and I suspect it is the main argument that leads them into signing contracts to buy at such high rates of interest and such other real extortionate charges in addition to the high interest rates.

I would like to ask each of you gentlemen to respond to a question that concerns me.

Last week representatives of the administration told this committee that they favored continuation of the surtax plus a tight money policy, in order to achieve less inflationary pressure in the economy. They also conceded under questioning that this would increase unemployment.

Will you gentlemen please comment on this policy. Do you agree? Professor Williams, suppose we start with you first on that.

MR. WILLIAMS. I think I can agree with that in general. However, it should be pointed out that if the surtax were not extended, and this was the point that I would like to make quite strong, the monetary policy would have to be tighter than otherwise. So it is a question of combining the surtax with a tight money policy or the lack of a surtax with a much tighter monetary policy, which I would not like to see.

I think there is a point at which housing might be affected adversely by tight money. I think that unlike 1966 housing will expand with the present high interest rates. As you indicated, money is available now, but I think the ceiling on the amount the savings and loan associations can pay, for example, at the present time would possibly lead to disintermediation with very high interest rates.

Chairman PATMAN. Professor Perry, do you believe you can stop inflation just by increasing interest rates?

MR. PERRY. That would be only one indirect, initial result of a monetary policy aimed at slowing inflation. Certainly, too, today's higher interest rates partly reflect the existence of inflation and inflationary expectations.

Chairman PATMAN. I believe that the higher you put the interest the higher you put prices. Therefore, the higher the price is the more infla-

tion, and I personally don't agree. I don't see where you can stop inflation that way.

Now, of course, there are ways of stopping inflation, and I will ask you gentlemen if you agree that these two ways of stopping inflation, No. 1, is to increase the reserve requirements of banks, in other words, to dry up to some extent the sources, the volume of funds. If it gets really ruinous and it looks like prices are going up through the roof, the next step is to siphon off the purchasing power, the excess purchasing power through taxes, siphon it off and pay it on the national debt.

In that way you would serve two purposes. You would stop the inflation and at the same time you would help the Government by reducing the cost of servicing the national debt, because cost of the national debt now is approximately about \$16 billion, and if you will go back 14 years to the time we kept the interest rates low, and compare it with that, you will find we are paying \$8 billion a year too much.

Do you believe we can stop inflation like I suggested, Mr. Suits?

Mr. Suits. I think that there are a number of combinations of monetary policy and tax policy which could slow down the economy and stop inflation. If we are to operate on the global level without specific controls or specific programs, then one way or another we must reduce the aggregate amount of expenditure. We can do this by reducing the availability of loan funds, or we can reduce the availability of spendable income by removing income from individuals by taxation. Either way we operate on this global level, we are simply going to slow down the economy and buy reduced inflation with more unemployment.

Chairman PATMAN. Why do you say that is more effective than raising the reserve requirements of banks?

Mr. Suits. Well, the raising the reserve requirements of banks is a mechanism whereby one—

Chairman PATMAN. Or reducing the reserve requirements of banks.

Mr. Suits. Reducing the reserve requirements of banks would, of course, make the funds available, and would increase the rate of inflation.

Chairman PATMAN. I am talking about expanding 10 to 1 and have 8 to 1 or 6 to 1 or 4 to 1.

Mr. Suits. Yes.

Chairman PATMAN. That is bound to reduce the volume of the money; isn't it?

Mr. Suits. Yes, indeed.

Chairman PATMAN. And that would be an effective way, wouldn't it?

Mr. Suits. Indeed it would.

Chairman PATMAN. The Federal Reserve Board has never seen fit to use that method. Probably the one time was in 1936, when we were paying out four and a half billion dollars to three and a half million veterans. They wanted to do something about what they considered to be run away inflation. They made it so difficult and hard that the country didn't get as much benefit from the payment of that money to every section of our Nation that I felt our country should have. But I have never known them to use it generally, have you?

Mr. SUITS. I am not an authority on the existence of Federal Reserve controls, Mr. Patman, as you no doubt are.

Chairman PATMAN. Well, I have been disappointed because, of course, that would take a little profit away from the banks if they did that. But why shouldn't the banks come in this and sacrifice to help stop inflation. That certainly would be an effective way.

Mr. SUITS. Indeed.

Chairman PATMAN. Don't you agree?

Mr. SUITS. Indeed.

Chairman PATMAN. Don't you agree, Dr. Klein?

Mr. KLEIN. I would say, Mr. Chairman, that we are called here this morning to talk about the economic outlook and we have put our assessments—

Chairman PATMAN. That is all right, I apologize for getting you off the track.

Mr. KLEIN. Well, we put our assessments in terms of the policies that are usually followed, and I think the discussion is very circumscribed. We think of interest policy and we think of tax policy, and I would say that the thinking is a bit unimaginative. Surely there are other ways to stop inflation than having a rise in the unemployment rate, and I think there is a good deal of merit in your suggestion about considering reserve requirements as well as traditional discount and open market policies.

And I would like to say, in addition, that there has been very little thinking about ways of stimulating private savings. If we can drive the economy at a high rate of production and simultaneously induce people to save a higher portion of their income I think we could have a chance of reducing the pressure on prices and, at the same time, keep employment at a high level.

Chairman PATMAN. Thank you, sir.

Mr. Brock?

Representative BROCK. Thank you very much, Mr. Chairman.

I am intrigued by your last comment, Professor Klein, and I would like to pursue it a bit.

What would be the impact on interest rates if you raised the reserve requirements?

Mr. KLEIN. Well, I think we could equate things like changes in the discount rate of a point, and an open market operation of a billion dollars and a change in reserve requirements probably of 1 or 2 percentage points, as equivalent impacts on supply of money. I think if we would consider changing the reserve requirements behind either time or demand deposits, by a full point from the present levels, that would be a step in the direction that we would want to consider. We are now considering discount rate moves of a half point or so and this would be in the same order of magnitude.

Representative BROCK. What you are saying is that you have to have a balanced program and, in effect, the balance would reallocate the monetary resources to some degree particularly in the area of residential construction. For example, if you did this you would make more money available to savings and loans and less available to banks.

Let's just take the first question I asked you. If, taken by itself, you raised the reserve requirements of banks would it not have an effect of increasing interest rates?

Mr. KLEIN. This would have an effect through the private money market. The traditional methods that we see through open market operations and discount operations have a direct effect on the Government bill markets and bond markets, but what is being suggested through a change in reserve requirements would percolate through the money market, through private transactions as well as through the Government transactions.

Representative BROCK. But the net effect would be higher interest rates.

Mr. KLEIN. I think this would be one effect.

Representative BROCK. When you reduce the supply of money in a tight money situation you have a higher price for money, isn't that a fair statement.

Mr. KLEIN. Yes, I would agree with that.

Representative BROCK. Let's pursue another area that I think virtually all of you have raised that is most intriguing to me. I think I gathered from the gist of your testimony almost unanimously that you feel that there has to be some alternative to this current trade-off between employment and inflation, and that there can be a policy change at this level which would allow us to change the terms of the trade-off.

Professor Suits, you directed yourself specifically to this question and Professor Perry raised it also.

But I am delighted that you brought our attention to this. I think there is a method of reducing the impact of less inflation or gradual increase in inflation, reducing that effect on employment. You mentioned specifically and particularly some more training in given areas.

I would like to put this question to you. We had testimony from Secretary Shultz last week to the effect that some two-thirds of our jobs now are service related as opposed to manufacturing, and this has an impact on unemployment because this tends to be the more stable kinds of employment. Would it not be a matter of concern to you if this Government should direct itself to expanding our training programs in this particular area, for example?

Mr. SUITS. Yes, I think so.

Representative BROCK. Is this what you are talking about, and would you elaborate?

Mr. SUITS. Well, let's ask ourselves why we have so much price inflation when we still have well over 3 percent of the labor force unemployed.

In some European countries the unemployment rate can go as low as 1 percent of the labor force before this kind of price increase is observed.

It seems to me that the reason for the difference is that so large a proportion of our unemployed 3 or so percent, consists of employees who are extremely expensive to hire. They are untrained, uneducated, immobile. They are not located where the jobs are. In effect, in other words, our unemployment rate, measured in terms of what is really available to the employer, is much below 3.3 percent.

I suggest, therefore, that we try to convert this unemployable or expensively employable component of the labor force into higher grade workers.

Now this is not an easy program. It is a long-term program to train even one man. I feel that if we start now realizing that this is

the real problem, not whether to have a little more or a little less tax, then in 10 or 15 years we may have moved to a position where we can have, let's say, 2 percent unemployment, or whatever the rock-bottom rate is, and still have reasonably stable prices.

Representative BROCK. I appreciate you all bringing this up as a policy question related to our economy. It is very critical and I am very much delighted that you have said something about it.

Do you want to add something, Professor Perry?

Mr. PERRY. In response to your question, I am not very optimistic that you do a great deal through such measures to change this trade-off in any short period of time. What I tried to suggest in my remarks, is that the way the world is—and here I mean both the institutional structure of the labor market and what we are likely to do politically—you are faced with something like the present trade-off right. If you have to live with this and if you must pursue a policy of increased unemployment in the near future, it is useful to think separately about the need to pursue such a policy—the tradeoff we face—and the costs that go with such a policy. Costs which go with such a policy can be softened. You can pass bills which would simply make it much easier on those who are going to suffer the most in the process of increasing unemployment. I think that is a short-run question of great practical and immediate importance, as opposed to the long-run question of what we can do so that 5 or 10 years from now we can have less inflation with a low unemployment rate.

Representative BROCK. Thank you.

Let me just shift the subject briefly for a quick question. Professor Williams mentioned it, that he specifically endorsed continuation of the surcharge. You all included it in your projections. Is there any disagreement with the desirability of continuation of the surcharge?

Mr. PERRY. We are all in agreement.

Representative BROCK. If we continue the surcharge and accept that as our premise, I think the point was made, and I would concur and ask your concurrence, too, that we can have a considerably less restrictive monetary policy than we would have otherwise.

Now, the point I am getting at is this. I think Professor Klein mentioned the trade-off in terms of raising reserve requirements and, in turn, open market operations to put, say, another billion dollars into the economy. Can we assume that if this economy meets your projections which rank from a one and a half to a three and a half percent growth factor, which is not a terribly significant growth, if we assume these perjections, it is not conceivable that the Federal Reserve could have not just a tight money possibility—considerably eased monetary policy over what it is today within the next 6 months, could we not see a greater inflow of money into the economy through the open market operations, for example. Is it feasible, and if so, would it incur too high a rate of inflation or are you talking about increasing unemployment?

Mr. KLEIN. In the projections that I made, it was assumed that after midyear the degree of monetary restraint would ease, and we introduced this into our calculations through the traditional steps that have been taken recently, that is through open market operations and through discount policy.

But, of course, there is no reason why alternative methods could not be used. But I think that this easing of monetary policy later in 1969 concurrent with retaining the surcharge is quite a reasonable step and is not a strongly inflationary step, provided we get the slowdown that we are expecting in the next 6 months.

One other point in this connection is relevant, and that is that in all these considerations of economic policy I think it is much more sensible to consider a balanced policy and not pin everything on a surcharge, everything on tax policy or everything on monetary policy or everything on expenditure policy because when you have extreme moves of policy in one area there tend to be loopholes and distortions in the economy. It is much better to spread it around, and I think this is the reason why more instruments of policy should be sought after than are being considered at the moment.

Representative BROCK. Is there any other comment? My time has expired.

Chairman PATMAN. Senator Proxmire?

Senator PROXMIRE. I don't want to ask you questions on this but, first, I want to say I am surprised that none of you gentlemen seem to assume there is going to be any change in expenditure policy. You seem to make the assumption the surtax is based on a fixed given level of spending and that, therefore, whether we should have it or not depends on what happens in the economy and not what happens in expenditure policy. But it may be you can't cover everything.

I think these are helpful papers. It is so good to get the specification of precisely what you expect in various areas, and to have you pinpoint it by giving us the quantitative numbers. This is most useful because these general predictions—of course, it is easy to hedge and to make a prediction that can mean anything.

But having said that, I would like to say, I just wonder if this modern version of looking at the entrails of birds is really worth very much?

I don't see any crystal balls on your table but I just wonder if we have advanced very much in that kind of thing.

I say that because what I am referring to is a publication by Fels and Henshaw with which you may be familiar, put out by the National Bureau of Economic Research, it is part of a larger paper which questions the validity of short-term business forecasting, and this is pretty much what you are doing here.

Mr. Fels takes a series of publications and he says this:

In my study—the eight principal publications in my study—one month before troughs and three months after peaks on the average was what they were able to determine.

In other words, they are able to tell the turndown 3 months after it occurred on the average. They weren't able to forecast it but 3 months after it occurred.

I wonder—if we were sitting here in 1929—and you gentlemen were asked to predict, if you would be likely to do what I suppose so many economists did then; that is, to state that the GNP is going to go up. Actually, it went down 30 years ago; by \$20 billion, 10 percent.

In 1933 the tendency, I suppose, was to say it would go down. It went up. And in 1937 the temptation would be to say it was going to go up. It went down.

To predict in 1953 that it was going to go up, and in reality it went down, and so on.

My point is that it is easy, it is relatively easy and to be expected, to predict that a train moving in a certain direction is going to move in that direction, all things being equal; but really, the cutting edge is to tell when you are going to get the train to slow down or to maybe go in the reverse direction. And this study incidentally shows the Federal Open Market Committee had just about the same kind of feeble forecasting record.

The conclusion here is that out of 73 forecasts made on National Bureau of Economic Research reference peaks, there were 49 scores of zero for accuracy, that is 67 percent, and 40 scores of less than 50 percent for a degree of certainty. That is 55 percent.

That refers to the business publications. Then the Federal Open Market Committee—their comments on the business outlook in the vicinity of cyclical terms exhibits the same general pattern as found by Fels in the business publications, as time goes by becoming increasingly aware, first, of the *possibility*, then the *probability*, and then the *certainty* of a turning point, but it seems to come after the event has occurred, so that if we continue to have this 8-year prosperity, next year you gentlemen will be found to have been rather accurate.

But we don't know, and I don't know, if we know much more after listening to you about whether this is going to continue, or even the probabilities that it is likely to continue. Would any of you like to comment on that? Yes, sir; Mr. Perry?

Mr. PERRY. I am always appalled by how badly forecasts seem to have done when someone does a historical study of this sort. But then I am even more appalled as to why someone bothered to do that particular study. There aren't 73—

Senator PROXMIRE. I can understand why you would be.

Mr. PERRY. There aren't 73—or however many forecasts were surveyed—serious forecasts done at any one time. When you do something like this you have to evaluate particular forecasting models.

Senator PROXMIRE. These were 73 scores. I take it there are more than 73 scores you have given us today. You score not only on the GNP prediction, but what happens to prices, what happens to employment, and so forth.

Mr. PERRY. I took that to mean 73 forecasts that were somehow collected and sampled.

Senator PROXMIRE. No, these were scores of various kinds of forecasting by these eight publications.

Mr. PERRY. So that just eight were involved?

Senator PROXMIRE. Correct.

Mr. PERRY. The question is still whose forecasts are being evaluated and what period was involved.

Senator PROXMIRE. These are very able—this is the National Bureau of Economic Research. This is a responsible group, probably as fine a private organization as we have.

Mr. PERRY. NBER did the study, but it is still a question of what they had to sample.

Senator PROXMIRE. They selected the eight best publications they could find, and they picked the Open Market Committee. The Open

Market Committee, after all, is an agency that has to forecast and we presume they are able and competent economists who are making the forecasts.

Mr. PERRY. The other point I wanted to make is I think our ability to do this is a lot better than it was some years ago, certainly 1929 to 1933 that you cited, and quite a bit better than 10 or 15 years ago.

Senator PROXMIRE. These were within the last 15 years.

We don't know. We just had this upturn and everybody who got on the train has been right because they have been right in predicting the train is moving in the same direction.

Mr. PERRY. In this recent period, 1967 is the nearest thing to a downturn you had to worry about.

Senator PROXMIRE. We didn't even have a mini-recession, we didn't have two quarters in which the growth declined, so we didn't have a recession.

Mr. PERRY. You can be right in two directions. My point is, the good forecasts avoided calling a recession in 1967.

(In line with the foregoing colloquy, Professor Suits subsequently filed the following:)

EXTENSION OF REMARKS OF DANIEL B. SUITS

Senator Proxmire raised an interesting and important question about how accurately forecasters can, in fact, forecast. Each November for the past sixteen years the Research Seminar in Quantitative Economics has compiled and published an annual forecast for the coming calendar year. The complete record appears in the accompanying table.

During the entire period, the direction of economic movement was forecast correctly each year. The recessions of 1954 and 1958 were accurately forecast as well as the slowdowns of 1960-61 and 1963. Although the record shows substantial underestimation of the recoveries of 1955 and 1959, most of the forecasts show remarkable accuracy. In fact many of the forecasts appear to be more accurate than the measurement of the GNP itself.

TABLE 4.—REVIEW OF PAST GNP FORECASTS¹ (FIGURES REPRESENT CHANGES IN GNP OVER THE PRECEDING YEAR MEASURED IN BILLIONS OF 1954 DOLLARS, EXCEPT AS NOTED)

Outlook for year	November	Forecast	April	Observed
1953.....		13.0		15.5
1954.....		-4.5		-5.9
1955.....		4.4		29.6
1956.....		9.0		8.2
1957.....		9.1		7.7
1958.....		-2.9		-7.3
1959.....		9.0		27.3
1960.....		8.5		11.3
1961.....		7.4		7.8
1962.....		27.5		27.1
1963.....		14.1		15.9
1964.....		23.9		24.1
1965.....		15.8		30.8
1966 ²	23.9		29.2	35.9
1967 ²	28.0		24.5	16.0
1968 ²	29.0			31.9

¹ Except the April modifications, each of these forecasts was presented before the conference on the economic outlook held in November of the year preceding the year forecast.

² 1958 prices.

³ Preliminary as of November 1968.

Senator PROXMIRE. Let me ask you Dr. Klein, if you assume there will be an easing of credit tightness in the last quarter of 1969. I take it that you seem to be almost alone in that assumption. You base part of your estimates on GNP, and I assume other ingredients in it, putting

housing starts in that. Last week the Secretary of the Treasury and Chairman of the Council of Economic Advisers testified they thought credit tightness would have to be pursued throughout the year. In fact, Secretary Kennedy specifically called the relaxation in tightness in 1967 a mistake.

Recently, in an interview in U.S. News & World Report, Governor Mitchell of the Fed said this, and I quote:

We mean business—

Speaking of the Federal Reserve Board—

in braking the inflationary psychology that has developed. It will probably take a reduction in real growth about two percent to get the kind of environment in which the present inflationary psychology will be halted. Economic growth will be retarded for a year or more before the needed change in climate takes place.

How then can you justify an assumption that the discount rate would be in the first quarter at 5 percent and the net free reserves would be continued at \$500 million and then be allowed to raise to zero.

Mr. KLEIN. Let me comment on that. The public statement that the credit conditions will remain tight is just the kind of loose statement that you said we don't make. They are still fairly tight even at a 5-percent-discount rate. I am simply assuming there will be a change in the level but still at a very high level of tightness.

Now, as you also remarked in the previous commentary, that we hadn't considered expenditure policy, may I point out that due to the brevity in our presentation I didn't go into all the calculations that we have made. We have actually made alternative calculations.

Assuming, for example, that military expenditures, especially on sophisticated hardware systems, are somewhat higher and that the surcharge is continued not only through June 30, 1970, but even indefinitely, and that credit policy is kept severe for a longer period than through the first three quarters of 1969, then in those calculations we would find that the economy will perform at a somewhat better level on an overall basis. The unemployment rate will rise less, it will stay, according to my calculations, under 4 percent for almost all of 1970, but there is a considerable lag in the effects of monetary policy, and to maintain these very high rates of interest, and these very low levels of net free reserves at negative values, then we will find that by the end of 1970 there should be repressive—or there should be restrictive—signs in the economy, particularly in the areas of capital formation.

Senator PROXMIRE. Does this mean to you, first, that we will have a slowdown to perhaps a 2 percent level of real growth, 5 percent overall? You see, when Governor Mitchell—what he seemed to want was a 2 percent real growth and no more than a 3 percent deflator, in other words 3 percent rise in prices, so that together you wouldn't get a combination of more than a dollar increase of 5 percent at an annual rate in the GNP. Have you concluded a slowdown to that level by the end of this year?

Mr. KLEIN. Are you talking about the case in which interest rates are kept high, monetary policy is kept more restrictive, and expenditures are higher along with it; is that the case you want to present?

Senator PROXMIRE. Well, I am talking about what your assumptions

are as to what is going to happen this year. I say that the Federal Reserve Board seems to be telling us that they are going to keep the brakes on the economy and try to make credit tight, keep reserves at a minus figure, and so forth, discount rate high until we slow down to a dollar increase GNP at an annual rate of 5 percent, real 2 percent.

Mr. KLEIN. I would say that we won't find that big a drop in the price level to three percent inflationary rate as a result of these more severe monetary policies. I would agree—

Senator PROXMIRE. But you think they are going to change their minds and let up a little bit on monetary policy anyway?

Mr. KLEIN. Well, I think they will be forced to, not by the movement of the price level but by the movement of overall income performance. There are many more indicators.

Senator PROXMIRE. Including employment.

Mr. KLEIN. Employment, yes.

I would agree very much with Professor Suits' notion that we are locked in for much of the price inflation in terms of the costs that we have incurred and the wage increases that we have had in the last 12 months. The techniques of slowing down the rate of economic expansion are going to show very modest results in terms of slowing down the inflationary pressure.

Senator PROXMIRE. My time is up, I will be back.

Chairman PATMAN. Senator Percy?

Senator PERCY. I would like to join our chairman and vice chairman in saying how valuable this testimony has been this morning.

Dr. Klein, you seem to be the most pessimistic in forecasting the lowest GNP increase, the highest unemployment level, and the highest wage increase estimates.

Dr. Shultz seems to be in general agreement with the AFL-CIO on the effect of an increase of the minimum wage. Do you agree that if the minimum wage were extended this year that we may have further unemployment problems? What effect would it have on the economy?

Mr. KLEIN. Well, the problem of the wage effect enters in more than one way. The minimum wage has its special effect, I think, on one of the problem areas of the economy: namely, teenage unemployment, especially in urban areas, and I think we should reconsider the whole question of minimum wage legislation until we have made much more headway in eliminating this big problem of unemployment of teenagers and especially of nonwhite teenagers.

As for the overall wage picture, I would say that the change in the minimum wage won't have a very big effect on the average hourly earnings or the average wage rate because that really is going to be dominated by the kinds of overall trade union agreements that have been negotiated in the last 2 or 3 years, especially those that have long-term contracts.

I think the most favorable thing we can say for the wage picture at the moment is that many of these 2- and 3-year contracts are now negotiated so that we can expect not as much pressure on the wage front in 1969 as we had in 1968 and toward the end of 1967.

Senator PERCY. Dr. Perry, Dr. Shultz testified that about 85 percent of all the gain in male employment since 1965 has been attributable to the war in Vietnam, that is two and a half million people in the

Armed Forces and defense-related activities. He attributes a good part of this current inflation to the growing demand on their part with no compensating civilian production. Do you think that is accurate?

Mr. PERRY. I wouldn't think very much of our inflation stems from the specific source of the increased demand. You could reach the same situation by increasing demands elsewhere. The fact that these demands came from war-related industries is of secondary importance.

Senator PERCY. Dr. Suits, last week Dr. McCracken laid out his plan for combating inflation—a gradual and persistent reduction of inflation with hopefully little impact on unemployment. Is this how you would approach the problem and do you assess it the same way? It would seem to be that from your testimony you see a much closer correlation between stopping inflation and resulting unemployment.

Mr. SUITS. I believe, Senator, that if we are to operate on the level of merely slowing the economy down by global controls whether by monetary policy, tighter money, or by tax policy, but on some overall level, then, as one businessman put it to me, you can't slow it down without slowing it down, and this means not only slower prices but it also means slower employment.

In my view, if we take a gradual approach to slowing the economy down, it will gradually slow down. We will gradually get less inflation, and we will gradually get more unemployment. This is a serious, and can be a tragic situation for us particularly at the present time, and I think it would behoove us to think very carefully about applying direct countermeasures to meet the problem of the people who are going to be affected sooner or later.

Now you mentioned the minimum wage. One step we might take—I am not necessarily advocating this as a policy measure but merely while we are discussing these questions, to suggest something that might be done—we could retain or even perhaps increase the minimum wage, and then counterbalance this effect by some kind of payment, recoupment, tax recovery or other device to firms in exchange for hiring and training these people.

Senator PERCY. In other words, give them a subsidy.

Mr. SUITS. Indeed.

Senator PERCY. And the subsidy would represent the difference between the actual productivity of the person and the minimum wage.

Mr. SUITS. Indeed.

Senator PERCY. And maybe the subsidy would be scaled down over a period of months as the worker's productivity increases?

Mr. SUITS. Indeed, exactly.

Senator PERCY. I couldn't agree with you more. It just so happens I put in a bill last year to do just that.

Dr. Williams, do you feel a steadier growth in the money supply over the past several years would have been a major contribution to economic stabilization?

Mr. WILLIAMS. Well, I think, with hindsight one might—if he had it to do over—not increase the money supply as fast as it was, perhaps at two stages, in 1967 and again in the summer and fall of 1968, when the fear of fiscal overkill was widely held, especially at the Fed, where recently they changed their minds completely.

But really, I would rather not focus on the money supply. I think that credit availability and interest rates are the important factors and I certainly would not advocate any rule for regularly increasing the money supply at a given percentage rate.

Senator PERCY. Would you care to comment however, on what the growth of money supply in 1969 should be taking into account your own forecasts?

Mr. WILLIAMS. I have not made any calculations on the increase of money supply. I just don't know what it would be.

Senator PERCY. You wouldn't want to comment on what you feel would be best for this year?

Mr. WILLIAMS. I think what would be best for this year would be the fiscal and monetary policies that I have outlined. Continuing the surtax so that a more flexible monetary policy could be continued, so that interest rates would not be any higher than they are now hopefully, and hopefully a little less. I think this is of particular importance in the housing industry. Again just what that means as to the level of money supply, I don't know.

Senator PERCY. Dr. Klein, I am sorry that I do not recall whether you forecast a surplus or a deficit in the budget with the figures that you are using.

Mr. KLEIN. On the national income accounts definition.

Senator PERCY. A deficit?

Mr. KLEIN. Yes.

Senator PERCY. Could I ask this question and then you can comment any way you want?

Mr. KLEIN. Yes.

Senator PERCY. How important do you think it would be psychologically, for us to have a small surplus as against a small deficit or a large deficit, of course, in combating the problem of inflation? In other words, based on your predictions would you say to the Director of the Budget "Do something to reduce the budget." Is that correct? How important would it be that we take action and cut some expenses or bring some new revenue in to give us the surplus that we are hopefully looking forward to?

Mr. KLEIN. Well, first, on just the passive prediction aspect, my calculation is for the national income accounts definition of the deficit or surplus. After midyear the figures that are to be in the national income accounts, that are seasonally adjusted at annual rates, will show a swing over to a deficit from the surplus that will come in the first 6 months and, as I stated in my opening remarks, the reasons for this are a somewhat slower income base and growth rate in my projections generating less revenue, the higher benefits that would have to be paid out of transfers in a slower economy, and the higher interest payments that will have to be made under the high interest rates.

Now, I think I would agree that you can never do harm by showing surplus in terms of combating inflationary psychology.

I think this would have a good effect. Here I think that we have a curious problem that we economists always face of having a trade-off. The question is whether you want to have good news from a surplus or whether you want to have the consequences on the economy that a surplus would entail.

In order to achieve the surplus with the current set of policies that we are considering this morning, we would have to change the structure of the economy considerably. We would have to have much higher revenues or if we had such low expenditures that we got to that level we would give up many more government services than most people are wanting to give up and we would slow down the economy through lower expenditure.

It seems to me that it is much better to take the surplus or deficit as it comes out and achieve—use it as a tool for achieving our objectives which are not to have a particular number on the budget account but to have a particular employment situation or to have a particular price level movement.

Senator PERCY. Thank you very much, Mr. Chairman.

Chairman PATMAN. Senator Sparkman?

Senator SPARKMAN. Thank you, Mr. Chairman.

I want to say that I think that has been a very fine discussion this morning. We are indebted to you gentlemen, all of you, for making this presentation.

There are several things that I want to ask you about, but not at any great length. By the way, I notice in the GNP something rather interesting, the highest prediction is \$923 billion, the lowest prediction is \$914.9 billion. If you average up the four of them it gives \$918.7 billion. Who is going to be nearest right? I don't ask for any answer.

Now let me say something about the interest rates. I gather from you gentlemen that you rather expect interest rates to remain about the same as they are now throughout 1969.

Mr. SUITS. I think, Senator Sparkman, this depends on what the Federal Reserve Board does, and all we can do is look at the currents that are in the wind now. This is the posture which the Federal Reserve has taken, and I think that explains our belief that there will be a continued tight money policy.

Senator SPARKMAN. I have some rather interesting figures here on the mortgage debt. I would like to read them off for the last 5 years: 1963-64 it was \$25.8 billion; 1964-65, \$25.7 billion; 1965-66, \$21.2 billion; 1966-67, \$22.8 billion; and 1967-68, \$26.8 billion.

It has been estimated that the rise in mortgage interest rates accounted for 10 percent of the increase in the mortgage debt.

Now, if the interest rate, if we assume that the present interest rate, continues and doesn't rise further that within itself will be somewhat of a brake no inflation, will it not, so far as the mortgage market is concerned?

Mr. SUITS. Yes, sir.

Senator SPARKMAN. In other words, it would be the increase that would have the inflationary pressure.

Mr. SUITS. That is right.

Senator SPARKMAN. I notice, Mr. Perry, that you estimate an increase in housing starts, an increase of a hundred thousand. Mr. Williams has the same projection. Mr. Klein, I believe yours is given in money rather than in units. I don't find where you mention the units.

Mr. KLEIN. It is on the calculation I handed out. It is somewhat higher in the fourth quarter.

Senator SPARKMAN. Somewhat higher than a hundred thousand?

Mr. KLEIN. It is \$31 billion in the nonfarm sector. In the fourth

quarter of 1968 and our average for the four quarters of 1969 are very close to \$32 billion.

Senator SPARKMAN. What I am trying to get is a measurement as to these new starts. Would that be approximately the same?

Mr. KLEIN. About one and a half.

Senator SPARKMAN. Oh, yes, one and a half million.

Mr. KLEIN. Yes.

Senator SPARKMAN. It would be the same then in 1968—1968 had a million and a half didn't it?

Mr. KLEIN. Yes.

Senator SPARKMAN. Now, Mr. Suits, I don't believe I saw in your paper any estimate. Do you make an estimate?

Mr. SUITS. No, I only gave the money figure but this implies about the same rate of starts with somewhat higher prices.

Senator SPARKMAN. The same as 1968?

Mr. SUITS. Yes.

Senator SPARKMAN. So among the four of you, you say it would not be lower than the 1968, it might go as much as a hundred thousand above.

Mr. SUITS. Right, sir.

Senator SPARKMAN. I notice that recently, contrary to the thinking of most people, the number of starts has gone up, and I noticed in yesterday's Washington papers a rather interesting article about the sales of housing around here that sales are booming. Of course that may be explained by something the chairman has said, I believe it was the chairman, trying to buy before the rates go higher, before the costs go higher.

I just wonder if that might be taken as an indication of a greater interest in housing during 1969 than perhaps you have contemplated.

Mr. SUITS. Well, certainly if the January figure, which—I don't recall the starts figure but I remember it is very, very high—

Senator SPARKMAN. I don't remember them either.

Mr. SUITS. But it was very, very high.

Senator SPARKMAN. Yes.

Mr. SUITS. And certainly if this development continues our estimates on housing is far too low, if that unquestionably is so. The only question is whether it is a temporary phenomenon, as I am inclined to believe at the present time, or whether this is an indication of some further developments, later on.

Mr. PERRY. May I say one thing on that.

Senator SPARKMAN. Yes.

Mr. PERRY. I think we all probably feel the underlying demand for housing as shown by family formation and vacancy rates is very strong and probably consistent with the numbers we see this winter in housing starts. I suspect all of us who feel we are going to get a lower number do so entirely because of the restricted supply of mortgage funds that we foresee.

Senator SPARKMAN. Of course, the rather moderate weather we have had this winter has helped certainly in this area, has helped the housing program, at least it hasn't slowed it down as has been the case in the past.

We have housing goals for this year. Have you given any thought as to those goals, as to your idea as to whether or not we had the re-

sources available in order to attain those goals. For instance, we have 300,000, I believe, is the number of—233,000, and we have a program of attaining a total of 26 million units over the next 10 years of all residential property.

Have you given thought to the question as to whether or not we have the resources to attain those goals?

Mr. WILLIAMS. I think I would like to comment on that in another connection, too.

Senator SPARKMAN. Please do.

Mr. WILLIAMS. I think we don't have the resources, and I think we would have trouble producing more than the 1.6 million houses I am talking about for 1969.

Senator SPARKMAN. You are measuring it by what, manpower?

Mr. WILLIAMS. Yes. I think skilled manpower is tight in housing, and I think that it is important to open up the construction trades to new entrants. I think it is very important to make these employment opportunities available to minority groups. This will help solve their unemployment problem and also will provide the human resources to construct these large numbers of housing units that you are talking about.

Senator SPARKMAN. I heard Secretary of Housing Romney on one of the national programs yesterday, in which he said that the thing we needed was organizing, organizing our resources in order that we could meet the goals that have been set. In the past he has made some rather pessimistic statements about not being able to reach those goals.

It seemed there was some modification in what he had to say yesterday, to the effect that we needed to—we had to organize quite efficiently in order to meet these goals.

Would you think that could be done with reference, for instance, to the manpower problem?

Mr. WILLIAMS. Referring to the manpower situation in housing, if you look at the data in my table 1, line 3, showing the number of private housing starts going back to 1964, you see that this is a very volatile industry. In 1966 housing starts declined to 1.16 million, and to some degree the supply of skilled labor—

Senator PROXMIRE. What line is that?

Mr. WILLIAMS. Line 3, table 1.

Senator SPARKMAN. Line 3, "private housing starts"?

Mr. WILLIAMS. Yes.

Senator SPARKMAN. Yes.

Mr. WILLIAMS. This is a very volatile series, and the supply of skilled labor, I think, has not increased very much. Construction workers tended to drift away into other pursuits, so that we do not have the resources of skilled labor to produce many more than the 1.5 to 1.6 million units that we are talking about, and to increase that number by another million would require development of many more skilled workers.

Senator SPARKMAN. My time is up but I just want to throw out this thought that maybe we can't do it, but we are going to have to do it if we are to provide homes for the new family formations and replace those that are destroyed, torn down, worn out in this country. So we have a job on our hands.

Mr. WILLIAMS. Yes.

Senator SPARKMAN. Thank you, Mr. Chairman.

Chairman PATMAN. On what Mr. Romney said, of course, organization is all right but don't you think allocation of credit is more important?

Senator SPARKMAN. I think we have a lot of things to do but my thought is we set the goal and we ought to aim for the attainment of it.

Chairman PATMAN. 26 million in 10 years.

Senator SPARKMAN. Yes, and whatever was set for this year.

Chairman PATMAN. All right.

Mr. Conable?

Representative CONABLE. Thank you, Mr. Chairman.

Gentlemen, I think it is generally conceded that the capital investment is going to be possibly as much as double this year what it was last year; isn't that right? Something like 4.7 percent last year, and close to 8 percent this year.

Mr. SUITS. Those were the early figures. In making my projection I have tempered that somewhat.

Representative CONABLE. It still is going to be substantially higher.

Mr. SUITS. Oh, yes.

Representative CONABLE. Is this largely the result of a banana-republic psychology? Really, this is not an auspicious time to increase our productive capacity, is it, generally?

Mr. SUITS. Oh, yes; I think it is.

Representative CONABLE. It is?

Mr. SUITS. This is one of the internally self-generating components of high prosperity, that when we get utilization rates on existing equipment very tight we simultaneously generate the need for additional facilities and, at the same time, provide a flow of funds in retained earnings.

Representative CONABLE. But doesn't a certain amount of this reflect the assumption that it is going to cost more to have capital expansion later?

Mr. SUITS. I am sure that some of it does, but how much I am not sure. One can point to the fact that when you have low rate of unemployment such as we have now, additional calls on industry for output have to be made through higher labor productivity, and this means capital investments. So while it would doubtless pay a firm to do it now rather than sometime later, I don't think that is the primary consideration.

Representative CONABLE. Have you considered at all whether anything should be done with the 7-percent increase in investment tax credit?

Mr. SUITS. No.

Representative CONABLE. Certainly the capital goods area is one of the so-called superheated areas in the economy generally. You don't consider this abnormally high and, therefore, you wouldn't consider any remedial action on the part of the Government in this respect?

Mr. SUITS. Not specifically, at this moment.

Representative CONABLE. I think you have something to add?

Mr. PERRY. I do have a somewhat different opinion. It seems to me that as you look at where we might restrict demands, the capital goods area is a good candidate for taking some of the burden this year. I don't know whether removing the investment tax credit is a feasible proposal at this time. But this is the kind of year, in my opinion,

where restricting a surge in investment demands would make good economic sense.

Mr. KLEIN. May I say something?

Representative CONABLE. Yes, sir.

Mr. KLEIN. I think the investment tax credit definitely supports the high level of capital formation that we are having, but I have detected among business executives of this country a dissatisfaction with the idea of using something like that as a shortrun policy instrument.

Representative CONABLE. It certainly affects their plans rather adversely to have it frequently changed.

Mr. KLEIN. Yes.

Representative CONABLE. Businessmen's plans have to be made over a longer period of time.

Mr. KLEIN. That is precisely it.

Representative CONABLE. Too short a period of time was involved in manipulating it over the past few years. I understood there was a great deal of business dissatisfaction.

Mr. KLEIN. It is a longrun capital expansion.

Representative CONABLE. We were considering it a manipulative device in having taken it off and putting it back on immediately, and it is not desirable from a business point of view certainly. You think it is not desirable from an economic point of view also?

Mr. KLEIN. I think it didn't work in late 1966 because it was a shortrun measure designed to deal with a longrun issue, and it was ineffectual. Also it really represented at the time a kind of flip-flop in Government policy, something that was wanted in September was not wanted 3 or 4 months later. It isn't like an open market operation, and it isn't like a changing of current expenditure policy, current fiscal policy of the Government. It is a basic longrun consideration.

Representative CONABLE. Certainly quite apart from the effectiveness of such a device an on-again-off-again use of it does create very serious inequities in the business community.

Mr. PERRY. May I just say one thing. I don't see that you can both argue that it is ineffective in the sense that was just suggested and also that it is highly undesirable because it is so upsetting of plans. Also, if you are going to affect the capital goods area, however you do it will affect plans. If you did it by some very severe credit rationing and it had the same effect on capital goods producers I don't see that it would be more or less objectionable than if you did it via the tax credit.

Representative CONABLE. I realize you have to make a lot of assumptions in answering such a question but does an inflating economy have a greater impact on the reliability of information about interest rates, or capital investment, or inventory levels? In what areas are the variables the greatest here in the course of an inflating economy?

Mr. KLEIN. Well, let me say something about the present state of our national income account. We now carry along a figure in these numbers, which we all rely on so heavily, a statistical discrepancy between the income side and the expenditure side which is now as big as over \$5 billion.

When we are dealing with these large numbers, inflated numbers, and making very strong corrections for inventory valuation adjustments and similar kinds of manipulations. We are having difficulty, and this is a very disturbing aspect to see that the range of disparity

in our GNP forecasts at this table are about the same order of magnitude as the statistical discrepancy in the account, and it makes a lot of difference.

Of course, it is a question of the residual items in the account, and one of the things like inventory and inventory evaluation, and savings and profits, those numbers are very weak in this kind of situation.

Representative CONABLE. One last question. What do you think has had the greatest impact on housing starts lately, variations in the interest rate or variations in the cost of construction? I think we tend to overemphasize interest rates as a factor here, and to ignore the tremendous increases that have been occurring in the cost of construction services and materials. Isn't it true that these have had a substantial impact on housing starts? Which would be of the greater order of magnitude, in your view?

Mr. KLEIN. I would say that construction costs are a less flexible item in the house-purchase decisions because in the case of interest-rate variations there are other dimensions such as the length of the amortization period and the amount of the down payment; and the thing that many homeowners look at is the average payment they are going to have to make on the mortgage every month, and this is easy to move around in the case of financing by stretching out the amortization period or changing the down payment to compensate for movements in the interest rates.

It is less easy to do this in the case of the overall price of a house.

Therefore, I would attach a good deal more importance to the construction costs.

Representative CONABLE. The same psychological factors apply to car sales, of course.

Mr. KLEIN. Right.

Representative CONABLE. Psychology plays a very large element in the study you gentlemen made, I am sure, and this is one of the great problems. One doesn't know what the psychological climate is going to be regardless of what the long-term trend may be.

Thank you, that is all, Mr. Chairman.

Senator PROXMIRE (now presiding). Mr. Bolling?

Representative BOLLING. Thank you, Mr. Chairman.

I would like to comment very briefly on the colloquy—or not colloquy—between the chairman and the panel on forecasting. My own experience has been rather more satisfactory than apparently the chairman's has.

I have found that in the years that I have been on this committee that the forecasting by certain groups has become really very excellent. My own experience is that the independent economists, be they academic or members of the staff of the Joint Economic Committee, or other independent economists, tend to be a great deal more accurate than those who represent a particular interest. For some reason unknown to me the interest economists seem to project policy and the independent economists seem to project predictions based on economic facts, and I have had a very satisfactory experience in the last 18 years on forecasting. I think it has improved substantially and I think the performance of the economy of the last 8 or 9 years has indicated that the improvement is very substantial.

One thing that interests me about the study which I only had an opportunity to examine very quickly, is I can't find out what publica-

tions they researched. I should think that would be very pertinent. I have a couple of questions.

All of you gentlemen have assumed that the surtax will be extended. What would you suggest would happen to interest rates if it weren't?

Mr. WILLIAMS. I think I addressed myself to that in some degree saying they would be higher.

Representative BOLLING. Would there be any disagreement with that?

Mr. KLEIN. I would say that would be true. We are trying to out-guess what the Federal Reserve is trying to do, and we probably do agree that the Federal Reserve would have to be more restrictive on monetary policy if there was a weakening on the fiscal front.

Representative BOLLING. Right. So that, in other words, you would have a very substantial impact on interest and with so substantial an impact on interest at least in theory you could have the same kind of thing happen this year, despite the surprising experience with housing, that happened in 1966 on housing. You could have a crunch.

Mr. WILLIAMS. That is right.

Representative BOLLING. If you didn't have an extension of the surtax.

Mr. SMITH. There is one qualification that Professor Klein mentioned earlier, however, and that is the shift in the institutional arrangement. To the extent that that is different, the credit crunch has different implications.

Representative BOLLING. Right, right.

Now this is a question that I don't really expect anybody to give a definitive answer to, and I have a prejudice which I will make clear in the question. Who is hurt most by inflation? Is it not the old, the blacks, the poor, that being a redundant phrase, that last one, at least in part. Who is hurt most by inflation?

Mr. SMITH. Well, surely the old who are substantially supported by social security, which does not respond very rapidly. For the blacks and the poor one has to make a very careful study because, on the one hand, aid to dependent children allowances do not respond very rapidly and such children are, of course, punished badly by rising prices. On the other hand, as was pointed out earlier, employment rises most rapidly in precisely this same area, so it is very difficult to determine who is being hurt or how much. On the one hand we provide the breadwinner with a job. On the other hand we take purchasing power away from the family without a breadwinner.

Representative BOLLING. The point I was getting at was that it would seem to me there is a fair probability that the "least able to defend themselves" segments of the society face a year in which they can't win. If we have a significant increase in unemployment in order to stop inflation they are going to be hurt, and if we don't stop inflation they are going to be hurt. So they have got a no-win year except for the addition that I think you in your statement brought in and that is the direct aid to them in specialized kind of employment, if that is the way to put it. In other words, it is very clear there has to be some method to reach them beyond the classic methods we have been mostly talking about today or they are going to suffer or continue to suffer

which, in turn has implications for the society as a whole that are too obvious to go into.

Mr. SUTTS. That is correct.

Representative BOLLING. Now, isn't it possible, given the peculiarity—and I think it is a peculiarity—of the society today, that you have this, the easy way is to talk about affluence, you have this fabulous affluence with tremendous poverty, which we as a society are just beginning to realize the extent, the depth, and the degradation of. It is sort of interesting to find people catching on to the fact people are starving in the South. They have been doing it ever since I grew up there in the 1930's, as well as in other parts of the country, too.

But isn't it possible in this particular year, given the conditions of great affluence with pockets of poverty, wouldn't it be possible for demands to remain so high, despite a significant increase of, say, a half or a whole percent in unemployment, that inflation would continue at about the present rate, despite the substantial—

Mr. SUTTS. I certainly think it will, at least through this year. I think this is reflected in all the forecasts that have been presented this morning.

Representative BOLLING. I thought it was, too, and I want to make it explicit because what we may be facing is getting inflation under control sometime next year, if we are lucky, and in the meantime everything that is going in the economy, regardless of which way you mix the policy is going to be, I don't want to use an inflammatory word, but more and more irritating to the social unrest that exists.

Mr. SUTTS. I think that is correct.

Representative BOLLING. Thank you.

Senator PROXMIRE. Senator Miller?

Senator MILLER. Thank you, Mr. Chairman.

Gentlemen, the Employment Act of 1946, as you well know, set forth two basic goals—namely, full employment and a stable dollar—and repeatedly administrations have clung to those two objectives down through the years.

The act was overwhelmingly passed. I wasn't here at the time, but I am advised it was completely a bipartisan measure. Now I find according to the statements of Dr. Suits and Mr. Perry that they apparently don't think we can achieve those goals, and I am wondering why. And if you think we can't then why don't you recommend that we revise the Employment Act of 1946?

Mr. SUTTS. I think we can. I think the problem is that we cannot easily. It is not an easy job.

Senator MILLER. I am aware of that.

Mr. SUTTS. In those days—

Senator MILLER. Here is your statement wherein you say, "Rapid price inflation and low unemployment are ultimately tied together in our economy."

Mr. SUTTS. Yes, and if I may just amend that statement, as it occurred to me when I was reading it, this should read in terms of using global controlled policy. In other words, we have to have a wider spectrum of things that we can do. If all we do is speed the economy up to make more jobs, or slow it down to hold prices in check, then we are always going to play this business of seesaw. One man is up and another man is down and that is the only game we are really playing.

We can indeed maintain both high employment and stable prices, but we cannot do it with global controls.

We must get very specific, as, for example, the question of subsidizing employment or training programs and so on.

Senator MILLER. I am glad to hear your explanation because you cover yourself by saying "*if* we do this"—and that is a very big "*if*." To me it would be a false assumption to assume that what is contained in the "*if*" is going to be there. Certainly it shouldn't be there.

I assume you want those objectives, and if you are not going to attain those objectives because of the "*if*," then you don't want the "*if*." I am glad that you state that you do think those objectives are attainable. If they are not attainable, then that would be a confession of defeat for the capitalistic economic system. Agreed?

Mr. SMITH. Agreed.

Senator MILLER. I would like to ask Dr. Klein why he takes such a dim view of my farmers' situation for 1969 when he says "farm prices and income will decline slightly in 1969." What is that assumption based on?

Mr. KLEIN. I will read you the numbers and you can—net farm income was \$15.5 billion in the fourth quarter of 1968 at an annual rate. We have it hovering just under \$15 billion during 1969 for the different quarters and farm prices on an index base of 100, well, 105, will go down to 104, 103.

Carryover stocks are in reasonably plentiful supply, livestock production is expanding, and the members of our forecasting group from the farm equipment sectors of the economy who conduct a very close watch over the farm economy have suggested that just a passive forecast of what they see happening, without doing anything about it, is that farm prices are going to ease somewhat over the next few months, and farm incomes will consequently be slightly lower.

Senator MILLER. Well now, as an offset against the easing of prices couldn't we have an easing of costs of production because of a slowing down in the rate of inflation?

Mr. KLEIN. Well, we could potentially but I think we are pretty well agreed that the things the farmers buy, the farm costs, are not coming down particularly because costs in the whole economy are not coming down very much.

Now, I think at this table we are talking about a national economy with something like a 4½-percent rate of inflation now, and some of us see it coming down to 3½ percent. Some of us seeing it coming down to 4 percent in the near term.

Hardly anyone here is going to predict stable prices or even a 2-percent rate of inflation.

Senator MILLER. I agree that Dr. McCracken stated as a goal of his Council having it come down to 3 percent for this calendar year.

Mr. KLEIN. I should say it is very optimistic.

Senator MILLER. Now if it did come down from 4½ this last year to 3 percent this year, in other words, if it dropped down 1½ percent, would that make enough difference in the costs of production to farmers so that you might change your assumptions?

Mr. KLEIN. That would be helpful to farm costs but I am very doubtful that that would be the crux of the matter for maintaining farm income.

Mr. SUTTS. I think I would go so far as to say that the only feasible way that that result could be attained would be precisely by lower farm prices. That is where the flexibility in the price system lies in the very short term.

There is not much that can be done about manufacturing prices.

Senator MILLER. You mean the only way of cutting this down to 3 percent would be a reduction in farm prices?

Mr. SUTTS. That is correct.

Senator MILLER. I am wondering if there was a reduction in farm prices, on the one hand, if that wouldn't be counterbalanced, on the other hand, by a reduction in costs of production, which would enable us to forecast at least a stable farm income in 1969 relative to 1968 rather than forecasting a drop.

Mr. SUTTS. I think that the production costs in terms of fertilizer, equipment, and other prices of materials that farmers have to buy are not likely to come down; that is, there are undigested costs still pushing on the prices of those products.

Senator MILLER. Well, suppose you have an easing of interest rates. Farmers out here are borrowing for their cattle loans and paying 7 to 7½ percent. Suppose they end up paying 6. It would make a lot of difference in a livestock operator's income. So I wonder why you don't think that this would ease costs of production?

Mr. SUTTS. Well to that extent, of course, it would. But if we look at the price side rather than the interest side, interest rates, of course, can be varied; but again, there is the question whether, given the posture of Federal Reserve, they will in fact be brought down.

Senator MILLER. Well, if we did have a reduction in the rate of inflation from 4½ to 4, don't you think there would be a correlative easing in interest rates?

Mr. SUTTS. No, because I think that tight money is part of the force that is going to hold the expansion in place. We can't have it both ways.

Senator MILLER. Well, it seems to me that it is a correlative of inflation that you have high-interest rates. That just makes sense. If I borrow some money from you for a couple of years, and you forecast that the dollar is going to be less when I pay you back 2 years from now automatically you are going to charge me an interest to make up for the difference regardless of the tightness of the market, and the tightness of the market is an added factor to that.

Mr. KLEIN. I think the timing is to be considered here, because we are talking about a year's income and even if interest rates are going to come down they are not going to come down for a few months. They are not going to come down very much if they do come down. They are not going to come down until well after midyear, and it is going to be very difficult for farm income in 1969 to benefit from these low-interest costs in our economy.

Senator MILLER. I have no further questions. I apologize for not being here for your statement.

Thank you, Mr. Chairman.

Senator PROXMIER (presiding). Thank you, Senator Miller.

Gentlemen, I get the impression from you, and I am sure that individually you don't feel this way and I would like you to have a chance on the record to correct it, that we are kind of helpless in a sense; that

is, that we can expect during the next year for unemployment to increase, No. 1. We can expect during the next year for the rise in the cost of living to go on at an unacceptable rate. We can expect also to have high-interest rates maybe not quite as high as at present but high, but maybe just as high as they are now, and I get it from you that, as Mr. Suits put it, there is nothing we can do about it in terms of global action.

Now, having said that, however, we look around the world, and we see Germany, quite a different economy, of course, but with better price performance in the last couple of years, far lower unemployment than we have, and there are a few other small countries that perhaps have—Sweden—that perhaps have a similar performance.

What is it that we can do to help solve this problem? Mr. Suits, you were the one who indicated that you can't do it globally. How can we do it?

MR. SUITS. Well, first of all, when we look at the German case, there are some very special factors, as you know. They export part of their unemployment so their rate really isn't quite comparable to ours, but many of the other countries are—

Senator PROXMIRE. You might put it the other way, too, they are importing workers.

MR. SUITS. That is right. So when they no longer have the total demand, they export them and their unemployment never shows up in the records. That is a very special problem with respect to Germany, but it wouldn't be the same thing, let's say, for the Netherlands or for Sweden.

What they have there is a much more homogeneous, much more highly trained, much more mobile labor force than we have.

Senator PROXMIRE. We have to make our labor force better trained, we have to make them more mobile, we have to break down the terrible racial barriers we have had, we are making progress in those directions, but I take it as we do this we can begin to have greater price stability with a lower level of unemployment; is that right?

MR. SUITS. Exactly, exactly.

Senator PROXMIRE. Now, how about the wage guidelines, they have been battered and beaten and kicked out by this administration. They don't seem to feel they want it yet. We have a statement by Arthur Okun, just a couple of days ago, saying if the administration is going to dismiss the guidelines, that they had better find some way of bringing some consideration in the private area, in unions and in management, of the policy effects of their price decision. Do you share Mr. Okun's position? Is there another way, are guidelines this ineffective under present circumstances?

MR. SUITS. I see no real mechanism for making wage-price guidelines effective other than some form of legal price-wage control.

Senator PROXMIRE. Well now, how about the administration's proposals before they went out of office that you compromise them? In other words, you provide for a guideline of around 5 percent which would be somewhat more than the expected increase in the cost of living, and take into account some of the productivity increase. I should say all the productivity increase and some of the increase in the cost of living. In addition to that they would ask the management, in the administered price areas, to absorb the first 1-percent increase in costs. Is this a practical formula?

Mr. SUTTS. I question its practicality merely on the grounds that, in our economy, we have found ourselves unsuccessful in depending on good will for economic motivation. Good guys always lose. If I decide, in the interests of preserving the price level, to apply my own wage-price guideposts and not to ask for higher wages next year, or not to get higher prices for my services, this doesn't guarantee that everybody else will go along.

Senator PROXMIRE. Well maybe.

Mr. Perry, you, as I understand it, made some study of this, and you found, as I recall, that the wage-price guidelines perhaps reduced inflation by eight-tenths of a percent, which is a very significant contribution if we can verify it, and I have the feeling that the good guys, at least those who abide by it, were big steel companies, big automobile companies, big steel unions, and big automobile unions, and none of them were exactly hurt. They aren't certainly at the bottom in any case of the economic spectrum. How about it?

Mr. PERRY. That is correct, as you described it. But I think someone would point out, if he wanted to argue the other side, that the real spendable income of workers in these areas hasn't gone anywhere for a few years now. I don't know where you come out. I believe guidelines were working; a lot of my colleagues aren't quite so sure.

Senator PROXMIRE. Are they beyond revival? Would you say that the Johnson administration's proposals in this area cannot be practically enforced or go into effect?

Mr. PERRY. I see no reason why, if the administration wanted to get into this business, they couldn't go back to approximately the same kind of applications as were being made in 1965. They would have to use different numbers.

Senator PROXMIRE. You think it might have some effect, at least, a significant effect, in keeping down the rise in prices and perhaps move the Phillips curve over a little bit so the trade-off between inflation and unemployment wouldn't be quite so bad?

Mr. PERRY. I think it would have such an effect. There are people who would point out that it would have effects they don't like and you have to weigh the two. But it could have an effect, yes, sir.

Senator PROXMIRE. How about the policies that have been followed ever since Franklin Roosevelt—and I guess, more or less by Presidents of the United States—of speaking out publicly and emphatically when a big industry with pricing power, price leadership power, increases its prices, or a union has demands which seem unreasonable? Is this a useful action? Should the new President follow this policy, in your view?

Mr. PERRY. Yes, I certainly think it is useful and something that a President is right in doing. It becomes hard to know when you have a clear case when you have quite a generalized inflation as we do today, as compared to taking that sort of position when you don't have generalized inflation.

Senator PROXMIRE. Well, of course, President Nixon hasn't, to my knowledge, indicated that he is rejecting that but certainly administration spokesmen before this committee have made it pretty emphatic they don't think it very wise. For example, Mr. Shultz, the Secretary of Labor, said he would counsel the President in effect not to do it. He feels that the President's prestige shouldn't be put on this line that way. You disagree with that?

Mr. PERRY. Yes, I see no reason why the President shouldn't do that if he has a good case.

Senator PROXMIRE. How about you other gentlemen, would you agree with Perry or with Shultz?

Mr. KLEIN. I think while we can agree on a lot of things, like academic economists we have our disagreements, and we probably get different votes. I am dead set against the guidelines and I think I would agree with Professor Suits that they—

Senator PROXMIRE. I didn't say "Suits," I said "Shultz."

Mr. KLEIN. Well, they are both against.

Senator PROXMIRE. Yes.

Mr. KLEIN. And they are for a theoretical economy and not for the real facts of life.

I think I would agree with Professor Perry's calculations for 1961, 1962, and 1963, but I think you can attribute much of the present inflationary pressure to a great effort on the part of companies to make up for all the ground they lose in that period. There was restraint, and now they have boiled over. I would say overall, to take a long view, that it didn't do any good.

Senator PROXMIRE. Mr. Williams, what would be your position?

Mr. WILLIAMS. I think I am closer to Dr. Okun in his position.

Senator PROXMIRE. To Okun and Perry?

Mr. WILLIAMS. Yes, Okun and Perry. I think the guidelines approach might be useful again in particular situations; maybe not very useful, but I certainly wouldn't throw them away. I think the administration and the President have great moral power to bring to certain wage and price situations, and use of this power certainly has to be selective; but I think they may return to some such system in the future.

I might say while I am speaking that other things might be done to help with the inflation problem. I mentioned reducing restrictions on entry into certain trades. In addition I think Dr. McCracken mentioned that antitrust policy could be useful and should be enforced vigorously to the end of maintaining more stable prices.

Senator PROXMIRE. Houthakker, McCracken, and Stein, the three members of the Council of Economic Advisers, appeared before our Senate Banking Committee for confirmation. Houthakker said he thought antitrust policy would help in the long run, but he was talking about 10 years, he felt the antitrust action instituted this year, you have to win a court case or two or three to set a pattern and that takes a long time in their view.

Mr. WILLIAMS. In any case I think it is important to the long run.

Senator PROXMIRE. And it may well be in its psychological effect. If business knows that there is a stern, meaningful antitrust policy they are more likely perhaps to make their decisions within the public interest in stabilizing prices.

Mr. WILLIAMS. Right.

That is absolutely correct.

Finally, I would say that tariff policy gives us some opportunity to get more competition into industries which are in a position to control their prices. I would consider lowering tariff rates where this would have a beneficial effect, and I would certainly look very closely at demands for import quotas in industries where they might have an unfavorable effect on domestic prices.

Senator PROXMIRE. Along this same line, Dr. Perry, as I understand it, you advance the thesis that profits are one of the variables in prices, in the price-unemployment setoff, I should say. In other words, if I understand it correctly, we can have lower unemployment and a lower rate of inflation if profits aren't as high. We have had a tremendous increase in profits between 1960 and 1968. One of the most dramatic changes, I suppose, of all of the economic indicators has been the very sharp increase in profits, both corrected for inflation and after taxes and so forth. How about that?

Mr. PERRY. As to the effect of profits on this whole situation, I think that it probably is relevant only in the highly concentrated, highly unionized industries, where very high profits rates can serve as a target for large wage demands. I don't know that, economywide, it has a great deal of relevance.

Today, profit rates are probably at not unexpected levels. But if we measure them from 1961, we are measuring from a recession period when, of course, you expect profits to be low.

Senator PROXMIRE. That is a big part of the explanation, I would agree.

Mr. PERRY. Today, if one looks at rate of return on equity, I think it is probably about where you expect it to be, not extraordinarily high by historical standards for a period of high economic activity. Profits are, of course, highly volatile, and as you move to low unemployment rates, rates of return typically rise and if you have a slowdown profits will suffer disproportionately.

May I just make one last statement on your earlier question? Whether the administration, the President, is prepared to make a public statement, it seems to me, must depend on whether that statement is very well founded. Even today, a year when in manufacturing there were many large settlements, you couldn't single out manufacturing as being ahead of the rest of the parade.

If you have a situation such as a very large wage increase when wages elsewhere are not increasing rapidly, or a price increase warranted by shortages or by a former wage increase, then it is easier to advocate guidepost actions and Executive pressures may be justified.

If you couldn't on the basis of recent facts, single out prominent manufacturing industries and say that they are leading the parade, that they are causing the inflation. And this is what makes guideposts quite a different matter today and this is why the guideposts were abandoned in the first place.

Senator PROXMIRE. You said, Mr. Perry, that the surtax was effective and the best evidence of it is what has happened to retail sales.

Mr. PERRY. Yes.

Senator PROXMIRE. But you know we adopted the surtax for several purposes, No. 1, to hold down the increase in the cost of living, No. 2, to try to do something about the high interest rates and, No. 3, to help us on imports so that our balance of payments would be corrected. We failed dismally in every single one of them. As you know, since the surtax went into effect the rise in the cost of living has been sharper than before; the rise in interest rates has been much sharper than before; and, also, since it went into effect, we have converted a trade surplus into a trade deficit, a big trade deficit in the last quarter. How long do we have to wait on this? After all, part of economic policy is the timing effect.

It would seem to me that you could make a good argument that the surtax to date has been a real failure.

Mr. PERRY. Well, Senator, I guess I don't have to tell you that we don't forecast perfectly. You have to make a statement about whether these things that you have listed would be worse if we hadn't had the surtax, and the only statement I can make is that they would have been worse.

Senator PROXMIRE. Yes.

Let me reply to that again to get back to the argument that—you fellows zeroed in on the tax angle rather than the spending angle. In my view, we would be a lot better off if we cut \$10 to \$12 to \$15 billion out of the budget, especially out of the military budget, but also out of space and public works. Public works are now over \$10 billion, 10 times as high as they were in the depression when we had to have them for a work force 20 percent or so out of work. Of course, the value of the dollar has dropped a lot but not that much.

Under the circumstances, it seems to me we should take a good healthy look at spending policy and we can make a strong case for doing some of these things much more effectively especially in controlling inflation and also interest rates by a policy of reducing spending instead of reliance on higher taxes.

Mr. SUTTS. Senator, in our calculations, dollar for dollar, a tax dollar in terms of ability to hold the economy in check is only worth about 75 cents compared to an expenditure dollar. That is to say, the checking power of a dollar increase on my taxes is only three-fourths of the checking power of a dollar decrease in military.

Senator PROXMIRE. That is a fascinating statistic. I have not heard that before. Can you also say something about the timing of this? In other words, if you reduce spending, Federal spending, does that have a quicker or a slower effect on the economy than an increase in taxes would have in most cases?

Mr. SUTTS. I doubt that there is very much material difference.

Senator PROXMIRE. Why wouldn't there be a lag since people tend to adjust their spending patterns over time?

Mr. SUTTS. That might be very true, I hadn't thought about it, yes.

Senator PROXMIRE. Certainly you have the experience lately. It took them a while to reduce their spending proportionately to the tax increase.

Mr. SUTTS. Yes, that is very true.

Senator PROXMIRE. So in both cases in the first place you would have a bigger impact and, in the second place, you might have a swifter effect.

Mr. SUTTS. Yes, true.

Let me add this is, of course, a policy question on an entirely different level. I would be very happy to see \$10 or \$15 billion come out of our military budget purely as a policy measure even if we transferred that expenditure to some other programs that I consider to be much more essential.

Senator PROXMIRE. I think this is a very real prospect. After all you have the majority leader of the U.S. Senate, Mike Mansfield saying we should cut the budget, and cut it very sharply. We cut it before; we cut it last year by several billion dollars. I think this year there is far more sentiment in favor of that and certainly we can make a very strong case in terms of waste.

The Congressional Quarterly, as you may know, had a very interesting study in which they indicated they thought we could cut it by \$10.8 billion and have a stronger combat force after than before because of the fact that we have a great excess of service and support troops, and then in cutting expenditures in space, but in terms of its economic impact you feel it would be at least as good and perhaps better.

Mr. SURRIS. I think a \$10 billion cut in military spending would have a definite and immediate impact on the economy, so much so that I would certainly recommend that a cut in military spending not be taken out of the Federal budget, but be transferred to a number of other programs that desperately need funding.

Senator PROXMIRE. Well, I certainly would disagree with that at the present time. I think it is very hard to transfer any of that kind of money efficiently to some of our other programs. Maybe you can, but I wonder. For example, in the housing area Senator Sparkman and I talked about—he is chairman of the housing subcommittee and I am ranking member—here is an area in which we can have a great deal more activity than we have but I doubt if it would take billions of Federal expenditures to achieve this. It would come in the private sector, and that is why I was so startled that you gentlemen are so pessimistic about housing; you are being realistic, of course, and I am not criticizing your judgment of what is going to happen. I just say it is appalling we can't do better. In 1950 we spent 5.3 percent of our GNP in housing; this year the goals provide if we meet the goals we put 3.4 percent of our resources for housing, about 60 percent as much. Obviously, we can do better. It may very well take some kind of a crash program in training people, it may take a better effort in terms of financing.

We have a housing act now that provides for a subsidy to 1 percent of effective interest rate for low- and medium-income housing. I can't see why we can't do a better job.

I would like to ask Mr. Perry one other question, and I have a couple of other questions for you other gentlemen. Doesn't the transfer of income to ameliorate unemployment result in more inflation? This is one Senator Sparkman is interested in, too. In other words, you indicate that transfer payments of some kind, maybe a guaranteed income or something of that kind would help to ease the burden of unemployment for these people.

What I am saying is if they have an income without producing anything you increase demand because they have more to spend, you don't increase supply because they don't produce anything.

Mr. PERRY. The reason I introduced the thought was that we talk about the need to decide between unemployment and inflation and how much we are going to have. There is the other side of the picture which ought to be considered—whether you can do something about the amount of hurt that is involved in whatever policy choice you make. If you make a policy choice for a lot of inflation you can certainly do something to compensate some of the people affected there. If you make a policy choice for more unemployment it seems to me you ought to concern yourself in that direction; whether you worsen the inflation in the process would depend on whether you reduce someone else's income in the process.

If you were to make these transfers, they should be legitimate transfers, transfers from others to those who are becoming unemployed. If you increase total income—that is, make it an addition rather than just a shifting around—then your point is very well taken. You will generate more demand. So I think you do have to think of it as a real transfer, you have to consider simply whether the people you are going to unemploy are going to bear all of that burden whether you are going to shift some of it around.

Senator PROXMIRE. So you would have a trade-off? It would be a washout as far as the effect on the economy is concerned; you said you would have to increase taxes in order to compensate for it?

Mr. PERRY. Increase taxes or spend less money in some other area. If you wanted to increase transfer programs to these people, and say \$2 billion are involved, if you take \$2 billion out of some other area you accomplish this. I am not suggesting that this is the best way to do it. But if you are faced with a policy that is gradually going to increase unemployment, one should at least consider taking such steps.

Now, I think there are better steps. The Government, as an employer of last resort, in whatever fashion such a scheme were implemented, would be far more desirable. I am not suggesting that you do away with the wrongs of unemployment simply by some transfer device. Only that it is a minimum you should do if you plan to pursue this kind of policy. But I would prefer a policy which was much more active, which in fact found employment, found training programs, found something constructive to do. These transfers are not constructive in this sense. They are just a way of easing the pain.

Senator PROXMIRE. Now, Mr. Suits, I would like to ask you to tell me what effect this would have on housing and the economy? As you know we have regulation Q, which limits the amount that savings banks can pay so we don't have the disintermediation that we had in 1966, and I am for it. I think we have to have it although any kind of control like that is not desirable.

Now, a different kind of credit control for the same purpose would be to recognize the enormous amount that we are pouring into this credit economy of ours into consumer credit. It has expanded from \$5 billion in 1946 to \$110 billion today, 22 times in 22 years, just phenomenal, and it is a big element in our spending and in the movement of our economy.

Supposing we had another regulation W, which would have an effect of limiting or rather requiring a certain size down payment, say for an automobile one-third, one-fourth, or one-fifth, whatever seemed desirable, an amortization period of 18 months or 24 months or something of that kind. Wouldn't this have the effect in the first place of limiting the requirement for borrowed money and tend to slow down the rise in interest rates and make funds more available, perhaps, for housing?

Mr. SUITS. I think it certainly would, Senator.

The consumer stands at the head of the line when they are passing out credit. He is the least sensitive of all the borrowers in the economy. The typical automobile borrower, for example, hasn't the faintest idea really of how much interest he is paying, and the way the interest

rate is commonly stated to him, even is not ordinarily of much help, that is if he is paying—

Senator PROXMIRE. My bill on "Truth in Lending," which will begin to take effect on July 1, is going to have some effect on it.

Mr. SURRIS. It will indeed. It will an effect on what he sees. It is a question of whether it will have any effect on what he does. As somebody else pointed out earlier, what he usually looks at is the size of the downpayment and how many months to pay, and those are the things that will affect whether he can buy a car or not, or a television set or a new refrigerator or whatever it may be.

So surely if we want to ration credit in such fashion as to leave more of its available for houses or for business purposes, it must be directly diverted from the consumer. It cannot be restricted by merely letting interest rates rise because the consumer is not sensitive to those.

Senator PROXMIRE. Thank you very much.

I just have a couple of questions, I think, for Mr. Williams.

Mr. Williams, in your statement about housing you said nothing in your optimistic estimate—you call it optimistic—of 1,600,000 housing starts; would you give a figure or a money amount?

Mr. WILLIAMS. I gave both. I gave a figure of 1.6 million housing starts, up 100,000 from 1968. The dollar figures for residential construction are shown in table 2, line 7.

Senator PROXMIRE. You don't come down hard at all or didn't seem to give any allowance for the level of interest rates or availability of credit. Did you think this was because it was established policy by the Federal Reserve and we couldn't do much about it?

Mr. WILLIAMS. Well, I said that we believe there will be ample mortgage credit available. You might recall that I had the most optimistic forecast in terms of the number of units of any of the four members of this panel. I think one other has a range of 1.5 to 1.6 in his forecast.

Senator PROXMIRE. Don't you think it makes a big difference in housing that credit will be available at a particular interest price?

Mr. WILLIAMS. Well, I have a feeling that today people are more concerned about the availability than they are the price.

Senator PROXMIRE. That may well be but the market would broaden a lot, wouldn't it, if you could get that cost, that rate down. It is there for low- and moderate-income housing. We have the 1968 housing bill and we can peg the interest rate down but that is a relatively small segment of the 1,600,000 or 2 million.

Mr. WILLIAMS. Other constraints may come into play which would limit it to 1.6 million, perhaps the availability of skilled labor.

Senator PROXMIRE. But doesn't the actual payment by somebody who has to pay 8 percent for his mortgage, the actual monthly payment as compared to one who has to pay 6 or 6½ percent, isn't there a substantial difference when you are buying a \$25,000 or \$30,000 home?

Mr. WILLIAMS. Yes, it is substantial, but I would say that today the vacancy rate is so low and the basic demand for housing space is such that I think this price will be paid.

Now there may be—

Senator PROXMIRE. It is an interesting position. I don't recall anybody else stating that. It may be the proportion and it may be perfectly correct. But your feeling is as far as this year is concerned, that it doesn't matter a lot if we have interest rates at 8 percent on mort-

gages or 7 percent or even a little bit lower, the important thing is the availability of houses, that is the vacancy, family formations and things like that or people are going to have to economize elsewhere but they are going to get that house.

Mr. WILLIAMS. I think that is basic.

Senator PROXMIRE. You don't think the market is elastic enough to make that much difference?

Mr. WILLIAMS. Well, I feel if we do have the extension of the surtax that interest rates in the housing area will not be much higher than they are today, and I see them today as no limiting factor.

Senator PROXMIRE. Right now they are $7\frac{1}{2}$ —

Mr. WILLIAMS. That is right.

Senator PROXMIRE. Do you gentlemen share this, that the credit cost is not very important compared to these other elements in terms of what is going to happen to housing this year?

Mr. KLEIN. As long as the supply of funds doesn't dry up.

Senator PROXMIRE. Mr. Perry?

Mr. PERRY. Well, very roughly, it seems to me that the statement that we are making is that present credit costs are consistent with the rate of housing starts in the neighborhood of last year's. I don't feel that the credit costs are unimportant. I think that they make a substantial difference in the amount of homebuilding activity you have in a particular year. And I don't know that you can get very far in trying to hold down some rates so long as the total funds available in the mortgage market are limited. For instance the need to raise the VA, and FHA—

Senator PROXMIRE. I would agree with that. You can't put a ceiling on that makes any sense where the market is so far above it you just have point payments or rationing of money. I am talking about the prospects of trying to achieve this perhaps by fiscal policy, by spending policy as well as tax policy and so on. There you think if the interest rates did come down you would perhaps have a better market.

Mr. PERRY. Yes, I think housing is responsive to the changes.

Senator PROXMIRE. Mr. Suits?

Mr. SUITS. I think this is an open question. Certainly the primary element is how much is really available to the housing market, and this has to do with what mortgage rates are compared to other alternative investments, and with the distribution of loanable funds among institutions.

Senator PROXMIRE. I have one more question. Mr. Williams, you have a startling divergence in your predictions of GNP. In the first quarter of the year you expect a \$9.2 billion increase in GNP; second quarter \$14 billion; and the third quarter \$19 billion; and the fourth quarter it will tail off to \$15 billion. Why the big increase, sudden increase, of economic activity in the third quarter of the year, and then a cooling off?

Mr. WILLIAMS. Unfortunately, Senator, you have an old copy.

Senator PROXMIRE. Is that a typographical error?

Mr. WILLIAMS. No, it has been revised. Would it be possible to get a—

Senator PROXMIRE. What I have is \$897, \$911, \$930, and \$945 billion.

Mr. WILLIAMS. The revised—

Senator PROXMIRE. Four quarters of 1969.

Mr. WILLIAMS. My revised statement which I brought in at 10 o'clock this morning reduces variations in quarterly growth rate over the year. Annual total GNP hasn't been changed, but the quarterly increases in 1969 are: \$11.2, \$12.5, \$17.5 and \$15.5 billion.

Senator PROXMIRE. You still have the big increase in the fourth quarter, not quite as much but it is still a big one. Why is the third quarter expected to be so bullish?

Mr. WILLIAMS. I think most of us had this greater increase in the second half. In the third quarter you have a pay increase in the Federal sector.

Senator PROXMIRE. The pay increase is an element but you know everything we have heard from everybody who has testified here in the last week was that they are determined to slow the economy down, and it should be cumulative and we shouldn't have a period 6 months from now, after applying restraint over a period of time, which goes up higher.

Mr. WILLIAMS. Well, this overall increase that I have called for of 3.4 percent in real terms is a substantial slowing down in the economy.

Senator PROXMIRE. Well, except there is no slowing down between the second and third quarters.

Mr. WILLIAMS. That is true.

Senator PROXMIRE. There is a speedup.

Mr. WILLIAMS. Yes.

And that is due to a steady increase in Government spending, augmented by the pay increase in the third quarter. I don't see—

Senator PROXMIRE. That is when the credit is likely to get tight, the Federal Reserve is likely to have the brakes pretty firm during that period I would think.

Mr. WILLIAMS. If they wish to prevent this, that is what they will do, yes.

Senator PROXMIRE. Well, gentlemen, I have detained you and imposed on you long after other members have gone, but you were so interesting and so responsive and competent that I just couldn't resist. I very much appreciate a splendid job. Thank you very much.

The committee will have its next hearing tomorrow morning in room 1202, New Senate Office Building, when we will hear four experts on fiscal and monetary policy. The meeting stands in recess until then.

(Whereupon at 12:40 p.m., the hearing was recessed, to reconvene, Tuesday, February 25, 1969, at 10 a.m.)