LONG-TERM ECONOMIC IMPLICATIONS OF CURRENT TAX AND SPENDING PROPOSALS

516

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BEFORE THE

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OF THE

JOINT ECONOMIC COMMITTEE

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LONG-TERM ECONOMIC IMPLICATIONS OF CURRENT TAX AND SPENDING PROPOSALS

WEDNESDAY, MAY 5, 1971

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON FISCAL POLICY
OF THE JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The subcommittee met, pursuant to recess, at 10:05 a.m., in room G-308, New Senate Office Building, Hon. Martha W. Griffiths (chairman of the subcommittee) presiding.

Present: Representative Griffiths; and Senators Proxmire and Humphrey.

Also present: John R. Stark, executive director; James W. Knowles, director of research; Loughlin F. McHugh, senior economist; John R. Karlik, Richard F. Kaufman, and Courtenay M. Slater, economists; Jerry J. Jasinowski and Lucy A. Falcone, research economists; George D. Krumbhaar, Jr., minority counsel; and Walter B. Laessig and Leslie J. Barr, economists for the minority.

OPENING STATEMENT OF CHAIRMAN GRIFFITHS

Chairman GRIFFITHS. The subcommittee will come to order.

This morning the Subcommittee on Fiscal Policy of the Joint Economic Committee begins 4 days of hearings under the general title "Long-Term Economic Implications of Current Tax and Spending Proposals."

There has been considerable discussion of whether the economy needs additional fiscal stimulous to enable it to progress as rapidly as feasible toward full employment without at the same time aggrevating the inflation problem. A number of proposals have been made, including changes in the depreciation regulations for business; renewal of the investment tax credit; acceleration to this year of the individual income tax reductions provided for 1972–73 under the Tax Reform Act of 1969; an additional public works program costing perhaps $2 billion; a public service jobs program for the unemployed which could cost between $1 to $2 billion; and unfreezing the $12 billion in appropriations which the President has thus far prevented the agencies from spending. There have also been other proposals outside of the fiscal policy realm, including an increase in the minimum wage, as well as various wage-price proposals.

The subcommittee is interested in receiving expert views as to what the probable effects could be of these various proposals over the next 5 years if any one or several of them were adopted now.

What would be their contribution toward solving our present difficulties? What would be their effect upon economic conditions in future years when presumably we would have restored full employment? If we adopt such measures as these at present, would we wake up 2 or 3 years from now with accelerated inflation, excess investment, a renewed rise in unemployment, or a further deterioration of the balance of payments—or all four? It is possible that the currently discussed proposals for stimulating the economy would be counterproductive in the years ahead. We are concerned about these possible effects, as well as the economic problems which have evoked the proposals in question. We anticipate your views on the complex issues now before us.

Our concern with these problems has intensified as the considerations have come to the fore of our study of these issues. On the one hand, it is becoming increasingly obvious that the budget is moving toward ever bigger deficits. Indeed, even on a full employment basis the unified budget is now in deficit following the changes in social security benefits and taxes in the recent legislation. In total, the changes in that measure move the Budget from surplus to deficit by some $3 billion or more in fiscal year 1972. Future social security and welfare legislation is in the drafting process. A public works bill is well along the legislative track. This implies that at best, on a full employment basis of estimating, the unified budget will show a signficant deficit and even the NIA budget may at best be barely balanced. It might even show a deficit. If some of the proposals I listed earlier were adopted, both the unified and the NIA budgets would show large deficits, and the total cash flow in and outside of the government would show a very substantial full employment deficit.

One of the principal suggestions for stimulating the economy by the administration has been depreciation acceleration. Others have suggested the investment tax credit. Yet, when our staff checked the facts, is appears that business fixed investment amounted to over 10 percent of the full employment potential GNP in 1970—a year everyone credits now as a recession—and this is about the same ratio as prevailed in other years in the 1950's and 1960's when the rate of increase in capacity had been as rapid as to produce excess demand, excess capacity, and an increasing gap between actual and potential output.

I am sure, therefore, that you gentlemen, as experts in these fields, will recognize that the subcommittee has good reason to be puzzled both about the immediate effectiveness of some of these prescriptions that are being suggested, and even more concerned about their long-run effects. The subcommittee looks forward to receiving your analyses and advice.

Our first witness is Arthur M. Okun, senior fellow of the Brookings Institution and former Chairman of the Council of Economic Advisers. Our second witness is Wilfred Lewis, who after an already distinguished career, is now chief economist at the National Planning Association. Our third witness is Norman B. Ture, senior associate at the Planning Research Corp. who we are particularly delighted to welcome back since he served as an economist of this subcommittee back in the 1950's.

Mr. Okun, will you please proceed.

STATEMENT OF ARTHUR M. OKUN, SENIOR FELLOW, THE BROOKINGS INSTITUTION [1]

Mr. OKUN. I want to congratulate this subcommittee for exploring the critical fiscal policy issues of this year at a sufficiently early time to help guide the legislative decisions of the current session of the Congress.

RECENT ECONOMIC DEVELOPMENTS

Ten weeks ago I had the privilege of testifying before the Joint Economic Committee; at that time, I stressed the need for:

> Carefully controlled measures of additional temporary fiscal stimulus that would help the economy get rolling and would phase out when it gets into high gear.

Events since then underline the urgency of such additional fiscal action. The evidence of recent months clearly reveals that economic activity is not moving along a track toward the administration's laudable targets for brisk recovery. While the price performance of the first quarter had a number of encouraging features, the performance of production and employment was frankly disappointing, as I view it and as I would expect any economist to view it. Apart from the distortions created by the automobile work stoppage in the fourth quarter and the ensuing resumption in the first quarter, the pace of the economy certainly did not quicken and probably actually slowed down in the first quarter. The recent evidence did confirm that the economy is now in an expansion rather than a contraction; it should dispel any lingering doubts aboubt the direction of economic activity. But the evidence also confirmed earlier indications that the recovery is inadequate; private demand continues to be stuck in the mud, rather than popping up like a jack-in-the-box.

Nor in my judgment is a marked strengthening on the horizon. On the basis of present policies, I would expect an average quarterly advance in our gross national product for the next three quarters of $10 to $20 billion barring a prolonged steel strike. That would be only a slight improvement over the basic $16 billion quarterly rate that has prevailed in the past three quarters. It would mean that a 6 percent unemployment rate and a $60 billion loss of production due to idle man and idle machines would continue throughout the year. It would mean a GNP for the year of about $1,047 billion, or more realistically between $1,045 billion and $1,050 billion.

An unusual and undue amount of attention has been devoted to the precise numerical outcome of the 1971 GNP, for understandable reasons. The administration's figure of $1,065 billion essentially challenged the vast majority of private economic forecasters, whose predictions were concentrated in the range from $1,045 to $1,050 billion. As a result, the disagreement became viewed as a contest, perhaps even a numbers game; the dramatic interest was heightened when Director of the Office of Management and Budget refered to a new forecasting model in arguing the plausibility of that projection. The Congress obviously has no interest in economic forecasting as a spectator sport. But the Congress has an essential interest in the important message that the administration was conveying in its projection.

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[1] The views expressed are my own and are not necessarily those of the officers, trustees, or other staff members of the Brookings Institution.

When it took strong issue with the standard private forecast, the administration proclaimed that a year with a GNP in the $1,045 to 1,050 billion range would not represent a satisfactory recovery. That was an appropriate social judgment in January and it remains equally appropriate in May. Although such an unsatisfactory recovery has become more likely, it has not become more likable or less unsatisfactory.

The stubbornness or unemployment in 1971 reflects not only the normal lag of employment behind the recovery of production, but also the inadequate pace of the recovery. Given the present outlook and present policies, I do not believe that unemployment will be substantially below 6 percent at the end of this year. Nor, if present policies were to continue, would I be confident of improvement by the spring, summer, or even fall of 1972. Perhaps the expansion of private demand will gain momentum; but it is equally possible that the current recovery, like that of 1958–60, will never get rolling and will stall prematurely. To be sure, many private forecasts for 1972 are optimistic, but they generally rest on the key assumption that, as it becomes obvious that the problem isn't curing itself, the administration, the Congress, and the Federal Reserve will act more vigorously to promote recovery. If that assumption about policy should turn out to be incorrect, the recovery might as easily peter out as pep up.

IMPLICATIONS FOR POLICY

Additional fiscal-monetary support to economic recovery is needed. And it is needed now. It is not too early to make that judgment—to urge a delay one would have to see a realistic chance of GNP speeding up to a $30 billion quarterly rate, without further policy measures. Nor is it too late, either for the legislative calendar or for improvement in the year-end and 1972 outlook.

Fiscal policy should lead the way in providing that aid. But some additional expansionary support could and should be forthcoming from monetary policy. The money supply has essentially made up for its slow growth during the period from September 1970 to January 1971; it is now back on the 6 percent growth track that prevailed during the first 9 months of 1970. And since the money supply has returned to that track, the Federal Reserve has seemed to move toward the broker. If the maintenance of that 6 percent growth track is and remains a rigid target, I see no contribution coming from monetary policy to improve the prospect of a satisfactory recovery.

As I understand the current financial situation, it underlines the importance of maintaining stable and relaxed credit conditions and reasonable short term interest rates, rather than of cleaving rigidly to any particular target for monetary growth. Many investors and dealers in financial markets seem to fear or hope that the decline in interest rates of late 1970 and early 1971 represent only a temporary and tiny interim between two periods of tight money. As a result, they are hedging or speculating on the other side of the interest rate valley, and thus staying short and liquid despite the extremely attractive yield advantages of long-term securities. They are sacrificing interest income now in order to preserve opportunities of going long when and if bond rates move back to their 1969–70 heights, and in order to insure against a liquidity squeeze in the event of tightening. This situation reflects a lack of confidence by investors in long term securities. And it can be remedied directly by a Federal Reserve monetary policy that aims primarily for sustained stability in short-term credit markets while treating targets for money growth feasibly.

I believe such a monetary strategy would be consistent with the basic posture of the balance-of-payments policies. And perhaps I had better say another word or two about that, since that is front-page news today. It seems to me that whatever the problems and whatever the prospects on the foreign exchange front, it is inconceivable that we can deal with these by a major twist of monetary policy in the direction of restraint. The kind of monetary policy move that would be required to make any significant impact on foreign exchange markets would just sacrifice the domestic economy. One can envision small differences that might be made in the light of international situation. But I think the whole world requires, and our own interest certainly requires, that the United States maintain a healthy domestic recovery. Nonetheless, current balance-of-payments problems and policies provide a reason for placing greater (although not exclusive), expansionary emphasis on fiscal policy than was envisioned in the administration's January program.

That budgetary program called for a full employment surplus of $7 billion for fiscal year 1972 on the national income accounts basis—the concept of the budget that has always been most economists preferred gauge of the full employment budget. Since then, the social security program enacted by the Congress has wisely added $3 billion of stimulus to the budgetary proposal. As a rough guide, I would suggest that an appropriate amount of additional fiscal stimulus might be about $8 billion or, more broadly, in the range between $6 billion and $10 billion. The economic recovery program should consist of expenditures and tax reductions that could add to private purchasing power at once without committing the Nation to a more stimulative budget in future years.

The choice of self-limiting and self-terminating stimulative fiscal measures is critical in my view for several reasons. First, the Federal budget can and will become an engine of inflation in future years if we adopt massive new permanent expenditure programs as a means of promoting recovery. That is the valid and important lesson in the warnings by administration economists about fiscal stimulation. We must avoid action this year that would commit us to inappropriate and inflationary deficits when full employment is restored. Second, we should operate on the realistic, if regrettable, assumption that neither the Congress nor the President will move swiftly to raise taxes to head off any threat of inflationary boom that might develop in future years. Third, to conserve our precious Federal revenue potential for the long run, we should avoid any new permanent reductions in taxation for either individuals or businesses. In light of both the CEA 1971 Annual Report and the new study of national priorities by Charles Schultze and several other Brookings scholars, we should recognize how little elbow room exists for meeting urgent needs for public services, even with our present tax system.

AN ILLUSTRATIVE RECOVERY PROGRAM

The principle of using quick-starting, self-stopping measures is more important than the precise ingredients of the program. Let me nonetheless outline the elements of one illustrative fiscal package that appeals to me and meets my basic principle:

1. Personal taxes. The keystone of the program would be the immediate implementation—including retroactivity to January 1, 1971—of the personal income tax reductions already scheduled to take effect in January 1972 and January 1973. That measure would not sacrifice 1 cent of Federal revenues beyond January 1, 1972. It would add $4½ billion now to the flow of consumer purchasing power, aiding directly that sector most critical to the resurgence of the entire economy. Consumers are saving nearly 7½ percent of their income rather than a more normal fraction of about 6 percent. But the bulk of consumer income still flows into consumption and the bulk of any additional income provided by tax cuts would also, over time, flow to our supermarkets and our department stores. I have just completed a study of the impact on consumer demand of the personal tax surcharge of 1968–70. That statistical postmortem reveals that the surcharge curbed consumer spending on nondurable goods, services, and household durables about as much as would have been expected on the basis of previous evidence relating consumption to income. Except for automobile demand, which was seemingly immune to this restraint, the surcharge had about as much restrictive impact as would have been generated by an equal reduction of income coming from other sources. This new evidence reassures me that changes in personal tax rates—upward or downward, permanent or temporary—are a highly effective measure for supporting or restraining private expenditures.

2. Public service jobs. A program to place the unemployed in public service jobs should be one element in the fiscal package. Such a program could and should go into action promptly, and would obviously deliver income to those who need it and stand ready to spend it. It could also provide useful public services. It is particularly appropriate in a slump, when jobs programs that rely on the participation of private employers necessarily suffer. In a return to full employment, the emphasis of manpower program should shift back to private jobs, but public service jobs deserve a limited place in the Federal budget for the long run. I should guess that at least $1 billion could be efficiently spent on such a new program within fiscal 1972.

3. Earlier initiation of the Family Assistance Plan. If the Congress modifies and enacts—as I hope it will—the commendable family assistance plan this summer, the benefits of that plan could flow to the needy beginning January 1, 1972, rather than July 1, 1972, as proposed in the budget. That earlier launching would add $2 billion to outlays for fiscal 1972 without any increase in fiscal 1973 commitments.

4. Temporary recovery bonuses in Federal grant programs. A number of Federal grants-in-aid should be provided with an extra temporary allowance to alleviate the squeeze of the economic slump

on the treasuries of our States and cities. I would specifically recommend that the bonus should be based on the amount of excessive national unemployment so that it would automatically vanish when full employment was restored. Such a bonus should be confined to federally assisted expenditures in areas where States and cities are particularly hard pressed financially and are ready to put additional funds into the income stream at once. As a rough guess, I should think $2 to $3 billion could be productively spent this way in fiscal 1972. More generally, if the Congress does not enact the general revenue sharing program this year, it will be particularly important to rechannel those $3¾ billion efficiently in order to avoid any net reduction in fiscal support to the economy.

TWO OMITTED ITEMS

In your letter of invitation to me, Chairman Griffiths, you called my attention to several proposals for fiscal action. I should like to comment on why some of them are not included in my preferred program.

I would urge that the funds allocated to public works now should be no higher than would be justified if the economy were at full employment. Public works are not an effective means of promoting recovery in a temporarily weak economy. The startup time is simply too long to suggest that any significant job-creating benefits could be achieved in 1971 or 1972. An accelerated public works program received—and failed—a fair test under the Kennedy administration. An $850 million program was enacted in October 1962. My colleague, Nancy Teeters, who has studied that program, found that its pace was pathetically slow. Only $62 million (7 percent of the total) got into the economy during fiscal 1963. Less than half of the total was spent 21 months after enactment at the end of fiscal 1964. And we were still spending $88 million in fiscal 1966 when it was precisely the wrong medicine for the prevailing boom situation. In light of that experience, I would be very skeptical about the possibilities for instant public works; and I would fear that such a program, based on unreasonable expectations, could discredit flexible fiscal policy in light of the inevitable subsequent disappointments.

In my judgment, the proposed liberalization of depreciation allowance also fails to meet desirable standards for a recovery measure. By reducing Federal revenue from corporate taxation, it puts $2 billion into the private income stream this year; but it makes a serious permanent sacrifice of $4 billion a year of Federal revenues for that purpose. Abstracting, as I must, from the crucial legal issues concerning this proposal, I would feel that such a long-term sacrifice could be justified only if the state of investment demand urgently required direct fiscal stimulation.

Currently, business fixed investment amounts to 10.2 percent of GNP, an unusually strong performance in view of the low operating rates and depressed profits of American industry. The share was barely higher (10.4 and 10.5 percent) in the investment boom years of 1956 and 1957. Investment demand today is simply in a different ballgame than it was during the early sixties; after 1961, when its share was 9 percent and after it had failed to grow for 5 years, investment was crying out for direct support. Today, the consumer needs that help. If the sagging consumer sector of the economy is strengthened by the fiscal measures I have outlined above and if monetary policy is properly accommodative, businessmen will respond enthusiastically with rising capital budgets. I see no case for a particular fiscal stimulus to investment today.

When and if a fiscal stimulus to investment should become desirable, the investment tax credit is a far superior alternative to the acceleration of depreciation, because it has about twice as much effectiveness per dollar in increasing the incentive of businessmen to invest.

I should like to point out that there is plenty of room for differences of opinion, but there is no excuse for a display of surprise or suspicion about the opposition of many academic economists in accelerated depreciations. The Treasury was fully aware of these views on this issue before the administration made its proposal. They knew that many economists considered such a measure inefficient, inequitable, and inappropriate, and could not honestly support it.

In summary, a $6 to $10 billion package of quick-starting and self-terminating fiscal aids is needed to promote brisk, well-paced economic recovery and to help move the economy out of the mud of 6-percent unemployment and a $60 billion production gap.

Thank you.

Chairman GRIFFITHS. Thank you very much, Mr. Okun.

Mr. Lewis.

STATEMENT OF WILFRED LEWIS, JR., CHIEF ECONOMIST, NATIONAL PLANNING ASSOCIATION

Mr. LEWIS. Madam Chairman, I plan to comment on each of the policies listed in your letter of invitation. But before I do that, I would like to state my assumptions and prejudices about the present and prospective conditions of the economy against which I weigh the above and other proposals for stimulating the economy.

First, I consider full employment to mean unemployment of no more than 4 percent of the labor force and in fact I believe we should try to find policies that would allow us to get unemployment as low as 3½ percent and keep it there without generating intolerable amounts of inflation.

Second, it is my opinion that, once the present gap between actual and potential output is closed, the average condition of aggregate supply and demand in the U.S. economy for the balance of the 1970's will be such that a full employment Federal surplus of at least $5 billion and perhaps as much as $10 billion on a national income accounts basis will be required to stem excess demand, to keep inflation at an average rate of not more than about 2½ percent per year, and to keep long-term interest rates in the neighborhood of 6 percent. A full employment Federal surplus will be required by the prospective shortage of private savings associated with a changing age distribution of the U.S. population in the direction of a larger percentage of the population in the high-spending, low-saving 25- to

35-year-old age brackets. It is obvious that achieving a full employment Federal surplus will be extremely difficult. The pressures for increasing Federal spending for a whole host of programs good, bad, and indifferent are very great, and the resistance of the American public to the necessary increases in taxes rather overwhelming, as became abundantly clear at the time of the so-called Tax Reform Act of 1969.

Third, I think the U.S. economy has entered a new era which will make it distinctly harder than it has been for most of the time since World War II to achieve and maintain price stability at full employment even if we achieve adequate public plus private savings. The main reason for thinking so is, paradoxically, that we have at long last learned how to manage aggregate demand through the timely application of fiscal and monetary policy to achieve almost any level of unemployment we want. Unplanned recessions are a thing of the past. It should escape no one's notice that the 1970 recession differed in kind from the four previous recessions since World War II. The previous recessions were all unplanned and unexected, while the 1970 recession was brought on by deliberate fiscal and monetary actions and was accepted as a necessary means of combating inflation. In this connection, we should not be mislead by the niggling disagreements between the so-called Keynesians and the so-called monetarists into thinking that we do not have a concensus view about how to avoid recessions. Nine-tenths of the apparent disagreements between the keynesians and the monetarists are semantics more than anything else, and given the same set of facts about the economy, the same forecasts for private investment intentions, and the same assumptions about monetary growth and the full employment surplus, the forecasts for GNP, prices, and unemployment by either group are likely to be very similar. The unpopularity of unemployment, and the belief, right or wrong, that unemployment is politically unacceptable, coupled with our ability to avoid unwanted unemployment, work in the direction of imparting a somewhat inflationary bias to the system because the business community and Wall Street expect the Government to be more concerned with and more successful in avoiding unemployment than in avoiding inflation. We are all aware that the inflation we have been experiencing for the past 2 years is not excess-demand inflation. It is equally wrong to call it a cost-push inflation, as some people do, as that term implies a causal relationship that I do not think exists. A much more accurate term would be expectational inflation, reflecting the fact that if a large number of people with decisionmaking power in the price-wage arena expect inflation in the future, they will behave in such a way as to make this a self-fulfilling prophesy. This is not a proposition that is easily proved or disproved by statistical analysis of time series data. But then again, neither is any other theory of inflation. What is true is that the appropriateness of policy actions to achieve price stability depends importantly on what it is that is causing the inflation. My own view is that, at the present and for the last 2 years, expectations have been the principal cause of inflation, and that until we learn to deal with expectational inflation we will have a great deal of difficulty reconciling price stability with full employment. We have had a sharp reduction in the rate of inflation in the first 3 months of the year. It remains to be seen, however, whether this is a temporary phenomenom or whether renewed expansion of the economy will bring a renewal of inflationary expectations.

The fourth point that enters into my analysis of what stabilization policies are appropriate in the present situation goes to the issue of business confidence. Most present forecasts of expansion this year include little or no contribution from increased business investment, because that is what most businessmen have been indicating in various surveys of investment intentions. This is a situation which could change quickly. I believe the process will work something like the following: If it looks like the administration's antiinflation policies are at long last succeeding, then confidence will build up that the expansion can be allowed to continue, stock prices will remain high or increase further, and a full-fledged investment boom will be underway by the end of the year. If, on the other hand, the apparent move towards price stability we have had for the past few months turns out to have been based largely on temporary seasonal or accidental factors, and if prices start rising again, then the stock market will look beyond the current expansion to a realization that another bout of restrictive fiscal and monetary policy is around the corner, stock prices will retreat from current levels, and business fixed investment will remain soft. This analysis underscores the importance of assuring that inflation is in fact kept under control.

I wish I could share the administration's confidence that we have broken the back of inflationary expectations. It is possible that we have. But my recommendation would be to attach absolutely the highest priority to assuring that prices do not start back up again any time soon. This calls for the statement in quantitative terms of guideposts for noninflationary price-wage behavior, backed up by vigorous and aggressive enforcement. It would be little short of disaster if inflation started to increase again this year with the economy still so far away from full employment.

With this background, my views on the specific policy alternatives this committee has under consideration are predictable. Liberalization of depreciation allowances or renewal of the investment tax credit would be highly undesirable because they erode the long-run tax base we so urgently need to maintain an adequate full employment surplus in the Federal budget. They will be unsuccessful in stimulating business investment this year unless underlying business confidence revives, and they will be unnecessary if it does revive. Their primary effect will come in future years and will be in the wrong direction at that time.

Similar remarks apply to unfreezing presently frozen appropriations or cranking up a new public works program. I am not privy to knowledge of exactly what approrpriations have been bottled up. However, with the needs for high priority new Federal programs in the welfare, health, and environmental fields as great as they are; with State and local governments as starved as they are for additional funds; with the poor record of achievement in so many existing Federal programs; with the resistance to new taxes so high; and with the need for a significant full employment Federal surplus in coming years to compensate for foreseeable shortage of private savings; it is necessary to exercise great restraint with respect to any Federal spending programs which cannot demonstrate very high benefit-cost ratios.

By contrast, a public service jobs program for the unemployed would be a very sound move at this time, assuming the program is executed in a way that enhances rather than undermines the self-respect and self-development of the beneficiaries. We have been making a major mistake all along in excluding public sector jobs from our manpower development and training programs, as the public sector accounts for a very large fraction of the growth in employment opportunities for the less highly trained and less highly educated members of the labor force. This is particularly the case in our large cities, where the unemployment problem is particularly acute and where private sector jobs are expanding very slowly. Moreover, a public employment program would be at least partly self-liquidating in the sense of tapering off somewhat in terms of budgetary costs as the economy returns to full employment.

Going beyond public employment, we are in need of major modernization and improvement of our whole unemployment insurance system. It is fascinating to me how imaginative some of the Government's proposals for helping unemployed scientists and engineers have been, going far beyond traditional unemployment benefits to include such things as relocation and moving assistance, housing allowances, retraining benefits, and the like.

I certainly don't begrudge the scientists and engineers this assistance. But we need similar aids for a far larger number of the unemployed. Our present unemployment programs are really quite primitive and niggardly for a modern industrial society. One proposal that has been made which makes a great deal of sense to me is a new category of social security which has been referred to as national policy insurance.

The idea behind this proposal is that a significant amount of unemployment is attributable to policy actions by the Federal Government, such as trade liberalization, cutbacks in defense spending, and—as in 1970—fiscal and monetary actions to curb inflation. Such actions would justify funding unemployment benefits from Federal general revenues as distinct from the present reliance on payroll taxes, and could be the occasion for a considerably more helpful and more positive package of relocation and retraining benefits than is thrown up by the present clumsy and underfunded Federal-State unemployment insurance system.

A more positive approach to unemployment could provide important side benefits in the form of softening political pressures to protect inefficient and outmoded firms and industries that threaten to hold back our productivity and international competitiveness. For example, given present unemployment benefits, it is easy to understand demands to keep the SST program rolling or to keep out Japanese textiles because of the number of jobs involved. But that is a rather inefficient way to go about making decisions regarding the allocation of national resources.

The proposal to bring foward into 1971 personal income tax reductions now scheduled for 1972 and 1973 falls somewhere in between the above alternatives in terms of desirability. Personally, I don't think we will be able to afford these tax reductions in 1972 and 1973, and I would prefer that we unscheduled them altogether. That is probably unrealistic. If we are for sure going to go through with these tax cuts anyway, a case can be made for doing them this year rather than waiting. At the present time, there would be a somewhat greater economic kick from personal tax cuts than from a comparable amount of credit extended to the private sector. Moreover, as Otto Eckstein has argued recently, leaning a little more heavily on fiscal expansion in our policies to stimulate the economy this year will leave consumers and other private spending units in stronger asset positions than if we rely exclusively on private credit expansion.

Minimum wage boosts, which is one of the items on this committee's list of policy alternatives are inapprorpriate now or any other time. The problem of poverty can only effectively be tackled by public programs. To try to get the private sector to take over a public responsibility by raising minimum wages only has the effect of creating inflationary pressures, interfering with the efficient allocation of resources, and pricing out of the labor market altogether some groups who can sorely afford to do without jobs, such as low-skilled workers and teenagers.

Chairman GRIFFITHS. Thank you very much.

Mr. Ture.

STATEMENT OF NORMAN B. TURE, SENIOR ASSOCIATE, PLANNING RESEARCH CORP.

Mr. TURE. Thank you Madam Chairman.

It is a privilege to appear before the Subcommittee on Fiscal Policy and to have the opportunity to present my views on the "Economic Implications of Alternative Tax and Spending Policies: 1971–76." I must offer a disclaimer, that the views that I express here are my own and not necessarily those of any of my past and present associates. And I must tell you that I offer that disclaimer with the greatest regret.

The subcommittee is to be commended for the forward looking focus implied in the title of these hearings—for its concerns with the longer term effects of fiscal actions addressed to the resolution of pressing present problems. If these hearings were to accomplish nothing else, they would nevertheless represent another major contribution to constructive public policy formulation by virtue of their concern with the impact of present policy measures on the future condition of the economy.

In your letter of invitation, the specific matters which this panel has been asked to address are framed in two questions:

(1) What are the likely contributions of the various tax and spending proposals now being aired to solving our present difficulties, that is, toward accelerating the increase in real output and employment without renewing inflationary pressures?

(2) What are the likely effects of the various proposals on future economic conditions?

Of the two questions, only the second, I submit, is a matter of real concern and one which properly should engage the attention of this subcommittee. In the interests of economizing on the time of the subcommittee, permit me briefly to summarize my views on the first question with the objective of agreeing to disagree with my fellow panelists on whether fiscal actions have any consequential effect in the short run on aggregate demand, changes in the price level, and the rate of utilization of the economy's production capability.

At the most highly aggregate level, changes in fiscal parameters per se have no significant predictable short-run effect on the level of economic activity.

Changes in taxes relative to expenditures may be—but need not be—allowed to affect the stock of money.

If the monetary authority permits fiscal actions to affect the rate of growth of the money supply, a change in the level of economic activity measured in current dollar gross national product terms will occur, after some uncertain lag.

If the monetary authority offsets the monetary impact of the fiscal change, there will be no significant, predictable effect of the fiscal change on GNP.

If these propositions are acccepted, they lead to a number of conclusions about fiscal and monetary policy.

Public policy can make its most important contribution to short-run economic stabilization by pursuing a steady course, avoiding the temptation to fine tune to manage the economy.

In this context, the Joint Economic Committee's recommendation that Federal Reserve policy should aim at a steady rate of expansion of the money supply represents a major contribution to short-run economic stabilization policy.

The Joint Economic Committee would make a parallel contribution in recommending an analogous course for fiscal policy. The amount and composition of Federal expenditures should be determined on the basis of policymakers' assessments of long-run needs for publicly provided goods and services. Such expenditure should be determined on the basis of policymakers' assessments of long-run needs for publicly provided goods and services. Such expenditure plans should not be adjusted by reference to supposed short-run stabilization considerations. Tax revenues should be determined so as to grow at the same trend rate at which expenditures are anticipated to increase. With a tax system of roughly the present configuration, this rule would call for periodic tax reductions if the trend rate of expenditure growth were to be the same as the trend rate of increase in total economic activity. On the other hand if for whatever reason it were decided to increase the rate of expansion of government spending over some relevently long period of time, say 5 years or more, this decision should be recognized as simultaneously a decision to maintain or to increase taxes, such that revenue growth would proceed at the same trend rate as expenditure increases over the period. Short-term deviations of either expenditures or revenues from the planned trends should be ignored.

I fully recognize that the proposed fiscal rule departs widely from our fiscal history and would be difficult to implement. As a guide to fiscal policy, however, it is of much the same dimensions as the monetary policy rule which this committee has recommended.

The fiscal policy rule briefly described above is silent, intentionally so, on the question of the structure of the revenue system.

The rule for a stable fiscal policy aims at minimizing fiscal shock to the economy in the short run and reducing the burden which short-run fiscal policy shifts impose on the monetary authority in stabilizing the rate of growth of the money supply. As such, the rule need not be concerned with the specific system of taxes imposed; it is applicable irrespective of the relative revenue importance of the various axis in that system.

The kinds of taxes comprising the revenue system are, however, highly consequential with respect to how progressive, efficient, and rapidly growing an economy we have. It is in that context that I wish to examine some of the current tax proposals.

To undertake this examination, let us begin with two basic premises.

Every tax alters the price of the thing that is taxed relative to other prices.

Next to a vacuum, nature abhors nothing so much as a zero price elasticity.

These premises, I believe, afford a highly useful and constructive framework for analyzing the effect of taxes on economic activity. In our present state of knowledge, a great many of the most pertinent questions about taxation can be answered only in terms of nature and direction of effects, but looking at taxes in the context just suggested at the least permits us to raise the relevant questions.

For example, consider income taxes, the mainstay of Federal revenue. Given the general configuration of these taxes, what relative prices are altered? What type of response to the relative price effects of the income tax should be expected?

In the first place, an income tax of the sort imposed by the Federal Government is levied only on income which flows from market transactions; imputed income is not subject to tax. The Federal income tax, thus, increases the cost to the taxpayer of using the resources at his disposal to generate the former type of income relative to the latter. In broad terms, it reduces the cost of leisure relative to the cost of generating income, as the term "income" is popularly conceived.

Unless one assumes that there is no effect of this change in relative prices on the choice between leisure and effort, that is, unless one assumes a zero elasticity with respect to the relative price of effort, an income tax results in less personal effort of the types directed toward the market place than would otherwise occur.

To continue the illustration, the Federal income tax—indeed, most of the income taxes now imposed—generally includes in the base of the tax the saving undertaken by the taxpayer in the taxable period. The amount saved in any given period by a taxpayer is equal, at least to a first approximation, to the present or capitalized value of the future income stream attributable to the wealth in which the saving is embodied. To the extent that this future income stream will flow through the marketplace—as the vast proportions of such streams do—it will be subject to income tax as it materializes. Thus, taxing its capitalized value—the amount saved—currently and taxing the stream itself as it is realized in the future subjects the future income stream to multiple tax. In other words, this feature of income taxation increases the cost of saving relative to the cost of current consumption.

Where the saving is embodied in depreciable assets, some offset to this multiple taxation is afforded by depreciation allowances. The offset is incomplete, however, except in the rare case in which the amount of the outlay for the assets is deductible in the year in which it is made.

For individuals, the only significant, widely applicable offset is found in the exemption of employer contributions on behalf of employees to employee retirement plans in the taxable year in which the contributions are made. On the whole, however, personal saving embodied in human capital is afforded little if any shelter from multiple income tax. I believe there that in that sense one can agree with those who assert that the capital markets are indeed imperfect with reference to saving and investment in human capital.

Additional illustrations of the relative price effects of taxes could be provided at length. Let me, instead, merely cite the corporation income tax, the income taxation of capital gains, and the graduation of personal income tax rates as tax features the relative price effects of which should cast up interesting questions for anyone concerned with the effects of our tax system on economic efficiency and growth.

Examining our present tax system and proposals for tax changes in this light is highly instructive. The existing system emerges as highly antisaving and anticapital in its impact, and not merely on the affluent individual and large corporation but as well on each of us. And proposals such as those for reinstitution of the investment tax credit and for liberalizing depreciation are revealed as small, partial, but nonetheless consequential steps toward alleviation of some of the excessive tax burden on saving and capital, rather than as subsidies to business or sly giveaways to "fat cats."

This is not to deny that much of the immediate tax savings from such tax proposals would be realized by large corporations or affluent individuals. The pertinent question, however, is whether considerations regarding short-term changes in the distribution of tax liabilities—not the incidence of taxes, but tax liabilities—should be weightier than considerations of the long-term effects of changes in tax liabilities on the rate at which the economy grows and on per capital income and wealth.

These longer term effects, I submit, should be given much greater weight than they have customarily received in the formulation of tax policies. Indeed, in my judgment, the emphasis on the distribution of tax liabilities is misplaced and conflicts with the apparent objective of many of the most ardent advocates of redistribution fiscal measures.

Although I've not taken a poll, I believe that most economists, irrespective of their ideological "school," agree that the law of diminishing returns is still in effect, and that, consequently, the larger the amount of capital with which a given labor force is equipped, the greater is the marginal productivity of that labor force. Moreover, a substantial proportion of the economics profession also would agree, I am confident, that at least over time, the greater the marginal productivity of labor, the higher will be the average real wage rate.

With these supposed agreements in mind, consider the effect of tax-transfer policies of the Government which, focusing on the distribution of tax liabilities and of Government program benefits, are ostensibly implemented, at least at the margin, by progressive taxes and expenditures for the benefit of the poor. To the extent that the difference between affluence and poverty is accounted for the amount of capital, human or nonhuman, rather than random chance or mischance, the redistributive policy reduces the net return per unit of labor. The price to be paid for saving and capital accumulation, accordingly, is greater than otherwise. Unless the amount of saving is completely inelastic with respect to its price, the tax-transfer process results in less capital over time than otherwise would be the case. But the consequences of this must be that the marginal productivity of labor is lower than it otherwise would be while that of capital is higher, By the same token, the returns per unit of labor service are lower while those per unit of capital are higher, pretax, than otherwise. In short, what the poor qua labor gain as a result of the tax-transfer process they lose, in some part, from lower pretax earnings per unit, and what capital losses per unit from the tax-transfer policy, it recaptures, in some part, from its greater marginal productivity.

The effectiveness of a redistributive tax-transfer system in altering the distribution of income and wealth is subject to serious question on both conceptual and empirical grounds. Indeed, depending on the price elasticities of the long term supply of labor and of capital and on the elasticities of substitution of capital and labor in production functions, redistribution would be better served by neutral tax treatment of the returns to all factors of production, if not, in fact, by biasing the tax laws in favor of private saving and investment.[1]

I've suggested that it is useful and instructive to examine our present taxes and tax proposals in the light of their relative price effects and their consequences for the composition of economic activity rather than in terms of possible impact on aggregate demand and the total level of economic activity. Starting with these propositions, I confine my assessment of the longer-term effects of some of the current tax proposals to their impact on the composition of economic activity and the implications thereof.

Clearly given these propositions I have no concern that the proposed asset depreciation range regulations or a renewal of the investment credit will fuel another inflationary surge, not this year, next year, 3 or 4 years from now, or ever. Nor can I follow the rea-

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[1] A possible demurrer is that the private market place does not operate so as to permit the poor to accumulate capital effectively and that government expenditure programs to this effect, particularly to invest in the human capital of the poor, are more effective. This proposition cannot be categorically denied a priori, but I know of no scientific analysis or empirical studies to support it.

soning which suggests that such measures—indeed any tax reduction —would themselves be the source of a renewed rise in unemployment 2 or 3 years hence. Nor do I find it useful to examine proposals for increases in public works programs, public service job programs, or similar measures in terms of their likely effects a year or more from now on the movement of the general level of prices or unemployment rates. Any such measure might be expansionary in the short run if used as a vehicle for accelerating expansion of the money stock. If the monetary authority chooses so to accelerate the growth of the money supply—which it may do irrespective of any of these proposed fiscal changes—we might indeed find ourselves not too long hence confronting accelerated inflation. And if the Federal Reserve's response thereto were a sharp brake on further monetary growth, we might well, not long thereafter, again face the distress of a renewed rise in unemployment. Hopefully, however, the Federal Reserve will not act as a passive agency to transmit the monetary consequences of fiscal changes, but will pursue as steady a course of monetary expansion as it can manage to do.

I urge the subcommittee therefore, to shift its focus from the alleged stabilization aspects of fiscal policy to the far more consequential questions of the impact of specific fiscal proposals on economic efficiency and the growth of productivity and of production potential.

In the light of the above, how should the subcommittee evaluate the proposed Asset Depreciation Range regulations? The principal effect of the proposed regulations, to the extent that business taxpayers elect to be covered by them, would be to mitigate somewhat the effect of the personal and corporate income tax in raising the cost of saving and capital relative to consumption. The resulting reduction in the cost of depreciable capital services will increase the desired stock of the facilities providing such services above what it would otherwise be at every future point in time. Investment in such facilities, for this reason, will increase faster than otherwise until the new growth path of the stock of such facilities is attained. Thereafter, the average annual rate of increases in investment will be the same as before, unless the ADR regulation result in some shortening of the average replacement cycle—an excellent possibility. The average annual amount of investment, of course, will be larger than otherwise.

The consequences of this shift in investment will be not only a larger stock of capital, but also a newer and more productive inventory of depreciable facilities. Moreover, the higher capital-labor ratio will raise the growth path of labor's productivity and real wages, on the average, per unit of labor services.

The same set of observations are applicable with respect to renewal of the investment tax credit. It is commonly asserted that the credit is a more effective investment incentive than depreciation liberalization. Apart from some institutional barriers to ready adoption by taxpayers of liberalized depreciation, however, the difference in effectiveness depends on the specific provisions and is not inherent. Thus, the same incentive—reduction in the cost of capital—is afforded by any given depreciation liberalization or tax credit if the present value of the tax savings over a reasonable period of time from the two are the same.

Both the investment credit and depreciation liberalization somewhat modify the anticapital bias in our present income tax. As such, accordingly, they contribute to greater neutrality in the income tax and to a more efficient allocation of our production resources.

By virtue of their contributions to greater tax neutrality and to more rapid productivity growth, both the ADR regulations and the investment credit would also contribute to easing our balance-of-payments problems. I do not urge the adoption of either or both of these measures as a means of dealing with our balance-of-payments difficulties. But the gains from these measures in making United States manufacturing business more competitive in international markets surely should not be dismissed.

Compared with its principal competitors in international trade, the United States imposes a substantially more burdensome income tax on the returns to the physical capital used by business. One of the major factors accounting for this difference is the vastly more favorable capital recovery allowances afforded in these countries. While a large number of other factors bear weightly on the comparative advantages of each of these other countries and the United States, the differential tax treatment of business capital is certainly an important consideration as well.

Adoption of the ADR regulations and renewal of the investment credit will not of themselves resolve the U.S. balance-of-payments problems. These measures would, however, be important steps in the right direction. They would also tend to slow the exodus of U.S. production from United States to foreign sites. In doing so, as well as in accelerating the advance of labor's productivity, these measures would contribute to greater employment opportunity and security for United States labor without resort to restrictive foreign trade practices.

Permit me to treat briefly some other proposals now engaging the attention of the Congress. One such is to accelerate to this year the increase in the personal exemption and in the standard deduction now scheduled to become fully effective in 1972. These individual tax reductions in the Tax Reform Act of 1969 were ill-conceived to begin with, financed in large part by increases in taxes on the returns to capital. Accelerating them to this year would preempt, I fear, constructive tax reductions, those such as reinstitution of the investment credit that would contribute to increasing productivity and production potential in a less anticapital tax environment. On the other hand, individual income tax cuts would be highly desirable were they to take the form of reduction in the graduated tax rates, which flagrantly violate the neutrality criterion in taxation.

Expanding public works programs for the purpose of providing jobs for the unemployed would be highly ill-advised. Public works programs, like any other public spending program, should be undertaken with a view that over the long run the resources used in the program would produce more added value than in alternative employments. Initiating new public works programs now solely on the basis of providing additional employment would not be effective to this end—such programs do not have a zero startup time, but would probably remain in the inventory of public programs for many years to come as resource misallocators.

Much the same observations apply to proposals for public service jobs programs. Would such programs be turned on and off with fluctuations in the unemployment rate? If so, a far better course is to pursue monetary and fiscal policies which do not themselves contribute to such fluctuations and which, together with other public policies, facilitate reallocation of labor and other resources in response to changes in the composition of demand and output. Or would such programs become a permanent part of the Federal budget? If so, to what end? If the objective is to provide employment for persons who, irrespective of the state of the economy, cannot find employment elsewhere, the funds required for the programs would be better spent in diagnosis and cure, in equipping such persons with the skills needed for effective participation in the labor force. If this is not the target, then the expansion of public service employment for the sake merely of providing more jobs in public service runs directly counter to any sensible notions I know of good government.

Requiring the President, by legislative action to unfreeze $12 billion in appropriations is subject to the same sort of objections. Unless every dollar of those appropriations can be justified on the grounds that their value productivity is greater than in other uses, the economy would be far better served by allowing the appropriations to expire and/or by allocating the funds to constructive tax reductions.

There seldom if ever appears to be a time for the Congress to give careful, deliberate, and objective consideration in a longrun focus to the fundamentals of fiscal policy and the basic structure of the public finances. Questions of the sort this subcommittee has raised in these hearings might well serve as the beginning for such a consideration. Shortrun economic conditions, however, should be eliminated from this consideration. The fiscal policy should be viewed not as an effective regulator of the level of total economic activity, but as a powerful force affecting the allocation of the economy's production resources. Doing so, important and intriguing questions of long term fiscal policy emerge. They warrant the attention of the Joint Economic Committee.

Thank you very much.

Chairman GRIFFITHS. Thank you very much.

I would like to say to you, Mr. Ture, that I think the President exceeds his power in the withholding of funds. Only, personally, I don't understand why someone with a right to collect some of those funds hasn't sued, hasn't asked for permission to sue and sued, because I think he is liable. The bills were voted and they were passed and he signed them. He has no right to withhold money.

I would like to ask you, Mr. Lewis, in which year do you think we are going to get back to a 2½-percent inflation?

Mr. LEWIS. I am not necessarily forecasting. That is a target that requires policies——

Chairman GRIFFITHS. What do you think we have to do to do it?

Mr. LEWIS. As I said in my remarks, I think that we have a new ball game from now on, in which we are going to have to have a permanent price and wage policy, very aggressive guidepost policies along with fiscal and monetary policies as a permanent way of life. If we had that, I think we could have the combination of a 3½ percent unemployment rate and 2½ percent inflation. That is my judgment. Without price and wage policies, I don't know when we will ever get back to 2½ percent inflation at full employment.

Chairman GRIFFITHS. I notice you were opposed to increasing the minimum wage. So I would like to ask you a question that was asked the Ways and Means Committee the other day by a man representing a city of 16,000 people, 33 percent of whom were on aid to depend children, 15 percent on unemployment, and in the entire time more than 50 percent were on welfare. And his question to us was, how can you ever get these people off welfare when they are enjoying twice as much on welfare as they would be enjoying if they were paid full time at the Federal minimum wage?

Mr. LEWIS. It is my understanding that the family assistance plan and various forms of negative income tax are aimed at doing this, that is providing income supplements for the working poor. This whole question of incentives for welfare recipients is a very difficult one, as you know. But I think it is one that has had a lot of research. There are, I think, very positive proposals around, some of them before the Congress this year. I think the observation the man you cite is making goes to the present welfare programs which everybody agrees are pretty poor. The main motivation for the whole negative income tax approach, is exactly to change the incentives between welfare and work.

Chairman GRIFFITHS. Mr. Ture.

Mr. TURE. May I respond to your question, Madam Chairman?

Chairman GRIFFITHS. Yes.

Mr. TURE. I do not comment in my statement on the issue. But I found it delightful to be able to agree with my fellow panelists, at least one of them, on any one of the questions that are raised. And I do agree with Mr. Lewis on the subject.

I think the response to the question put to you during the Ways and Means Committee meeting should have been, what would you do to require employers to hire people whose productivity falls below the wage that must be paid by law? It seems to me that the principal effect of raising the mimimum wage is to screen out of effective employment those people whose contribution to the value product of a business is marginal and lies below the new minimum wage. In this case, it seems to me that what the minimum wage really does is reduce employment opportunities for the people who are at the bottom of the economic ladder, those with the least amount of skills, and the lowest productivity.

Chairman GRIFFITHS. This community hadn't taken that attitude and the employers in the community hadn't taken that attitude. They had done everything that they humanly could do to employ the hard core unemployed. It took them 6 months to get the people to learn to come to work 5 days a week. They made no objection that the productivity was less than that of other workers, and the people did become good workers. But now they are in a recession.

They can't employ those people. That is really part of the problem.

I talked with Detroit Common Council during the time of the recess; 75 percent of the youth in Detroit up to 24 years of age are unemployed. You are never going to get them to work. You have got to do something now.

Now, I would like to ask each of you, beginning with you, Mr. Okun, this question. Suppose we pass now the family assistance plan —and I am for it. The family assistance plan will pay $2,400 to a family over four as presently set up, and will end at $3,600 with eight, no matter how many additional people are in the family. Of course, all of this is subject to later changes. And suppose we do have money in there for public service jobs, about a billion dollars. But if you added to that one a provision which I am supporting, that if you pay $2 an hour for domestic labor, that you can deduct it from your income tax?

That is one.

Two, what if you drift to the cities that have welfare families a sort of impacted paid school provision, that is, you pay them an amount in lieu of taxes. And suppose you permitted that amount to be this year to be $5 billion. What do you think the effect would be?

And also you step up the income tax deductions, so that it takes effect immediately. And the welfare, the change in welfare would take effect faster. Then what do you think the effect would be on the budget and on prices and so forth?

Mr. Okun. I am sorry, I didn't quite get the way the impacted aid provisions would go.

Chairman Griffiths. You know we pay now in the schools where we have the children of Federal employees, we pay so much money into each of these schools. And it is called impacted aid.

Mr. Okun. Right.

Chairman Griffiths. Supposing you pay a city, not on a revenue-sharing basis, but you pay that city that has people on welfare so much for each welfare recipient.

Mr. Okun. Let me take the two proposals separately. I would be hard pressed to predict what the division would be of that tax deductibility provision between the people who were hiring the domestic servants and the domestic servants, themselves. Obviously, there would be a sharing of it. It would have some effect on the demand and the incomes of the domestic servants, which I am sure is your intention.

Chairman Griffiths. And it may have some effect on social security, because there are lots of domestic servants hired now on which social security is not paid. So, you are going to have to pick up some taxes, you are going to have to pick up some taxes because the person who gets the $2 is going to pay taxes, not only social security taxes, but they are going to pay income taxes.

Mr. Okun. But the people who get the benefit of that tax reduction who are now employing domestic servants or who would employ them in that event are people in the quite high-income groups.

Chairman Griffiths. Forget that, because one-half of the women in this country are employed, and many of these women, wives, would employ domestic help. So that you have a very small percentage of those people where you are giving a great big something to people who are rich. That is at least my judgment. There just aren't that many rich people.

Mr. OKUN. There aren't that many domestic servants either.

Chairman GRIFFITHS. There would be if you could pay them on this basis. You would have a much better situation.

Mr. OKUN. I would be surprised if that turns out to be as efficient as you are suggesting, Madam Chairman. But it would be an interesting thing to explore, and it is an interesting idea.

I think the provision of a grant based on the number of people on welfare can make a lot of sense as a Federal grant program.

Chairman GRIFFITHS. You mean even make some of the suburbs find these people kind of attractive?

Mr. OKUN. That strikes me as the more attractive of the two proposals to begin with.

Chairman GRIFFITHS. But the effect on the Federal Government of the welfare program is going to be beyond what anybody has known. Because you are going to pick up people that nobody ever dreamed of picking up. The fact is that many people who should be drawing welfare in many States aren't drawing it. And when you have it done by the Federal Government, they are going to draw it. Many of the people who should be getting food stamps aren't getting them. And when you put in the cash, instead of the food stamps, in the amount of $800, you are going to pick up a lot of additional people.

So that the effect of the welfare bill is going to be, in my judgment, much bigger than it is thought. I do not think it is going to cost $5 billion, and I think it is going to add to the program some 50 million people at least. So you are really going to change the face of America with it. And I am for it.

Mr. OKUN. For the better.

Chairman GRIFFITHS. Right. I agree.

Senator PROXMIRE. Mr. Okun, you refer in part of your statement to the article which shocked and surprised me. It was in the paper on Sunday. The article indicated that if you take automobiles out of the fourth quarter of 1970 and the first quarter of 1971, that there actually has been no increase and probably a reduction in real GNP corrected for inflation. I hadn't seen real confirmation of that. And I find in all of your statments, certainly in your statement here today, an assumption that we seem to be on the road to recovery and moving back toward better economic conditions. Is it your conclusion that there are other elements that somehow weren't reflected in the first quarter that are coming to surface now, which indicate that we can look forward to better economic conditions?

Mr. OKUN. As you are suggesting, I think it is terribly important to make whatever correction one can for the strike and the resumption of production in General Motors. It is not as easy, perhaps as one might like. You can, as the tabulation that you refer to from the press did, just take out the auto GNP and see what happened to everything else.

But that everything else includes tires, glass, and steel that were produced for automobiles. There is pretty good evidence that many of the supplying industries were building up inventories in the fourth quarter. In other words, they didn't cut back production as much as their reduced sales to General Motors would have required; they just built up inventory counting on General Motors to come back to work. And then in the first quarter they seemed to have depleted those inventories to some extent and let them run off—which is a quite reasonable business practice for a supplying industry.

So that means that the adjustment that simply subtracts auto GNP and looks at everything else, gives a somewhat misleading and perhaps too dismal picture of the first quarter. If you try to make some rough correction for inventory building and supplying of industries, I suspect that one can get a small increase in the real GNP in the first quarter on top of an increase in the fourth quarter.

What judgments I can make suggest to me nonetheless that with this correction you have somewhat less an advance in the first quarter than in the fourth, which is certainly not suggesting that the economy is building up momentum.

Senator PROXMIRE. Then you are allowing for the improvement of housing?

Mr. OKUN. Oh, yes.

Senator PROXMIRE. Of course it improved radically in January, and it fell off a little bit.

And you allowed for the improved retail sales.

Your esteemed friend and colleague, Mr. Samuelson, spoke in Washington a few weeks ago, and had indicated that he felt the economy is on the road to recovery, and that next year—the rest of this year would be a good year and next year would be, too. Would you fault him on that; or would you say it is too early to say?

Mr. OKUN. I don't know precisely what Paul Samuelson said. I think it is possible that he might have been operating on the assumption that I referred to; namely, that more is going to be done. And it is understandable for a private forecaster to count on reasonable policymakers to behave in reasonable ways. They are going to see that the economy isn't going anywhere near the goals that were laid out, and therefore more action will be taken, and that consequently things will get better. I don't know that Paul Samuelson said that, but I would hope that that is a reasonable assessment of the way that policy process goes. It would be most unfortunate if that kind of optimism turned into a self-denying prophecy by making public officials complacent.

Senator PROXMIRE. I think he is concerned with just exactly that process.

I notice that the Secretary of Labor has indicated his expectations are that unemployment will steadily decline, contrary to your opinion that it will stay at about 6 percent. He has it at a 5.9 percent in the first quarter, and 5.7 percent in the second, 5.6 and then 5.3. Of course it is still high; much too high. But it seems to disagree with your view.

With that kind of a trend it would mean that by the middle of 1972 we would be in much better shape.

Mr. OKUN. On the basis of everything I know or have seen to date, that would be a most optimistic forecast. It would certainly have to imply a major quickening in the pace of production. You will notice, Senator Proxmire, that the Secretary's path is still forecasting unemployment considerably higher than the Council did in February.

Senator PROXMIRE. Yes; it is.

Mr. OKUN. There just isn't a basis for making that kind of a forecast today. There is no rate of recovery to suggest that we are more than keeping up with our potential growth of four and a quarter percent in real terms per year.

Senator PROXMIRE. Whether there is a steel strike or not, you would feel——

Mr. OKUN. A steel strike would put some bumps into the profile; it will make the third quarter look dismal, and it will make the fourth quarter look glorious. And we will have the same problems that we had in the last two quarters, recognizing that the economy isn't quite as sick as it looks during the strike, and not quite as healthy as it looks during the resumption of production after the strike.

Now, on the basis of the present policies, my honest judgment would be that, as I put it, that this recovery is just as likely to peter out as to pep up over the next 18 months.

Senator PROXMIRE. You stated that we should be very careful about moving into big permanent programs, and now that the spending part of our budget could become an engine of inflation if we are not careful about it. And the demands are so great and so appealing and so right—the demand for health services, for example, I have seen one indication that we should be spending $40 billion a year more; not the Federal Government, but overall for health services, within the next 4 years, and that in many other areas: housing and so forth, there are so many things we should do and would like to do.

So you propose, as I understand it, that strictly temporary action which would get us down to 4½ or 4 percent unemployment would reduce the gap that we are now suffering in lost production, but it would then have put us in the position of where we could operate what, at a balance in our national income accounts on a full employment basis?

And would you agree with Mr. Lewis that it ought to be about a $7 billion surplus?

Mr. OKUN. My best judgment would be that when the economy has recovered, we will want a significant full employment surplus for just the reasons that Dr. Lewis indicated. I don't see that we need to make that judgment now. It does underline the need to be flexible, to be in a position where we can come back into a substantial full employment surplus, if our forecasts are right. That is an important reason for doing temporary things both on the expenditure and on the tax side.

Senator PROXMIRE. I notice that none of you gentlemen say anything at all about our shifting priorities. For example, a number of us on this committee and in the Congress are determined to do our best to reduce defense spending sharply. Do you think we have a chance to do it? Appropriations were cut $6½ billion 2 years ago, and they were cut by nearly $3 billion last year. Supposing this year we should succeed in getting an amendment adopted that would put a limit on defense spending, reducing it to $68 billion. The administration is asking for about $75 billion. Now, how would that affect your attitude toward other compensating fiscal policies?

And I would like all of you gentlemen to address yourselves to that. If we succeed in being able to cut defense spending, what would we do to be able to compensate for it? As I understand it, public works is not a satisfactory way to pick it up, because it is too slow. And you all agree that public works takes a long time to activate.

Mr. OKUN. I suspect that the elbowroom that would be provided by the cutback be taken up by grant programs, by perhaps more liberal funding of the Family Assistance Plan. And Mrs. Griffiths' concern that it may cost more than has been estimated would be less serious in that environment. I think if we look at this as you do, as a change in priorities, not just as a temporary dip in the fiscal 1972 period, but rather as a different defense profile for the long run, then we have opportunity to make judgments about major new initiatives that could be launched for the long run.

The caveat about doing things that are self-terminating and self-liquidating is associated with the fact that we are not making decisions to change priorities either by increasing taxes or by lowering expenditures in the nonpriority areas.

I think an imaginative review of our education, health, urban, environmental, and manpower aims would come up with a fair number of things that could be done promptly enough to offset the deflationary impact of that defense cutback with no problems to the economy and with only great opportunities for using the resources more productively.

Senator PROXMIRE. Mr. Lewis and Mr. Ture, would you comment on that?

Mr. LEWIS. Have you seen the counterbudget that the Urban Coalition put out?

Senator PROXMIRE. Yes, indeed. I put it in the record. I think it was one of the finest contributions to some thinking about priorities and fiscal policy that I have seen.

Now, that would cut by $16 billion the defense spending, but it would end up with exactly the same total amount of expenditures: $229.5 billion.

Mr. LEWIS. I read it rather hastily, so I may not be doing justice to it, but as I recall they had a much bigger cut in defense spending than the one you are talking about.

Senator PROXMIRE. Yes; I had $7 billion they had $16 billion.

Mr. LEWIS. But it still required a substantial tax increase.

Senator PROXMIRE. The tax increase would not come until 3 or 4 years from now.

Mr. LEWIS. That's right. But I mean sometime in the next 5 years.

Senator PROXMIRE. That is right.

Mr. LEWIS. In other words, they cataloged what they considered enough in the way of high priority domestic requirements for Federal spending to require a tax increase a couple or 3 years from now, even with a very large cut in defense spending. And this whole package, even with the tax increases and the cut in defense spending, was, I think, assessed by Otto Eckstein, whose judgment in these things I respect a great deal, as probably inflationary.

I share Mrs. Griffiths' opinion that the Family Assistance Program is going to cost a lot more than the numbers that have been talked about. And if we ever get around to actually doing something about the environment instead of just talking about it, that is going to be costly.

But, you would have to lay out the full array of defense and domestic Federal expenditures and revenues before you decided what it was that you wanted to do with the extra elbowroom that you had for defense spending, it seems to me, and I think this has to be done in the context of at least a 5-year horizon for the whole Federal program.

I have felt for a long time, Senator, that the Congress ought to require the administration to give more than an 18-month forecast in the annual budget document. They ought to lay out in great detail the spending consequences of all the plans and programs the President proposes as desirable.

Senator PROXMIRE. They were supposed to give it to us for 5 years; the law requires it. But they don't break it down.

Mr. LEWIS. Piece by price, new programs are supposed to be priced for 5 years, and there has been rather indifferent compliance. But even if you had complete compliance with that it would still give you, I think, only a piecemeal view. It is just not an adequate body of information from which to judge whether you should be considering tax cuts, or tax increases or just what.

I think there is a relatively simple remedy for this. That is to add a clause to the Budget and Accounting Act that sinply requires the President to do it. It is never going to be done voluntarily. It is not in the President's interest. He views it as reducing his flexibility. He would like to postpone to the last minute making decisions or sharing with the public what is involved in various proposals.

But I think that we have reached the point where the Congress and the American public have to have that information in order to make judgments about taxes.

Mr. TURE. Senator, I can't give you a strong view one way or another on the proposition you have put to the three of us. You are elected to the Senate for the purposes of formulating these judgments and making these recommendations, assessing what you regard as the needs of the U.S. community. It would be presumptuous for me to evaluate your preferences.

Senator PROXMIRE. I am not asking for that, Mr. Ture. What I am asking for is for you to give a notion of what economic impact it would have if we cut defense spending, and where we could act in such a way as to minimize the unemployment effects.

Mr. TURE. The dislocation.

Senator PROXMIRE. That is right.

Mr. TURE. You see, my whole approach to this—

Senator PROXMIRE. I am way over my time but I would just like to point out that we had this dramatic experience in World War II. We demobilized 10 million people in a matter of 2 years, and we cut down defense spending $66 billion, which in this economy would be

$200 billion. And we had 3½ percent unemployment when it was all over. There was pent up demand, but there isn't now.

So, it seems to me it is just a matter of leadership and intelligent alternatives that are vigorously and sensibly advanced in order to make sure that we wouldn't suffer from significant unemployment from a cutback in the military spending.

Mr. TURE. Let me frame a brief answer to your question. It is to this effect: If you were going to make any significant change in the composition of the Federal budget you should expect that there will be significant effects on the demand for resources in various uses. And that will, in fact, involve some dislocations in the economy. Those dislocations will be most effectively and smoothly handled in the context of substantially full employment, which I think is primarily a matter of maintaining a sound monetary policy, as I have indicated in my statement. Assuming that you have that it would also be useful indeed to revise those kinds of taxes and other measures outside of the realm of fiscal policy which would facilitate, rather than block, resources reallocation.

I think these are matters which deserve the closest possible concern of the Congress.

Senator PROXMIRE. Thank you.

Chairman GRIFFITHS. Senator Humphrey.

Senator HUMPHREY. Madame Chairman I am very happy to be here, and I am sorry that I wasn't here for the statements of the distinguished gentlemen that have shared their time with us. But I have been glancing through and looking at the summaries here.

I have just come back from a field trip to mid-America for a study of rural community development, and one thing that always amazes me about economists is that you never talk about agriculture and yet agriculture has approximately $40 billion worth of assests; it has presently mortgage indebtedness of $55 billion, and it is estimated that in the next 10 years that will increase to $110 billion. But the parity ratio for farmers is 70 today, which is just 3 points higher than it was in the depths of the depression.

Hogs are selling for $16 a hundredweight. We produce more hogs than any country in the world. It is every bit as important as producing automobiles, you know. Everybody gets all hung up on the automobile industry. But I suggest that the cattle and hog business makes the automobile industry look like small potatoes. It is a tremendous enterprise and it costs $19 to produce a hog for market, and you sell it for $16. And you never hear an economist say a word about it.

We had the National Farmers Union Convention here for 5 days, and there wasn't a newspaper reporter or a television camera or a radio camera that even covered it. They have forgotten that part of our economy.

I have just been out in the field, and I am amazed. I went to South Dakota, and I found out that 25 percent of the adults in that State have incomes under $3,000 and 45 percent under $5,000. And they are not asking for welfare; they are really just asking for a price for what they produce. They have got some unemployment, but they have mostly underemployment.

I think we get all hung up on welfare and we get all hung up on what we call "industry production," and we forget what is the largest export of our economy, which is agriculture.

And I still am of the old school that says the recessions are farm-led and farm-fed. They are and they have a tremendous impact.

I won't burden you with all the little simple things that we know, that farmers use more petroleum products than any industry or combination of industries.

What would you suggest we do about this situation? Everybody talks about accelerated employment and accelerated this and that, but nobody really gets down to—

What are you going to do about a man that is producing feed grains at less than cost, who is required to produce hogs at less than cost?

I met with some farmers just this morning. The farmer gets 18 cents a dozen for eggs. They are 71 cents a dozen in the stores here in Washington, D.C. and these are grade A, super-duper, not these little pigeon eggs that we get around here.

This is absolutely foreign to this Nation's Capital. There is absolutely no consideration of agriculture at all. The papers are filled with kids' pictures, policemen, but nothing at all about this. You can look through the Journal of Commerce, the New York Times—and your statement, I looked through here and I didn't see one word about agriculture; not one.

Now, this is a major part of our economy. It is a lot bigger, may I say, than some of the parts that we constantly discuss.

What is the total production of the automobile industry in this country?

Mr. OKUN. It ran about $40 billion in the first quarter.

Senator HUMPHREY. About $40 billion.

Mr. OKUN. And I think our agricultural output was something like $25 billion.

Senator HUMPHREY. That is only raw product.

Mr. OKUN. I think the final total.

Senator HUMPHREY. That is the raw products, not agriculture business. When you put it through the processing it goes through a lot more.

Mr. OKUN. Yes.

Mr. TURE. Mr. Okun, I believe, was referring to value added at specific stages.

Mr. OKUN. Sure.

Mr. TURE. Let me be as responsive as I can to your very challenging question.

One, I think that as a profession, we probably deserve your indictment. Our attention has been focused on a great many other questions. Many of us have been concerned with fiscal and monetary arithmetic rather than with the structure of the economy and what has been happening to it. I think it is an oversight, but it does not mean that no economists have given close attention to these problems. Indeed, there are a good many of them, as you well know. And they do extremely competent work. The subject matter with which they deal does not receive the same sort of treatment, is not regarded as glamorous, as many of the others are. It doesn't receive the same sort of treatment.

At the policy level, of course, a good number of economists have commented over a very long span of times about various elements of public policy which have contributed to difficulties in the agricultural sector of the economy. And it used to be almost the standard response—I recall when I used to sit on the other side of that table and we conducted hearings on expenditure policies. The witnesses would be asked as to where they would like to cut back on Federal spending programs. And economists, to a man would alway say, well, we ought to get rid of the farm price-support programs, because these are resources misallocaters. And that was sort of a pat, standard answer. I confess that I haven't heard much of that lately. I don't think that really represents a change in viewpoint on the part of most economists, sir. I think it simply represents a change in the focus of our interest.

Senator HUMPHREY. A change of emphasis, yes.

These people feel forgotten. And I am going to become a very loud and articulate spokesman, and I hope somewhat well-informed. I have been working with the director of the Census, and I look at the demographic protections, and if you fellows and we don't do something about it, this country is going to be hopelessly bogged down. You see the vast hinterlands in this country being depopulated, not only depopulated, but decapitalized, because that is what happened.

Mr. TURE. You do have public programs now which are immediately concerned with the exact focus you just articulated.

Senator HUMPHREY. Like what?

Mr. TURE. For example, the regional development programs, one aspect of which is to try to do something to arrest the movement of the rural population into larger clusters.

Senator HUMPHREY. How much money goes into that, sir?

Mr. TURE. Very little.

Senator HUMPHREY. That is the point. I go over here to EDA, and they have $50 million for the whole United States in development loans.

Mr. TURE. I think that what is needed more than money——

Senator HUMPHREY. That helps.

Mr. TURE. It surely does—what is needed more than money in that respect is, however, some high-powered conceptualization as to what can effectively be done.

Senator HUMPHREY. Also some coordination of policy.

You get Railpax, and it takes all your railroad services away from these areas. On the one hand you have a law which says that you are supposed to have better balance between urban and rural policies and urban and rural programs, and you raise the freight rates 1½ percent and cut out the rail service. How are you going to develop a country that way?

You know, we are really, I think, talking in terms here that sometimes have all too little meaning.

Somebody expressed some concern about the investment tax credit. I think the investment tax credit would be very good if you had some limitations on how much you could take, if it could be used profitably in the small areas.

I think we need in this country a rural development bank as a constant source of funds. I intend to introduce a bill on a national development bank. I don't know why people should have to come to Congress to ask for money all the time. We have got a World Bank, an Inter-American Development Bank, and we provide the funds for the whole world and yet we provide hardly a dime for people out in rural America who want to start up a factory.

I have a project like that in a county where people are either going to go on relief or welfare or start up an industry. The industry has a feasibility study, a technical study, the best in the country. And it is willing to put in 90 percent private capital and it needs 10 percent seed money. And the Government of the United States says it doesn't have enough money.

So, we will put them on Mrs. Griffiths' program for family assistance. It is just plain unadulterated nonsense.

Mr. TURE. I would just say, Senator, that I, myself, have not too long past worked on a program for an investment credit to accomplish the things you were talking about.

Senator HUMPHREY. Good. I am for you.

One other thing I would like to ask you: How come we don't address ourselves to the most important things that will stimulate this economy, like housing? Is there anything that you can think of in the form of construction, putting people to work, using materials, and using capital, that will be more productive of employment, that will give more immediate response to unemployment needs than housing?

I will leave it to any of you.

Mr. LEWIS. Senator, let me address the farm question that you raised first.

I am sure you realize that one of the problems with our policies in the past—and in fact this accounts for why farm-price programs are not very popular with economists—has to do with the fact that while there are a lot of farmers, most of the farm production is generated by large commercial operations. The policies that we have used in the past in order to get a little bit of benefit at the bottom of the ladder have cost a lot of money and have gone mostly to large commercial operations that just didn't need public support. So I would urge you——

Senator HUMPHREY. I am aware of that.

Mr. LEWIS. I would urge you, if we are going to have new policies in this area, to be efficient in the expenditure of public funds.

Senator HUMPHREY. I would point—my point was that men of your caliber—and I respect each of you greatly. I know of your tremendous professional competence—but you just don't think in terms, and talk in terms of this part of America. It is like most of the rules and regulations of the Federal Government: They are decided on the basis that does not relate to some of the local communities' needs.

Take, for example the JOBS program. In training the unemployed, in order to get funds under the manpower JOBS program, you have got to have a percentage, I think, of over 50 percent of what they call disadvantaged in that JOBS program. Well, now, today to be very frank with you, a lot of employers are dropping that program completely because there are other workers that are not disadvantaged that are available. They need retraining, but they can't get the training.

So, you have unemployed people and you have got a program now that stymies the whole works because of the lack of productivity of the disadvantaged, at least for a period of time. I tend to agree that in due time they do become productive. But you have semiskilled or skilled workers over here that need retraining for another position, but the JOBS program doesn't permit it because of rules and regulations that are designed strictly to what I call ghetto thinking.

Now, we have all kinds of ghettos. I just came from an area where there are rural slums in the sense that there are no real opportunities. They can't get any job training.

Mr. TURE. There is much to be said, Senator, it seems to me, for thinking of a tax credit as a device for supporting on-the-job training which would eliminate a good number of the kinds of bureaucratic interventions that you are addressing your complaint to.

Senator HUMPHREY. I am asking, in other words, for men of your caliber to kind of take a good look at the particulars rather than the theory, because it is the particulars that really add up and count. I just cannot believe that with a nation desperately in need of housing, with the money running out of our ears in the banks—they have got money all over the place; the bankers are really going around asking you to borrow money now; the savings and loan associations are loaded with money—and here we sit with unemployment among carpenters.

In my city of Minneapolis, 22 percent of all the carpenters are unemployed. They talk about overpaid building tradesmen. That is a lot of nonsense. The facts developed by the staff of the committee show that these people get paid on the average of $5 an hour. That is not being overpaid if you are a tradesman. I just want to get that point in the record. Most of them are nonunion.

But, we have a lot of myths going around the country. Why can't you economists help us design a program that will finance housing? Why is it that we have to have the kind of a program today that just won't work? Why can't we have some kind of a contract in which we have an aerodynamics company that is going out of business? Why can't we go to them as a government and say: "Look, here is a $2 billion contract for housing; start building it; let's see what kind of plans you can get."

I remember when Walter Reuther used to come by with his program and say we ought to produce housing like we do automobiles? It is more complicated to produce a car than a house. We would thus guarantee employment to all the building tradesmen during a full year. Why don't we come up with something like this? We are desperate for housing.

Mr. TURE. You are aware, of course, of the problems at the local level that have to be overcome before that would be feasible.

Senator HUMPHREY. Like what?

Mr. TURE. The building codes, to be specific.

Senator HUMPHREY. If you give these communities enough carrots—we are talking about revenue-sharing these days and, we are talking about grants to local governments. Maybe we ought to say: "Here is a big carrot, providing you drop that rock that you have been carrying around over there." I think that what is wrong here is that nobody conceptualizes what we could do about this. We could conceptualize accelerated public works. We dream up ideas about public service employment, but to produce a house and have land policies—I mean, the costs of land and financing are what really hurt today more than the construction costs.

Now, isn't it possible for this government of ours to be able once again to start providing land for the purposes of housing. Public ownership of land, with a 99-year lease would perhaps accommodate some of the housing?

I just want to ask you to put your mind to it. And I am doing this for the benefit of the committee. I want the committee to start concentrating upon the areas of real depression; namely, agriculture, the total agricultural business area, rural America, because what is happening in the ghettos is happening in rural America. The doctors are leaving; the good teachers are leaving; the same thing is happening in many places of rural America. The ghettos do not get the investment. The plants are building out in the suburbs. The jobs are out in the suburbs and there is no public transportation to get the workers out of the ghetto to the suburbs.

The same thing is happening, strangely enough, to the poor whites in rural America; the same thing is happening to them that is happening to the poor blacks in the inner city. And we sit here with these big dreams, but we don't get at it. And I am an important man. I don't have 50 more years to fuss around with these things and I wonder why in the heck we don't come up with some ideas.

I happen to think that we ought to have much more low-rent housing, and if the private market isn't willing to put up the money, let the Government put it up, subsidize it. It is better to subsidize a house than it is to subsidize unemployment. or to subsidize welfare. What about this welfare kick we have got ourselves on? I am a compassionate man; I want to see people have enough to eat. I want to see them with decent incomes, but I don't want them to live in a hovel. And you can give people $6,000 a year and they will be living in these dumps in New York City that charge them $500 a month.

The people in my area resent that, so you give them $6,500 cash instead of food stamps. Where are they going to live? We don't have anyplace for anybody to live at $6,500, unless it is the biggest dump in town.

I think it is about time we got first things first. I am asking you to come up with a program; you three good sharp men out there.

Mr. TURE. You have got more coming, too.

Senator HUMPHREY. Good.

Chairman GRIFFITHS. Senator, will you repeat the income statistics in South Dakota?

Senator HUMPHREY. Yes.

The dean of the School of Agriculture of the State College of Brookings presented us with a paper that said 25 percent of the adults have an income of under $3,000, and 45 percent under $5,000. They don't have large unemployment because there aren't many industries, but unemployment is just one of the many factors. We have a good deal of underpayment and underemployment. You see, they may work—this farmer over here, instead of getting 40 cents a dozen for his eggs he gets 18. That is like being two-thirds unemployed for him because eggs are his business.

Instead of getting $22 a hundred for hogs he gets $16. That is like being 25 percent unemployed That means instead of working 40 hours a week he works 30. You have got to translate whatever people do in terms of their medium of exchange, so to speak.

But I have some association with a small business. What happens is that costs go up and sales go down, and that is what inflation means. And I also see what happens when customers come in the store and they are not spending. There is lots of money, so they say, in banks for some people. But, some people don't have it.

Chairman GRIFFITHS. The welfare payment in South Dakota is $3,600 a year for a family of four, 70 percent of which is paid by the Federal Government. So, 45 percent of the people in South Dakota, I presume, could put the farm in the wife's name and the man could draw——

Senator HUMPHREY. But they wouldn't do that. They have too much character. They are not brought up to be a thief and a cheat and a crook.

Chairman GRIFFITHS. But since he has brought out so forcefully to you the problem of the farmers, let me refer to the fact that in a very brief time 20 million women and children in this country will be on aid to dependent children. And let me point out once again that the Treasury, the Federal Government is subsidizing every job, practically, but that of a domestic worker.

But, for this person there is no subsidization. I really think that what you are saying is that this job is of no value. And I think that is wrong. And if women are going to have those families, and other women are going to work, the women who are working are going to demand some of the rights of those who aren't. So, what we really need to do is consider some of the ways to put them to work would be in domestic jobs. And it should be subsidized.

And I would like to ask you, Mr. Ture. how far would you go in making equal the competitive position of American business with foreign business to keep American plants in this country?

Mr. TURE. You mean with respect to the tax law?

Chairman GRIFFITHS. Yes.

Mr. TURE. Well, as I look over the various tax provisions in a number of countries with whom we compete in the international markets, it strikes me that nothing in our tradition, in our history, in our current tax law, would allow us to duplicate the same sort of things they do.

I would not urge that we try to. On the other hand it seems to me that we can move toward a tax system that is less biased against saving and against capital accumulated by some very broad measures. One I would strongly urge would be the substitution of a value-added tax for the corporate income tax. The value-added tax would apply across the business community.

I think that substitution would represent a major improvement in the environment. I don't think it will do the whole trick by any means.

I think that will be the most far-reaching measure that we should contemplate, say, for the next few years. And I think that it would contribute very significantly to improving the effectiveness of production in the United States. I would be very hesitant to try to predict what its effects would be in the near term on our balance of trade. I think on our capital accounts the effects would be very quick and startling, and favorable.

Chairman GRIFFITHS. How would you achieve shortrun economic policy objectives?

Mr. TURE. My first problem would be to try to determine what they are. It occurs to me—I think there is a statement that was made by one of us this morning to the effect that the Federal Government, in fact, is a major source of economic instability in the short run. I believe that is true, largely by virtue of the fact that so many of our major policies are pursued on a substantially ad hoc basis. We are prepared to make quite substantial shifts in the magnitudes of Government demands for goods and the services in short periods of time.

I think that the best thing that we can do is to pursue the sort of monetary policy which this committee recommended, and an equivalent rule in fiscal policy.

Now, to pursue that rule in fiscal policy would require something that is not in the history of fiscal policy in the United States; I concede that out of hand. It would require not merely pricing out for periods as long as 5 years or more the costs of the present programs or proposed programs. It would involve doing something a good deal more than that; that is, really trying to determine what the trend rate of growth of that package of Government programs which you, as the policy formulators deem to be appropriate, will entail in terms of resource costs, in matching that trend rate of growth with the same trend rate of growth in revenues.

I think that would probably be as wholesome a development in fiscal policy as any I could come up with.

Chairman GRIFFITHS. In your judgment, is corporate tax in the long run passed on to consumers?

Mr. TURE. Only in the following sense: that is that the prices of corporate output are higher than they otherwise would be, while the prices of noncorporate output are lower. If you can find consumers who have predelictions for the output of the corporate sector, and they are not concerned with the output of the noncorporate sector—I don't know any such consumers—then you can see that for consumers the tax is passed on to them. Otherwise I think it rests primarily on capital.

Chairman GRIFFITHS. How do you, Mr. Okun and Mr. Lewis, reply to the contention of Mr. Ture that business is too heavily taxed now?

Mr. OKUN. It is a question of one's objectives and one's priorities. But Mr. Ture sees this neutrality criterion as being terribly important. I don't think the basic problem of the United States is to accelerate its long-term growth rate.

When we have full employment with our existing tax system, our gross national product rises about four and a quarter percent a year, and about 3 percent a year in per capita terms. That means in real terms, correcting for any inflation, we would move, say, from about \$5,000 per capita average gross national product today to \$12,000 per capita in the year 2000. Now I am sure we could make that \$13,000 or make \$14,000 by constraining current consumption, and obviously by constraining it among the people who would be taxed more heavily in the reallocation that Dr. Ture is promoting.

I don't think it is terribly important to offer more jam tomorrow; jam tomorrow, never jam today. It seems to me it is time to provide some jam today to the people who have been deprived of opportunities.

It seems to me that the investments in human resources in this society have been considerably neglected at the expense of investments in physical resources and plant and equipment. These are matters of values. These are matters of diagnosing what our social needs are.

I think the tax system has a proper function in redistributing income. We start out with egalitarian principles in our society: we give a man one vote, and we give each person a right to one spouse. And we don't let them buy additional ones in the marketplace. And we talk about equal justice before the law. Our basic reason for not imposing that kind of egalitarianism in the economic system is because we recognize that there is some efficiency in giving people incentives to earn more income. And that is a perfectly sensible criterion.

But it also has to be recognized that the efficiency criterion and the egalitarian criterion can conflict at times. And we have to balance them. We have to decide whether we want enormous wealth to be accumulated; whether we want over 90 percent of the wealth of this country to rest in the hands of 5 percent of the population, or whether we want half of the income of this country to be earned by less than a fifth of the population, and for the bottom half of the income distribution to earn about a fifth of the income.

These are social issues. They are proper issues for public policies. And one could reach different judgments on them. In my judgment, if we take care of our urgent needs, if we start providing some jam today to the people who have no jam, and if we run a properly managed fiscal and monetary policy which gives us full employment and a doubling of our national product per capita in 20 years, that is a pretty good performance. I wouldn't worry about trying to double it in 17 years instead of 20.

Chairman GRIFFITHS. Thank you.

Mr. Lewis.

Mr. LEWIS. I think my views are very similar to Mr. Okun's. Mr. Ture is expressing a value judgment which I don't personally share and which I don't think very many people in this society share.

The proposition that we should increase savings is equivalent to the proposition that we should be reducing consumption. I am not aware of any large number of people who are eager to forgo consumption in the interest of a higher growth rate.

I don't know anybody who wants his consumption cut back any more than he is now required to by present taxes. I would be interested in knowing whose consumption is going to be cut back. And I just don't know of any objective criteria for deciding how to allocate this burden equitably.

Mr. TURE. May I have one moment of rebuttal?

Chairman GRIFFITHS. Yes.

Mr. TURE. I want to make it perfectly clear that I offer no target rate of growth as the objective in the proposals that I offered to you. I don't know what the correct rate of growth by the U.S.

economy should be. I am convinced, however, that the Federal tax system should not be bias against the marketplace in determining the appropriate growth rate, as I am convinced it is now.

So far as determining who is to be burdened by having consumption cut, I offer no proposal in that respect, either. As a matter of fact, it seems to me that probably the people at the bottom and middle part of the income and wealth distribution of the United States are most burdened by the bias in the tax law against saving.

And what I am proposing indeed is to allow each such individual, no matter what his income or wealth status has been, to make his own decision as free from intrusion by the tax structure as possible with respect to how much he wishes to consume today as opposed to how much he wishes to consume in the future.

Chairman GRIFFITHS. Thank you.

I want to thank all of you.

And I am going to turn this meeting over to Senator Proxmire now.

Senator PROXMIRE (presiding). Mr. Ture, what concerns me about your position is that you seem to say that we need to have a stable and steady monetary, a stable and steady fiscal policy.

And I have great sympathy for that. I think I was chairman of the subcommittee when we suggested that kind of limited variance we should have in monetary policy. This has been both criticized and approved by economists. I completely share the position of your other two fellow panelists that we simply must act now to reduce unemployment.

And I think that the position taken by Mr. Okun convinces me—I think he is right, that if we go along on the present basis, we are going to have 6 percent unemployment at the end of this year, and too little improvement next year. At least we won't be moving down toward that 4 percent unemployment nearly as rapidly as we ought to.

And you seem to be saying, well, in the long run that is a price that we have to pay, or, rather, that the unemployed have to pay.

I don't want to be unfair to you, but that is the conclusion I seem to be driven to by the position you take in your statement.

Mr. TURE. Quite clearly, I would not like you to draw that inference from my remarks. And I did not dwell, as did Mr. Okun, on the forecast of the economy in the near term.

Quite candidly, I haven't put myself to that in the last few months. In my judgment, however—and this is really an off-the-cuff kind of forecast—the rate at which the money stock has been expanding in recent months augurs a very substantial recovery this year.

Senator PROXMIRE. As I understood Mr. Okun—and he will correct me if I am wrong—he seems to agree with that, at least in the next month or so.

But he indicated that if now they level off and stay at 6 percent monetary increase level for the rest of the year, there won't be sufficient monetary impetus, and in addition, he has suggested specific fiscal stimulation, tax reductions, would be temporary, and would be restored—at least we wouldn't lose it in the long run—and speeded up grant programs and other expenditures programs that would provide jobs now.

And you don't seem to approve of those.

Mr. TURE. Let me be sure that we are in agreement on the critical premise.

I did not interpret Mr. Okun's remarks to mean that he anticipated that there would be no further growth in the money stock from this point or this quarter, during the rest of the year.

Senator PROXMIRE. No. I think his assumption was that it might go along at about the average it had had for the last 6 months.

Is that right, Mr. Okun?

Mr. OKUN. That is right.

Mr. TURE. My judgment would be that with that rate of growth in the money stock continuing this year, the recovery during the latter part of this year will be very strong, and that going into 1972 will be quite strong.

Senator PROXMIRE. Without any additional fiscal stimulus?

Mr. TURE. Right.

Senator PROXMIRE. And by strong you mean you will be able to to reduce unemployment to close to 5 percent by the end of this calendar year?

Mr. TURE. That judgment does not strike me as at all out of line. My recommendations with respect to fiscal measures, I would like to emphasize, are not concerned with the providing of a stimulus for raising the level of aggregate demand more rapidly than otherwise.

They are, however, concerned with increasing the level of that activity in particular sectors of the economy.

For example, the machine tool industry, I understand, is in extremely difficult circumstances currently, and measures of the sort to which I direct my attention I think would be extremely helpful in providing some additional strength for that vital part of the U.S. economy.

The machine tool sector of the U.S. economy is not to be measured, it seems to me, in terms of the aggregate amount of value added which it produces, but rather the strategic role it plays in production generally in all parts of the economy, the agricultural sector as well as the manufacturing sector.

Senator PROXMIRE. Mr. Okun.

Mr. OKUN. I just wanted to say that people who take Mr. Ture's methodological position that monetary policy is all important in determining the course of nominal GNP have done considerable work in trying to forecast with the orientation.

The best performing monetary model is that of the St. Louis Federal Reserve Bank. I don't understand why it works as well as it does some of the time, but it has worked reasonably well.

And its estimate for GNP for the rest of this year, for this year on a 6 percent money growth path, is virtually identical to mine.

And I come at it in a completely different way. The St. Louis table I have before me gives GNP both for 5 percent growth and 8 percent growth of the money supply.

If you interpolate for 6 percent growth, you come out with a $1,073 billion GNP for the fourth quarter, and a pattern for the year that is something like $1,045 billion.

Senator PROXMIRE. With a 6-percent increase in the money supply.

Mr. OKUN. In terms of that reasoning and that orientation, the objective of bringing unemployment down calls for a more expansionary policy.

Mr. TURE. I do not want in any way to deprecate the excellent work done by the research staff of the St. Louis Federal Reserve Bank.

It really has been enormously important. However, I think that at least so far as predicting the course of events last year is concerned, the First National City Bank model, which is quite similar in many respects, does a better job.

And I haven't seen their most recent forecast, but my understanding is that they have not backed materially away from an earlier forecast which would have placed GNP at $1,060 billion for this year.

Senator PROXMIRE. You gentlemen have stated your positions clearly and convincingly.

Let me move on to something else:

I think Senator Humphrey opened up, with his accustomed vigor and eloquence, the neglect which the economic profession and this committee and others who are responsible for economically policy are guilty of with respect to agricultural policy.

This committee this year did hold hearings on agricultural policy, and we did have the Secretary of Agriculture for the first time in a long time.

And we did have a section in our report on agricultural policy.

And we did call on the Council to give us more thinking in this area. But would you agree that if we are going to do anything about improving the opportunity for the farmer to earn more income as a farmer, that we ought to take a good, hard look at the institutional organization?

The fact is that the farmer is disorganized. He relies on Government policy. The number of farmers is diminishing. They are 6 percent of the population.

They have much less political clout than they used to have.

Under the circumstances, some kind of organization, cooperative organization, or some kind of organization similar, it doesn't have to be the same, but similar to a union organization, it would seem at least from the farm standpoint would make some sense.

And if you gentlemen would think about that— I wouldn't expect you to come in on it now, but think about it and its implications and possibly its adverse implications with respect to prices, and its desirable implications with respect to income for farmers. It might be very helpful.

I would like to ask Mr. Okun, you talk about a temporary grant in aid increase. And that sounds very appealing.

And it is another one of the kind of novel ideas that you toss out before this committee that have been picked up and on which Congress has acted favorably.

I would like to ask you to give us a little more specific notion of how we could apply this efficiently and wisely.

It sounds like a very ingenious idea.

Mr. OKUN. I would like to see this generalized into a long-term kind of Federal insurance policy for States and cities.

It seems to me that the Federal Government has the responsibility for overall management of the economy when a recession occurs, the States and the localities don't have the same ability to engage in deficit financing as the Federal Treasury does.

The States and localities get hit from both sides: Their revenues shrivel up, because incomes are down, and the needs for public services greatly expand.

And it seems to me that there ought to be an automatic system—perhaps even a kind of general revenue sharing—just on a cyclical basis that indemnifies the States and localities against the squeeze in their budgets resulting from recession.

I think you could make a case for general revenue sharing in a recession of an automatic turnon, turnoff, variety.

Senator PROXMIRE. What does this do to the localities that are constantly saying that what they want is a steady, predictable Federal program on which they can rely, you can turn it off and you can turn it on and decrease it? Wouldn't that be upsetting for them?

Mr. OKUN. The intention is to give them a predictable total revenue growth that they could rely on. What you are doing here is trying to even out the dents and bumps in their own revenue.

Senator PROXMIRE. You are compensating for the fact that this year the testimony was that the States and the cities lost at least $3 billion, and I think more than that, in revenues, and there was a substantial increase in cost because of the recession in 1970.

And your program would try to compensate for that?

Mr. OKUN. Precisely.

Senator PROXMIRE. But it wouldn't be a general revenue—or would it?

Mr. OKUN. At this point I suggested that rather than trying to carve out a long term program that one ought to look at those particular grant programs—and I think education is an obvious case —where the cities and states are particularly hard pressed by the squeeze, and put it in the form of a specific categorical grant. But I would formulate it in such a way as to let every mayor and every Governor, know that this is meant to be a Federal compensation rather than a steady Federal flow, that it steadies the overall flow of revenue rather than providing an underwritten Federal grant for years to come.

I think many States and cities that are so hard pressed now would spend these funds rapidly. I am not sure how widely applicable this is. I am sure it is applicable to some manpower efforts, and I am sure it is applicable indeed to some welfare and public assistance efforts where one could well imagine that the Federal Government would take an extra share of the cost.

When one looks at many of the problems of last year individually, the farm price problem, the welfare, the jump in the welfare rolls, the pressure on State and local budgets, we ought to remember to what extent all of these reflect the underlying weakness of the economy.

I am not saying that is the only problem, but I am saying that the story would have been very different in a full-employment economy.

It is not an accident that the jump in the welfare rolls last year was twice as much as it had been in previous years. And it seems to me that if we recognize this and diagnose it properly as a problem of overall economic performance, we can deal with the offset to it as a means of compensating states and localities for this squeeze that recession imposes on them.

Incidentally, building in an automatic tapering off of these flows helps to put the Federal budget right back where it was.

Senator PROXMIRE. An unemployment compensation program for the cities and States?

Mr. OKUN. That is right.

Senator PROXMIRE. Mr. Lewis.

Mr. LEWIS. Similarly, if we do revenue sharing, I think this factor ought to be incorporated in the design of the revenue sharing system. That is, instead of stating that the amount of revenue is x percent of actual Federal personal income tax collection, which was the administration's formula last year, it ought to be, say, y percent of full employment GNP or full employment personal income to eliminate the cyclical instability.

Senator PROXMIRE. The administration proposes one that would be cyclical. Mr. Okun proposes one that would be countercyclical and provide more funds and encourage the recession. Are you suggesting that you stabilize it?

Mr. LEWIS. No. My proposal is sort of a minimal one. I would also go along with the suggestion that in addition, in recession periods, we should have some temporary countercyclical advances as well.

Senator PROXMIRE. Mr. Okun, why did you say that the depreciation action by the administration, which has been strongly criticized by many, including many members of this committee, why did you say that represents a permanent loss?

As I understand it, it doesn't enable business to depreciate a piece of equipment more than once. It would seem to me that there might be a larger loss in the initial year or years, but the Federal Government would reclaim part of that.

And, of course, you would lose part of it because of the time preference on money. But why would there be more of a loss than that?

Mr. OKUN. Because we have a going capital stock, and will continue to have a growing capital stock. If you think of it in very simple terms—suppose you gave double depreciation in the first year to every piece of equipment, and no depreciation in the last year. Then on every single piece of equipment the Federal Government would recapture in the last year what it lent in the first year.

But at that point we would have more new pieces of equipment than old pieces of equipment. So that the free loan keeps going up and up and up, over time. And the Treasury on judgment day may find some consoliation in knowing that it has a lot of future tax liabilities from the business community on the basis of capital equipment already purchased.

But it takes a judgment day to bring that about. As long as we are a growing economy with a growing capital stock, the amount of that loan keeps expanding, and there is a permanent drain on the Federal revenue potential.

And once a commitment like that is made, it is practically irreversible. It is like trying to unscramble eggs ever to change a provision, a depreciation provision, in the direction of restriction.

It amused me last week to wonder what might have happened if our lawyers in the Johnson administration had been as permissive and had told us that the President had discretionary tax authority amounting to $4 billion a year, when we wanted taxes to go up. I wonder whether the President could have promulgated a restriction of depreciation allowances on that basis. But we never found a lawyer who was quite that congenial.

Mr. TURE. May I comment on that question, sir?

Senator PROXMIRE. Yes, indeed.

Mr. TURE. First, one quick word:

Back in 1934 the administration had no difficulty in finding the lawyers that were that permissive.

Senator PROXMIRE. What year was that?

Mr. TURE. 1934. In fact, all depreciation deductions were reduced by 25 percent by administrative action.

But let me come back to the question you raised explicitly:

I think Mr. Okun's arithmetic is perfectly correct. For any given rate of growth of the capital stock, the kind of provision that the Treasury is now suggesting, the asset depreciation range system, indeed will involve a revenue loss, with quotes around the words, that will continue, it will never be recaptured.

It would only be recaptured, if, in fact, the size of capital stock levels out, at which point there would be no further revenue loss, and if thereafter, the stock declined.

Senator PROXMIRE. Still because the time preference, it would be a loss?

Mr. TURE. That is right.

However, I think you would be interested in an analysis that was prepared by Mr. Jorgensen of the Data Resources Institute and presented at the Internal Revenue hearing on Monday.

Mr. Jorgensen's model showed that within a relatively short period of time the ADR not only will not involve a revenue loss, but will involve a revenue gain for the U.S. Treasury, because of the stimulative effect that he assigns thereto.

I have not seen the model. I cannot comment on it, but I think it would be in the interest of the committee to obtain a copy.

Senator PROXMIRE. Of course, that stimulated effect depends upon assumptions in the economy. And the assumptions are not going to be very favorable.

There is going to be some testimony, I understand, from Jorgensen before this committee.

There has been much speculation over the possibility that the administration is going to propose a bailout of the Lockheed Corp. through a Federal guaranty loan or some other device.

Yesterday two Senators, two of the leading Senators, were reported as saying that the administration has indicated they are just on the verge of doing this and perhaps it will be consummated.

One argument being made is that such a move is necessary to prevent widespread unemployment and to avert the catastrophic effect of bankruptcy of a large corporation like Lockheed upon the economy.

Would you respond to that point and tell me your views on the wisdom of the Federal Government moving in the direction of guaranteeing the loan?

And I might point out that it is argued that this would be for the L-1011 airbus, not for a Government contract.

The L-1011 airbus, as you know, is a commercial plane.

Mr. Okun first.

Mr. OKUN. That is a very tough question to answer, Senator. I must confess that I don't know the particular situation with respect to Rolls Royce that might justify some special attention to Lockheed in the sense that there was an international negotiation involved.

I am just greatly concerned about the precedent involved in that kind of Federal intervention in the private marketplace. Once the Federal Government gets into the business of preventing bankruptcies. I wonder whether there is any stopping place then. I wonder whether there is any limitation that would prevent it from merely maintaining inefficient and poorly run businesses in operation.

Senator PROXMIRE. From an economic standpoint, isn't it equivalent in a sense to assuring the presence on the market of a competitor for McDonnell, Douglas, and Boeing, and therefore putting them into some jeopardy, perhaps, and in some position where they might ask for equitable treatment?

After all, if you have a given demand for the products—perhaps this isn't the case, but it is my understanding that it is, and we now have a very substantial surplus of airfreight capacity—but if you have a given demand for a product, what does the Federal Government do when it enables one competitor to stay in the market?

Mr. OKUN. Basically there is a competitive race. And those who lose, lose with their eyes open. The only question that arises is whether the losses in particular cases have such widespread social effects that they might justify for special Federal action.

To the extent that that Federal action is called for, it should clearly be based on who else gets hurt rather than on the maintenance of a corporate entity in some apparently solvent form.

Penn Central went bankrupt, it was reorganized, and people continued to work, and the passengers and the freight were carried, no more efficiently, and probably no less efficiently than before.

Senator PROXMIRE. The unemployment was primarily the unemployment of the top management.

Mr. OKUN. Yes; who seemed to be heavily indemnified against such risks.

One really has to look at this with the presumption that this is precisely the kind of thing the Federal Government doesn't want to do. Is there anything so overwhelming in the present circumstances about the nature of the problem that Lockheed got into or about its consequences that would justify special action? And if that action is taken, it seems perhaps terribly important to me that it be clarified on what basis that decision is made, so that it is never used as a precedent for anything else.

I haven't seen the case so far for taking that action. But I don't know the case well enough to argue against action.

Senator PROXMIRE. Mr. Lewis.

Mr. LEWIS. Since I have a brother who is an engineer at the Lockheed Aircraft Corp., I really should disqualify myself on this.

Mr. OKUN. That is one way of getting rid of a tough question.

Mr. LEWIS. I would offer a few observations here.

I have heard it said by experts—I am not an expert in the aircraft industry—I have heard it said that the prospective demand for airframes 10 to 20 years from now or so is such that we will only really need two firms in this industry, rather than three.

This industry has been closely related to public sector activities. It really isn't violating a hands-off-the-private-sector posture, which I think is generally the correct posture, to suggest that it is a governmental responsibility to rationalize the aircraft industry.

Now, whether or not there should be two firms or three, and if two, which one should be phased out I am not sure.

Senator PROXMIRE. Shouldn't the rationalization, if you have one, be on the basis of Government work?

If you are going to do it to save a C–5–A or a new helicopter that Lockheed is producing, that is one thing. But why should it be for the purpose of enabling them to produce a commercial product, as it seems to be?

Mr. LEWIS. It seems to me the inefficient way to rationalize the industry would be to generate some artificial demand for the output, which is something that gets suggested from time to time.

I just don't really consider myself knowledgeable enough on this to make a suggestion on how it should be done.

But the opinion I have heard that the Government has some special responsibility to the aircraft industry does not strike me as outlandish.

Senator PROXMIRE. Mr. Ture.

Mr. TURE. I would voice a bias against government intervention in the fate of any company.

So far as the instant case is concerned, however, it seems to me that would be looking at Lockheed entirely out of context with the fact that the bias that I expressed is not observed by the Government any place else. The Government has no hesitation, or has not at one time or another in the past, in intervening in the pricing decisions of particular companies, in intervening in decisions about corporate reorganizations, mergers, congomerates, and so forth.

I don't think that we can——

Senator PROXMIRE. If you are going to do it, why not treat everybody alike? If they—if you are going to save them, why not save everybody?

We have got some pretty good businessmen in trouble in Wisconsin, going out of business, and a lot of farmers. Why shouldn't they be saved? Where do you draw the line?

Is it only the big fellows?

Mr. TURE. You have expressed the concern that is basic to the bias that I have expressed. And the point I was attempting to make is that the bias that I do voice is simply unrealistic.

And what basis there is in theory and analysis for saying, we can go so far, but we must go this far, I just don't know.

I have to confess an almost complete lack of familiarity of the details of the Lockheed case.

And so I simply cannot offer any judgment based on the details.

But in terms of a matter of policy, it seems to me that the issue is really quite obscure. I would like to see the view that you have expressed in the question that you raise much more generally applid throughout the Government.

Mr. OKUN. I think it would be unprecedented and very different from current practice to engage in this bail-out operation.

I am unaware of any precedent for action of this type. And I think that this does open a new area of potential Government responsibility and the fact that there are other areas in which the Government has chosen to assume some responsibility about doesn't change the presumption that this is an area that one should tread into which extreme and utmost caution.

Mr. TURE. It is surely not unprecedented, Art. I don't profess to a keen present knowledge of American history, but it seems to me that at the very founding of the Republic there was a political issue as to whether or not the Federal Government would bail out the States with respect to their indebtedness.

Senator PROXMIRE. The States and Lockheed are a little different.

Mr. TURE. Very well. And one might at that point consider the bonds that were issued by the private companies to finance the construction of canals and roads, indebtedness which they were unable to service adequately, and responsibility for the service of which was taken over by one governmental unit or another, including at one time or other the Federal Government. It is certainly not an unprecedented thing in our history.

But I don't know that that is particularly pertinent in the instant case.

Senator PROXMIRE. Senator Humphrey.

Senator HUMPHREY. I have resolved this a lot easier than you fellows have. I am for it. I think it is a company that deserves to survive, and I see nothing wrong with the Government of the United States insuring loans— this isn't a gift, it is a loan.

I think they ought to do it a lot more broadly, frankly. I think the RFC was loaning money where the private industry wouldn't do it, and RFC worked out very good.

The Senator from Wisconsin and myself have a mild disagreement on this one. It doesn't bother me a bit. I don't approach it from a doctrinaire point of view, I approach it from a pragmatic point of view.

This company was caught up in the Rolls Royce problem. Also this is not producing a supersonic transport, it is producing an airbus.

I think you gentlemen are saying hopefully that the economy will expand. And if it does, air travel will expand, and international air travel will expand, and we will need this air travel capacity.

I haven't the slightest doubt about it, at all. I will vote for it three times, if I can.

I would like to ask a little about the GNP. Everybody talks about it, but I would like to know what is in it. You can get a lot of GNP out of just whiskey or building nightclubs or racetracks.

But ought not we to have some kind of pressure, some kind of forces within our governmental structure that gives some direction to the GNP.

I have never been overly impressed by just the fact that the gross national product increases. Maybe it is all in bubble gum. Wouldn't it be better if it were in housing?

Would it be better if there were some social standards involved here?

I know there was a hearing here sometime ago by the Federal Reserve as to whether we could have credit policies, loan policies. Is that socially significant?

I think this is where you are coming down. Otherwise we are going to have GNP produce more cars than you can park, GNP increases produce more luxury items that you don't need, GNP increases just because it provides jobs.

If that was the case, we should have voted for the SST. But we made some value judgments. There were problems involved in the SST. That is what bothered me about it. But I made up my mind that there were other factors that had to be considered.

So it seems to me that if we are going to talk about the gross national product, we ought to get some guidance as to what goes into this GNP.

This country is privately rich and publicly poor. It is perfectly obvious. The only way I know to give this egalitarian principle any meaning except by sheer rhetoric is to add something to it, namely, if some people have a $100,000 income they can buy private education, they can buy private health care, they can buy a private yacht for the Caribbean, they can buy all these things.

But what about someone who has $6,000 a year? Are we going to provide any public parks for him, any good public education for him? A couple of rowboats that he can rent for 50 cents an hour?

Are we going to provide decent streets for him?

Mass transit?

We build interstate highways, but we don't build mass transit.

I think that you have come up with some programs when you talk about fiscal and monetary policy. We had better put in a factor relating to fiscal and monetary policy, as it relates to GNP, what kind of GNP.

We have got a lot of GNP without much housing.

We have got a good deal of GNP without a good health program.

We have got $70 billion going into a health program that doesn't give people nearly enough health protection.

Is it possible through fiscal and monetary policies, or what needs to be added to fiscal and monetary policies, to give a better mix to the GNP, so that we have a little less roads, maybe, and a little more outdoor recreation, and maybe have a few less commercial race tracks and more bike or hiking trails?

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What do we do to get a better mix? How do we work that out? Mr. Okun.

Mr. OKUN. Let me begin by saying one thing: I think you are quite right in suggesting that you can't infer that the society is better off just because GNP goes up. But it is a pretty fair inference that the society is worse off when it goes down.

Senator HUMPHREY. Yes.

Mr. OKUN. When you get into a period in which it contracts into a recession, the cutbacks are not bubble gum, they are the meat and potatoes of a great many people.

Senator HUMPHREY. That doesn't answer my question. We all agree on that, it isn't good to have it go down. But we have the GNP go up, and there are fewer homes for low-income people that are usable, suitable homes today than we had 5 years ago. What about that?

Mr. OKUN. There are a fair number of things we can do. But most of them point in one direction, that the remedy for an economy which is publicly starved over the long run is to finance more public services, and finance them in the only way we can, which is through paying higher taxes.

That we have to get people to recognize. They have to recognize that if they want clean, green, safe cities, they are asking to buy certain services. And unlike the private economy, they can't walk in and just decide how much to purchase. We have to make that choice collectively.

And I think we must get across to the people that they are buying the things that they want with taxes—and maybe, to take a somewhat heterodox view on public finances, to make it clear that certain taxes are being asked to finance certain things that people want.

Senator HUMPHREY. Why can't we have different tax rates and different kinds of investment? For example, if you were willing to loan money for the purposes of building low-income housing, why couldn't we have it that the profits that you make off of that loan will be taxed at one-half the rate that they would be if you loan money for conventional housing of $35,000 and up?

Why can't we have fiscal policy like that?

Senator PROXMIRE. If the Senator would yield, we suggested in our committee, and we held it in the subcommittee and then lost in the full committe—and we obviously didn't have the votes to go to the House—a variable reserve requirement provision which certainly Federal Reserve can have lower reserve requirements for housing loans than, for instance, the corporate borrowing or consumer borrowing or that kind of thing, and channel money into housing?

The same thing for State and local governments.

Senator HUMPHREY. Exactly. Why not?

Senator PROXMIRE. So you can do this not only from the standpoint of fiscal policy, expenditure, but also from the standpoint of the monetary policy.

Senator HUMPHREY. Why is it that we can have 40-year loans for Rio de Janeiro out of the U.S. Government money, but we can't get 40-year loans for St. Louis?

What is it in our fiscal policy and monetary policy that hangs us up on this stuff, Mr. Okun?

Mr. OKUN. I would caution a slight wait-and-see attitude on housing from this point of view. Housing has been generating almost the only good news in the economy for the last 9 months.

Senator HUMPHREY. What kind? The kind that my son bought costing $42,000.

Let's face it. I have been around, and I am kind of mad.

What kind of low-income housing is being built? Where is it being built? Let's take a look at the egalitarian principle that has been talked about here.

I am asking you, what kind of advice can you give this committee so that by the use of governmental powers and fiscal policy we can direct funds that are private into the low-income housing market by an incentive system, where the person that loans that money and makes a profit has an incentive to loan it, or a large proportion of it, for low-income housing?

Should we tax him at different rates, or have different reserve requirements?

Mr. OKUN. We have a new program which subsidizes the mortgage interest payments of people below median income by region. I think that is a promising program. I hope it proves to have a significant effect. It is obviously going to have its effect on the people in the $5,000 to $7,000 range. It is not going to do very much for people in the very low-income range.

Senator HUMPHREY. But you can't get money for that kind of housing, Mr. Okun. I am going to be very blunt with you—there just isn't money for that kind of housing.

Mr. OKUN. With the present savings and loan situation, I think the thing is improving greatly. As you pointed out earlier, the thrift institutions are really drowning in cash at the moment, and they are much more lenient about lending provisions, particularly in the Government or Government-guaranteed area.

I am not suggesting that we have solved the problem by any means for the very low-income groups. Everything they have—housing, food, clothing—is unacceptable, it is intolerable. Basically this housing problem is a problem of their low incomes.

It seems to me that we are obliged to talk about what we can do to get people to be productive enough to hold higher income jobs, and what we can do to alleviate the pain for those who can't.

And we come back to welfare or a guaranteed annual income or public assistance to some extent. You can't get away from the fact that as long as incomes are low, the condition of those people in all parts of their budget is going to be something that we have to be ashamed of.

I think some of us who are participating very fruitly in our affluent society are most struck by the housing problems, because that is the most visible part of the problem.

We don't see how these people eat inside the houses. We don't see what their problems in clothing children decently and sending them to school.

I am not trying to minimize the housing problem, at all.

Senator HUMPHREY. I understand. I picked on this one because we tend in these discussions to theorize and conceptialize and never get down to brass tacks.

For example, a town of 1,200 cannot get an FHA loan at the same percentage as a town of 5,000 to 10,000. And so you have got slum housing going all across the country.

Here we talk about all these good homes for families and so on. What you really mean is that ifyou live in Philadelphia, Pa., but not if you live out at Toivola, Minn. I don't believe we have yet come to grips with the basic need in this country of a national growth policy, not only economic growth, but population dispersal and the utilization of space as it relates to man.

And I don't think we have any governmental policies that are helping—in fact, we have problems that are aggravating the situation rather than helping it.

And getting back to this agriculture thing, when I go out and find that it costs much more for a farmer to ship his goods than it does for a manufacturer in transportation rates, I think there is something wrong.

What I find out, for example, if you were out in a little town in Iowa or South Dakota or Minnesota, or any other place, small town, that doesn't have much growth, you can't get money to buy a house, at least an insured mortgage, to the degree that you can get it in larger cities.

So what you are really saying is that you are designing policies that aggravate your situation.

Secretary Freeman testified before a committee of ours. And when I saw the data that he had developed as to the cost of social services in New York City, Philadelphia, Detroit, as compared to the cost of social services, in Dubuque, just taking a town, or Des Moines or Marshall, Minn., it is fantastic. From the point of view of the taxpayer we are getting robbed.

But the fact that people pour into these big cities is a result of Government policy. It is a Government policy. We used to have one that got them out of those cities, like 160 acres of free land and getting railroads to span this country, and rural free delivery.

We had population national growth policies. Today we have got another one, namely, pile them up on top, pile them up.

In other words, you can get a loan. Private banks will loan money for commercial development in a large city, plenty of money for office buildings. Private banks will loan money for housing developments in large cities. Private banks will not loan money for low-income developments as readily as for middle-income developments, or as openly or generously.

They will not loan for economic development in certain parts of the Nation.

You have Railpax, the Federal Government coming through cutting out rail services all over the United States.

And on the other hand you have another law on the book that it is the declared policy of the Congress that there must be a better balance between rural and urban America in all facilities, and it lists them like a laundry list.

And then this says in Railpax, "You people out there aren't going to get any rail service or any airplane service or even any highway service, because the highways won't take the trucks."

And so we have funds for interstate highways, but not enough funds for what you call a grant-in-aid highways. So when we talk about what we do for this economy we have got to get economists who talk with us about how we get a national growth policy in this country, population dispersal policy. We should put the researchers of this Nation to work on these problems.

I recognize the need of $6 billion to $10 billion of self-terminating fiscal aid. I am for that. It makes a lot of sense.

But ultimately it is a bandaid. It is sort of an economic transfusion. It doesn't really get at the problem, which is being aggravated.

I had the Director of Census, Senator Proxmire, before us. And I think it would be very good to get him here with new data. And if that new data is 50 percent correct, this country has an insoluble problem by the demographic projections from here on out.

The new data that isn't even printed out yet is incredible. And the fiscal and tax policies of this Government and the monetary policy aggravates this situation, and will continue to do so.

And that is where we need your help. You men are brilliant and able and skilled. And some of us are just sitting by here frustrated and somewhat angry about it. I know there is an answer.

You can't tell me that there isn't a way to do better than having the New York Welfare Department pay $700 a month for a couple of stinking rooms in a hotel when they ought to be building for a welfare family. When it is municipal housing, there ought to be a way to finance it. I don't know how much it costs, but nobody is going to go broke building houses.

This is a capital asset. And when you pay $500 to $700 a month to keep people living in hotels, it seems to me it would be better to build those persons homes and let them finance it out of their welfare checks, which they could do, and let them have a sense of ownership.

But we don't get to it. I got a little kick on this one, because I think it will put people to work, which is what we are really interested in. I don't just want people to work raking up the parks, although I will buy that rather than unemployment.

I will take Mr. Lewis next.

Mr. LEWIS. I really don't have time to do justice to this in such a short period of time. But this is something that I have researched quite a bit, the question of population distribution and policies that might be appropriate. I just want to caution you that it is very much more complicated than what you have just stated.

Senator HUMPHREY. I realize that.

Mr. LEWIS. There are opportunities for spending huge sums of money in this bill without accomplishing anything except perhaps to make the situation very much worse, for example, by spreading blight and pollution more widely than it is now.

We don't know what incentives it takes to get people to move or not to move. An awful lot of people are leaving rural areas because they want a wider range of cultural experiences and employment opportunities that are only possible in large urban places.

And I caution you that it is a very complicated subject.

Senator HUMPHREY. I am not advocating a back-to-the-farm movement. You misunderstand me. I am saying that if the Prime Minister of the United Kingdom tells me that they can reduce the population of London in 10 years by 1 million by an outmigration, we ought to take a look at the horrendous figures that appear on the horizon for the next 10 years for New York City with a population of 18 million projected.

That doesn't make me feel very happy. If industry can't handle it, how can I handle it when it gets to be 18 million? I am talking about growth centers, new towns. I am talking about policies that force people, out of sheer economic attrition, from the smaller towns into the urban areas of the great cities which aggravate the problems that Chairman Griffiths was talking about.

Isn't there some way, some fiscal, monetary and social policies that we can come up with, recognizing its complexity—I know it is complex, it is not easy—but you can't tell me that towns of 50 or 100,000 are not possible.

And I don't think that after you get to a town of 12,000 or 15,000 that you are without cultural opportunity. What cultural opportunity do you have in the crosstown traffic of New York, except to see miniskirts as you wait at the stoplight?

Senator PROXMIRE. What is wrong with that?

Senator HUMPHREY. I didn't draw a value judgment on it, it was a rhetorical question.

Senator PROXMIRE. Mr. Ture.

Mr. TURE. I think, Senator Humphrey, you have made a very powerful point. It is one that I offered, myself, in my formal remarks, that this does have a tremendously powerful influence on the allocation of resources, and on the composition of economic activities.

I will take issue only with respect to the role of the economist in dealing with the problems that you have identified. The economist, as an economist, does not have the capability that you invest him with. He is not entitled, by virtue of the fact that he is trained as an economist, to say, this is the appropriate composition of GNP, as opposed to that composition of GNP.

There is nothing about his training nor his expertness that gives him that kind of competence.

On the other hand, you are here for the express purpose of making those judgments. That is why you get elected. Having formulated those judgments, and found a consensus among your colleagues, indeed the economist can give you some help, some very good help indeed, and tell you what kind of fiscal measures will move in the direction of accomplishing the results you wish.

He also, if he is fair, should, do more than merely, as Mr. Lewis suggested, point out to you that it is a complex and difficult process. He ought to point out some of the hazards that are involved.

For example, we have had a public policy to support the private housing market ever since the war. That policy has not been a static policy. It has changed through time. The impact of that policy on the housing activity of the United States has also been conditioned by certain regulations that have been developed in the monetary area of the Federal Reserve Board.

The interplay of that with a great number of other factors has had a significant influence on housing activity in a direction which quite clearly we have found unsatisfactory.

Now, if you put the problem to us as economists, or economists generally, as to what kind of changes in existing regulations, existing laws in fact will reverse some of the price trends and start getting activities in other directions, I am confident that you can find some of us who will give you very good technical advice.

Senator HUMPHREY. That is exactly what I was driving at.

You talk in terms of models. And I am under the assumption that economics is not an abstract science. I consider it, hopefully, somewhat pragmatic. And it seems to me that economists are alive to the fact of what is going on in the country. They know that there is traffic congestion, and if there is, how do we best provide the economic incentives to best alleviate.

Presuming that you have a socially declared policy of mass transit, how do you provide the economic incentives? I don't need to draw any more pictures to anybody about the slums of America.

What are the economic incentives? What kind of taxes, what kind of monetary policy?

Mr. TURE. Mr. Okun suggested, for example, only illustratively, one route to pursue on this. It is not a route that is going to give you an immediate payout. It may be that for any reasonable length of time with which we ought to be concerned, as concerned citizens, and policy formulators, that it is the best route to go. That is to say, instead of trying to structure the choices of individuals, whether they be poor, middle class, or highly affluent, what we ought to do is simply to deign policies which over a period of time will increase their incomes, their wealth, and remove those restrictions in public policy which in effect do distort their choices.

What would we do if indeed we were able to pull off the policy of that sort and find that the people still did have a preference for automobiles and for television sets and for this and that and the other thing, as opposed to better housing?

We would no longer be able to say that the reason why they didn't have better housing is because they can't afford it, we would have to say that they don't have it because they don't prize it as much as they prize other things.

And there is case study after case study in poorer rural America as well as in poor urban America where indeed experiments have been conducted of one sort or another to change the incomes and wealth of the individuals there to see what their response would be.

In many cases they did not respond by picking out the particular kind of improvement that any one of us, looking at it from the outside, would have bet they would. They selected other things.

I don't know how you fault their choices, except by making them unhappy.

Senator PROXMIRE. Thank you very, very much.

Gentlemen, it has been a most stimulating and helpful morning. The subcommittee will stand in recess until 10 a.m. tomorrow.

We will meet in room 318 of the Old Senate Office Building.

Tomorrow we will hear Prof. James Duesenberry, of Harvard University; Nat Goldfinger, AFL-CIO; and Carl Madden, the U.S. Chamber of Commerce.

(Whereupon, at 1 p.m., the subcommittee adjourned, to reconvene at 10 a.m., Thursday, May 6, 1971.)

LONG-TERM ECONOMIC IMPLICATIONS OF CURRENT TAX AND SPENDING PROPOSALS

THURSDAY, MAY 6, 1971

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON FISCAL POLICY
OF THE JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The subcommittee met, pursuant to recess, at 10:05 a.m., in room 318, Old Senate Office Building, Hon. Martha W. Griffiths (chairman of the subcommittee) presiding.

Present: Representatives Griffiths and Widnall; and Senator Proxmire.

Also present: John R. Stark, executive director; James W. Knowles, director of research; Loughlin F. McHugh, senior economist; Richard F. Kaufman and Courtenay M. Slater, economists; George D. Krumbhaar, Jr., minority counsel; and Walter B. Laessig and Leslie J. Barr, economists for the minority.

OPENING STATEMENT OF CHAIRMAN GRIFFITHS

Chairman GRIFFITHS. This morning the Subcommittee on Fiscal Policy continues its hearings on the long-term economic implications of current tax and spending proposals. It might be useful at the outset this morning to emphasize to the witnesses that we have found the suggestions so far in the first day very interesting—such as those recommending a full employment deficit in the near future.

However, I am somewhat puzzled as to how we are supposed to plan the complex details of revenue and spending so as to produce the full employment deficit in the immediate months ahead, but end up with a full employment surplus of $5 to $10 billion 2 or 3 years from now, or whenever we get to full employment. The mechanics of this are still puzzling. I hope today and in subsequent sessions we can clear them up.

Today we are honored with four outstanding economists. The leadoff witness will be the distinguished professor from Harvard University who has appeared previously before the Joint Economic Committee and this subcommittee, James S. Duesenberry. Professor Duesenberry is accompanied by one of his associates from Harvard, Barry Bosworth. They will present a joint statement. Our second witness is Nat Goldfinger, the director of research of the AFL-CIO whom we have welcomed to the subcommittee many times before.

Our last witness will be Carl H. Madden, known to us for many years and now chief economist for the U.S. Chamber of Commerce.

We are very happy to have you here, Mr. Madden.

Professor Duesenberry, you may proceed.

STATEMENT OF JAMES S. DUESENBERRY, PROFESSOR, HARVARD UNIVERSITY, ACCOMPANIED BY BARRY BOSWORTH, ASSISTANT PROFESSOR

Mr. DUESENBERRY. I ask if I might take 1 minute on a subject which is connected very intimately with the fiscal policy.

Chairman GRIFFITHS. We would be delighted to have you do it.

Mr. DUESENBERRY. I just want to say after last week's events here, that although we might find the approach that some of our young people are using not very attractive, I hope the Congress will remember that in addition to the very small numbers of people who came here there are millions of young people and millions of older people as well who feel very deeply the moral problems of the war in Vietnam and the need for the Congress to take whatever action it can to bring our involvement there to an early conclusion, and I may add, to a complete conclusion.

Chairman GRIFFITHS. Thank you. You may proceed, sir.

Mr. DUESENBERRY. I would like to emphasize that this testimony is indeed a joint effort. We had a very short time and we worked together to produce this prepared statement very quickly. And it is a completely joint effort.

We appreciate this opportunity to speak before the Subcommittee on Fiscal Policy concerning the subject of the economic implications of alternative proposals to provide additional fiscal stimulus to the economy over the next year. We would like to preface our remarks with a brief review of the economic outlook. The projections, which we believe to be in general agreement with the majority of forecasts outside of the Government, have provided the basis for our more specific recommendations.

It is clear that the recession has finally bottomed out; but there is no indication of an immediate upsurge of the type envisioned in the CEA annual report—there never was. The general economic outlook is for a 1970 GNP increase of about 7.5 percent to $1,051 billion—but less than half of this will reflect any real growth in demand. The rate of inflation should continue to fall gradually to 4 percent by yearend. Continuing growth of real output will stabilize the unemployment rate at about 6 percent with the beginning of a decline in the last half of the year.

The more detailed aspects of the outlook are—

1. Business fixed investment will not be a major stimulating factor. On the basis of recent Government surveys, business outlays should rise but little more than that required to cover increased prices of capital goods—about 4 percent.

Manufacturing investment is severely constrained by high levels of excess capacity; the boom in commercial building is coming to an end as vacancy rates are beginning to rise; and the only strong note is concentrated in investment of the public utilities who have not yet caught up to the boom in demand during the 1960's. The problem of excess capacity makes it unlikely that the revisions in depreciation allowances will significantly stimulate investment in the near future.

2. Residential investment should provide the major source of immediate expansionary pressure.

Housing starts of 1.8 million units in recent months are 35 percent above the depressed levels of a year ago. This is one clear benefit of the easing of interest rates; but its expansionary influence will rapidly dampen as starts level out at 1.8 to 2 million units for the year.

3. Business inventory investment sharply differentiates the current situation from previous postwar expansions.

Since the current recession developed more slowly, inventory investment did not fall to the extreme negative levels of past recessions.

The resulting recovery, therefore, will be more limited and will not be a major source of stimulus.

The failure to fully recognize this difference appears to be a major error in administration projection of a rapid expansion.

4. Consumer expenditures continue to be a source of some uncertainty. Savings rates are very high by historical standards. A sudden reversal could provide additional stimulus; but there are few signs of such a development as yet.

The enactment of the social security benefit increase, postponement of the matching tax increase, and the effective provisions of the tax reform act could give a strong push for the rest of the year. Thus, even without a major drop in the savings rate, consumer spending will be expansionary.

5. The rate of inflation should decelerate in 1971.

The shift toward rising output will result in a substantial improvement in labor productivity; and there is some slowing in the rate of increase for labor contracts. By relieving the pressures on unit labor costs, both of these factors will contribute to an improvement in price performance. But a return to any form of price stability simply is not going to occur in the near future. Instead of focusing on month-to-month variations in food prices, we must remember that labor contract increases of 12 percent in 1970 were even higher than the 9.25 percent rate of 1969. This is far above the 3 to 4 percent rate that could be absorbed by productivity gains.

6. The Federal budget underlying the projections is, in general, consistent with that released by the administration in January. It incorporates the social security benefit increase, delay of the taxable wage ceiling increase, and the depreciation revisions. The increase in expenditures in the next year is roughly in line with normal revenue growth; there is no major shift toward expansion as the Government is merely putting back what it takes out. The deficit for by 1972 will exceed that projected by the administration because they substantially overestimate the rate of growth of GNP during the period.

The economic outlook for 1972 appears to be somewhat better than for 1971. This judgment reflects a reversal of the downtrend in defense expenditures, continued growth in residential construction, a strengthening of private investment, the delayed impact of the social security benefit increase and further steps of the Tax Reform Act, and the hoped for decline in savings rates.

While such forecasts are subject to a wide range of error, a reasonable estimate for 1972 is a 5 to 6 percent growth in real output and a continuing decline in unemployment to 5 to 5.5 percent in the last half of 1972, and some further deceleration in the rate of inflation.

Although this is definitely an improvement over recent performance, we believe that a somewhat higher rate of growth could be attained with little or no adverse effect on the rate of inflation.

Given the present high level of unemployment and low level of capacity utilization there is no danger of inflationary pressure from excess demand or bottlenecks.

A rapid rate of growth might have some adverse effects on expectations, but these should be largely offset by the improvement in productivity from a higher rate of growth, and the increase in take-home pay from a longer workweek.

Our desire for a more rapid rate of growth in the near future must be tempered by longer term objectives. A real rate of growth as high as 8 percent would lead to a costly revival of inflationary expectations. It would also set off expansionary forces continuing into 1973 which could not be readily controlled as the economy approaches full employment without disrupting Federal expenditures and tax programs, or a return to a severely restrictive monetary policy with serious adverse effects on the housing market and State and local financing.

In our judgment, a package of fiscal and monetary policy actions which would raise the forecasted rate of growth for 1972 to about 6.5 percent would be appropriate at this time.

We recognize that in view of the uncertainties of forecasting such actions might lead to an excessive rate of growth. However, we think that the risks of a large error on the downside is greater than the risk of a large overshoot.

Finally, it is our personal judgment that the risk of continued high unemployment outweighs the risk of renewed inflationary pressures. The danger of increased inflationary pressures could be significantly reduced by an aggressive effort to restrain excessive wage and price increases directly.

But our judgment is that in 1972 it will be better than 1971. Let me interject here that I think it is very common for people to say that we must pursue a cautious policy in generating expansion. And by caution I mean caution with respect to problems such as inflation and the balance of payments. I think we have to recognize that the need for caution is symmetrical, that there are obvious dangers in a renewal of inflationary pressures. And there are obvious dangers in the balance of payments problems.

It is also true that there are dangers in too long a continuance of a period of high unemployment. I think that if you go back to the early 1960's you can see that we paid a very high price in terms of social problems by having had too much caution on this side with respect to expansion in the period before that.

So I think it is not appropriate to say, I am a wise man who recommends caution, and therefore I say hold everything down. I think a wise man has to recognize dangers on both sides and be cautious about trying to secure a middle course. So that our recommendation here, we feel, is a middle course, although I am sure there are people who will believe that our judgment has erred on either side.

As the economy expands there will undoubtedly be renewed concern over the balance of payments. I suppose that is putting it mildly in view of the headlines the last couple of days. But I will come back to that in a moment.

A higher rate of growth of U.S. output can be expected to contribute to this deficit through some deterioration of the trade account. However, this effect should be relatively small and would be partly if not wholly offset on the capital account—through an improvement in the United States compared to investment abroad. In any case we do not believe that the United States should pursue an inappropriate domestic policy for the sake of the balance of payments. If the dollar deficit generated by a prosperous U.S. economy exceeds the amount that other countries wish to absorb, they must revalue rather than ask the United States to suffer excessive unemployment.

I think that while many of us are disturbed by the actions which have occurred in Europe in the last couple of days, that in a way we should view it as an optimistic sign, because I think that we are finding that the Europeans are willing to take some revaluing action, so that we could hope that it will be possible for us to pursue a domestic policy which is appropriate to our internal goals with respect to interest rates, inflation, and unemployment, without having to have a conflict with our balance-of-payments objectives.

Any expansionary actions which are taken must be evaluated also within a very severe long-term budget constraint.

I won't attempt to go into the details. But it does appear to us that a good deal of the prospects for any expansion in the resources of economic growth have already been optioned by administration proposals, or by other versions which the Congress is likely to pass in the same areas. Whether the Congress passes the welfare program recommended by the administration or some other welfare program, whether they follow the administration's recommendations on revenue sharing or do something else to assist the States, we think it is quite probable that they will make use one way or the other of the resources coming to us from economic growth of long-term permanent programs. And therefore the amounts which are available for immediate action, other than those connected with the welfare programs, revenue sharing, and things of that sort, which are of a long-term nature and a long-term legislative process, we think are relatively small.

In achieving the objective of accelerating the rate of expansion, proposals have been made for a further easing of monetary policy and in the area of fiscal policy: acceleration of the provisions of the Tax Reform Act, an expanded public works program, unfreezing of $12 billion in appropriations currently being held back by the administration, changes in depreciation regulations, a public service jobs program, and improved unemployment benefits. We would like to examine each of these proposals in turn.

Monetary policy has already made a significant contribution to expansion through the increased flow- of -funds to mortgage lending thrift institutions, reductions in market interest rates, and easier bank lending conditions.

If the present level of short-term interest rates can be maintained, further reductions in long-term rates can be expected and that will also provide a modest stimulus to economic activity.

It is important that this objective be achieved but that is about all that can be expected from monetary policy. It should be noted that if GNP in current dollars is to grow at the desired high rates, relatively rapid expansion in monetary aggregates will be required to meet our interest rate objectives.

Acceleration of scheduled personal income tax reductions: The stepping of scheduled tax reductions could provide $5 to $6 billion of additional disposable income in the last half of 1971. This could raise the level of GNP in the last half of 1972 by $10 to $15 billion.

Since the reductions are due to take place at a later date, the net affect on GNP in 1974–76 would be relatively small. The proposed rescheduling of tax deductions therefore conforms closely to the criterion set forth above. It is also relatively simple from an administrative and legislative point of view.

I might also say that I deeply regret that the Congress made those tax concessions when they made them, but I don't see any prospect of them taking them back. The only question is when they are going to come about.

PUBLIC WORKS PROGRAMS

By contrast an increase in authorizations for public works expenditures is likely to have a very small effect in the near future, and a substantial impact in 2 to 3 years.

For example, over 90 percent of the expenditures from the 1962 accelerated public works program occurred in 1964 and later years. Moreover, quickly formulated public works expenditures would be relatively low on the national priority list.

THAWING OF FROZEN APPROPRIATIONS

The $12 billion of NOA frozen by the executive branch has properties which are a mixture of the two items already discussed. Some of these funds could be spent relatively quickly but others would not be spent for a long time—for example, some highway funds are delayed by local controversies.

Without a detailed examination of the individual items we cannot judge how much of a stabilization contribution a thaw would make. If Congress wishes to review this matter from a stabilization point of view, the criterion should be the speed with which actual expenditures could occur. Otherwise they should evaluate those frozen appropriations in terms of long-term budget priorities. And no doubt some of the things which the Congress has already appropriated should belong in an appropriate list of commitments for long-term expenditures. But we are not prepared to attempt any evaluation yet.

STIMULATING PRIVATE INVESTMENT

The revision of depreciation guidelines is a very bad example of methods to achieve short-run stimulus. The investment process has a long lag as a result of extended decision and production periods. With high levels of excess capacity, investment is not one of those categories requiring stimulus at present. On a priority basis this is equivalent to spending $4 to $5 billion on a continuing yearly basis as a subsidy to business when that money is critically needed in other areas. Although opinions differ, there is considerable evidence that even the longer term stimulus will be very small—a small "pop" for the buck. Although other issues are involved in the revision of the regulations by executive action, we find no merit in the proposal on the basis of current stabilization needs.

The argument may be made that further tax incentives to business investment would relieve the inflation-unemployment conflict by accelerating the rate of productivity growth. We are unable to support this view since the rate of physical capital formation even in the long-run appears to be a small part of productivity growth —technological gains, education, health, and other forms of non-physical capital investment appear to dominate.

There is some question as to whether or not there will be enough capital resources to meet demands in areas such as housing, pollution control, and other pressing social needs. Thus, there is an issue as to the appropriate allocation of scarce capital resources.

A general reduction in investment taxes would not in any case be the best method of stimulating the purchase of more productive capital. Finally, a general stimulus to total long-run growth through accelerated productivity gains raises more fundamental issues in the area of ecological control.

However, if we must accept some form of tax relief to business investment the Congress should choose a measure which will contribute to future stabilization objectives. Some form of influence over the short-term timing of investment, more effective than monetary policy, has long been an objective of stabilization policy. One alternative is some form of variable tax and/or credit. Another recently discussed proposal is direct control of lending.

In our view, direct credit controls are not likely to be effective in controlling business investment. Although they are used in some other countries, the flexibility and sophistication of our financial markets suggests that an extremely elaborate and burdensome system of regulations would be required to control investment through the credit mechanism.

MONETARY POLICY VERSUS VARIABLE INVESTMENT TAXES

In its effect on investment incentives a rise in interest rates is basically similar to an increase in business outlays—or a reduction in a credit. They differ in that the tax is collected by the government. and the interest by a lender. A tax tends to have a greater effect on short-lived projects than an interest rate increase of the same average impact. The tax deductibility of interest together with the flexibility of financing decisions reduces the immediate impact of interest rate changes on business spending. A tax measure can be designed to influence particular types of investment—plant and equipment and exempt others, like housing—while interest rate changes appear to have a more adverse effect on housing than on plant and equipment investment.

We therefore feel that it would be desirable to supplement the operation of ordinary monetary measures with some form of flexible investment tax or credit provided that means can be found either to allow for presidential discretion or quick legislative action to change the tax or credit rates. They would also be preferable to controls on lending for stabilization purposes.

It is often argued that such measures cannot affect investment expenditures quickly. That, however, is equally true of interest rate increases or direct lending controls. Much of the impact of a variable tax and/or credit would arise from the knowledge that once imposed it would be changed in a year or two. This expectation could produce a significant variation in the timing of investment projects.

Arguments can be made for either an orders or delivery basis for the imposition of an investment tax and/or credit. In either case it would be a useful addition to our stabilization policy instruments.

At present we oppose either a simple acceptance of more generous depreciation guidelines or a permanent restoration of the investment credit in its old form. We would support legislation providing more flexible taxation of business investment. If such legislation were adopted quickly, the initial tax adjustment would of course operate to encourage rather than discourage investment.

I won't read all this next section of our prepared statement, but I do want to say that we are going to have a continuing problem of a balance between unemployment and inflation over the years. It won't stop in 1971 or 1972 or 1973. We are going to continually find either an uneasy compromise between those two objectives, or we will find that we are swinging between first having excessive unemployment and taking actions which drive us to excessive inflation, and back again. I think if we are going to have a rational policy, a policy which will give us a steady path of growth, we are going to have to take action outside the monetary and fiscal field of two sorts. On the one hand I think we are going to have to take some action to find longer term ways in which we can get a better control over the weight of wage and price increases without resorting to controls or through excessively high rates of unemployment. At the same time I think we are going to find that there necessarily will be periods when severe restraint is necessary. We may find that it will be very difficult for us to achieve as low a level of unemployment as we would like to have. And therefore without saying that I think that high rates of unemployment are desirable, I think that realism compels us to believe that high rates of unemployment are sometimes going to occur, and we ought to do something to make it a little bit more variable.

I have therefore suggested in the prepared statement that we ought to think seriously about ways to reduce the burden of excessive unemployment on those who have to bear it. And therefore we have to seek ways to find a more generous, effective system of unemployment compensation.

We have suggested here, to put it very briefly, that in doing that we should first of all adopt a triggered system. And Congress has already taken some action on a triggered system of extended periods of benefit. We are also suggesting that there should be a triggered system which would raise a proportion of wage replacement on the basis of dependency allowances, and possibly also to raise the proportion of wage replacement on the basis of length of steady participation in the labor force.

Our point in recommending that approach is that much of the difficulty in the administration of unemployment compensation—I would uses the word "abuses," but I know that Mr. Goldfinger would object strenuously if I did—is concentrated on those workers who have a relatively marginal attachment to the labor force. So that would be doing something which would provide for more generous treatment for those people who have been in the labor force working a substantial part of each year, and with people whose support I think would enable us to raise benefit levels during the period of high unemployment without running into those difficulties of administration.

I also feel, of course, that any addition to unemployment compensation benefits should be paid out of the general fund rather than out of the wage tax.

I believe that if we were to do this on a triggered basis we would only be spending money during those periods when unemployment is high, when the economy is slack. And I would not regard this, then, as using up a commitment of our long-term resources at full employment.

Of course, such a system of extending the force of a triggered benefit program would add to the automatic stabilization of our economy.

Chairman GRIFFITHS. May I interrupt for just a moment.

Are you saying that you would raise the benefits or extend the length of time, or both?

Mr. DUESENBERRY. Both. I believe that Congress has already taken action on benefit extensions. But the newspaper accounts—if those gentlemen don't mind—are so confusing that I haven't been able to find out exactly what the Congress did. But I know they did something.

I won't try to go into details on income policy. I do think that something in that area is necessary. I think that it will be successful, whether we emphasize structural reform or efforts to interfere with wage and price making by private parties, only insofar as there is strong public support for it. I think the central issue is not the details of the machinery, but the question of leadership and the rounding up of public support for any general program which is meant to reduce excessive wage and price increases. And I do think that something in that area is necessary for the long-term health of our economy.

Let me summarize. We have argued that additional actions to stimulate the growth of real output by about an additional 1 percent during 1972 would now be appropriate. The additional stimulus could be expected to speed the reduction of unemployment without seriously increasing the risk of renewed inflationary pressures. However, much of the fiscal dividend for the next 4 years has already been spoken for by programs already adopted or proposed by the administration. Fiscal policy actions involving permanent increases in expenditures or permanent loss of revenue should not be undertaken unless they are deemed to have a higher priority and will in fact displace those proposed by the administration.

We have argued that monetary policy should be aimed at accommodating the expansion by maintaining the present level of short-term interest rates and the ready availability of bank lending. Relatively high rates of growth of monetary aggregates may be required for that purpose. But since we do not know what rate of growth of monetary aggregates are required, the Federal Reserve should not use the aggregates themselves as a policy guide. Nor should we count on monetary policy as a major source of additional stimulus to economic activity.

We do not believe that a public works program, an increase in business depreciation allowances, or a permanent restoration of the investment tax credit are resirable at this time.

An acceleration of personal tax reductions already scheduled, a flexible investment tax credit system, a triggered expansion of an unemployment compensation benefits, or a triggered public program would all have desirable stabilization properties. I think that in the prepared statement we had some discussion of the interrelation between the public and private employment, so-called, and the triggered unemployment compensation system.

Expenditures from frozen appropriations fall into two classes. In some cases a thaw would result in increased expenditures within the next year. Those projects should be considered as competing with the items just listed. In other cases a thaw would result in expenditures stretched out over a long period. They must be evaluated in terms of longer term budget priorities.

Within the constraints on total demand which we believe are appropriate to and relevant within the present stabilization problem, there is not room for all the items which have desirable stabilization properties. We cannot simultaneously accelerate the personal tax reductions due between now and 1973, provide business tax concessions, initiate a public employment program, and undertake a substantial thaw in frozen appropriations.

The total stimulus should provide about a $10 billion addition to projected GNP in 1972 (allowing for the induced expenditures from any fiscal actions, which is perhaps $6 billion). The choice within this limit must rest not on stabilization considerations, but on the merits of increased personal consumption, increased investment, the benefits from public employment, and the value of the frozen expenditures.

We have orientated our testimony toward 1971 and 1972. We do not see any reasonable possibility of reducing unemployment below 5 percent in that time. Stabilization policies can no longer have a significant impact on 1971. Thus the issue of the conflict between high employment and price stability arises only in connection with the speed of growth in 1972. However, when we look beyond this period we must recognize that further reductions in the level of unemployment will make this conflict a much sharper one.

At some point we must ask ourselves whether, with present labor and product markets we can find a tolerable compromise between these two objectives. As mentioned earlier we believe that a more aggressive policy to restrain wage and price increases could make a significant contribution in the near future. A basic restructuring of the existing wage-price mechanism will be even more vital in the following years.

We have grave doubts that an acceptable compromise exists with the present institutional structure. We are likely in the future to again alternate between excessive unemployment and excess inflation. This conflict will neither die nor fade away.

(The joint prepared statement of Mr. Duesenberry and Mr. Bosworth follows:)

JOINT PREPARED STATEMENT OF JAMES S. DUESENBERRY AND BARRY BOSWORTH

We appreciate this opportunity to speak before the Subcommittee on Fiscal Policy concerning the subject of the economic implications of alternative proposals to provide additional fiscal stimulus to the economy over the next year. We would like to preface our remarks with a brief review of the economic outlook. The projections, which we believe to be in general agreement with the majority of forecasts outside of the government, have provided the basis for our more specific recommendations.

It is clear that the recession has finally bottomed out; but there is no indication of an immediate upsurge of the type envisioned in the C.E.A. *Annual Report*—there never was. The general economic outlook is for a 1971 GNP increase of about 7½ percent to $1051 billion—but less than half of this will reflect any real growth in demand. The rate of inflation should continue to fall gradually to 4 percent by year-end. Continuing growth of real output will stabilize the unemployment rate at about 6 percent with the beginning of a decline in the last half of the year.

The more detailed aspects of the outlook are:

1. *Business Fixed Investment* will not be a major stimulating factor. On the basis of recent government surveys, business outlays should rise but little more than that required to cover increased prices of capital goods—about 4 percent.

Manufacturing investment is severely constrained by high levels of excess capacity;

The boom in commercial building is coming to an end as vacancy rates are beginning to rise; and

The only strong note is concentrated in investment of the public utilities who have not yet caught up to the boom in demand during the 1960's.

The problem of excess capacity makes it unlikely that the revisions in depreciation allowances will significantly stimulate investment in the near future.

2. *Residential Investment* should provide the major source of immediate expansionary pressure.

Housing starts of 1.8 million units in recent months are 35 percent above the depressed levels of a year ago.

This is one clear benefit of the easing of interest rates; but its expansionary influence will rapidly dampen as starts level out at 1.8–2.0 million units for the year.

3. *Business Inventory Investment* sharply differentiates the current situation from previous postwar expansions.

Since the current recession developed more slowly, inventory investment did not fall to the extreme negative levels of past recessions.

The resulting recovery, therefore, will be more limited and will not be a major source of stimulus.

The failure to fully recognize this difference appears to be a major error in Administration projection of a rapid expansion.

4. *Consumer Expenditures* continue to a source of some uncertainty. Savings rates are very high by historical standards. A sudden reversal could provide additional stimulus; but there are few signs of such a development as yet.

The enactment of the social security benefit increase, postponement of the matching tax increase, and the effective provisions of the tax reform act should give a strong push for the rest of the year.

Thus, even without a major drop in the savings rate, consumer spending will be expansionary.

5. The *rate of inflation* should decelerate in 1971.

The shift toward rising output will result in a substantial improvement in labor productivity; and there is some slowing in the rate of increase for labor contracts.

By relieving the pressures on unit labor costs, both of these factors will contribute to an improvement in price performance.

But a return to any form of price stability simply is not going to occur in the near future. Instead of focusing on month to month variations in food prices, we must remember that labor contract increases of 12 percent in 1970 were even higher than the 9.25 percent rate of 1969. This is far above the 3–4 percent rate that could be absorbed by productivity gains.

6. The *Federal Budget* underlying the projections is in general consistent with that released by the Administration in January.

It incorporates the social security benefit increase, delay of the taxable wage ceiling increase, and the depreciation revisions.

The increase in expenditures in the next year is roughly in line with normal revenue growth; there is no major shift toward expansion as the government is merely putting back what it takes out.

The deficit for FY 1972 will exceed that projected by the Administration because they substantially overestimate the rate of growth of GNP during the period.

The economic outlook for 1972 appears to be somewhat better than for 1971. This judgment reflects:

A reversal of the downtrend in defense expenditures;

Continued growth of residential construction;

A strengthening of private investment;

The delayed impact of the social security benefit increase and further steps of the tax reform act; and

The hoped for decline in savings rates.

While such forecasts are subject to a wide range of error, a reasonable estimate for 1972 is a 5% to 6% growth in real output and—

A continuing decline in unemployment to 5–5½ percent in the last half of 1972, and;

some further deceleration in the rate of inflation.

Although this is definitely an improvement over recent performance, we believe that a somewhat higher rate of growth could be attained with little or no adverse effect on the rate of inflation.

Given the present high level of unemployment and low level of capacity utilization there is no danger of inflationary pressure from excess demand or bottlenecks.

A rapid rate of growth might have some adverse effects on expectations, but these should be largely offset by—

the improvement in productivity from a higher rate of growth, and

the increase in takehome pay from a longer workweek.

Our desire for a more rapid rate of growth in the near future must be tempered by longer term objectives.

A real rate of growth as high as 8% would lead to a costly revival of inflationary expectations.

It would also set off expansionary forces continuing into 1973 which could not be readily controlled as the economy approaches full employment without disrupting federal expenditures and tax programs; or a return to a severely restrictive monetary policy with serious adverse effects on the housing market and state and local financing.

In our judgment, a package of fiscal and monetary policy actions which would raise the forecasted rate of growth for 1972 to about 6½% would be appropriate at this time.

We recognize that in view of the uncertainties of forecasting such actions might lead to an excessive rate of growth.

However, we think that the risks of a large error on the downside is greater than the risk of a large overshoot.

Finally, it is our personal judgment that the risk of continued high unemployment outweighs the risk of renewed inflationary pressures.

The danger of increased inflationary pressures could be significantly reduced by an aggressive effort to restrain excessive wage and price increases directly.

As the economy expands there will undoubtedly be renewed concern over the *Balance-of-Payments*. A higher rate of growth of U.S. output can be expected to contribute to this deficit through some deterioration of the trade account. However, this effect should be relatively small and would be partly if not wholly offset on the capital account—through an improvement in the U.S. equity market and an increase in the attractiveness of direct investment in the U.S. compared to investment abroad. In any case we do not believe that the U.S. should pursue an inappropriate domestic policy for the sake of the Balance-of-Payments. If the dollar deficit generated by a prosperous U.S. economy exceeds the amount that other countries wish to absorb, they must revalue rather than ask the U.S. to suffer excessive unemployment.

Any expansionary actions which are taken must be evaluated also within a very severe long-term budget constraint.

Under the assumptions that—

policies to restore high employment are successful;

Federal tax revenue will reflect current tax laws;

current civilian programs remain constant except for work-load, pay, and price increases; and

the termination of the Southeast Asian conflict and a maintenance of other defense expenditures at real 1971 levels;

the Federal government will have available about $30 billion of annual expenditures for new program initiatives by 1975–76.

This implies a rather severe restriction within which the vast array of new spending and tax proposals must be evaluated.

For example, just the set of initiatives proposed by the Administration in the FY 1972 budget would by 1975 represent $20 billion of this margin.

The proposed depreciation changes would be an additional $5 billion.

There is no room for the initiation of low priority expenditure or tax programs which would intensify the budgetary difficulties of future years.

We conclude that the expansive policy measures to be taken should be those:

Whose impact in the near future is large relative to their long term impact on demand, and

Which are most consistent with long term budgetary priorities.

EVALUATION OF SPECIFIC POLICY PROPOSALS

In achieving the objective of accelerating the rate of expansion, proposals have been made for a further easing of monetary policy and in the area of fiscal policy: acceleration of the provisions of the Tax Reform Act, an expanded public works program, unfreezing of $12 billion in appropriations currently being held back by the Administration, changes in depreciation regulations, a public service jobs program, and improved unemployment benefits. We would like to examine each of these proposals in turn.

Monetary Policy has already made a significant contribution to expansion through—

The increased flow-of-funds to mortgage lending thrift institutions,

Reductions in market interest rates, and

Easier bank lending conditions.

If the present level of short-term interest rates can be maintained, further reductions in long-term rates can be expected and that will also provide a modest stimulus to economic activity.

It is important that this objective be achieved but that is about all that can be expected from monetary policy.

It should be noted that if GNP in current dollars is to grow at the desired high rates, relatively rapid expansion in monetary aggregates will be required to meet our interest rate objectives.

Acceleration of Scheduled Personal Income Tax Reductions.—The stepping of scheduled tax reductions could provide $5–6 billion of additional disposable income in the last half of 1971. This could raise the level of GNP in the last half of 1972 by $10–15 billion.

Since the reductions are due to take place at a later date, the net affect on GNP in 1974–76 would be relatively small.

The proposed rescheduling of tax reductions therefore conforms closely to the criterion set forth above.

It is also relatively simple from an administrative and legislative point of view.

Public Works Programs.—By contrast an increase in authorizations for public works expenditures—

Is likely to have a very small effect in the near future; and

A substantial impact in 2–3 years.

For example, over 90% of the expenditures from the 1962 accelerated public works program occurred in 1964 and later years.

Moreover, quickly formulated public works expenditures would be relatively low on the national priority list.

Thawing of Frozen Appropriations.—The $12 billion of N.O.A. frozen by the executive branch has properties which are a mixture of the two items already discussed.

Some of these funds could be spent relatively quickly but others would not be spent for a long time (for example, some highway funds are delayed by local controversies).

Without a detailed examination of the individual items we cannot judge how much of a stabilization contribution a thaw would make.

If Congress wishes to review this matter from a stabilization point of view, the criterion should be the speed with which actual expenditures could occur.

Stimulating Private Investment.—The revision of depreciation guidelines is a very bad example of methods to achieve short-run stimulus.

The investment process has a long lag as a result of extended decision and production periods.

With high levels of excess capacity, investment is not one of those categories requiring stimulus at present.

On a priority basis this is equivalent to spending $4–5 billion on a continuing yearly basis as a subsidy to business when that money is critically needed in other areas.

Although opinions differ, there is considerable evidence that even the longer term stimulus will be very small—a small "pop" for the buck.

Although other issues are involved in the revision of the regulations by executive action, we find no merit in the proposal on the basis of current stabilization needs.

The argument may be made that further tax incentives to business investment would relieve the inflation-unemployment conflict by accelerating the rate of productivity growth. We are unable to support this view since—

The rate of physical capital formation even in the long-run appears to be a small part of productivity growth (technological gains, education, health, and other forms of non-physical capital investment appear to dominate).

There is some question as to whether or not there will be enough capital resources to meet demands in areas such as housing, pollution control, and other pressing social needs. Thus, there is an issue as to the appropriate allocation of scarce capital resources.

A general reduction in investment taxes would not in any case be the best method of stimulating the purchase of more productive capital.

Finally, a general stimulus to total long-run growth through accelerated productivity gains raises more fundamental issues in the area of ecological control.

However, if we must accept some form of tax relief to business investment the Congress should choose a measure which will contribute to future stabilization objectives. Some form of influence over the short-term timing of investment, more effective than monetary policy, has long been an objective of stabilization policy.

One alternative is some form of variable tax and/or credit.

Another recently discussed proposal is direct control of lending.

In our view, direct credit controls are not likely to be effective in controlling business investment. Although they are used in some other countries, the flexibility and sophistication of our financial markets suggests that an extremely elaborate and burdensome system of regulations would be required to control investment through the credit mechanism.

Monetary Policy vs. Variable Investment Taxes: In its effect on investment incentives a rise in interest rates is basically similar to an increased tax on business outlays (or a reduction in a credit). They differ in that—

The tax is collected by the government, the interest by a lender.

A tax tends to have a greater effect on short-lived projects than an interest rate increase of the same average impact.

The tax deductability of interest together with the flexibility of financing decisions reduces the immediate impact of interest rate changes on business spending.

A tax measure can be designed to influence particular types of investment e.g. plant and equipment and exempt others e.g. housing; while interest rate changes appear to have a more adverse effect on housing than on plant and equipment investment.

We therefore feel that it would be desirable to supplement the operation of ordinary monetary measures with some form of flexible investment tax or credit provided that means can be found either to allow for presidential discretion or quick legislative action to change the tax or credit rates. They would also be preferable to controls on lending for stabilization purposes.

It is often argued that such measures cannot affect investment expenditures quickly. That, however, is equally true of interest rate increases or direct lending controls. Much of the impact of a variable tax and/or credit would arise from the knowledge that once imposed it would be changed in a year or two. This expectation could produce a significant variation in the timing of investment projects.

Arguments can be made for either an orders or delivery basis for the imposition of an investment tax and/or credit. In either case it would be a useful addition to our stabilization policy instruments.

At present we oppose either a simple acceptance of more generous depreciation guideline or a permanent restoration of the investment credit in its old form. We would support legislation providing more flexible taxation of business investment. If such legislation were adopted quickly, the initial tax adjustment would of course operate to encourage rather than discourage investment.

Unemployment Compensation and Public Employment.—The proposals discussed so far would aid the unemployed only indirectly. In the best of circumstances it will be some time before excessively high unemployment has been eliminated. Moreover, realism compels us to expect that the conflict between the objectives of high employment and reasonable price stability will be settled by uneasy compromise or alternation between periods of excessive unemployment and periods of excessive inflation, for some time to come. That will be true to some degree even if more direct measures to limit wage and price increases are undertaken. Accordingly, we feel that further measures to maintain the incomes of workers who lose their jobs during periods of high unemployment would be appropriate.

The unemployment compensation system is the natural vehicle for that purpose. Though action has been taken to extend the benefit period we believe that more could be done.

Without going into details we believe that the Congress should consider—

Adding dependency allowances to unemployment compensation, and

Relating benefits in part to the number of years worked so that larger benefits would be paid to workers with a well established attachment to the labor force.

It can be argued that additional benefits as well as extended benefit periods should be paid for from general revenues not from additional payroll taxes.

A more generous system of unemployment compensation would increase the automatic stability of our economy. If it could be adopted soon, it would provide a near term expansion of demand which would automatically phase out with declining unemployment.

The provision of federal funds for the creation of "public employment" in state and local government for the unemployed can be considered to be either a substitute for improved unemployment compensation or as a complement to it.

As a substitute for more generous unemployment compensation a public employment program is not satisfactory because the number of useful well supervised jobs which can be created outside the regular public services is limited. That is particularly true of a program which is to vary with the unemployment level. Moreover, a large scale public employment program offers opportunities for political manipulation, and would probably meet resistance from public employee unions.

Public employment could be a useful complement to improved unemployment compensation. Public employment could be offered to those drawing extended unemployment compensation benefits. In particular such jobs should be offered when training programs are not suitable or not available to the workers in question.

We recognize that a redesign of the whole unemployment compensation system is likely to take a long time. We would therefore support a limited public employment program at this time which would phase out as unemployment fell to 4½%. Such a program would provide a temporary stimulus to demand while giving direct assistance to those who need it most. But we would regard such a measure as a stopgap pending a general overhaul of the unemployment compensation system.

Though our discussion of public service employment has been directed at the problems of high general unemployment we do not mean to rule out the possibility that a permanent public employment program might prove to be a useful part of a welfare reform program.

SUMMARY

We have argued that additional actions to stimulate the growth of real output by about an additional 1% during 1972 would now be appropriate. The additional stimulus could be expected to speed the reduction of unemployment without seriously increasing the risk of renewed inflationary pressures. In addition, much of the fiscal dividend for the next four years has already been spoken for by programs already adopted or proposed by the administration. Fiscal policy actions involving permanent increases in expenditures or permanent loss of revenue should not be undertaken unless they are deemed to have a higher priority and will in fact displace those proposed by the administration.

We have argued that monetary policy should be aimed at "accommodating" the expansion by maintaining the present level of short term interest rates and the ready availability of bank lending. Relatively high rates of growth of monetary aggregates may be required for that purpose. But since we do not know what rate of growth of monetary aggregates are required, the Federal Reserve should not use the aggregates themselves as a policy guide. Nor should we count on monetary policy as a major source of additional stimulus to economic activity.

We do not believe that a public works program, an increase in business depreciation allowances, or a permanent restoration of the investment tax credit are desirable at this time.

An acceleration of personal tax reductions already scheduled, a flexible investment tax credit system, a triggered expansion of an unemployment compensation benefits, or a triggered public employment program would all have desirable stabilization properties.

Expenditures from frozen appropriations fall into two classes. In some cases a "thaw" would result in increased expenditures within the next year. Those projects should be considered as competing with the items just listed. In other cases a "thaw" would result in expenditures stretched out over a long period. They must be evaluated in terms of longer term budget priorities.

Within the constraints on total demand which we believe are appropriate to and relevant within the present stabilization problem, there is not room for all the items which have desirable stabilization properties. We cannot simultaneously accelerate the personal tax reductions due between now and 1973, provide business tax concessions, initiate a public employment program, and undertake a substantial "thaw" in frozen appropriations.

The total stimulus should provide about a $10 billion addition to projected GNP in 1972 (allowing for the induced expenditures from any fiscal actions). The choice within this limit must rest not on stabilization considerations; but on the merits of increased personal consumption, increased investment, the benefits from public employment, and the value of the "frozen" expenditures.

We have oriented our testimony toward 1971 and 1972. We do not see any reasonable possibility of reducing unemployment below 5% in that time. Stabilization policies can no longer have a significant impact on 1971. Thus the issue of the conflict between high employment and price stability arises only in connection with the speed of growth in 1972. However, when we look beyond this period we must recognize that further reductions in the level of unemployment will make this conflict a much sharper one.

At some point we must ask ourselves whether, with present labor and product markets we can find a tolerable compromise between these two objectives. As mentioned earlier we believe that a more aggressive policy to restrain wage and price increases could make a significant contribution in the near future. A basic restructuring of the existing wage-price mechanism will be even more vital in the following years.

We have grave doubts that an acceptable compromise exists with the present institutional structure.

We are likely in the future to again alternate between excessive unemployment and excessive inflation.

This conflict will neither die nor fade away.

Chairman GRIFFITHS. Thank you very much.

Mr. Goldfinger.

STATEMENT OF NAT GOLDFINGER, DIRECTOR, DEPARTMENT OF RESEARCH, AFL–CIO

Mr. GOLDFINGER. With your permission, Madam Chairman, I would like to submit the prepared statement for the record and then read parts of it and skim others.

The American economy is in urgent need of a substantial stimulus —to boost sales, production, and employment.

Following the administration's engineered recession of 1969–70, most parts of the national economy are in a state of sluggishness and stagnation. These facts are abundantly clear, particularly to those who are its major victims—the 5 million unemployed and the millions of underemployed, the hundreds of thousands of returning GI's and other labor-force entrants who find the job markets weak.

There were 5 million unemployed in March, after accounting for seasonal changes—up 1.4 million from a year ago and 2.3 million from January 1969, when the administration took office.

Substantial unemployment has spread to 52 major industrial areas in April—from six in January 1969—and to 687 smaller areas.

The buying power of the weekly after-tax earnings of the average nonsupervisory worker—over half the labor force— in the January–March quarter was hardly any greater than a year ago, less than in the early months of 1969 and even below 1965.

Although the administration attempted to blame the high unemployment of the October–December quarter of 1970 on the effects of the auto strike, the rebound of auto production in the January–March quarter brought no improvement in the unemployment situation. About 5 million people were unemployed in both quarters; the number of jobless, 15 weeks and more, rose to 1.1 million in March; and the Labor Department's report for March declares that "full-time employment was down by 190,000 from the last quarter of 1970, mostly among adult men."

In March, 4 months after the end of the auto strike, industrial production was below last summer, before the auto strike started. It was even slightly less than in January, when General Motors was filling its inventory pipeline. And it was 5.4 percent below the peak reached in July 1969, 20 months before.

As a result, manufacturing employment, in March, was down 600,000 from last summer and 1.6 million below the peak reached a year and a half ago.

Employment in contract construction, in March, was 300,000 less than at the end of 1969, after accounting for seasonal changes.

Unemployment rates, in March, were up to 17.8 percent for teenagers, 10.9 percent for construction workers and 9.4 percent for Negroes.

And unemployment among young men 20 to 24 years old—including GI's returning from Vietnam—has shot up from 4.7 percent to 10 percent in the past 2 years.

And I might add that the rate of unemployment among veterans in this age group of 20 to 24 is over 13 percent.

Except for the rebound of auto production in January–March and the building of steel inventories, the only parts of the economy that have been moving up at a significant rate in recent months are homebuilding and State and local government activities. Other parts of the economy are increasing slowly, like consumer goods; or they are declining, like machinery and business equipment.

The much-hearlded increase in the gross national product in the January–March quarter amounts to merely about one-half of 1 percent in real volume—or an annual rate of only about 1½ percent to 2 percent—after discounting the rebound of auto production and the temporary accumulation of steel inventories.

The need for a substantial stimulus is hardly the issue at all. The issue is the kind of stimulus—the specific type of stimulus that is required, now, and which meshes with the immediate and longrun needs of American society.

The need for a continuing monetary stimulus—to drive down interest rates, which are an inflationary cost factor and a deterrent to economic expansion—is especially clear, at this point when long-term interest rates, have turned up. But that is not the focus of this hearing. The issue before us is in the fiscal policy area.

In terms of the aggregate, the administration's fiscal policy in 1971 is hardly any different from 1970.

In a recent speech, the administration's former assistant director of the Budget Bureau, Mr. Maurice Mann, had this to say:

> It is an open question as to whether the Federal budget for fiscal year 1972 is an expansion as has been suggested—the budget is in effect essentially neutral in fiscal year 1972.
>
> We are now being treated to a double-barreled "blackbox" approach—after fixing budget expenditures at full employment revenues, all we have to do is pour enough money supply in one end of the box and somehow—in some form—enough additional GNP comes out the other end.

In view of these conditions, the AFL-CIO has recommended:

1. Immediate measures to create jobs through increased public investment outlays to help meet America's needs for improved and expanded public facilities and public services—and under that I would say that what we are talking about is (*a*) increasing the more than $12 billion of frozen funds that have been appropriated by Congress, particularly those funds for essentially vital needs; (*b*) enactment of a large-scale public service employment program to provide Federal funds for Federal agencies, State and local government for the creation of jobs, for the unemployed, and seriously underemployed; (*c*) adoption of a $2 billion Federal program to accelerate public works programs immediately in areas of high unemployment—to increase the Federal minimum wage to at least $2 an hour, to extend unemployment insurance payments for at least an additional 13 weeks, with Federal payment of the extended benefits, for those whose payment periods have been exhausted and to provide a further rise in social security benefits.

2. Longer run measures for Federal Government assumption of welfare payments, for the planned expansion of public investment and for a national health security system.

3. Renewed steps toward the achievement of justice in the Federal tax structure—by closing loopholes of special tax privilege for wealthy families and corporations and reducing the relative tax burden of middle- and low-income taxpayers—as well as efforts to reduce the regressive nature of State and local tax structures.

Instead of measures along these lines, the administration has proposed a $3 billion to nearly $5 billion annual tax bonanza to business—particularly to large corporations and unincorporated enterprises—in the form of accelerated depreciation writeoffs. It is a wrong-headed move, which will have very little, if any, early effect in providing a much-needed stimulus to boost sales, production, and employment.

Over the decade, $37 billion of business tax revenue would be wiped out—$37 billion that could be used for rebuilding the urban areas, mass transit, education, healthcare, and pollution controls.

Corporate taxes generally would be cut by about 7 percent. For some corporations, the tax reduction could go as high as 10 percent and many high-income unincorporated businesses would receive even greater windfalls.

This proposal is the wrong remedy for the present economic ills that have pushed the number of unemployed up to 5 million, or 6 percent of the labor force, and cut industry's operating rate down to about 73 percent of productive capacity. And in the longer run it represents a serious danger of adding to the national economy's instability.

This depreciation ruling was announced in January, only weeks after the President vetoed a bill passed by both houses of Congress to provide Federal funds for the creation of public-service jobs for the long-term unemployed and seriously underemployed; it came only weeks after the President vetoed congressional appropriations for housing and urban development; and only weeks after he vetoed funds for education. On the heels of these actions to veto funds to create jobs for the unemployed and provide improved public facilities and services—and at a time, when the administration has frozen billions of dollars of appropriated funds for expanded public facilities—it is incredible that the administration could announce its decision to provide business with a tax bonanza, through the device of depreciation gimmickry.

And administration spokesmen have launched trial balloons, threatening new consumer taxes, such as the so-called value-added tax, or new corporate tax giveaways such as the reinstatement of the investment tax credit.

In the first quarter of 1971, industry, according to the Federal Reserve Board, was operating at a rate of merely 73 percent of its productive capacity. This rate of capacity utilization was slightly lower than in 1958, the year of a deep recession; it was substantially below industry's operating rates in the recession years 1954 and 1961.

As a result of the very low level of sales and production, in relation to industry's capacity to produce, the real volume of business outlays for plants, machines, and equipment moved down in 1970 and in the first quarter of 1971, it was below the peak, reached in the final months of 1969.

The reasons for this situation are clear.

One major cause is the unsustainable capital goods boom of 1963–69, which was encouraged and subsidized by the Federal Government's policies—witness the step-up of depreciation writeoffs of 1962 and the 7 percent tax credit for investment in machines and equipment, adopted in that year. In almost every year of that period, business outlays for fixed investment shot up much faster than the gross national product or any other sector of the private economy. In the 6 years, 1963–69, the real volume of such outlays soared almost 56 percent, close to 9 percent per year. This unsustainable capital goods boom generated inflationary pressures in the economy. It was inevitably building up for a leveling off or decline, since it was adding to the economy's productive capacity at a much faster pace than the demand for goods and services.

The other major cause of the present very low rate of capacity utilization has been the administration's engineered recession of 1969–70, followed thus far by stagnation and sluggishness in most parts of the economy. The inherent and inevitable buildup of troubles of the unsustainable capital goods boom was compounded by the administration's decision to curb the rise of sales and production. The result has been a decline of industrial production, while new productive capacity was being added. The very low rate of capacity utilization, therefore, is largely the result of Government policies, which created economic instability.

The weekness is insufficient sales and production—not insufficient plants, machines, and equipment. The urgent need, at present, is for measures to lift sales, production, and employment—not tax bonanzas for business.

The rational and economically sound way to obtain an increase in the real volume of business investment is to boost industry's operating rate from its present depressed state—through a substantial lift of sales and output. And, in the long run, the major incentive for the sustained expansion of business investment is high levels of capacity utilization and an increasing volume of sales and production.

The clear relationship between industry's operating rate and the volume of demand for capital goods was recently indicated in a report in the Wall Street Journal. According to the April 26 issue of that newspaper, J. T. Bailey, president of Warner & Swasey Co. stated: "Historically, an operating rate of 80 percent is required to produce a good level of orders for machine tools." And I would add that a good level of orders for other types of capital goods may require an operating rate of about 80 percent or more. So the problem is not enough sales, not enough customers, and not enough public investment, and not enough consumer buying power and consumer confidence about the future of jobs and income.

In the short run, therefore, the Treasury's proposal will be entirely—or almost entirely—a windfall to business and to major stockholders, with the probability that part of the tax bonanza will be exported for foreign subsidiary operations, with the loss of American jobs and displacement of U.S. production.

In the long run, after the rate of capacity utilization improves, the Treasury's proposal poses the serious danger of another lopsided, inflationary capital goods boom, as in 1963–69, followed by another recession. American economic history is replete with such instability and the experience of the past 8 years is merely the most recent. Moreover, if the trend develops again, the boom period probably will be much briefer and the recessionary decline may be deeper.

The American economy needs greater stability, balanced expansion, and full employment. If the Treasury does not rescind the proposed depreciation rules, the AFL–CIO urges the Congress to bar their enforcement.

In the short run, therefore, the economy needs immediate measures to lift employment, consumer buying power and consumer confidences, through increased public investment outlays, which would create jobs and improve industry's operating rate—as well as the other measures indicated above.

In the long run, America needs planned programs, with Federal leadership and funds, to increase public investment to help meet the needs for improved and expanded public facilities, public services, and the establishment of a national system of health security.

I have appended a report of the AFL–CIO Economic Policy Committee to my prepared statement, which goes into the longer run issues, in some detail, "Public Investment To Meet America's Needs," which I will not read or even skim at this point because in our view the shortrun immediate needs of the American economy should be met by meshing them with our longrun needs. And our longrun needs are to provide a substantial expansion and improvement of public facilities and public services to rebuild the cities, to improve mass transit, pollution control devices, and so forth. And these are needs which have been building up in the kind of turmoil and social dislocations that have occurred almost continuously now for over 30 years in this country, with a high rate of migration of the population, and the decay of the center city cores. In our view, a long-range planned national effort to meet the needs of the American people for public facilities and services can provide the basis for long term economic growth in the period ahead.

Each era of economic expansion in America has been accompanied by growing investments and employment in new industries. The last third of the 19th century saw the building of the railroads, the agricultural implement, steel and oil industries. In the first two decades of the 20th century it was the public utilities, the electric, gas, telephone, and urban transit systems. During the 1920's economic growth was accompanied by the development of the auto and the radio industries. In the period after World War II there was a television, aircraft, air travel, electronics, and advanced technology. Now in the 1970's America's new frontiers are the major emphasis on public investment to strengthen the foundation of American society and provide the investment and employment bases for a new period of national economic expansion.

So in our view the immediate shortrun need to provide a substantial stimulus to the economy should be meshed together with these longrun needs, with an emphasis on increasing public investment.

Thank you.

(The prepared statement of Mr. Goldfinger, with attachment, follows:)

PREPARED STATEMENT OF NAT GOLDFINGER

The American economy is in urgent need of a substantial stimulus—to boost sales, production and employment.

Following the Administration's engineered recession of 1969–1970, most parts of the national economy are in a state of sluggishness and stagnation. These facts are abundantly clear, particularly to those who are its major victims—the 5 million unemployed and the millions of under-employed, the hundreds of thousands of returning GI's and other labor-force entrants who find the job markets weak.

There were 5 million unemployed in March, after accounting for seasonal changes—up 1.4 million from a year ago and 2.3 million from January 1969, when the Administration took office.

Substantial unemployment has spread to 52 major industrial areas in April —from 6 in January 1969—and to 687 smaller areas.

The buying power of the weekly after-tax earnings of the average nonsupervisory worker—over half the labor force—in the January–March quarter was hardly any greater than a year ago, less than in the early months of 1969 and even below 1965.

Although the Administration attempted to blame the high unemployment of the October–December quarter of 1970 on the effects of the auto strike, the rebound of auto production in the January–March quarter brought no improvement in the unemployment situation. About 5 million people were unemployed in both quarters; the number of jobless, 15 weeks and more, rose to 1.1 million in March; and the Labor Department's report for March declares that "full-time employment was down by 190,000 from the last quarter of 1970, mostly among adult men."

In March, four months after the end of the auto strike, industrial production was below last summer, before the auto strike started. It was even slightly less than in January, when General Motors was filling its inventory pipelines. And it was 5.4% below the peak reached in July 1969, 20 months before.

As a result, manufacturing employment, in March, was down 600,000 from last summer and 1.6 million below the peak reached a year and a half ago.

Employment in contract construction, in March, was 300,000 less than at the end of 1969, after accounting for seasonal changes.

Unemployment rates, in March, were up to 17.8% for tenagers, 10.9% for construction workers and 9.4% for Negroes.

And unemployment among young men 20 to 24 years old—including GIs returning from Vietnam—has shot up from 4.7% to 10% in the past two years.

Except for the rebound of auto production in January–March and the building of steel inventories, the only parts of the economy that have been moving up at a significant rate in recent months are home-building and state and local government activities. Other parts of the economy are increasing slowly, like consumer goods; or they are declining, like machinery and business equipment.

The much-heralded increase in the gross national product in the January–March quarter amounts to merely about one-half of one percent in real volume—or an annual rate of only about 2%—after discounting the rebound of auto production and the temporary accumulation of steel inventories.

The need for a substantial stimulus is hardly the issue, at all. The issue is the kind of stimulus—the specific type of stimulus that is required, now, and which meshes with the immediate and long-run needs of American society.

The need for a continuing monetary stimulus—to drive down interest rates, which are an inflationary cost factor and a deterrent to economic expansion—is especially clear, at this point when long-term interest rates, have turned up. But that is not the focus of this hearing. The issue before us is in the fiscal policy area.

In terms of the aggregate, the Administration's fiscal policy in 1971 is hardly any different from 1970.

In a recent speech, the Administration's former assistant director of the Budget Bureau, Dr. Maurice Mann, had this to say:

"It is an open question as to whether the federal budget for fiscal year 1972 is as expansive as has been suggested . . . the budget is in effect essentially neutral in fiscal year 1972 . . .

"We are now being treated to a double-barreled 'blackbox' approach—after fixing budget expenditures at full employment revenues, all we have to do is pour enough money supply in one end of the box and somehow—in some form —enough additional GNP comes out the other end."

In view of these conditions, the AFL-CIO recommended:

1. Immediate measures to create jobs through increased public investment outlays to help meet America's needs for improved and expanded public facilities and public services, to increase the federal minimum wage to at least $2 an hour, to extend unemployment insurance payments for at least an additional 13 weeks, with federal payment of the extended benefits, for those whose payment-periods have been exhausted and to provide a further rise of Social Security benefits.

2. Longer-run measures for federal government assumption of welfare payments, for the planned expansion of public investment and for a national health security system.

3. Renewed steps towards the achievement of justice in the federal tax structure—by closing loopholes of special tax privilege for wealthy families and corporations and reducing the relative tax burden of middle- and low-income taxpayers—as well as efforts to reduce the regressive nature of state and local tax structures.

Instead of measures along these lines, the Administration has proposed a $3 billion to nearly $5 billion annual tax bonanza to business—particularly to large corporations and unincorporated enterprises—in the form of accelerated depreciation write-offs. It is a wrong-headed move, which will have very little, if any, early effect in providing a much-needed stimulus to boost sales, production and employment.

Over the decade, $37 billion of business tax revenue would be wiped out—$37 billion that could be used for rebuilding the urban areas, mass transit, education, health-care and pollution controls.

Corporate taxes generally would be cut by about 7%. For some corporations, the tax reduction could go as high as 10% and many high-income unincorporated businesses would receive even greater windfalls.

This proposal is the wrong remedy for the present economic ills that have pushed the number of unemployed up to 5 million, or 6% of the labor force, and cut industry's operating rate down to about 73% of productive capacity. And, in the longer-run, it presents a serious danger of adding to the national economy's instability.

This depreciation ruling was announced in January, only weeks after the President vetoed a bill passed by both houses of Congress to provide federal funds for the creation of public-service jobs for the long-term unemployed and seriously underemployed; it came only weeks after the President vetoed Congressional appropriations for housing and urban development; and only weeks after he vetoed funds for education. On the heels of these actions to veto funds to create jobs for the unemployed and provide improved public facilities and services—and at a time, when the Administration has frozen billions of dollars of appropriated funds for expanded public facilities—it is incredible that the Administration could announce its decision to provide business with a tax bonanza, through the device of depreciation gimmickry.

And Administration spokesmen have launched trial balloons, threatening new consumer taxes, such as the so-called value-added tax, or new corporate tax giveaways such as the reinstatement of the investment tax credit.

In the first quarter of 1971, industry, according to the Federal Reserve Board, was operating at a rate of merely 73% of its productive capacity. This rate of capacity utilization was slightly lower than in 1958, the year of a deep recession; it was substantially below industry's operating rates in the recession years, 1954 and 1961.

As a result of the very low level of sales and production, in relation to industry's capacity to produce, the real volume of business outlays for plants, machines and equipment moved down in 1970 and in the first quarter of 1971, it was below the peak, reached in the final months of 1969.

The reasons for this situation are clear.

One major cause is the unsustainable capital goods boom of 1963–1969, which was encouraged and subsidized by the federal government's policies—witness the step-up of depreciation write-offs of 1962 and the 7% tax credit for investment in machines and equipment, adopted in that year. In almost every year of that period, business outlays for fixed investment shot up much faster than the gross national product or any other sector of the private economy. In the six years, 1963–1969, the real volume of such outlays soared almost 56%, close to 9% per year. This unsustainable capital goods boom generated inflationary pressures in the economy. It was inevitably building up for a leveling off or decline, since it was adding to the economy's productive capacity at a much faster pace than the demand for goods and services.

The other major cause of the present very low rate of capacity utilization has been the Administration's engineered recession of 1969–1970, followed thus far by stagnation and sluggishness in most parts of the economy. The inherent and inevitable build-up of troubles of the unsustainable capital goods boom was compounded by the Administration's decision to curb the rise of sales and production. The result has been a decline of industrial production, while new productive capacity was being added. The very low rate of capacity utilization, therefore, is largely the result of government policies, which created economic instability.

The weakness is insufficient sales and production—not insufficient plants, machines and equipment. The urgent need, at present, is for measures to lift sales, production and employment—not tax bonanzas for business.

The rational and economically sound way to obtain an increase in the real volume of business investment is to boost industry's operating rate from its present depressed state—through a substantial lift of sales and output. And, in the long-run, the major incentive for the sustained expansion of business investment is high levels of capacity utilization and an increasing volume of sales and production.

The clear relationship between industry's operating rate and the volume of demand for capital goods was recently indicated in a report in the Wall Street Journal. According to the April 26 issue of that newspaper, J. T. Bailey, president of Warner & Swasey Co., stated: "Historically, an operating rate of 80% is required to produce a good level of orders for machine tools." And a good level of orders for other types of capital goods may require an operating rate of 85% or more.

So the problem is not enough sales, not enough customers, not enough public investment, not enough consumer buying power and consumer confidence about the future of jobs and income.

In the short-run, therefore, the Treasury's proposal will be entirely—or almost entirely—a windfall to business and to major stockholders, with the probability that part of the tax bonanza will be exported for foreign subsidiary operations, with the loss of American jobs and displacement of U.S. production.

In the long-run, after the rate of capacity utilization improves, the Treasury's proposal poses the serious danger of another lopsided, inflationary capital goods boom, as in 1963–1969, followed by another recession. American economic history is full of such instability and the experience of the past eight years is merely the most recent. Moreover, if such trend develops again, the boom period will probably be much briefer and the recessionary decline may be deeper.

Our recent problems are in no small measure related to the high rate of capacity accumulation that took place during most of the years between 1963 and 1969–fed by misguided tax policies such as the investment credit, depreciation gimmickry and the failure to enact a corporate tax increase soon enough and high enough to stem the capital goods boom.

The American economy needs greater stability, balanced expansion, and full employment. If the Treasury does not rescind the proposed depreciation rules, the AFL-CIO urges the Congress to bar their enforcement.

In the short-run, therefore, the economy needs immediate measures to lift employment, consumer buying power and consumer confidence, through increased public investment outlays, which would create jobs and improve industry's operating rate—as well as the other measures indicated above.

In the long-run, America needs planned programs, with federal leadership and funds, to increase public investment to help meet the needs for improved and expanded public facilities, public services and the establishment of a national system of health security.

I am appending a report of the AFL-CIO Economic Policy Committee, which goes into the longer-run issues, in some detail.

Report of Economic Policy Committee to AFL–CIO Executive Council, Feb. 18, 1971

Public Investment to Meet America's Needs

America, in the 1970s, needs a long-range, national effort to greatly expand and improve public investments in facilities and services. Planned public programs, during the remainder of the 20th Century, are required to revitalize the nation's urban areas as centers of American civilization and to improve the quality of life of the American people. Such effort is essential to strengthen the basic foundation of American society by meeting the requirements of a growing and increasingly urban population, in the midst of rapid and radical changes in technology, urban growth and race relations.

For 40 years, the country has been undergoing vast social changes, with rapidly multiplying needs for every kind of public investment from sewer systems and waste treatment facilities to urban mass transit, education, health-care, public safety, libraries, roads and airports. Despite efforts to meet these growing needs in the past 25 years—and particularly during the latter 1960s—large backlogs of unmet needs have remained and some have expanded to monumental size. Putting fingers in the dike can no longer be depended on to prevent a potential flood.

From 1930 to the end of 1970, the population soared from 123 million people to over 206 million, a rise of about 70 percent. Moreover, the Great Migration of the American population, in these recent decades, resulted in a sharp decline of rural areas, while the growth of metropolitan areas boomed. Huge rural regions of the country—in the southern, central and Rocky Mountain states—saw their populations decline, and some of these areas, such as Appalachia, remain in depressed economic condition. At the same time population-growth skyrocketed in the metropolitan areas that stretch along the Atlantic and Pacific Coasts and the Great Lakes.

Under the impact of the technological revolution in agriculture, employment in farming dropped from 10.3 million, or 20 percent of the labor force, in 1930, to 3.5 million, or only about 4 percent of the labor force, in 1970. Hundreds of thousands of farmers, farm workers and their families—as well as scores of thousands of other inhabitants of small towns in agricultural parts of the country—left the rural areas in search of jobs and homes in the cities.

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The rural and small-town life that dominated much of American society as recently as 1930 is now largely gone. About 70 percent of the population lives in urban areas and this percentage is continuing to increase. Although the overall growth of the population has slowed down considerably in the past several years, after nearly two decades of very rapid expansion, migration to urban and, particularly, large metropolitan areas, has continued.

This social upheaval has been greatest among Negroes. From an overwhelmingly Southern rural population in 1930, Negroes have become overwhelmingly urban—as a result of the Great Migration out of the rural South to the cities, particularly the large cities of the North and West.

All of the new migrants to America's cities—whites and Negroes, Puerto Ricans and Mexican-Americans—have faced the difficulties of adjusting to a new and strange environment. The Negro migrants, in particular, have brought with them a history of 350 years of slavery, segregation, poverty, lack of education and, frequently, poor health, as well as suspicion of government authorities. The cities are now suffering, in part, from the social ills and delinquencies of the Southern rural areas.

On coming to the cities, the new migrants have faced the discriminatory practices of those areas, as well as a lack of low- and moderate-income housing and the impact of the technological revolution in industry on job opportunities for uneducated and unskilled urban workers. The types of industrial jobs that helped previous generations of foreign immigrants and rural Americans to adjust to urban life have not been expanding.

In addition, there has been another Great Migration in the past quarter of a century. Millions of middle- and upper-income families have been leaving the cities for the suburbs, the most rapidly growing sections of the country. This movement has opened up older housing in the inner-cities. But, combined with the additional migration of industry to the suburbs and countryside, it has reduced the tax-base of the cities, when the demands on their financial resources for low- and moderate-cost housing, welfare, education, police and fire protection, manpower training and other public facilities and services have been mounting. Increasingly, the inner-cities have become concentrations of decaying and poverty-stricken areas, with small pockets of wealthy families, while the needs for city facilities and services multiply and the tax-base narrows.

Moreover, the change of industrial location has compounded the problem of inadequate mass transportation facilities for lower-income city dwellers to get to the new areas of employment-growth. And most suburban communities have had color-barriers, as well as a continuing absence of low-cost housing.

The major burden of trying to solve these problems has fallen on the states and local governments, whose expenditures and taxes have shot up. But most of these governments have inadequate, as well as unfair, tax systems and they lack the necessary resources. So public investment needs multiplied faster than the states and local governments could provide, even with a helping hand from the federal government. As a result, many states and most cities face an immediate or potential financial crisis, while public facilities and services fail to meet the mounting needs of their inhabitants.

During the early 1930s and from 1941 to 1945, many public investment needs were neglected when the Depression and World War II caused shortages of money, manpower or materials. For a brief period of about eight years, from 1933 to 1941, the New Deal started vast federal efforts to modernize and strengthen the underpinnings of American society—including a social insurance system, public housing, a federal home mortgage system, rural electrification, flood control, TVA, Bonneville, conservation, irrigation, the development of parks and recreational areas. But during most of the years since the end of World War II, many of these federal public investment efforts were terminated or their expansion and improvement was slowed down by traditional, conservative opposition. Between 1952 and 1966, for example, the New Deal's beginnings to provide low-cost public housing nearly perished.

Federal efforts to help meet public needs lagged through most of the late 1950s and early 1960s. Finally, in 1964–1966, the long-delayed federal response came with an outburst of programs, involving grants-in-aid to the states and local governments, including the hard-pressed cities. Such federal grants-in-aid —for such programs as elementary and secondary school education, model cities and public safety—almost doubled, from $13 billion in the fiscal year ending June 30, 1966 to about $24 billion in fiscal year 1970. Nevertheless, actual appropriations and outlays for these programs fell increasingly behind the planned expansion of their authorized funding—from about 80 percent of authorizations in fiscal year 1966 down to only 65 percent in 1970.

An analysis by the staff of the Advisory Commission on Intergovernmental Relations, issued in June 1970, reports: "Dollar authorizations were established for these new and expanded programs three to five years in advance, in ever-increasing amounts . . .

"The fact remains, however, that the actual outlays represented a substantial scaling down of domestic program funding, when compared to the optimistic 'Great Society' program authorizations of the 1964–1966 period. As a consequence, the authorization-appropriation gap widened steadily, increasing from about 20 percent in fiscal 1966 to 35 percent in 1970. Had it been possible to retain even the 1966 gap margin, federal aid would approximate $30 billion by the end of fiscal 1970, rather than the $24 billion estimated for this year."

This increased gap of $6 billion of federal aid for specific programs by 1970 is greater than President Nixon's $5 billion of "general revenue sharing"—with no program purpose, no national priorities and no performance standards—for 1972, two years later.

The programs of 1964–1966, with their great promise, aroused expectations of overnight solutions to problems that had developed over many years. Moreover, the increasing gap between authorizations and appropriations held back even realistic achievement of their goals in aiding states and local governments to meet public investment needs. In addition, tight money, high interest rates and the recession of 1969–1970 resulted in smaller state and local tax receipts than expected, while their welfare burden, interest payments and other costs mounted.

So public needs and expectations multiplied, while increases in public investment outlays proved to be insufficient. The great growth of unmet public investment needs brought a deterioration in the quality of life of many Americans: the near-collapse of elementary and secondary school education in sections of the major cities; the increase of violent crime and lawbreaking; traffic jams in the cities and in the air above airports; the spread of poverty-stricken slum areas in the inner-cities; the increasing pollution of the water and air.

Moreover, during the past quarter of a century, the tax system, which provides the foundation for public investment outlays, moved further and further away from a structure based on ability-to-pay. Tax loopholes for the benefit of corporations and wealthy individuals riddled the federal tax system and the Tax Reform Act of 1969, on net balance, was merely one small step forward. State and local government tax structures became increasingly regressive—with their emphasis on sales and property taxes, which are an inequitable and heavy burden on low- and middle-income families; and inequitable assessments make property taxes even more unfair. In addition, the tight-money and high-interest rate policies of 1969–1970 resulted in postponing many public-investment programs and greatly increasing the costs and debt-burdens of those that were pursued.

Unfortunately, there are no instant solutions to such complex of pressing problems. But rapid forward strides are essential.

Some public-type investments are usually provided by regulated public utilities—such as electric, gas and telephone—usually privately owned. And some are provided by private nonprofit institutions, such as many hospitals. But for the overwhelming majority of public facilities and services, the American people depend on government—state, local and federal governments.

The federal government, representing all of the American people, holds the key to workable solutions to most of the public investment needs of American society, since they usually involve nationwide social issues that cut across the boundary lines of the states, cities, counties and school districts. Moreover, with all of its defects, the federal tax system is much more productive and equitable than state and local tax structures. In addition, only the federal government can establish national priorities, goals and nationwide performance standards.

No state or local government can solve the nation's vast public investment needs in isolation. Neither can private enterprise, even with the promise of tax subsidies. The basis for meeting these needs requires national policies and nationwide measures, with adequate federal funds and standards—and the cooperation and backing of the states, local governments, business firms and private groups.

A long-range, planned national effort to meet the needs of the American people for public facilities and services can also provide the basis for economic growth in the period ahead. Each era of economic expansion in America has been accompanied by growing investments and employment in new industries. The last-third of the 19th century saw the building of the railroads, the agricultural implement, steel and oil industries. In the first two decades of the 20th century, there were the public utilities—the electric, gas, telephone and urban transit systems. During the 1920s, economic growth was accompanied by the development of the auto and radio industries and, in the period after World War II, there were television, aircraft, air travel, electronics and advanced technology. Now, in the 1970s, America's new frontiers are in a major emphasis on public investment to strengthen the foundation of American society and provide the investment- and employment-basis for a new period of national economic expansion.

The following steps are essential to America:

1. The first prerequisite is the full funding by the federal government of present public-investment programs—plus a temporary acceleration of funds for short-term projects, to lift sales, production and employment in this period of economic stagnation.

Such immediate step-up in the appropriation of federal grants to state and local governments and federal agencies for the expansion and improvement of public facilities and services could be the key to reconversion—to offset the declining military defense proportion of total national production. It would provide opportunities to employ the talents and skills of unemployed scientists, engineers and technicians, as well as job opportunities for returning GI's, production, maintenance, construction and other categories of unemployed workers.

2. To sustain the planned expansion of public investment, the federal government should develop, coordinate and maintain a national inventory of public investment needs, based on estimated future population growth and present backlogs—in each major category, such as low- and moderate-cost housing, schools, health-care facilities, day-care centers, parks, pollution controls, other community facilities and public services. Each state and metropolitan area should be encouraged, with the assistance of federal planning grants and technical aid, to develop a similar inventory of needs within its geographical jurisdiction. Such comprehensive inventory of needs should provide the foundation for planned nationwide programs in each category—based on adequate federal financial and technical assistance to the states and local governments, including federal grants-in-aid and guaranteed loans, as well as direct federal efforts.

Target dates should be established for achieving specified objectives in each category—along the lines of the 10-year national housing goal, established by the Congress, under the Housing and Urban Development Act of 1968—and the pace of continuing advance should be speeded up or slowed down, with sufficient funds, depending on the availability of manpower and productive capacity. In this way, the inventory would also be a shelf of public works, with an accelerated pace in times of general economic recession and a slower advance in periods of shortages of materials and manpower.

To facilitate such programs, a federal urban bank or similar mechanism may be required to provide long-term, low-interest loans for the construction of moderate- and low-income housing and community facilities, as well as for aiding state and local governments in financial crisis.

3. An Office of Public Investment Coordination should be established in the Executive Branch of the federal government to encourage, assist and coordinate public investment planning and execution by state and local governments and federal agencies.

4. Congress should direct the Federal Reserve System to allocate a significant portion of available bank credit, at reasonable interest rates, to effectuate the construction of housing and community facilities.

5. A land-use policy is needed to provide the basis for the rational development of urban areas, new towns, parks and recreational facilities—and to curb

land speculation, which has substantially increased the costs of housing and community facilities. Idle or under-utilized federal land should be examined for such possible use as sites for housing, parks, recreation areas, wild-life and nature preserves.

6. We urge the Administration to develop a capital budget, as an integral part of the annual federal budget, to assist the federal government in planning, financing and executing public investment programs. Such business-like budget for the federal government would establish a federal investment account, including outlays for the creation, improvement or acquisition of assets or the acquisition of recoverable claims—separate from the account for general housekeeping expenses and national security. Such budget methods are almost universally used by modern business firms, most western democracies, at least one-third of the states and most large American cities.

7. Proposals to dismantle the system of federal grants-in-aid to the states and local governments—as well as proposals to supplant the expansion of such programs with no-strings federal funds that lack program purposes, national priorities and standards—should be rejected. However, administrative simplification of the large number of federal grants requires the consolidation of many overlapping grants, without undermining their purposes, goals and standards.

8. Justice in the federal tax structure—and additional revenue—should be achieved by eliminating the loopholes of special tax privileges for corporations and wealthy families. Congress should also prohibit the implementation of the Treasury Department's tax bonanza to business, in the form of accelerated depreciation, which will amount to annual revenue losses of $2.7 to $4.1 billion in the next several years. Efforts to move the federal tax structure further away from the principle of ability-to-pay—such as the proposal for a national sales tax under the name of a value-added tax—should be rejected.

9. Federal efforts are needed to assume the costs of welfare payments and lift this burden from the backs of state and local governments. The federal government should also encourage and assist states and local governments in developing more productive and equitable tax structures. Such measures would provide state and local governments with additional funds to meet their responsibilities.

10. The provision of health-care for the American people should be greatly improved by the establishment of a national health security system, as well as the expansion of health-care facilities and services.

Chairman GRIFFITHS. Thank you, Mr. Goldfinger.

Mr. Madden.

STATEMENT OF CARL H. MADDEN, CHIEF ECONOMIST, CHAMBER OF COMMERCE OF THE UNITED STATES

Mr. MADDEN. It is a privilege to appear before this distinguished committee as it deliberates on the economic implications of alternate tax and spending policies, 1971–76.

I would like to request permission, Madam Chairman, to file my prepared statement for the record and summarize it.

Chairman GRIFFITHS. Thank you very much. It will appear in the record at the end of your oral statement.

Mr. MADDEN. In considering the need for various taxing, spending, and other proposals, aimed to provide added fiscal stimulus for getting the economy—

> To progress as rapidly as feasible toward full employment without at the same time aggravating the inflation problem—

the committee is wisely concerned about the longer term effects of enacting any one or several such proposals on inflation, employment, the balance between consumption and investment, the balance of payments and other structural features of the economy. As the committee points out, these measures include change in depreciation regulations for business; renewal of the investment tax credit; acceleration to this year of the individual income tax reductions provided for 1972–73 under the Tax Reform Act of 1969; an additional $2 billion public works program; a $1 to $2 billion public service jobs program for the unemployed; the unfreezing of $12 billion in appropriations; and measures outside the realm of fiscal policy such as an increase in the minimum wage as well as various wage-price proposals.

In addressing these complex issues, it is convenient to examine briefly the structural characteristics of the economy as it moves along the short-term path and then to turn to longer run implications of various policy alternatives. Since the short- and long-term economic developments are necessarily related, the longer term implications of short-term policies should be carefully weighed.

The fundamental short-term issue concerning the need for fiscal stimulus is the prospect for the strengthening of consumer spending. The economy is now recovering from the 1969–70 slowdown. True, only about $9 billion of the $28.5 billion output gain in the first quarter was due to non-auto activity, a small part was due to strike-anticipatory buildup of steel inventory, and a slight amount was due to the $2 billion Federal pay increase. Even so, the first quarter output gain reflected a solid advance in residential construction and in spending by State and local governmental units. Also the marked rise in consumer spending for durable goods—at an annual rate of $10.8 billion—does indicate some recovery in consumer spending.

The consumer, however, is the key to a satisfactory recovery this year and the next. The severe erosion of consumer confidence from early 1969 through all of 1970 came partly from economic development such as inflation, increasing unemployment, and the sharp decline in stock prices in the first half of 1970. The 26-point drop during this period of the University of Michigan's index of consumer confidence was also a result of what Mr. George Katona, director of the survey, describes as "the social issues," of Vietnam, rising crime and drug use, student unrest, and social unreast. As a result, despite a continued strong flow of personal disposable income, the consumer has held back on his purchases of durables and has saved at an abnormally high rate.

The latest Michigan survey indicates that consumer confidence is strengthening. March and early April figures on sales of autobiles show a sizable increase over last year's corresponding period. There seems also to be pronounced pickup in sales of durable consumer goods in recent reports of big chain stores. The recent movement of stock prices reflects growing investor confidence. And a recent Chamber of Commerce survey of businessmen indicates, as does the latest McGraw-Hill survey of plant and equipment spending intentions, that business confidence is rising. Significant improvements since last summer in the behavior of various price indexes, including interest rates, and in first quarter reports of business profits add to the improving aura of confidence in the economic recovery.

Underlying the incipient recovery of confidence in the economy is a markedly changed climate of public policy. During the past year there has been a powerful shift in monetary and fiscal policy towards encouraging renewed business expansion. During the past 4 months, the money supply of the country—demand deposits plus currency—has been expanding at an 8.7 percent annual rate and was expanding at a 6 percent annual rate in the preceding 9 months. The money supply plus time deposits, which is even more significant to the potential for expansion of bank lending and investing, increased at an 18 percent annual rate in the past 4 months and at a 15 percent rate in the preceding 9 months.

So the big question for monetary policy when viewed structurally is not whether it has been sufficiently stimulative. The economy, as Chairman Arthur F. Burns of the Board of Governors of the Federal Reserve System recently said, is "awash with money." The big question is whether the authorities may not already have overdone the policy shift by laying a monetary base for a resurgence of demand-pull inflation when the economy really gets rolling again.

The Federal budget has also become increasingly expansionary in its effect on the economy. On a national income and product accounts basis, the Federal budget has shifted dramatically from a surplus at an annual rate of $6.1 billion in the fourth quarter of 1969 to a deficit of $17.6 billion in the fourth quarter of 1970. It is expected that the deficit will average somewhere around $15 billion in the first half of calendar 1971. What is more, the President's budget for fiscal 1972 is designed to be strongly expansionary. If anything, the fiscal 1972 budget is likely to show a full employment deficit because of actions already taken by the Congress in raising social security benefits more than the President's budget provided, in postponing the recommended increase in social security taxes, and in other ways.

Business economists foresee a steady recovery in 1971 which I believe will accelerate in the latter part of the year as consumer confidence strengthens further and as business capital spending in manufacturing industries should be added to present expansion of capital spending in public utilities. There are good reasons for expecting a solid advance in consumer spending this year. Despite today's level of unemployment and reduced overtime, total disposable personal income keeps increasing at a fairly good rate (7.2 percnt from the fourth quarter of 1969 to the fourth quarter of 1970). The cautious consumer, who saved at an historically high 7.3 percent last year reduced savings to a 7.2 percent rate in this year's first quarter as evidenced by improved retail sales nationwide. As consumer confidence strengths, it is consistent with logic and past experience to expect a decline in the savings rate. If the savings rate drops from last year's 7.3 percent to 6.5 percent, total consumer outlays would rise somewhere around $6 to $7 billion. Liquid asset holdings of the public have increased more than $74 billion since January 1970, and total consumer credit outstanding since January 1970 has risen only $4 billion. This means that the consumer is in a strong position to reduce liquidity somewhat and to add to consumer debt. And, in turn, if consumer confidence improves, the evidence of consumer income, savings, liquid assets, and indebtedness gives good reasons for expecting a significant gain in cosumer spending this year.

The latest Commerce-SEC ad McGraw-Hill surveys show that business capital spending, expected to rise by only 4 percent in curent dollars, will not be a significant stimulus to the economy for the year as a whole. A sizable rise in spending by public utilities of 17.5 percent is offset by declines in capital spending by manufacturers, and the 4 percent money increase of the total means that there will be a small decline in real terms, when price increases are taken into account. Business capital spending tends to lag behind the fluctuation of total output. It is consistent with logic and experience to expect that towards year-end with sales rising and profits improved, capital spending in industries besides utilities will begin to pick up.

The most worrisome aspect of the prospective recovery is the danger of persisting "stickiness" of both inflation and unemployment which could put in jeopardy for the rest of this decade the stable economic growth which is the nation's goal. Now that there are clear signs of both a weakening of inflation and a pickup of business, it would seem to be ill-advised of the Government at this juncture to try to accelerate the expansion through even greater monetary or fiscal ease. To do so would threaten to renew demand-pull inflation.

There is no doubt that the major source of inflation pressure now comes from the cost side, and that if monetary growth were to continue at recent rates, the wage cost push would be validated by price rises in the zone of full employment. Cost push inflation is plainly evident in the data. During the four quarters ending December 1970, the average increase in wages and employee benefits in newly negotiated contracts covering 5,000 or more workers was 9.1 percent per year over the life of the contract, most of which are for 3-year terms. This compared with increases of 8.2 percent in 1969 and 6.5 percent in 1968. During 1970 the first year increases in these contracts amounted to 13.2 percent on the average. The situation is at its worst in construction where, for 1970, new settlements resulted in first year increases whose arithmetic average was 18.3 percent in wages and employee benefits, while over the life of the contract the rise amounted to 14.7 percent. It is no wonder, in view of such settlements, that unit labor costs in the year ending last February rose at 5.3 percent a year.

The recent policy of the Federal Reserve and Treasury to induce a rise in the Treasury bill and other short-term market rates, designed mainly to reduce the outflow of liquid funds from the United States to foreign money centers, may be beneficial in slowing down the rate of growth in the money supply. As short term interest rates fell sharply during 1970 and remained low during the first quarter of this year, there was a powerful incentive for liquid funds to flow abroad where short-term rates were much higher. This outflow added to the difficulties of the U.S. balance of payments. The payments deficit on an "official settlements basis"—measuring the increase in holdings of dollars mainly by foreign central banks—rose to a huge $9.8 billion in 1970. This magnitude compares with the total U.S. gold stock at present of $11 billion. By the fourth quarter of 1970 the deficit rose to an annual rate of $13.3 billion and may have gone even higher in the first quarter of 1971, to an $18 billion level at an annual rate. Measures reminiscent of Operation Twist in the 1960's are at best cosmetic devices for calming short-term market movements unless they also reflect some basic readjustment to a long-term goal of steady monetary growth consistent with national price, output, and employment goals.

The economic recovery now under way, marked by early evidence of rising consumer, investor, and business confidence, by a shift downward since last fall in the trend of price increases, and by a strong resurgence of housing, is taking place in a social and economic climate of change. At home, concern over the environment poses a challenge to the nation's economic goals and involves shifts in the mix of output and the pattern of consumption. Dramtic shifts in population lie ahead, bringing important changes in the pattern of American life. Abroad, the United States faces a new era of heightened competition with trading partners which have adopted modern management, marketing, and technological advances but whose wage rates are lower than ours. These new realities have an important bearing on the economic implications of various tax and spending proposals.

The argument of environmentalists, that the pursuit of goals of maximum employment and purchasing power have distorted the composition and pattern of U.S. economic output, gains support in indications by the Environmental Protection Agency that major United States cities cannot meet national air pollution standards to take effect by mid-1975 if the private automobile remains the major means of transportation. To respond to the point made in the Report of the President's National Goals Research Staff, "Toward Balanced Growth: Quantity with Quality," that attaining national economic goals may mean minimizing (rather than maximizing) the throughput of materials in the production process, will involve substantial shifts in the U.S. industrial structure. Environmentalists argue that the postwar pursuit of conventional economic goals of maximum employment and purchasing power had led to wasteful growth sought mainly to create jobs, has depleted matetrial resources at unsustainable rates, has generated environmental pollution threatening to the public health, and has created social costs and disamenities in "gross national byproducts" which reduce rather than increase human welfare.

Yet, in the next decade the dramatic shifts in U.S. population will see the number of people in their twenties and thirties grow by 18 million—up 34 percent, while people in other age groups will grow by 9 million—just 6 percent. These young adults, marrying and raising families, are expected to demand, through spending and borrowing freely, apartments, houses, transportation services, cars, clothing, and recreation. Jobs in rising numbers to employ their highly educated talents will require heavy investment by business if the promise of this affluent young population is to be realized.

Abroad, the United States is entering a new area. Since World War II we have seen the period of reconstruction, when the United States and its undamaged economy could dominate world trade and investment. Beginning in the middle 1950's there followed a period of heavy U.S. investment abroad as free world industrial nations expanded from their newly created post-World War II industrial base. With the advent of the Vietnamese war, which diverted the energies and attention of the United States, there began a new era which the ending of the Vietnam war will bring sharply into focus. This is an era of increased, peaceful competition in free world trade and investment for a growing number of industrial countries marked by modern management, marketing and technology. The next 5 years is likely to see the further rise of Japan as an industrial power and rapid development of the European Common Market. It will be a period when negotiations in trade and investment will set the pattern for peaceful cooperation in an open world of enhanced freedom and quality of life or when, because of disunity of understanding and purpose, the free world will risk the dangers of a new isolationist trend. It will be an era when gains in the U.S. payments balance must be earned by superior U.S. technology strong enough to offset growing imports based on price rather than income sensitivity.

The climate of change, then, refers to change in economic goals, the pattern of output and consumption, the composition of the population and its degree of education, the conditions of foreign trade and investment, and the political and economic policies needed to achieve balanced, high level growth. Leading economists at home and abroad are concerned about continued inflation which they anticipate may average from 3 to 3.5 percent during the first half of the decade of the 1970's unless major industrial countries can achieve better control of Government spending and the demands of trade unions.

Turning to the relation of demands and resources, a Brooking Institution study, according to the press on May 2 (the Washington Post, May 2, 1971, p. A1), supports the earlier analysis of the President's Council of Economic Advisers that: "If Americans continue to demand more and better services of their government, they probably will have to pay for them in higher tax rates." The Brookings study finds that the "fiscal dividend"—the normal growth of Federal revenues available for discretionary spending—will amount to only $17 billion in fiscal 1976, or just 1 percent of the gross national product. Earlier, in January of this year, the President's Council of Economic Advisers calculated that only 1 percent to 2 percent of the potential output in 1975–76 would be left unallocated for specific uses. The Council pointed out (Economic Report of the President, 1970, p. 97): "Adding $3 billion each year to the cost of existing programs, in 1969 dollars, would exhaust the unallocated economic resources that now appear for 1975–76." The Council's estimates were based on the total output that would be available in 1975–76 if, among other assumptions, the capacity of the economy were fully utilized, the trend rate of increase in productivity—output per labor-hour—in the private economy were 3 percent, hours worked declined 0.2 percent per year, and the labor force increased 1.8 percent per year, yielding a potential GNP growth rate of about 4.3 percent a year.

Since the mid-1950's, public outlays have been increasing as a share of the total economy. Says the Council:

> They have risen from an amount equal to 23.2 percent of GNP in 1955 to 29.6 percent in 1969.

And since the 1950's, the council suggests, the Nation—

> has been increasing steadily the share of its economic resources devoted to education and manpower training, health, general government, and business investment by reducing the share of its resources devoted to national defense, residential construction, and basic necessities.

Federal budget decisions influence many of the demand components of the GNP, and as the Council says, "This influence will be quite pervasive in the next 5 years." The magnitude of demands on our resources is very great according to projections of existing tax and expenditure programs. Since the potential output left over after visible claims are met is small, either tax rates must be raised or some existing claims will have to be cut. And if a significant change in the composition of the output is desired, difficult explicit decisions must be made.

"One alternative," says the Council, "to making hard choices is inflation, since inflation is a process by which competitive claims on output are finally arbitrated. But this is a capricious way to resolve these conflicting demands." Currently, the threat of cost-push inflation in the goods-producing industries makes for particular difficulty in restoring employment to desired levels. Today's unemployment is concentrated in the goods-producing industries that are faced with sluggish demand, especially for consumer durables aside from housing, but inflation is concentrated in labor-intensive service industries, such as construction, transportation, communication, health care, education, and government, where demand has been rising steadily and labor shortages—natural or artificial—have brought sharp wage-cost increases.

The problem of inflation stems not only from the demand for more government spending but from the growing militance of labor union members. Today's union members are younger. They have lived through an inflation when rising prices and taxes have eaten away most of their gains in money wages since 1965. Their increased militance is seen in the rise in grievance activity, increased refusals to ratify leader-negotiated contracts, increased union instability due to a growing generation gap between leaders and members, and more complex bargaining issues with benefits harder to understand. Therefore, it becomes harder to get integrated settlements, and collective bargaining becomes less responsive to adverse circumstances, as employees gain in ability to withstand strikes because of growing welfare-type benefits, more working wives, and easy credit. Finally, the prospect for inflation is increased by the trend downward of political tolerance of unemployment.

Therefore, even though the climate for business looks highly favorable for 1971–76, the climate of change and the threat of inflation and unemployment could jeopardize the prospect for a significant shift in output and employment patterns, in response to the demands of environmentalists and the young marrieds, that would occur in conditions of stable economic growth at high employment. It is from this background that the alternative measures before this committee should be examined.

The next 5 years will be critical in the Nation's history because more and more people are "fed up with government" as it is now organized, at Federal, State and local levels. The implacable rise in taxes which, when combined with price rises, leaves the typical U.S. family now earning $11,000 per year hardly better off than during the 1960's has created impatience with government promises. Shall we now further increase the role of government? Or shall we return the flow of power and money to U.S. families, allowing them to make more of their own decisions? Of two broad political strategies, one requires direct government action through programs of income redistribution, public works, and other direct expenditure programs, while the other calls for tax actions to return to ordinary families a greater role for the individual in the national decision-making process.

Programs of tax relief proved successful in the midfifties and midsixties in inducing growth and reducing unemployment. Expenditure programs that have been problem oriented, such as the war on poverty, welfare, compensatory education, and the like, have been unproductive and unsuccessful in reaching their goals. Their difficulty stemmed not from a lack of funding but from a lack of ability on the part of the large governmental organizations to effectively deal with problems related to individuals.

A number of tax proposals have been put forth recently to promote economic growth.

If we wish to stimulate the adjustment of the private sector to environmental demands and standards and to promote desired economic growth, the depreciation allowances that are currently part of the tax system in the United States must be revised. They must at least be brought into line with other Free World industrial nations if we are to compete effectively in world markets.

A capital cost recovery system can be the basic means of inducing a turnover of technology. Since we are living through the world's greatest historic revolution in science and technology, and since the rate of transfer from innovation to competition is shortening from something like a decade to something under half a decade, the capital cost recovery system of a nation is crucial to its ability to adapt to new conditions and to achieve the turnover of technology that is essentially for maintaining technological parity with world competitors.

The U.S. faces profound adjustments to achieve strategies for maintaining its economy in a state of ecological balance. These strategies include: (1) Changes in our present production and consumption patterns; (2) treatment of wastes; (3) more skillful reliance on the natural processes of the environments; and (4) further protective measures to reduce the impact upon waste receivers. Because in any closed energy system entropy—roughly a measure of disorder—increases, to maintain the environment in a steady state requires controlled cycling of materials in the production process, decreasing disorderly flows, developing better environmental checks and balances in our energy systems, increasing the diversification of means to satisfy wants, and new methods for achieving stability of production processes in relation to throughput of materials.

Up to now, wealth has been considered as represented by physical stocks yielding future income streams discounted to present value without regard to environmental constraints. These constraints, however, and their consideration, markedly increase the relative value of future forms of economic activity which are entropy—offsetting, which up to now have been largely ignored, and markedly devalue forms of wealth which are highly entropy generating. They increase the value to the society of additions to its productive capital which conform to entropy-offsetting technology.

With 6 percent of the world's population and 7 percent of its land area, the United States consumes 40 percent of the world's annually available world resources. It is, therefore, of great import to the world as well as to the United States to shift capital and technology rapidly to entropy-offsetting investment. This means, to illustrate, fewer million-ton transoceanic, ocean-floor cables and more 7-pound satellites as a means to communicate with other continents. It means fewer college classrooms occupied by dull lecturers and more nationwide TV universities with the Nation's best talents devoted to producing and teaching mass audiences. It means intensified industrial research and development to produce nuclear breeder reactors and controlled fusion reactors and more conservation, through changed consumption, of vital fossil fuel energy sources such as oil and natural gas. It means relatively less transfer, storage, and retrieval of information by paper products and more by electronic tape and microfilm. It means the expansion of communication—which cheaply and with less pollution moves information—rather than the transportation of human bodies for informational purposes. And so on through a list that stretches the imagination.

A capital cost recovery system should be adopted in the United States that meets the requirements of the revolution in science and technology. The U.S. system of depreciation is now considerably less conducive to investment than that of all other major industrial nations that depend on private capital as a source of production. For example, in the United States, an investor in industrial machinery would recover 7.7 percent of his investment in the first taxable year; in Japan an investor would recover almost five times that percentage, or 34.5 percent; in the United Kingdom an investor would recover almost eight time the U.S. rate or 57.8 percent.

Early capital cost recovery is vital because the sooner cash is freed, the sooner it can be reinvested and the sooner American industry can have the most modern plant and equipment available, thereby lowering costs, raising productivity, and permitting American workers real rather than inflationary wage increases.

What is the cost to the Treasury of the new depreciation regulations? One estimate is that the revision would lead to a deferral or between 2 and 3 billion of business tax liability for each of the next 5 years. However, the long term cost to the consumer and taxpayer must be considered zero, since one piece of equipment may only be depreciated one time and the producer's long term tax liability does not change. The new depreciation regulations will affect short term liability which will be lower in year 1 as opposed to year 10 but will result in the same long term liability for a given depreciable property.

The short term decline in income tax revenues from a change in depreciation regulations will be more than offset by the extra income that would be generated by these revisions. During the years following depreciation changes in 1962, private investment and corporate income tax liability increased significantly. There is every reason to believe that this will occur again since capital investment, as mentioned earlier, is now sluggish and there is a backlog of demand for investments to shift the industrial structure to meet environmental and population demands.

The alternative to creating an atmosphere more conducive to business expansion and development is to continue along the path we are currently following. But capital is international; it flows to where yields, considering risk, are best. If the U.S. Government continues to give the business community the lowest yields in the world, incentives are created for U.S. investors to pick up their chips and go to a game where the odds are better. In fact U.S. industry has been expanding its investment in foreign nations at a much faster rate than in the United States. In the past 5 years plant and equipment expenditures of foreign affiliated companies of American corporations have increased from $8.6 billion in 1966 to a projected level of $15.3 bilion in 1971, an increase of over 80 percent, while domestic plant and equipment expenditures are expected to expand by only 30 percent for this same period. Foreign expenditures by U.S. affiliates for new plant and equipment increased from 13.6 percent of domestic outlays in 1966 to 18.4 percent in 1971 in spite of controls on foreign investment that have been in effect for the past 3 years.

The American consumer is also a player in this game, and he is increasingly deciding that he gets a better deal on foreign than domestic goods. He buys almost 15 percent of his cars, 30 percent of his TV sets, and 75 percent of his radios from foreign producers. The American Government also plays this game, purchasing 90 percent of the generating equipment installed by TVA in the past 5 years from foreign manufacturers.

American workers are the highest paid in the world. The only way we can maintain the wage advantage of U.S. workers is for American industry to remain the most modern in the world. The productivity of U.S. workers rests most importantly not on their working harder and harder or even on the improved education of production workers as such, but on improved management and marketing methods, improved materials and production methods, and on advancing technology. We cannot handicap our workers with obsolete plant and equipment and expect them to compete effectively in world markets. Neither can we continue to imply that we can pay for imports with gold. Our gold stocks are now only one-third of what they were immediately following World War II, and other nations now have the power to completely exhaust our supply of gold in 24 hours. This would place the United States in the position of being an insolvent financial power in much the same way Penn Central found itself with billions in assets but not enough money to meet its everyday cash requirements.

There is an immediate demand for industry to curb industrial pollution. This can be done. In most cases the technology is available. However, the cost will be high. Some plants will have to be closed down. New, more modern plants will have to be opened. There will be a need for more new investment dollars than would otherwise have been the case. U.S. industry is willing to make the investment. Provisions of the Clean Air Act of 1967 and standards set by the Federal Water Quality Control Administration will result in the need for $8 billion in pollution control expenditures by industry in the next 5 years. While these outlays will add to our quality of life, they represent expenditures that will increase industry's investment without any related increase in productivity as now measured. Air and pollution control expenditures are necessary if we are to survive. But if we expect our industry to compete with goods from other nations that do not have these controls, something will have to be done to equalize these costs between foreign and domestic goods. True enough, some of the costs may result in longer term economies and lower future costs as new processes are developd for recycling waste materials that may not only contribute to a reduction in pollution but that will also conserve our natural resources. But initially, investment costs of industry will rise. It is therefore necessary to provide a proper tax climate to induce investment and reinvestment in the United States and not in foreign nations.

Unlike the proposed depreciation regulations that result in no long-term revenue loss per depreciable item, the investment tax credit as enacted during the early sixties did result in a net reduction in business tax liability. The effect of a tax credit over the next 5 years would be a reduction in income taxes paid by about $3.5 to $4.5 billion annually. By now, the history of the on-again, off-again investment tax credit makes clear that it is viewed as a temporary stimulus by governments. The result of any temporary tax credit would be an undesirable zigzag expansion on the part of business. Moreover, the induced speedup of investments could lead to uneconomic results as businesses tried to take advantage of a temporary measure.

The cost in lost revenues of the 7 percent tax credit would be considerably more in the short run than the proposed revisions in the depreciation regulations. The tax credit may result in as much as $1 billion greater loss of revenue for each of the 5 years compared to the proposed depreciation regulations. And, ignoring the comparable investment-stimulative effects in the short run, a dollar in tax credits results in a dolar of tax loss forever, while the depreciation regulations merely defer tax liability. It is also doubtful whether the investment tax credit would stimulate more investment than would a revised asset depreciation schedule which placed U.S. producers not at an advantage but merely on a par with other nations.

The Tax Reform Act speedup would result in a $3 billion decline in Federal revenues for 1972 and an infusion of new funds into the hands of consumers. In the past 18 months we have gone through a series of three tax cuts that have affected the same people who would benefit from a speedup of the Tax Reform Act; yet, such tax cuts have not served to spur the economy sufficiently to avoid the present economic downturn.

What is needed more than another tax cut for consumers is improved consumer confidence. Economic developments suggest such improvement is underway, as mentioned earlier. An improved social climate would contribute further. However, as explained, personal savings at this juncture are at a higher level than they have been in recent years and there is no reason to increase the rate of personal savings at this time.

There are those who prefer programs of direct Government intervention and expenditure which are generally more expensive to the taxpayer and place Government in the undesirable rôle of having greater power and force of direction in the economy.

One direct action proposal that has received much attention is the negative income tax or guaranteed annual income approach. This proposal must be looked at in a number of ways.

What income level should we guarantee? There is no necessary logic to the most popular dollar figure presently quoted, $2,400 per year, since it is substantially below the present poverty level, almost $4,000. It, therefore, seems justified to assume that once enacted, the goal will be guarantees at no less than the poverty level. The results of the guarantee of poverty-level income is a work disincentive for both the working and nonworking poor. The magnitude of the work disincentive has not been sufficiently considered.

Chairman GRIFFITHS. Mr. Madden, may I ask that you just extend your remarks in the record and let us ask you some questions.

(The prepared statement of Mr. Madden follows:)

PREPARED STATEMENT OF CARL H. MADDEN

I am Carl H. Madden, Chief Economist, Chamber of Commerce of the United States.

It is a privilege to appear before this distinguished committee as it deliberates on the "Economic Implications of Alternative Tax and Spending Policies: 1971–1976."

In considering the need for various taxing, spending, and other proposals, aimed to provide added fiscal stimulus for getting the economy "to progress as rapidly as feasible toward full employment without at the same time aggravating the inflation problem," the Committee is wisely concered about the longer term effects of enacting any one or several such proposals on inflation, employment, the balance between consumption and investment, the balance of payments and other structural features of the economy. As the Committee points out, these measures include changes in depreciation regulations for business; renewal of the investment tax credit; acceleration to this year of the individual income tax reductions provided for 1972–73 under the Tax Reform Act of 1969; an additional, two-billion-dollar public works program; a one-to-two-billion dollar public service jobs program for the unemployed; the unfreezing of $12 billion in appropriations; and measures outside the realm of fiscal policy such as an increase in the minimum wage as well as various wage-price proposals.

In addressing these complex issues, it is convenient to examine briefly the structural characteristics of the economy as it moves along the short term path and then to turn to longer run implications of various policy alternatives. Since the short-term and long-term economic developments are necessarily related, the longer-term implications of short-term policies should be carefully weighed.

STRUCTURAL ASPECTS OF THE RECOVERY

The fundamental short term issue concerning the need for fiscal stimulus is the prospect for the strengthening of consumer spending. The economy is now recovering from the 1969–70 slowdown. True, only about $9 billion of the $28.5 billion output gain in the first quarter was due to non-auto activity, a small part was due to strike-anticipatory buildup of steel inventory, and slight amount was due to the $2.0 billion Federal pay increase. Even so, the first quarter output gain reflected a solid advance in residential construction and in spending by state and local governmental units. Also, the marked rise in consumer spending for durable goods (at an annual rate of $10.8 billion) does indicate some recovery in consumer spending.

The consumer, however, is the key to a satisfactory recovery this year and the next. The severe erosion of consumer confidence from early 1969 through all of 1970 came partly from economic developments such as inflation, increasing unemployment, and the sharp decline in stock prices in the first half of 1970. The 26 point drop during this period of the University of Michigan's index of consumer confidence was also a result of what Dr. George Katona, director of the survey, describes as "the social issue," of Vietnam, rising crime and drug use, student unrest, and social unrest. As a result, despite a continued strong flow of personal disposable income, the consumer has held back on his purchases of durables and has saved at an abnormally high rate.

The latest Michigan survey indicates that consumer confidence is strengthening. March and early April figures on sales of automobiles show a sizable increase over last year's corresponding period. There seems also to be a pronounced pickup in sales of durable consumer goods in recent reports of big chain stores. The recent movement of stock prices reflects growing investor confidence. And a recent Chamber of Commerce survey of businessmen indicates, as does the latest McGraw-Hill survey of plant and equipment spending intentions, that business confidence is rising. Significant improvements since last summer in the behavior of various price indexes, including interest rates, and in first quarter reports of business profits add to the improving aura of confidence in the economic recovery.

Underlying the incipient recovery of confidence in the economy is a markedly changed climate of public policy. During the past year there has been a powerful shift in monetary and fiscal policy towards encouraging renewed business expansion. During the past four months, the money supply of the country (demand deposits plus currency) has been expanding at an 8.7 per cent annual rate and was expanding at a 6 per cent annual rate in the preceding nine months. The money supply plus time deposits, which is even more significant to the potential for expansion of bank lending and investing, increased at an 18 per cent annual rate in the past four months and at a 15 per cent rate in the preceding nine months.

So the big question for monetary policy when viewed structurally is not whether it has been sufficiently stimulative. The economy, as Chairman Arthur F. Burns of the Board of Governors of the Federal Reserve System recently said, is "awash with money." The big question is whether the authorities may not already have overdone the policy shift by laying a monetary base for a resurgence of demand-pull inflation when the economy really gets rolling again.

The Federal budget has also become increasingly expansionary in its effect on the economy. On a national income and product accounts basis, the Federal budget has shifted dramatically from a surplus at an annual rate of $6.1 billion in the fourth quarter of 1969 to a deficit of $17.6 billion in the fourth quarter of 1970. It is expected that the deficit will average somewhere around $15 billion in the first half of calendar 1971. What's more, the President's budget for fiscal 1972 is designed to be strongly expansionary. If anything, the fiscal 1972 budget is likely to show a full employment deficit because of actions already taken by the Congress in raising social security benefits more than the President's budget provided, in postponing the recommended increase in social security taxes, and in other ways.

Business economists foresee a steady recovery in 1971 which I believe will accelerate in the latter part of the year as consumer confidence strengthens further and as business capital spending in manufacturing industries should be added to present expansion of capital spending in public utilities. There are good reasons for expecting a solid advance in consumer spending this year. Despite today's level of unemployment and reduced overtime, total disposable personal income keeps increasing at a fairly good rate (7.2 per cent from the fourth quarter of 1969 to the fourth quarter of 1970). The cautious consumer, who saved at an historically high 7.3 per cent last year reduced savings to a 7.2 per cent rate in this year's first quarter as evidenced by improved retail sales nationwide. As consumer confidence strengthens, it is consistent with logic and past experience to expect a decline in the savings rate. If the savings rate drops from last year's 7.3 per cent to 6.5 per cent, total consumer outlays would rise somewhere around $6-to-7 billion. Liquid asset holdings of the public have increased more than $74 billion since January 1970, and total consumer credit outstanding since January 1970 has risen only $4 billion. This means that the consumer is in a strong position to reduce liquidity somewhat and to add to consumer debt. And, in turn, if consumer confidence improves, the evidence of consumer income, savings, liquid assets, and indebtedness gives good reasons for expecting a significant gain in consumer spending this year.

The latest Commerce-SEC and McGraw-Hill surveys show that business capital spending, expected to rise by only 4 per cent in current dollars, will not be a significant stimulus to the economy for the year as a whole. A sizable rise in spending by public utilities of 17.5 per cent is offset by declines in capital spending by manufacturers, and the 4 per cent money increase of the total means that there will be a small decline in real terms, when price increases are taken into account. Business capital spending tends to lag behind the fluctuation of total output. It is consistent with logic and experience to expect that towards year-end with sales rising and profits improved, capital spending in industries besides utilities will begin to pick up.

The most worrisome aspect of the prospective recovery is the danger of persisting "stickiness" of both inflation and unemployment which could put in jeopardy for the rest of this decade the stable economic growth which is the nation's goal. Now that there are clear signs of both a weakening of inflation and a pickup in business, it would seem to be ill-advised of the Government at this juncture to try to accelerate the expansion through even greater monetary or fiscal ease. To do so would threaten to renew demand-pull inflation.

There is no doubt that the major source of inflation pressure now comes from the cost side, and that if monetary growth were to continue at recent rates, the wage cost push would be validated by price rises in the zone of full employment. Cost push inflation is plainly evident in the data. During the four quarters ending December 1970, the average increase in wages and employee benefits in newly negotiated contracts covering 5000 or more workers was 9.1 per cent per year over the life of the contract, most of which are for three year terms. This compares with increases of 8.2 per cent in 1969 and 6.5 per cent in 1968. During 1970 the first-year increases in these contracts amounted to 13.2 per cent on the average. The situation is at its worst in construction where, for 1970, new settlements resulted in first year increases whose arithmetic average was 18.3 per cent in wages and employee benefits, while over the life of the contract the rise amounted to 14.7 per cent. It is no wonder, in view of such settlements, that unit labor costs in the year ending last February rose at 5.3 per cent a year.

The recent policy of the Federal Reserve and Treasury to induce a rise in the Treasury bill and other short term market rates, designed mainly to reduce the outflow of liquid funds from the U.S. to foreign money centers, may be beneficial in slowing down the rate of growth in the money supply. As short term interest rates fell sharply during 1970 and remained low during the first quarter of this year, there was a powerful incentive for liquid funds to flow abroad where short term rates were much higher. This outflow added to the difficulties of the U.S. balance of payments. The payments deficit on an "official settlements basis" (measuring the increase in holdings of dollars mainly by foreign central banks) rose to a huge $9.8 billion in 1970. This magnitude compares with the total U.S. gold stock at present of $11 billion. By the fourth quarter of 1970 the deficit rose to an annual rate of $13.3 billion and may have gone even higher in the first quarter of 1971, to an 18-billion-dollar level at an annual rate. Measures reminiscent of "Operation Twist" in the 1960's are at best cosmetic devices for calming short-term market movements unless they also reflect some basic readjustment to a long term goal of steady monetary growth consistent with national price, output, and employment goals.

THE CLIMATE OF CHANGE

The economic recovery now under way, marked by early evidence of rising consumer, investor, and business confidence, by a shift downward since last fall in the trend of price increases, and by a strong resurgence of housing, is taking place in a social and economic climate of change. At home, concern over the environment poses a challenge to the nation's economic goals and involves shifts in the mix of output and the pattern of consumption. Dramatic shifts in population lie ahead, bringing important changes in the pattern of American life. Abroad, the U.S. faces a new era of heightened competition with trading partners which have adopted modern management, marketing, and technological advances but whose wage rates are lower than ours. These new realities have an important bearing on the economic implications of various tax and spending proposals.

The argument of environmentalists, that the pursuit of goals of maximum employment and purchasing power have distorted the composition and pattern of U.S. economic output, gains support in indications by the Environmental Protection Agency that major U.S. cities cannot meet national air pollution standards to take effect by mid-1975 if the private automobile remains the major means of transportation. To respond to the point made in the Report of the President's National Goals Research Staff, "Toward Balanced Growth: Quantity with Quality," that attaining national economic goals may mean minimizing (rather than maximizing) the throughput of materials in the production process, will involve substantial shifts in the U.S. industrial structure. Environmentalists argue that the postwar pursuit of conventional economic goals of maximum employment and purchasing power has led to wasteful growth sought mainly to create jobs, has depleted material resources at unsuitable rates, has generated environmental pollution threatening to the public health, and has created social costs and disamenities in "gross national by-products" which reduce rather than increase human welfare.

Yet, in the next decade the dramatic shifts in U.S. population will see the number of people in their twenties and thirties grow by 18 million—up 34 per cent, while people in other age groups will grow by 9 million—just 6 per cent. These young adults, marrying and raising families, are expected to demand, through spending and borrowing freely, apartments, houses, transportation services, cars, clothing, and recreation. Jobs in rising numbers to employ their highly educated talents will require heavy investment by business if the promise of this affluent young population is to be realized.

Abroad, the U.S. is entering a new era. Since World War II we have seen the period of reconstruction, when the U.S. and its undamaged economy could dominate world trade and investment. Beginning in the middle 1950's there followed a period of heavy U.S. investment abroad as Free World industrial nations expanded from their newly created post World War II industrial base. With the advent of the Vietnamese war, which diverted the energies and attention of the U.S., there began a new era which the ending of the Vietnam war will bring sharply into focus. This is an era of increased, peaceful competition in Free World trade and investment for a growing number of industrial countries marked by modern management, marketing, and technology. The next five years is likely to see the further rise of Japan as an industrial power and rapid development of the European Common Market. It will be a period when negotiations in trade and investment will set the pattern for peaceful cooperation in an open world of enhanced freedom and quality of life or when, because of disunity of understanding and purpose, the Free World will risk the dangers of a new isolationist trend. It will be an era when gains in the U.S. payments balance must be earned by superior U.S. technology strong enough to offset growing imports based on price rather than income sensitivity.

The climate of change, then, refers to change in economic goals, the pattern of output and consumption, the composition of the population and its degree of education, the conditions of foreign trade and investment, and the political and economic policies needed to achieve balanced, high level growth. Leading economists at home and abroad are concerned about continued inflation which they anticipate may average from 3 to 3.5 per cent during the first half of the decade of the 1970's unless major industrial countries can achieve better control of government spending and the demands of trade unions.

DEMANDS AND RESOURCES

Turning to the relation of demands and resources, a Brookings Institution study, according to the press on May 2 (*The Washington Post*, May 2, 1971, p. A1), supports the earlier analysis of the President's Council of Economic Advisers that: "If Americans continue to demand more and better services of their government, they probably will have to pay for them in higher tax rates." The Brookings study finds that the "fiscal dividend"—the normal growth of Federal revenues available for discretionary spending—will amount to only $17 billion in fiscal 1976, or just 1 per cent of the gross national product. Earlier, in January of this year, the President's Council of Economic Advisers calculated that only 1 to 2 per cent of the potential output in 1975–76 would be left unallocated for specific uses. The Council pointed out (*Economic Report of the President, 1970*, p. 97): "Adding $3 billion each year to the cost of existing programs, in 1969 dollars, would exhaust the unallocated economic resources that now appear for 1975–76." The Council's estimates were based on the total output that would be available in 1975–76 if, among other assumptions, the capacity of the economy were fully utilized, the trend rate of increase in productivity (output per labor-hour) in the private economy were 3 per cent, hours worked declined 0.2 per cent per year, and the labor force increased 1.8 per cent a year, yielding a potential GNP growth rate of about 4.3 per cent a year.

Since the mid-1950's, public outlays have been increasing as a share of the total economy. Says the Council: "They have risen from an amount equal to 23.2 per cent of GNP in 1955 to 29.6 per cent in 1969." And since the 1950's, the Council suggests, the Nation "has been increasing steadily the share of its economic resources devoted to education and manpower training, health, general government, and business investment by reducing the share of its resources devoted to national defense, residential construction, and basic necessities."

Federal budget decisions influence many of the demand components of the GNP, and as the Council says, "This influence will be quite pervasive in the next five years." The magnitude of demands on our resources is very great according to projections of existing tax and expenditure programs. Since the potential output left over after visible claims are met is small, either tax rates must be raised or some existing claims will have to be cut. And if a significant change in the composition of output is desired, difficult explicit decisions must be made.

"One alternative," says the Council, "to making hard choices is inflation, since inflation is a process by which competitive claims on output are finally arbitrated. But this is a capricious way to resolve these conflicting demands." Currently, the threat of cost-push inflation in the goods-producing industries makes for particular difficulty in restoring employment to desired levels. Today's unemployment is concentrated in the goods-producing industries that are faced with sluggish demand, especially for consumer durables aside from housing, but inflation is concentrated in labor-intensive service industries, such as construction, transportation, communication, health care, education, and government, where demand has been rising steadily and labor shortages—natural or artificial—have brought sharp wage-cost increases.

The problem of inflation stems not only from the demand for more government spending but from the growing militance of labor union members. Today's union members are younger. They have lived through an inflation when rising prices and taxes have eaten away most of their gains in money wages since 1965. Their increased militance is seen in the rise in grievance activity, increased refusals to ratify leader-negotiated contracts, increased union instability due to growing generation gap between leaders and members, and more complex bargaining issues with benefits harder to understand. Therefore, it becomes harder to get integrated settlements, and collective bargaining becomes less responsive to adverse circumstances, as employees gain in ability to withstand strikes because of growing welfare-type benefits, more working wives and easy credit. Finally, the prospect for inflation is increased by the trend downward of political tolerance of unemployment.

Therefore, even though the climate for business looks highly favorable for 1971–76, the climate of change and the threat of inflation and unemployment could jeopardize the prospect for a significant shift in output and employment patterns, in response to the demands of environmentalists and the young marrieds, that would occur in conditions of stable economic growth at high employment. It is from this background that the alternative measures before this committee should be examined.

PUBLIC VERSUS PRIVATE

The next five years will be critical in the nation's history because more and more people are "fed up with government" as it is now organized, at Federal, State and local levels. The implacable rise in taxes which, when combined with price rises, leaves the typical U.S. family now earning $11,000 per year hardly better off than during the 1960's has created impatience with government promises. Shall we now further increase the role of government? Or shall we return the flow of power and money to U.S. families, allowing them to make more of their own decisions? Of two broad political strategies, one requires direct government action through programs of income re-distribution, public works, and other direct expenditure programs, while the other calls for tax actions to return to ordinary families a greater role for the individual in the national decision-making process.

Programs of tax relief proved successful in the mid-50's and mid-60's in inducing growth and reducing unemployment. Expenditure programs that have been problem oriented, such as the war on poverty, welfare, compensatory education, and the like, have been unproductive and unsuccessful in reaching their goals. Their difficulty stemmed not from a lack of funding but a lack of ability on the part of large governmental organizations to effectively deal with problems related to individuals.

TAX PROPOSALS

A number of tax proposals have been put forth recently to promote economic growth.

Speed Up of Depreciation To Stimulate Investment

If we wish to stimulate the adjustment of the private sector to environmental demands and standards and to promote desired economic growth, the depreciation allowances that are currently part of the tax system in the United States must be revised. They must at least be brought into line with other Free World industrial nations if we are to compete effectively in world markets.

A capital cost recovery system can be the basic means of inducing a turnover of technology. Since we are living through the world's greatest historic revolution in science and technology, and since the rate of transfer from innovation to competition is shortening from something like a decade to something under half a decade, the capital cost recovery system of a nation is crucial to its ability to adapt to new conditions and to achieve the turnover of technology that is essential for maintaining technological parity with world competitors.

The U.S. faces profound adjustments to achieve strategies for maintaining its economy in a state of ecological balance. These strategies include (1) changes in our present production and consumption patterns; (2) treatment of wastes; (3) more skilful reliance on the natural processes of the environment; and (4) further protective measures to reduce the impact upon waste receivers. Because in any closed energy system entropy (roughly a measure of disorder) increases, to maintain the environment in a steady state requires controlled cycling of materials in the production process, decreasing disorderly energy flows, developing better environmental checks and balances in our energy systems, increasing the diversification of means to satisfy wants, and new methods for achieving stability of production processes in relation to throughput of materials.

Up to now, wealth has been considered as represented by physical stocks yielding future income streams discounted to present value without regard to environmental constraints. These constraints, however, and their consideration, markedly increase the relative value of future forms of economic activity which are entropy-offsetting, which up to now have been largely ignored, and markedly devalue forms of wealth which are highly entropy-generating. They increase the value to the society of additions to its productive capital which conform to entropy-offsetting technology.

With 6 per cent of the world's population and 7 per cent of its land area, the U.S. consumes 40 per cent of the world's annually available world resources. It is therefore of great import to the world as well as to the U.S. to shift capital and technology rapidly to entropy-offsetting investment. This means, to illustrate, fewer million-ton trans-oceanic, ocean-floor cables and more 7-pound satellites as a means to communicate with other continents. It means fewer college classrooms occupied by dull lecturers and more nationwide TV universities with the nation's best talents devoted to producing and teaching mass audiences. It means intensified industrial research and development to produce nuclear breeder reactors and controlled fusion reactors and more conservation, through changed consumption, of vital fossil fuel energy sources such as oil and natural gas. It means relatively less transfer, storage, and retrieval of information by paper products and more by electronic tape and microfilm. It means the expansion of communication—which cheaply and with less pollution moves information—rather than the transportation of human bodies for informational purposes. And so on through a list that stretches the imagination.

A capital cost recovery system should be adopted in the United States that meets the requirements of the revolution in science and technology. The U.S. system of depreciation is now considerably less conducive to investment than that of all other major industrial nations that depend on private capital as a source of production. For example, in the U.S. an investor in industrial machinery would recover 7.7 per cent of his investment in the first taxable year; in Japan an investor would recover almost five times that percentage, or 34.5 per cent; in the United Kingdom an investor would recover almost eight times the U.S. rate or 57.8 per cent.

Early capital cost recovery is vital because the sooner cash is freed, the sooner it can be reinvested and the sooner American industry can have the most modern plant and equipment available, thereby lowering costs, raising productivity and permitting American workers real rather than inflationary wage increases.

What is the cost to the Treasury of the new depreciation regulations? One estimate is that the revision would lead to a deferral of between two and three billion dollars of business tax liability for each of the next five years. However, the long-term cost to the consumer and taxpayer must be considered zero, since one piece of equipment may only be depreciated one time and the producer's long-term tax liability does not change. The new depreciation regulations will affect short-term liability which will be lower in year one as opposed to year ten but will result in the same long-term liability for a given depreciable property.

The short-term decline in income tax revenues from a change in depreciation regulations will be more than offset by the extra income that would be generated by these revisions. During the years following depreciation changes in 1962, private investment and corporate income tax liability increased significantly. There is every reason to believe that this will occur again since capital investment, as mentioned earlier, is now sluggish and there is a backlog of demand for investments to shift the industrial structure to meet environmental and population demands.

The alternative to creating an atmosphere more conducive to business expansion and development is to continue along the path we are currently following. But capital is international; it flows to where yields, considering risk, are best. If the U.S. government continues to give the business community the lowest yields in the world, incentives are created for U.S. investors to pick up their chips and go to a game where the odds are better. In fact U.S. industry has been expanding its investment in foreign nations at a much faster rate than in the U.S. In the past five years plant and equipment expenditures of foreign affiliated companies of American corporations have increased from $8.6 billion in 1966 to a projected level of $15.3 billion in 1971, an increase of over 80 per cent, while domestic plant and equipment expenditures are expected to expand by only 30 per cent for this same period. Foreign expenditures by U.S. affiliates for new plant and equipment increased from 13.6 per cent of domestic outlays in 1966 to 18.4 per cent in 1971 in spite of controls on foreign investment that have been in effect for the past three years.

The American consumer is also a player in this game, and he is increasingly deciding that he gets a better deal on foreign than domestic goods. He buys almost 15 per cent of his cars, 30 per cent of his TV sets, and over 75 per cent of his radios from foreign producers. The American government also plays this game, purchasing 90 per cent of the generating equipment installed by T.V.A. in the past five years from foreign manufacturers.

American workers are the highest paid in the world. The only way we can maintain the wage advantage of U.S. workers is for American industry to remain the most modern in the world. The productivity of U.S. workers rests most importantly not on their working harder and harder or even on the improved education of production workers as such, but on improved management and marketing methods, improved materials, and production methods, and on advancing technology. We cannot handicap our workers with obsolete plant and equipment and expect them to compete effectively in world markets. Neither can we continue to imply that we can pay for imports with gold. Our gold stocks are now only one-third of what they were immediately following World War II, and other nations now have the power to completely exhaust our supply of gold in 24 hours. This would place the U.S. in the position of being an insolvent financial power in much the same way Penn Central found itself with billions in assets but not enough money to meet its everyday cash requirements.

There is an immediate demand for industry to curb industrial pollution. This can be done. In most cases the technology is available. However, the cost will be high. Some plants will have to be closed down. New, more modern plants will have to be opened. There will be a need for more new investment dollars than would otherwise have been the case. United States industry is willing to make the investment. Provisions of the Clean Air Act of 1967 and standards set by the Federal Water Quality Control Administration will result in the need for 8 billion dollars in pollution control expenditures by industry in the next five years. While these outlays will add to our quality of life, they represent expenditures that will increase industry's investment without any related increase in productivity as now measured. Air and pollution control expenditures are necessary if we are to survive. But if we expect our industry to compete with goods from other nations that do not have these controls, something will have to be done to equalize these costs between foreign and domestic goods. True enough, some of the costs may result in longer term economies and lower future costs as new processes are developed for recycling waste materials that may not only contribute to a reduction in pollution but that will also conserve our natural resources. But initially, investment costs of industry will rise. It is therefore necessary to provide a proper tax climate to induce investment and reinvestment in the U.S. and not in foreign nations.

Tax Credits as a Means of Inducing Recovery

Unlike the proposed depreciation regulations that result in no long term revenue loss per depreciable item, the investment tax credit as enacted during the early 60's did result in a net reduction in business tax liability. The effect of a tax credit over the next five years would be a reduction in income taxes paid by about 3.5 to 4.5 billion dollars annually. By now, the history of the on-again, off-again investment tax credit makes clear that it is viewed as a temporary stimulus by governments. The result of any temporary tax credit would be an undesirable zig-zag expansion on the part of business. Moreover, the induced speed-up of investments could lead to uneconomic results as businesses tried to take advantage of a temporary measure.

The cost in lost revenues of the 7 per cent tax credit would be considerably more in the short run than the proposed revisions in the depreciation regulations. The tax credit may result in as much as $1 billion greater loss of revenue for each of the next five years compared to the proposed depreciation regulations. And, ignoring the comparable investment-stimulative effects in the short run, a dollar in tax credits results in a dollar of tax loss forever, while the depreciation regulations merely defer tax liability. It is also doubtful whether the investment tax credit would stimulate more investment than would a revised asset depreciation schedule which placed U.S. producers not at an advantage but merely on a par with other nations.

Speed-up of Tax Reform Act of 1969 Enactments

The Tax Reform Act speedup would result in a $3 billion decline in Federal revenues for 1972 and an infusion of new funds into the hands of consumers. In the past 18 months we have gone through a series of three tax cuts that have affected the same people who would benefit from a speed up of the tax reform act; yet, such tax cuts have not served to spur the economy sufficiently to avoid the present economic downturn.

What is needed more than another tax cut for consumers is improved consumer confidence. Economic developments suggest such improvement is underway, as mentioned earlier. An improved social climate would contribute further. However, as explained, personal savings at this juncture are at a higher level than they have been in recent years and there is no reason to increase the rate of personal savings at this time.

PROGRAMS OF DIRECT GOVERNMENT INTERVENTION

There are those who prefer programs of direct government intervention and expenditure which are generally more expensive to the taxpayer and place government in the undesirable role of having greater power and force of direction in the economy.

The Negative Income Tax

One direct action proposal that has received much attention is the negative income tax or guaranteed annual income approach. This proposal must be looked at in a number of ways.

What income level should we guarantee? There is no necessary logic to the most popular dollar figure presently quoted, $2,400 per year, since it is substantially below the present poverty level, almost $4,000. It therefore seems justified to assume that once enacted, the goal will be guarantees at no less than the poverty level. The results of the guarantee of poverty-level income is a work-disincentive for both the working and nonworking poor. The magnitude of the work-disincentive has not been sufficiently considered. If significant, it could serve not only to increase Federal expenditures but also to erode the income tax base. The work disincentive could mean that to raise poverty income by $1, the government would have to disburse x dollars of income to the poor and near poor. For example, to guarantee a minimum income at the poverty level, about $4,000 (3,743 for a family of four in 1969) and reduction of benefits by $1.00 for every $2.00 of earned income, would result in an increase of almost $30 billion in Federal expenditures. But, what is more important, as reported in *The New England Economic Review*, January/February, 1971, pp. 2021, it would result in a 40 per cent erosion of the personal income tax base. Those left to pay the tax to support this program would be faced with a tax load almost twice their present burden. Also, it stands to reason, government guarantee of an income equivalent to what many low income persons presently get, when combined with an initial tax bracket of 50 per cent, could create a tremendous disincentive for low paid workers, both poor and near poor. The result would be to raise costs above present estimates, reduce labor force participation, reduce total earned income and supply of labor, and reduce the GNP, while increasing total personal disposable income and increasing inflationary pressures under high employment conditions in the overall economy.

However commendable the idea of guaranteeing a liveable income, it seems excessively naive to put low income families in an explicity 50 per cent tax bracket and expect them to go to work. This high rate of taxation would present a devastating blow to the work incentive of many individuals who at present have a high degree of work motivation.

Minimum Wage Legislation

Minimum wage legislation is currently being considered as a means of raising the wages of the working poor and reducing the cost of the proposed guaranteed income. The proposal calls for a $2.00 per hour minimum wage level.

It has been demonstrated by Professor Yale Brozen of the University of Chicago that raising minimum wages above the productivity of lowest paid employees does not raise their income but places them in the already existing pool of unemployed. One cannot legislate productivity, the basic determinant of wages. An increase in the minimum wage will not decrease welfare payments but increase them, because of induced unemployment. A $2.00 minimum wage will raise prices in exactly those industries that are already least capable of competing in world markets at this time, and will thrust additional industries into this posture. An increase in minimum wages tends to support protectionist measures or concede a larger share of these industries to foreign nations. Neither alternative would appear to contribute to the economy or our balance of payments at this time.

The process by which wages in excess of productivity lead to the loss of industry and employment is familiar enough. In the short run, owners of affected industries try to adjust their variable costs to higher wage costs. But as time goes on, owners disinvest their funds by not replacing equipment as it wears out or becomes obsolescent. Not only workers in manufacturing but in unskilled and semi-skilled service industries will be disemployed. The result will be the loss of another industry to American workers and a further withdrawal of people from the labor force to become permanent welfare recipients.

Acceleration of Public Works

A program of accelerated public works, besides being too slow in getting started to do much good cyclically and, quite likely, out of phase with the business upturn, would not provide any solutions to the long term problem of unemployed persons in the labor force. Public works as a means of combating unemployment merely looks at the short term and does not seek the basic changes in our economy that are necessary to get at the root causes of unemployment. More and more, people both young and old appear to suspect that paying tax dollars for hastily-conceived public works is not a way they wish government to serve them. The issue for today's society is not the prospect of stagnation from lack of private job opportunities, given adequate monetary and fiscal policies. The issue is that of matching labor skills to improved technology. Going back to the shot-in-the-arm, pump-priming techniques of the Thirties has even less to offer the American people today than it did then. There are needed public works, but they should be properly planned and programmed. Many of today's unemployed lack the skills to benefit directly from public works programs. The construction industry, the direct beneficiary of these programs, is already the biggest contributor to the current cost-push inflationary binge. Any sudden added demand in construction would probably fuel inflation more than economic growth.

The process of conversion from a partial wartime to a peacetime economy requires more creative thinking than either a $2 billion speed-up in public works or a new program of federally controlled public service employment. Many of the people displaced by a lower defense effort and a change in national priorities away from space and the SST, are among the most highly skilled and creative minds in our society today. They would rightfully be insulted by programs not appropriate to their talents. These people made a reality of something that twenty years ago could only be termed science fiction. It is therefore essential for the government to create a market climate conducive to private industry to seek the best minds and the most highly skilled individuals and to use their talents to produce more effectively what people want. There will be some readjustments, since Government, in reaching for the moon, pulled out all the stops on cost. Young men coming out of college were wined and dined by aerospace employers and were given undreamed-of salaries. Industry, under the influence of cost-plus, lost touch with the realities of the marketplace. Indeed, some aerospace companies may never succeed in adjusting to the marketplace and may be merged or consolidated as private industry adapts to future demand.

But disemployed aerospace workers are needed elsewhere in the economy if we are to remain a world industrial power. We should not relegate these people to meaningless, short-run tasks. The civilian applications of the sophisticated technology developed in the space and defense programs attest to the need for these highly trained people in our civilian industries.

REEXAMINING THE CURRENT WELFARE SYSTEM

Proposals for a negative income tax, unemployment compensation, social security, food stamps, public housing, and health care payments have the objective of providing a form of insurance of the individual against risks generated by our industrial society. Is it not time to examine the interrelationships of these separate programs in order to coordinate them into a system which would permit a more effective and coordinated approach at lower cost to the taxpayer? Currently a job-holder in private industry earning a living to support his family must also support almost ¼ of a government employee, ¼ of a person on public welfare, and ½ of a person on social security. Compared to 1950 there are today 15 times as many people collecting social security, 5 times as many people on welfare, and four million more government employees.

Much talk about poverty-reducing strategies is basically misleading because it does not reflect a defensible definition of the U.S. welfare system, its scope, its parts, its objectives. *The 1970 Statistical Abstract* shows, in Table 415, "social welfare expenditures under public programs" amounting, in 1969, to $126.1 billion. About 40 per cent went for social insurance, 35 per cent for education, 10 per cent public aid, and smaller amounts for health, veterans, housing, etc. Another approach is to examine the existing system of transfer payments. Taken in its largest dimension, the existing transfer system in 1964 distributed $97 billion in every form of transfer payment by Federal, State, and local government, and by private agencies, as best could be estimated. Robert Lampman, Professor of Economics at the University of Wisconsin, showed that of the $97 billion, only an estimated $30 billion of these transfer payments went to people who, before receiving the, were poor (i.e., had family incomes of $3,000 or less). More than two-thirds of the $97 billion went to people who, before receiving the transfer payments, were nonpoor.

In the next five years, the competition for funds between government and the private sector resulting from deficits in the full employment budget caused by expansion of separately considered welfare-type government spending programs means that such deficits would result in a shortage of funds available for housing and capital formation. There is a significant prospect, meanwhile, that much piecemeal thinking about government spending proposals and programs has been counter-productive.

To illustrate, consider the analysis of urban systems by Professor Jay W. Forrester of MIT, reported most lately to the Subcommittee on Urban Growth of the Committee on Banking and Currency, U.S. House of Representatives, on October 7, 1970. Forrester pointed out that complex systems, such as urban systems, are counter-intuitive; that is, intuitive solutions to urban problems are more often likely not merely to be wrong but to be causes of further difficulty compared to a chance selection of solutions. Thus, urban renewal required until recently three pounds of forms and three years to get a program started, which is surely bad enough. But urban renewal has also hardly more than replaced the housing it displaced. Moreover, according to Forrester's computer analysis of and modelling of urban dynamics, it is not indicated that construction of low cost housing, training of low income family heads, busing of central city residents to suburban jobs or federal subsidies to depressed central cities are effective. Says Forrester, "All of these are shown to lie between neutral and detrimental almost irrespective of the criteria used for judgment."

CONCLUSIONS

To summarize, this testimony has established the following points as guidance to the committee in considering Economic Implications of Alternative Tax and Spending Policies: 1971–1976.

1. The recovery in the economy has begun, and will accelerate late in 1971, and extend into 1972, depending on consumer confidence for its pace, and gaining momentum with the late-year revival of manufacturing capital investment. Monetary and fiscal policy appear currently to be amply stimulative.

2. The nation is entering a new climate of change. Concern over the environment and shifts in the age-distribution of our population at home, combined with a new era of heightened competition abroad, require adequate policy attention to long-run changes in the depreciation system to assure ability to shift capital to areas of new demand and new environment-saving wealth at home and to assure technological parity with trading partners abroad. The U.S. balance of payments will be improved only by basic adjustments that stimulate research and development and capital investment to create jobs for the world's highest-paid work force; otherwise, U.S. industry, forced abroad by investor opportunity, and U.S. consumers, increasing their imports to gain more for their money, will move the basic payments situation towards import surplus.

3. The fiscal dividend to 1976 is almost entirely preempted by existing demands on output, including demands of government which today is a larger share of the total economy than ever before and has grown at a rapid rate as

a share of the total economy since the mid-1950's. Therefore, short-run spending programs to stimulate the economy represet future revenue-drains which must be financed either by increased tax rates. or inflation.

4. The prospect of inflation to 1976 at rates between 3 and 3.5 per cent is seen by many leading business economists as stemming from the combination of rising government spending and the demands far in excess of productivity by increasingly militant labor union members.

5. Taxpayers are disillusioned with the record of government spending programs. Results do not match intentions and costs escalate as program complexity increases. Tax changes, by contrast, can stimulate investment and growth.

6. The U.S., both for environmental and for international reasons, positively needs a revision in its depreciation system. Accelerated depreciation costs some tax revenues in the short run. But such acceleration stimulates investment, economic growth, and resulting productivity gains that offset inflation. In the long run, because new equipment is depreciated only once, acceleration represents no revenue loss, and, because it enlarges the tax base in the entire economy, it actually increases the total tax-take of the government.

7. An investment tax credit, as an on-again, off-again measure, is apt to distort investment, and it does not necessarily generate any more investment than accelerated depreciation.

8. The Tax Reform Act of 1969 speed-up would result in a $3 billion decline in Federal revenue for fiscal 1972 and added consumer income; but presently the key to the recovery is consumer confidence, not income, since savings are at a near-record and income is rising. As a temporary measure with the least adverse long-run consequences, the speed-up appears the best candidate for entirely temporary stimulus.

9. The nation needs a systematic look at programs which redistribute income by transfers to individuals to protect them against the risks of industrial life. The current hodge-podge, grab-bag of such programs is surely administratively wasteful and duplicative. However, the negative income tax offers no logically defensible addition, both because of its level and the general disregard by its proponents of its work-disincentive effects which would reduce total income, the labor force, and GNP but would raise the tax burden on the rest of us.

10. The minimum wage is a device that should not be related to welfare programs as a form of income maintenance. Under today's conditions an increase to $2.00 in the minimum wage would add to inflationary cost-push of wages throughout the wage scale at just the wrong time; it would after a time reduce jobs in labor-intensive industries, drive such industries either out of business or into protectionist measures because of overseas competition, and would reduce employment among unskilled service workers and young unskilled workers, thus increasing the public burden of welfare-type payments and concomitant taxes.

11. Acceleration of public works would take too long to start to do any good in stimulating recovery, would heighten cost-push pressures in the construction industry, is ill suited to achieve reconversion of defense and space industry or workers, and would only swell the ranks of government programs already under sharp and broadening taxpayer criticism.

Chairman GRIFFITHS. To start with, I think you point out at one point that people are tired of paying taxes. Obviously they are. And they are going to rebel.

Right now in the inner city of Detroit 70 to 75 percent of the young men between 16 and 25 years of age are unemployed. Supposing we gave a tax reduction to the extent of $10 billion, which would accomplish employing those unemployed young men, or do you think that $10 billion spent by the Federal Government in employing those young men would be better and more effective?

Mr. MADDEN. I would oppose either approach as compared with private industry employing those young men on the basis of producing goods and services which people want to buy.

Chairman GRIFFITHS. How are they going to do it? They can do it right now.

Mr. MADDEN. Private industry is unable to provide employment for these people in Detroit right now because of the sluggishness of consumer demand for automobiles, and also because of the shift of sales of automobiles from domestic manufacturers to imports. And it seems to me that we should take a longer run view, as the hearings suggest, of the problem of unemployment to bring our own economy up to a higher level of competitive effectiveness with economies abroad, in order that such people can be employed in activities whose long-run benefit contributes to the continued rise in wages in the United States and the continued effectiveness of the U.S. economy in the world economy.

Chairman GRIFFITHS. We are not going to be able to do that just by the investment tax credit. You are going to have to do a great deal more than that, because in some areas of the world American business is finding that the country itself will build the building and supply most or all of the equipment. Would you suggest we compete that far? Of course, I realize that we have been doing that for the airplane manufacturers, but are you for doing that for everybody else?

Mr. MADDEN. No, I am not for doing that for everyone else, although I know that there are States in the United States which provide inducements to industries——

Chairman GRIFFITHS. Cities, towns.

Mr. MADDEN. Yes. What I am trying to address myself to, Madam Chairman, is to the long-term problem of the American economy faced with new understanding of the impact of its production on the environment, and faced with the prospect of a rapid growth in young people coming onto the labor market and in the vigorous period of their lives, which will happen over the next 5 years. As I was trying to suggest that measures taken, in view of the stringency of our resources compared to demands, that are short run in nature, could be deleterious in the long run in accomplishing the objectives which I believe that we have to face in view of the reality both at home and in the world.

Chairman GRIFFITHS. Personally, I feel that for this summer and for the next summer, and maybe the next summer, before any long-term thing is going to take effect, we are going to have to use some money in the Federal Treasury and employ these kids at jobs that have some sense and some meaning. And we shouldn't wait until summer gets here to start employing them. And we should have a problem set up.

I listened to the Mayors' Program, and I was amazed. I don't think the mayors have asked for enough in the first place.

I listened also to the effect of what happened last summer. Some of those kids in Detroit stood in line for those jobs until they fainted. Now, to me that is unconscionable. The kids should have the jobs.

I really think, in addition—and one of the councilmen in the city of Detroit suggested it too—we ought to reform these child labor laws.

What do you think, Mr. Goldfinger? And I don't mean by that that we ought to hold the kids out of the labor market until they are 25 years old.

Mr. GOLDFINGER. I would like to know what that gentleman means by reforming the child labor laws. And I would like to know the specifics—

Chairman GRIFFITHS. He would reduce the age at which a child could enter the labor market.

Mr. GOLDFINGER. The age is down to 16. How much lower do you want it?

Chairman GRIFFITHS. I don't think we would have to go below that.

Mr. GOLDFINGER. I would be glad to talk to this gentleman. We have discussed this issue with the people in the Labor Department over the past number of years in both administrations. And the issue is not the age limit, Madam Chairman, the issue is the issue of work hazards. And that is where there are regulations applying to youngsters between the ages of 16 and 18. And I don't see any need for reducing the standards in connection with work hazards, because these involve hazards to life and limb.

Chairman GRIFFITHS. Of course, I don't think they should be put into that sort of situation at all.

Mr. GOLDFINGER. But we have been glad to talk and review all of these issues. We are not inflexible. But we are opposed to child labor. This was done away with a long time ago. We are opposed to its resurgence. And we are opposing to introducing 16-, 17-, and 18-year-olds to all kinds of work hazards.

Chairman GRIFFITHS. Mr. Duesenberry, I was quite surprised when you suggested that we are going to have an increase in defense expenditures. You have quite a few people on this committee that are dedicated to stopping that. Now, suppose we are successful and suppose we reduce it by $10 billion, what will the effect be?

Mr. DUESENBERRY. First of all, may I just correct one misapprehension? I think what we had in mind was our prediction that the period of sharp decline in defense expenditures was over, and we anticipated a flat to a slowly rising dollar expenditure change. We did not recommend that. We attempted to make a judgment on what we think the live options were. If you tell me that there is another option, I will be glad to hear it.

Second, a reduction in defense outlays means, of course, that our long-term fiscal dividends will be larger. I would assume that the cutbacks which the Congress would make would have only modest effects in the immediate future. I am not sure that this would make a great change in the outlook as we see it for the next year or two. But it would imply that there would be much more room for commitments to public expenditures of an enduring nature. And naturally some of those could be started right now.

So that insofar as there is a real opportunity to change the budget commitments which we judge to have been already made, then of course there is room for expanding in other areas. And there is certainly plenty of useful and valuable long-term public expenditure programs which we would support. Mr. Goldfinger mentioned a number of areas. I won't try to get into the question of my own set of priorities. But there is certainly plenty of room for replacing a long-term change in defense expenditures with other changes.

There is of course a technical problem, if it turns out that there is to be an immediate cutback in defense expenditures. But if you cut them in a way now, then you could put some in some place which will have the effect of offsetting any reduction in defense expenditures. And I would be delighted to see that happen.

Chairman GRIFFITHS. I was interested in your flexible investment tax credit. I suggested to Henry Fowler when I was sitting on the Ways and Means Committee that this would be a great idea, why don't we just use this in time of depression and shut it off when things get going well. I ran into buzz-saw opposition. Everybody wanted to be able to plan all the expenditures ahead of time, and so forth. So we got no place with that. But of course it would create wide swings.

Mr. DUESENBERRY. It would create wide swings in the tax, but not in the investment expenditure, because I would assume that the purpose of using the tax would be to discourage investment at times when other forces were driving it up rapidly, and to encourage when other forces were driving it down. So one would hope that its effect would be to counteract other forces of instability rather than to cause instability.

Now, I confess that the record of forecasting changes in monetary policy is such that there is no guarantee that we are going to come out right. What I want to emphasize is that one can say the same thing both for and against flexible tax credits and flexible interest rates. They have the same basic economic logic. But there are various technical differences in detail.

So that anybody who believes that the use of monetary policy is a valuable instrument for controlling private business investment ought to believe to just about the same degree that tax flexibility would do the same thing. We know that it is difficult either way, with monetary policy or with tax credits to do that. But most people believe that there are forces which generate instability in business investment, and that some action ought to be taken to offset them. It is just a question of whether the action is going to be taken through the tax route or through the monetary policy route. Since almost everybody, I think, including everybody in the Federal Rerserve System, will admit that we have had a great deal of pain in trying to use monetary policy for that purpose, and have run into all kinds of difficulties with the housing industry, and the State and local finances, and had to invent all kinds of devices to try to offset the impact of monetary policy on the sector where we don't want its impact, I think we ought to consider something else. And I put it this way partly because I have recently been involved in discussions of measures for direct credit controls. And I must say that I find it very difficult to see how they could be operated effectively. Even so, I know that some people think it is nicer for the Fed to have to take the rap for operating them than for the Congress or the President to do it. But I really think that as between those three things, one could at least make some gain by introducing into the package, without total reliance on it, some flexible investment tax measure.

Chairman GRIFFITHS. My time is up. I will come back to you when I have more time.

Mr. Widnall.

Representative WIDNALL. Thank you, Madam Chairman.

I appreciate the fact that all three of you gentlemen are here before the Joint Economic Committee today, and you are certainly making some very distinct and worthwhile contributions to the testimony which is being obtained by this committee.

Mr. Goldfinger, how much do you estimate that cuts in Defense and space spending have affected unemployment?

Mr. GOLDFINGER. Mr. Widnall, I was working on that last night for other purposes. I have no estimate. There obviously has been an aggravation of the unemployment situation due to the cuts in Defense, because from fiscal 1968 to 1971, there has been a reduction in real Defense expenditures of somewhere in the neighborhood of about 20 percent. And there has been a cutback, roughly, of about 1.4 million employee jobs, plus the reduction in the size of the Armed Forces. But what I would emphasize, Mr. Widnall, is that even though I have no estimate on this, and it obviously has been a factor that has aggravated the unemployment situation, I think that one of the problems here is that with this kind of process of winding down the Vietnam War and the welcome reduction in the real volume of Defense outlays, we not only did not have administration action and plans for conversion and adjustment but, on the contrary, the administration went ahead in 1969 and followed a policy of restriction. So that you have got a compounding of the problem. And this reduction in Defense occurred largely during the period of recession.

Representative WIDNALL. Isn't it a fact that there is a different set of circumstances than there was at the end of World War II? You have no pentup consumer demand at the present time.

Mr. GOLDFINGER. I agree with you, sir.

Representative WIDNALL. At the end of World War II they had pentup consumer demand because the consumer had been cutoff from buying automobiles. And a tremendous amount of business was done in the upturn that took place in the economy. We have got to have some artificial stimuli, I believe, to get the economy going again. You can't wind down everything at the same time. If I were to be critical of the administration, I would say that this has been their fault. But also I feel that we have got to concentrate on just one or two things. Heaven knows, we are going to have enough trouble getting through Congress the number of changes that should be made in order to have a better economy and in order to get things moving better than they have been.

But I would like to ask all three of you this. If Congress was able to make just three effective moves in this present session, what would you say would be the most significant moves they could make in order to be helpful to an upturn in the economy?

Mr. Duesenberry.

Mr. DUESENBERRY. I would seek a total package of expenditure and tax reduction which amounted to somewhere in the neighborhood of $6 billion, and within that I would give first priority to those expenditures which have valuable properties from the standpoint of our national priorities. I would include whatever amount of public service employment could be well managed. I am not in a position to know what the mayors can do in that area. I have a small suspicion that it is not an enormous amount. But I don't want to make a judgment on something about which I don't know much. I would include however, as having some value from a national priority point of view, whatever amount of public service employment the mayors and other local governments could come up with as being worthwhile and consistent with public acceptance of that kind of a thing.

I would include those expenditures which have met the criterion of having a high ratio—I don't want to put a figure on it—a high ratio of expenditure impact in 1971–72 compared to later impact, or those which have a higher ratio of expenditure in 1971–72 to future expenditures, but have a high place in our national priorities over longer periods. I would fill the gap with whatever amount of bringing forward the consumer tax reduction remains. In other words, I would avoid making commitments to relatively low-priority programs, or expenditure programs having a high impact in the future compared to their impact now. That is why I objected specifically to public works programs.

Now, I don't know how much the Congress can come up with in terms of expenditure items. I know, for instance, that the city of Boston has a number of urban renewal projects which are small projects which are stopped in the middle, and where within a year and a half we could complete most of the projects, because they involve things such as building relatively small public facilities where the land is cleared and everything is ready to go, but the money has been held up. Giving the money for that kind of project where the expenditure would be almost completely within the next year and a half I think would get a very high priority, whereas building some highway which everybody is arguing about and where you have to take land and go through a lot of difficulty, and you won't spend your money for 3 or 4 years, seems to me to be at the opposite extreme.

I am sorry that that is not as precise a package as I would like to give, but I don't know enough about the details of the expenditure program to be able to do better than that.

Representative WIDNALL. Mr. Madden, what do you think about that?

Mr. MADDEN. I am not convinced that any measures that the Congress could take at this time would necessarily achieve the balance between the appropriate rate of expansion in the economy and the problems of demand-inflation. However, if I had to choose, I think the least dangerous longrun measure, the least dangerous temporary measure for its effect on the long run, would be a reduction in taxes or bring forward the reduction in the Tax Reform Act of 1969, as I indicated in my statement, as one measure.

The second measure I would suggest, personally, not necessarily representing the Chamber's viewpoint, although I don't think it is inconsistent with it, is the passage of special revenue sharing, which would include provisions for the modernization of local and State governments. While this would not necessarily involve—I can't estimate the amount of immediate stimulus of such a package, but I do think that a large portion of the problems of our metropolitan areas is due to the outmoded government in those areas and the lack of incentive for any improvement which would cause a saving of the taxpayers' dollars, which they could then spend on the things they want.

Representative WIDNALL. Mr. Goldfinger.

Mr. GOLDFINGER. Sir, you were asking for immediate action to lift the economy. I would say, first, the enactment of a large-scale public service employment program to provide Federal funds to the State and local governments and Federal agencies for the creation of jobs for the long-term unemployed and the seriously underemployed in providing needed public services in the localities. There have been numerous studies of needs here and the job potential, studies for the Urban Coalition and other groups, which indicate a very large need and a very large job potential. And in our estimation, this is something that is needed immediately.

Secondly, I would say that the final adoption of the bill that the House passed about a week or two ago, which was introduced by Representative Blatnik, to accelerate public works expenditures, to provide $2 billion to step up short-term public work projects in areas of high unemployment, projects which, as Mr. Duesenberry described in Boston, are ready to go, where there are no lengthy delays or anything like that. And I might add that it is our understanding, for example, that at the end of 1970 there were about 3,000 applications for Federal approval for waste treatment plants, 800 applications for water and sewer projects, 1,900 applications for hospital and public health facility centers, in addition to hundreds of other kinds.

A large number of these projects in our estimation are ready to go and should be eligible for accelerated public works grants. This would not only create jobs within the state of high unemployment, but it would create employment opportunities throughout the country in the production and distribution of building materials and equipment.

Further, I would say that we need an immediate adoption of the $2 minimum wage, to lift the wage level of the lowest wage workers and to extend the coverage of the Fair Labor Standards Act to millions of people who are still outside of the protection of the Fair Labor Standards Act.

And, fourthly, I would say that the kind of extension of unemployment insurance benefits which has been discussed, should be enacted and put into effect immediately with a Federal assumption of the cost of the extended benefit.

Representative WIDNALL. Thank you.

Mr. BOSWORTH. May I comment on that?

I can't resist the opportunity to make specific recommendations.

The first point I would like to make with respect to what Congress can do right now, is to not undertake any tax or expenditure programs that will either reduce revenues or increase expenditures in the long run, for reasons having to do with the current economic problems. All the indications we have imply that the Federal budget is going to be under extreme pressure 4 or 5 years from now. The recurrent question of what happens to the fiscal dividend, I think, is being answered. It gets frittered away in small tax cuts based on immediate problems and small expenditure programs that don't answer allowance. In this area I would say that the new depreciation guideline move should be offset, because in the long run it will only cost more money. There seems no clear evidence that the United States at this time would find it desirable to stimulate fixed investments.

Second, one measure that Congress can take that does not conflict with long run budget objectives is to speed up the tax reductions that are already scheduled, since they imply no loss of revenue whatsoever in 1975–1976.

Third, they could undertake extended unemployment benefits over and above what we have already, as long as that program includes a trigger, so that the long-run expenditures on unemployment are not increased without consideration of the complete program and the possibility for a complete overhaul. That same feature should be built into any kind of a public employment program that might be enacted on an immediate basis.

And, finally, the urban program, at least on the appropriations that are being held back, seems to be one area where expenditures could be increased in the next six months to twelve months. It would have an economic impact in 1972, but, again, it would not conflict with the long run budget outlook. The Congress shouldn't undertake things like public works program which, as we mentioned before, always has a 2-year delay before they have an expenditure made, and will only reduce revenue available for social programs 2 years from now.

Representative WIDNALL. Thank you all very much.

Chairman GRIFFITHS. Senator Proxmire.

Senator PROXMIRE. Mr. Duesenberry and Mr. Bosworth, and all of you gentlemen, I want to congratulate you. These are fine prepared statements, all of them.

But I was especially taken by this last point, which you make, which is one that I think has been made by the Congress and the President and by all of us in debating the situation, to wit, that we have to take a closer look at the very serious problem of getting involved in permanent expenditures at a high level, which are going to be either very inflationary, impose enormous tax burdens, or much more probably, are going to result in a failure to face up to the tough priority choices. I take it what this means is, No. 1, we ought to really look hard at cutting Defense spending.

No. 2, we ought to look hard at cutting other kinds of spending too; not only space and public works and so forth, but even those that have a high priority. And I don't mean just cutting overall aggregate spending, but I mean cutting in the educational area, for example, and in the area of pollution, choosing strategies that are the most efficient and economical. And there is a real burden on us to do this kind of thing. If we don't do it, it means that we just are not going to be able to meet the great needs that we have.

For example, I notice that Brookings had in their most recent publication and analysis of the pollution problem. And they looked at three alternatives for solving the pollution problem: The administration proposal, the Senator Muskie proposal; and the Proxmire proposal. I was delighted to see that they chose the Proxmire approach, because my approach is a tax on effluent discharges, which puts a clear economic incentive on the polluter for reducing pollution. And it raises money from those sources which are engaged in pollution, without tapping the general budget.

But, in general, I think this a most useful contribution.

Mr. Okun made a similar proposal yesterday calling for prompt vigorous stimulation of the economy, but not in ways that would put us in a position where we have our resources committed for a long time and will be unable to do the kind of a job in health and welfae and education we all want to do as soon as possible. And that is most useful. I would like to ask you, Mr. Duesenberry—with the most recent development that is in the papers this morning on what has happened to the dollar and the re-evaluation of the German mark, and perhaps some other foreign currencies, as I read it, it looks like very good news for our economy. With all the concern about the terrible consequence of the balance of payments, it seems to me that when they revalue the mark and revalue foreign currency, it is going to make our exports cheaper to foreigners, so that they will buy more, and also reduce our imports, without a tariff or a quota, or anything like that, which is self-defeating. The imports are going to be more expensive, so we will buy fewer imports and our tourists will be less likely to spend abroad, because it will be more expensive to do so. Why isn't this approach a logical, healthy approach, and good news for our economy in the future?

Mr. Duesenberry. I think it is basically good news.

What I was afraid of was that we would be in a position of continuing large financial outflows, if we tried to pursue what I would regard as a reasonable monetary policy at home, and have hanging over us for some time to come the pressures which inevitably come from a large deficit. And, now, I think that that shoe has dropped. And I think that it should, as you said, help our balance of trade.

Senator Proxmire. It should also tend to keep us from being too tied up and tight about the balance of payments, so that we are afraid to permit monetary policy to do the constructive, stimulating job that it should do.

Mr. Duesenberry. That is right. I think you were absent when we gave our statement, but in our statement we noted that there is some difficulty about trying to stimulate the economy because of the balance of payments deficit, but we don't think that is as great a concern in any case as people make it. But we said that the proper thing for the United States to do is to pursue that policy, which is correct from a domestic standpoint, and if that results in large deficits, that the surplus countries ought to revalue. And I regard it as good news that the surplus countries are in the process of revaluing, and I think that gives us better opportunity to pursue a correct policy at home. It doesn't, of course, mean that we can just blow our tops and do anything we want. But we can pursue a reasonable and sensible domestic policy without having so much balance of payments constraint.

Senator Proxmire. In the joint prepared statement you seem to set a very high limit indeed on the kind of activity that would be inflationary. You said that a real growth of as high as 8 percent would lead to a costly revival of inflationary expectations. I asked the staff in the few minutes they had here to come up with any years in our history when we have had a rate of growth of eight percent. They couldn't do it. We may have had that in World War II. But, certainly, it is extraordinary in peacetime, perhaps unprecedented.

Mr. DUESENBERRY. I mentioned that partly because some people in the administration a few months ago were suggesting 8 percent.

Senator PROXMIRE. Real growth?

Mr. DUESENBERRY. Yes, sir—people who were talking about getting back to full employment by mid-1972, and things like that, were implying by that an 8-percent rate of growth. And I think that Mr. Stein went further than merely implying it, he gave that figure, and recognized that there were difficulties about modulating out of it. So I used that figure simply because it has in fact been used by this administration.

Senator PROXMIRE. The significance of the figure, then, is that we would have to have an absolutely unprecedented expansion to get unemployment down by the end of next year to a 4 percent level. And we aren't going to do it, in other words.

Mr. DUESENBERRY. That is right.

Senator PROXMIRE. And it also implies that we can stimulate the economy very aggressively without any fear of demand-type inflation being stimulated, in your view; is that right or not?

Mr. DUESENBERRY. That is right, I think that we can stand a higher rate of growth than is now the prospect. Even so, we can't stand, I think, a high enough rate of growth to get unemployment down where we want it by the end of 1972, but we can stand a higher rate of growth than we now foresee as being likely with our present policies. And, therefore, I feel that we can afford some net stimulus to the economy at this time.

Senator PROXMIRE. Mr. Madden, you seem to imply that the Federal budget, even now, might be highly stimulated. And you take a position quite different than Mr. Duesenberry and Mr. Okun and Mr. Goldfinger have taken. The position that you take is that because we have taken the action we did on social security, and because we had before that action about a full employment balance, that this might be a stimulative budget. I think these other economists rely on the national income accounts, and point out that even with that, we will have a surplus in the national income accounts, that being the usual measure of the impact of Government on the economy. Why aren't they right? In other words, are we going to have a budget that is likely to be more restraining and stimulating, or a best and mutual?

Mr. MADDEN. The reason I think that the budget is likely to be in deficit at full employment is my observation of the history of the Government's budgetmaking, which suggests that expenditures are almost always underestimated this far in advance, and that the Congress usually adds to expendutures and are more than the President's budget suggests, either because of increases in what are called uncontrollable outlays, or because of legislative programs that the Congress enacts.

Senator PROXMIRE. Then you are saying that the eventual budget which Congress enacts is going to be stimulative?

Mr. MADDEN. Right.

Senator PROXMIRE: You would agree that this budget is not stimulative?

Mr. MADDEN. As written, it is in balance with full employment.

Senator PROXMIRE. The consolidated budget is in balance. It is in surplus $7 or $8 billion on the national income accounts.

Mr. MADDEN. That is right.

Senator PROXMIRE. So wouldn't you agree that it is a restraining budget?

Mr. MADDEN. It is a restraining budget as it is written, I would agree, on a national income accounts basis. But I think the $6–$7 billion will disappear.

Senator PROXMIRE. I tried to go through your prepared statement as rapidly as I could. I had to be absent, unfortunately. How do you foresee unemployment? I think your colleagues here have told us that they expect unemployment on the basis of policies that the Government seems to be determined to pursue this year, to remain at about 6 percent. That was the conclusion of Mr. Okun yesterday, too. You seem to think that the economy is moving along pretty well. How do you foresee unemployment at the end of the year?

Mr. MADDEN. I didn't state in my prepared statement what unemployment would be. But my opinion is that it will remain above 5½ percent for the rest of this year.

Senator PROXMIRE. Doesn't that pretty much mandate us to take more stimulative action than you have proposed or that the administration has proposed? Isn't 5½ percent by the end of this year much too high a price for us to pay, especially when you recognize that we can reduce it below that without that action being inflationary?

Mr. MADDEN. I certainly agree that it is a rate of unemployment that is too high. But I don't agree that stimulative actions by the Congress would necessarily contribute to the reduction of that unemployment in such a way as to meet Mr. Bosworth's point about the problem of future balance between resources and expenditures.

Therefore, the Chamber of Commerce would propose a consideration of such things as the special revenue-sharing proposal to the President, which includes some public service employment on a triggered basis. We would propose some form of action with respect to the construction industry, which would allow for more opportunities for employment and construction. We would propose more work-training programs and educational programs in the Federal Government. We have been very conscious of the problem of teenage unemployment. And it is our view that a considerable amount of teenage unemployment is the result of a legislative minimum wage which is in excess of the productivity of these workers when they first come on the labor force. And, therefore, we have favored a two-part minimum wage, when the minimum wage would be increased, although we are opposed to the increase in that wage now, by means of which it would be possible for private employers to hire these young workers at rates which they can afford to pay on the basis of the productivity of these workers.

Senator PROXMIRE. My time is up, Madam Chairman.

I just observe that Mr. Madden seems to still come down on the side, unfortunately—I think you are a wonderful man, and you are doing a good job for the Chamber of Commerce, and we are fortunate to have you, but you still come down on the side of 5½ percent or more unemployment, no matter what you do, you still have 4 or 5 million people out of work.

Mr. MADDEN. I do want to add a cautionary note. I do think the committee should pay some attention to the arguments of the monetarists, who hold that we are going to see a stronger increase in economic activity than is apparent now, because of the very stimulated rate of growth in the money supply. I don't know whether they will be right, but I think their view is worth a cautionary mention in respect of the rate of advancing economy, and also with respect to the way in which unemployment behaves.

Chairman GRIFFITHS. I have been interested that the only things suggested yesterday or today that would meet the criteria you gentlemen have imposed really is stepping up the tax cuts. Now, I would like to ask Mr. Bosworth——

Mr. GOLDFINGER. That doesn't include me, Madam Chairman.

Chairman GRIFFITHS. Just a minute.

I would like to ask Mr. Bosworth, especially, would you now put into effect a new welfare bill, the financial assistance plan, or do you think that has some dangers?

Mr. BOSWORTH. No. I would think that if the welfare plan that Congress decides on and wants to enact could be passed, and if it would have an expenditure impact starting the first of the year, yes, that meets the criteria. It is just that Congress should not be forced to act in its overhaul of the welfare plan by some argument that says, you have got to do it right now, and not fully consider all the costs and other issues involved, because of stabilization needs. Increased welfare expenditures would have a stimulative import. But it is a big social program that should not be poorly designed because of the short-term desire for stabililization.

Chairman GRIFFITHS. Would you put into effect a national health plan?

Mr. BOSWORTH. All of those things are desirable at the present time, since the increased expenditures are consistent with the stabilization goal; but this should not be a primary criteria for their enactment.

Chairman GRIFFITHS. I would like to ask Mr. Goldfinger this. I am a real supporter of the $2 minimum wage. But I am supporter in a very particular area. I want to put into the welfare bill a provision that if any person is employed in a domestic capacity at home or outside the home, and paid $2 an hour, the person doing the employing can deduct it from their income tax in exactly the same way any other employer can deduct it. Would you support that or not?

Mr. GOLDFINGER. I would have to think about that. In other words, you are suggesting a subsidy for domestic employment; is that it?

Chairman GRIFFITHS. You subsidize it, and everybody else is, why not them? Is is because they are women and because you are saying that their work, therefore, is of no value?

Mr. GOLDFINGER. No, it is most certainly not because they are women, and certainly not because their work is of no value. The work is of great value to families and to society.

Chairman GRIFFITHS. Right.

Mr. GOLDFINGER. We are for universal coverage. And we are certainly for protecting domestic employees, as well as others.

Chairman GRIFFITHS. Then why not treat them just like everybody else, and let the employer deduct it? You subsidize every other person. The Federal Government is subsidizing other employees. Why not these people?

Mr. GOLDFINGER. I would have to take a look a this, at the costs, and look at the aggregate amount. It is an interesting idea which I have not considered, Madam Chairman.

Chairman GRIFFITHS. What would you do, Mr. Duesenberry?

Mr. DUESENBERRY. Like Mr. Goldfinger, I would like a few details. I wasn't quite clear whether you meant, for example, that if a working wife employs domestic help while she is at work, that she will be able to deduct it—I think you are suggesting that she would be able to deduct it as a business expense.

Chairman GRIFFITHS. Sure. Why isn't it an expense? You have given somebody a job.

Mr. DUESENBERRY. I understand that. And since I have a working wife, I have a great deal of sympathy for that approach. So I think I had better stop by simply expressing my sympathy for that approach until I see the details of your bill. I would be glad to send you a comment after I see the details. But I don't have any idea what the costs would be, or who would be the beneficiary, and what would be the income distribution of benefits and things of that sort.

Chairman GRIFFITHS. The very first consideration of everybody would be to say, only the rich are going to get it, it will be a benefit to the rich—50 percent of today's wives are working, so it is going to be a benefit to those women. But it is going to be chiefly a benefit to the women who are employed as domestics. Why shouldn't they have that advantage? Why shouldn't they have a $2-an-hour minimum wage?

Mr. GOLDFINGER. They should.

Chairman GRIFFITHS. Of course they should.

Mr. DUESENBERRY. I don't want to make a negative argument, but I have learned enough caution that I don't want to endorse something I haven't seen.

Chairman GRIFFITHS. I have asked the tax experts over and over again—I am convinced that the real reason they have never been considered is because America is saying that that work is of no value. And if that is what they are saying, then we are wrong. And it shouldn't be said, the work is of value. It is just as valuable as to have somebody out working in a factory. It makes life a lot more pleasant, too, whether your wife is doing the work or whether you are employing somebody to do the work.

Would you like to comment?

Mr. BOSWORTH. No.

Mr. MADDEN. I would.

Chairman GRIFFITHS. I would like to hear your wife's comments. But go right ahead.

Mr. DUESENBERRY. I was about to say that I could get you an endorsement from my wife.

Chairman GRIFFITHS. I have a built-in constituency.

Mr. Madden.

Mr. MADDEN. In my prepared statement I have pointed out the impact of the environmentalists and the welfarists in their challenging the current definitions of wealth and income. Of course, the work of a housewife herself is not now included as a part of the wealth and income calculated in the GNP. Leaving aside the question of the legislative wage rate which the Chamber as a monitor of a policy opposed, I think the Chamber would be very interested in examining the proposal that this type of employment be considered a normal part of the gross national product, and that, therefore, it be considered appropriate to treat such employment costs to the employer in the tax laws symmetrically with other types of employment. And I think it is part of a general class, I am trying to say, of wealth, which we have not previously calculated, measured, an income which we have not previously calculated and measured, which is, relatively speaking, not creative of waste and pollution, but which, in fact, adds to human welfare. I think there is a whole class of such types of wealth which we do not now consider to be wealth which we should examine.

Chairman GRIFFITHS. I would appreciate it if you would do so. I think it would be tremendously interesting. I think there would be some gain in taxes, because, of course, a woman employed in that way would be paying taxes. We would also step up the collection of social security taxes. So that it would have some merit from that standpoint.

At any rate, I hope all of you will consider it, because this is really one of my pet programs. At the present time, a couple making less than $6,000 and paying only $600 for a babysitter can deduct it. So that it is really quite inequitable. If it works for them, it should work for everybody. And I think it is a misguided view of labor value.

I would like to say something more about the welfare bill. One of the problems that we are now encountering is that, having set a floor which will pick up a good many States completely eight southern States, I believe, now we have objections that we should also help pick up northern States to a greater extent, we should pay a percentage of what they pay. Now, personally, I am opposed to this because I think what you ought to have is a universal payment paid by the Federal Government, and permit the person receiving the money to go to that area of the country where he gets the best deal. I think that is the error of our welfare in the beginning, that it pays you to produce children, and, secondly, it pays differently according to where you live. Jobs don't do that.

So that we have, in my opinion, two built-in errors in the system. And I think that if we had a proper—and I don't think you can do that—but if you have a proper floor you can rely on the people drawing the money to have sense enough to go to the area where that money buys the most. They are already doing that. So there is no reason to assume that they are going to fail.

Now, if we add to the welfare bill this new percentage thing, we are right back at the same old stand, at least in my judgment. And I think this welfare bill—and I hope it passes—is going to be something beyond anyone's imagination today. You cannot really estimate what is going to happen from this welfare. In the first place, I might say that the expenditures are going to be much greater than anybody has ever thought.

I would like to express my appreciation to each of you for being here. I thank you very much. It has been very nice. And I am going to leave you to the tender care of Senator Proxmire.

Senator PROXMIRE (presiding). I just have a very few more questions.

Mr. Goldfinger, how do you answer the points made by Mr. Okun yesterday and Mr. Duesenberry and Mr. Bosworth today, that public works are much too slow a way of stimulating the economy in the short run, we need short-run stimulation now? Yesterday, it was pointed out that in 1962, I think, the administration began to put into effect stimulation through public works, and it took almost 2½ years before it could really get rolling. And it wasn't until almost 5 years that they began to complete the short-term public works program that they had begun in 1962. And by that time, of course, it was just the wrong time for it.

Mr. GOLDFINGER. First, sir, in terms of the 1962 legislation, which we strongly supported, that legislation didn't go into effect until the tail end of 1962 or early 1963, in terms of the funds and so forth. There was no preparation. And the staffs in the various agencies like the Commerce Department were not prepared to really move.

Senator PROXMIRE. Of course, that would be true now wouldn't it?

Mr. GOLDFINGER. No, I think the thing is different now. We now have had a period of years during the 1960's, Senator Proxmire, in which we had some growing emphasis on public facilities and public services, so that there is now a backlog, and quite a backlog of various kinds of public investments, with plans. And what we have been suggesting is a program that could move forward fast, and also a program to meet our general social needs. We are not saying——

Senator PROXMIRE. Can you give me a notion of the kind of public works, because I know these big projects, the Trinity River project, the Cross Florida Barge Canal project, those kinds of things take years to get moving.

Mr. GOLDFINGER. No, we are not talking of that sir. I am quite sure—I haven't done this, but I am quite sure that if you speak to the mayor and the officials of the city of Milwaukee you will find that there are quite a number of short-term projects ready to go, which are being held back for a lack of funds.

Senator PROXMIRE. That is right. But wouldn't that fit into expanding the grant program and releasing impounded funds?

Mr. GOLDFINGER. I think we need both. I endorsed both at the very start of the hearing. I think that we need the release of impounded funds, particularly for programs to meet socially vital needs. And I think we also need a step-up of short-term public works programs in areas of high unemployment. There are some cities in this country at this time which are disaster areas—New Bedford, Mass., for instance, for one, Seattle, for another, and Muskegon, for another.

Senator PROXMIRE. Of the 16 largest American cities, 13 are in desperate financial shape—New York, Chicago, Detroit, and Newark. Many of those mayors testified before our committee earlier this year.

Mr. GOLDFINGER. In our statement to the Public Works Committee of the House, Mr. Meany stated that the funds should be available to initiate or step-up only those public works programs which meet an urgent public need and which can be initiated or accelerated within a reasonably short period of time.

Furthermore, I think that the immediate problem should be meshed with the long-term problem. The long-term problem of American society is to meet the backlog needs to rebuild the cities, urban mass transit, education, health care facilities, pollution controls, and so forth. And I think that we should begin to mesh some of those long-term programs with our immediate need—for example. water and sewer projects, which are related to pollution controls and things of that sort, which can be stepped up now and which should be stepped up now. It would create jobs in the areas of high unemployment. And it would stimulate the economy.

I don't understand the reaction on the part of the other gentlemen on this panel, the reaction that I frequently hear from conservatives, such as the other gentlemen on this panel—I mean this seriously, because the gentlemen from Harvard to me are conservative—they view public investment as something downgraded from private investment. I believe public investment is important. It is essential, socially. It has similar kinds of economic impact in terms of employment and in terms of multiplier impact. And I don't understand why public investment is downgraded and private investment is upgraded. I am not opposed to private investment.

Senator PROXMIRE. If you are referring to Mr. Duesenberry, he has been called all kinds of things, but I haven't heard him called conservative. He may be happy to be called that. I just wonder if that is consistent with his argument, which coincides with yours today, that he is against the administration's depreciation proposal, which was a way of encouraging private investment and which he feels is untimely and ineffective.

Mr. GOLDFINGER. We agree on a number of things. I even agree with Mr. Madden on a number of things, and they are all friends of mine.

But there is a kind of attitude which is found in many circles, that something is inherently wrong with public investment, and something is especially holy about private investment. I want to insist that we need both. Furthermore, in terms of American society, I think that in the 1970's, where there must be a shift to some greater emphasis on public investment.

Senator PROXMIRE. Before I call on Mr. Duesenberry, let me say a word as to why I strongly disagree with the notion that being opposed to many public works is not necessarily being opposed to public investment.

We followed for years a discount factor in appraising our benefits in public works that was most unrealistic. It was down to around 3 percent. We discounted the future benefits that would justify the public works at 3 percent. We have gotten that up to 4¾. In the private sector investments aren't made until there is a return before taxes, and that is a fair comparison at 12 percent. So what we have been doing is moving funds out of the private sector, where there is a much bigger return, into the public sector, where there is a much lower return. Mr. Otto Eckstein has made a very exhaustive study of this, and I haven't seen it challenged on the basis of its assumptions. I haven't seen it challenged on the basis of its merit in any sense. And he is not saying that we shouldn't have public investment, he is not saying that we haven't starved the public sector in some ways, but he is saying that we ought to rationally, cooly look at this. And to the extent that you can get a better return in the private sector, and you don't have value judgments that would suggest that you move the resources in any way, you ought to leave those resources in the private sector.

I don't know any economist other than perhaps you, Mr. Goldfinger, who would disagree with that notion, that this is an economical, efficient way to operate.

Mr. GOLDFINGER. I am not disagreeing with that basic principle, sir. But I am disagreeing with the continuing downgrading of public investment that you hear frequently at this hearing and elsewhere.

Furthermore, sir, you know much better than I do about the wasteful private investments that we have had in this country in the past number of years, where millions of dollars, in periods of very tight money, were going into private investments for such purposes as conglomerate takeovers. You have the example of Penn Central. You have other examples which you and others have documented. You have the example of investments in gambling casinos and, furthermore, you have the continuing large scale outflows of private capital to foreign subsidiary operations, which are causing other kinds of troubles. So that I don't think that there is anything especially holy about private investment as against public investment.

Senator PROXMIRE. I would agree with that. I would just like to put them on something like the same basis in terms of your discount. The discount is another way of saying a profitability factor. In other words, if you can invest in the public sector in a way that can show and you can get a good return, go ahead and do it, and make assumptions that are fair so that you can have that return calculated on an equitable basis. You can't do that with everything, I would agree, of course, you can't. But in many of the hard investments, such as the dams, the roads and the other things that the Federal Government is engaged in, that kind of a comparison, it seems to me, is reasonably objective and fair.

Mr. GOLDFINGER. I am highly suspicious of the computer approach to the cost-benefit analysis on public investment. It is garbage in and garbage out. And you get an awful lot of subjective judgments involved in assessing the benefits, sir.

Senator PROXMIRE. Mr. Duesenberry.

Mr. DUESENBERRY. I guess I deserve a reply after having been called a conservative. I don't think anybody but Nat ever called me a conservative in the past.

But on the substantive issue, first of all, I agree on the necessity of getting a more reasonable rate of return criterion for our public investment. And I think it has to be emphasized, it isn't a question of whether one is for public investment or against public investment, it is a question of what kind of public investment. And the kind of public investment which gets encouraged by emergency programs, I think, has not in the past been particularly good public investment, and uses up resources which at a later date turn out to be badly needed for other types of public investment.

So what we are urging is that the Congress try to adhere to a priority list for support of public investments which will give the highest returns which we can get from our limited resources. And we know that there are certain areas where we badly need school buildings. We know that in some areas we need health facilities, we need local health centers and clinics and all kinds of things of that sort, and we also know that from our experience the Congress, when it passes legislation supporting public works for short-term stabilization policy often opts for highways or Corps of Engineers projects which, generally speaking, are projects which come in very marginally even with the cost-to-benefits rules of the game.

So that our emphasis has been on trying to support those public investments which would give the public the highest return for their investment.

Now, it is also important to say, I think that when we talk about public expenditures—that there are lots of investments, that don't involve brick and mortar, and we are making choices here between highways, between Corps of Engineer projects, and between health facilities and education facilities, and also between expenditures on welfare and expenditures on current outlays rather than capital outlays for public health. And it is an extremely difficult task that Congress has in trying to arrive at reasonable judgments as to where the priorities actually lie. And we simply don't want to get into a situation where we distort the long-term priorities in an effort to deal with a short-run situation. So what we have urged is that we try to use the criteria, which I won't repeat again, to get us as much stabilization effect as we can with as little distortion in our long-run priorities for public investment of both the bricks and mortar type and the human type. And if that is a conservative position, okay, I am a conservative. But I hope that is a liberal position.

Mr. Madden. I want you to know that I agree with Mr. Duesenberry on all of the points that he just made. And if that makes him a conservative, I guess he will just have to live with it.

Senator Proxmire. I have always been proud if people who were conservatives called me conservative, and I have had people who were liberals call me liberal.

Mr. Goldfinger, I think you have been probably called a conservative in a constructive way, too.

Mr. Goldfinger. Yes. I don't think it is an insult to be called a conservative. I use it as a description of one's basic philosophy and/or policy proposals.

Senator Proxmire. I would just like to ask Mr. Duesenberry one question.

You said that you thought we had bottomed out and we are moving up. That seems to be the general consensus among the economists. But it is hard for us on the committee, in talking to the staff of the committee, to really see the basis on which you make this optimistic assumption. If you exclude the effects of an auto strike, we find that the first quarter was below the last quarter of last year. And now it is true that we have had a good recovery in housing. It is true that the retail sales seem to be moving up somewhat. But it is awfully hard to see that we can confidently say that we have turned the corner and now we can look forward to a period of expansion. How are you so confident about that? How can you assert that without qualification?

Mr. DUESENBERRY. I hope I didn't assert it without qualification —perhaps I did about 1971. I think we have bottomed out and are moving up slowly at present. But I think the first quarter—the fact that the number was very big has no significance. And various people have processed their numbers in various ways and whether you get the zero rate of growth or a negative rate of growth, excluding the effect of the auto strike, is a matter of exactly how you process those figures. But given that there was an auto strike in the fourth quarter, what happened in the first quarter is nothing to write home about. And we don't anticipate rates of growth at a dollar GNP of anything like that magnitude in the coming quarters. That is why we concluded that there would be relatively little change in the unemployment rate for the year.

Now, there are positive forces working in the direction of some expansion. Federal expenditures including transfer payments will be rising through the year. Residential construction is rising. There will be some very modest rise in plant and equipment investment. And consumers have received considerable increases in personal income in the last couple of quarters. So that we anticipate that consumer expenditures will move up.

Now, any return to any substantial rate of growth in 1971, and any high rate of growth in 1972, is in part predicated on the assumption that the savings rate will be declining.

Now, most of the forecasters, faced with the fact that the present rate of savings is unusually high, have put into their formal calculated forecast a gradual reduction in the saving of rates from where it was down to some place below 6½ percent.

Now, they have put it in at an even rate. They did that not because they have some scientific knowledge which tells them that the savings rate is going to gradually fall, but because they said it is unusually high now, and it will probably go down sometime, and it might go down quickly, it might go down slowly, the middle of the road position is to just smooth it out and take it down a little bit each quarter. The fact is that we don't really know. But that means that we cannot have complete confidence, that we are going to have even the modest pace of growth for the rest of 1971 that we suggested, or a rapid expansion in 1972. We think that is a reasonable judgment as to what will happen. It is possible, because the savings rate might fall quite quickly that we could be on the upside of our estimates.

Senator PROXMIRE. If the savings rate didn't fall at all, or increase, you may be wrong, and you may not have bottomed out?

Mr. DUESENBERRY. That is right. That is why we thought that one has to take the position that there is bound to be a great deal of uncertainty about these forecasts. If we can take a stimulative action, we take a risk that everything else will turn out to be on the high side, and we will regret that. It is also true that everything might be on the low side. And I think in that case we would even more deeply regret that we did not take that action. So we conclude that, facing the fact that there is a great deal of uncertainty about forecasts, we think some stimulative action here would be the sensible, cautious gamble.

Let me add one thing, if I may. I think there is a tendency in the past few years for us to develop the rhetoric of policy recommendations—and I have participated in some of it. Anyone who makes policy recommendations says, now, if you don't do what I say, there will be disaster, and if you do do what I say, you will be completely happy. I think we make a mistake doing that. Many of us are afraid to say, I am very uncertain as to what will happen, and I am uncertain as to the right policy. We fear that the Congress will say, why should I pay attention to a fellow who is as uncertain as that. So we came to soup up our rhetoric and say, we know the answer, but the fact is that there is a lot of uncertainty in life and making a policy is trying to buy the right kind of insurance against the right kind of danger.

Senator PROXMIRE. That is a very helpful and honest response. Everything I have seen indicates that the economic forecasts beyond 6 months ahead, aren't very good, even from the best economists. Some people have said that you might as well go out on the street and get a taxicab and ask the cab driver what is going to happen a year from now, maybe he could give you just as good an answer as the economist.

The Bureau of Economic Research made a study in which they analyzed the forecast of the best academic, Government, business, and labor economists that they could find. And they came up with the conclusion that they were pretty good for 6 months, but after that flip a coin, or, as I say, consult your friendly cabdriver.

Just one other question for the panel. There has been a great deal of speculation about the administration's plans to bail out the Lockhead Corp. from its financial difficulties. A Federal loan guarantee appears to be the approach that will be taken. As you know, Lockheed's current crisis stems from the L-1011 airbus project, which is a commercial project, not a military one. The justification for rescuing Lockheed seems to be based on a fear that bankruptcy of such a large corporation would add to the unemployment problem and would disrupt the entire economy.

I would like for each of you to respond to these points, and also to give us your views on the potential economic impact of the bankruptcy of the Lockheed Corp. Will it necessarily create additional unemployment and will it disrupt the economy? With all the over capacity that now exists in both the airline industry and the aircraft manufacturing industry, is there a national interest in this program?

Mr. Duesenberry, will you lead on?

Mr. DUESENBERRY. I just arrived here after having made a speech in California so I have already had to answer that question.

Senator PROXMIRE. I had better stay away from California. It seems that if you go out there you catch Lockheeditis.

Mr. DUESENBERRY. I was not there long enough to catch anything. And I have to confess that I have not followed the details, so that I can't really answer the question as to exactly what effects bankruptcy would have. Of course, it is often the case that a bankruptcy doesn't stop production, it only is costly to some of the debtors and the stockholders. And I don't know exactly what would happen in the event of a bankruptcy.

I can only say that I view the notion of bailing out private companies on this scale with a great deal of caution. I am not in a position to assess all the details. I think that Congress before it engages in this, should really assure itself that there is indeed a very important effect. And I am very skeptical that the damage that would be done to the economy from this kind of a thing is so great that it would justify the Congress making that commitment. As I say, it is possible that after you examine it, you will find that out. But I think you ought to examine it very carefully before you make that commitment.

Senator PROXMIRE. Mr. Goldfinger.

Mr. GOLDFINGER. First, like Mr. Duesenberry, I have not followed this particular issue in any detail. But I am skeptical of the Federal Government bailing out private businesses from difficulties, which result from their own mismanagement.

Second, I think that if Congress moves ahead on the basis of the facts, perhaps there should be some governmental quid pro quo, in other words the corporation would not merely be required to pay back the loan with interest, but there should be some kind of quid pro quo for this process. I am not sure what kind of quid pro quo. But, as Mr. Duesenberry said, I share some skepticism about the idea of the Government bailing out private businesses. If such a thing is done, perhaps there should be a quid pro quo that the Government should require from the corportation. I do certainly believe that the Federal Government should be the lender of last resort in areas of social need, such as housing, public facilities, and so forth. I am not so sure that it should act in that fashion for private corporations.

Senator PROXMIRE. Can you give us some idea as to what possible quid pro quo there should be, what you have in mind in suggesting it? It is very appealing to me, but I am not quite sure what you mean.

Mr. GOLDFINGER. I am not acquainted with the details. I haven't thought this through and have not examined the facts in the case.

Senator PROXMIRE. Would you have in mind, for example, that if the Government goes ahead and does this, that we insist on a new management?

Mr. GOLDFINGER. I don't know that that would be a quid pro quo.

Senator PROXMIRE. Is this a possibility?

Mr. DUESENBERRY. If I may interject, I think what Mr. Goldfinger has in mind is that the Government should get a piece of the equity. Whether that takes the form of getting some of the stock, as lenders of last resort do, or whether they should get something like some insurance companies have got, some profit-sharing——

Senator PROXMIRE. A piece of the action.

Mr. DUESENBERRY (continuing). Arrangement. It is a game in which the Government is asked to put up a fixed interest loan, and it loses it if the thing goes down, and it doesn't win anything if it turns out to be successful.

Mr. GOLDFINGER. This is more in line with what I had in mind, which was just off the top of my head.

Senator PROXMIRE. How would you like to be the Boeing Co. or the McDonnell Douglas Co. in competition not only with Lockheed but the Federal Treasury? Where in the dickens do you draw the line?

Mr. GOLDFINGER. That is one of the reasons why I have some doubts about the process.

Senator PROXMIRE. And when you get into that kind of quid pro quo where the Government holds some stock, or is part owner, it is a pretty nice owner to have, pretty rich one, too.

Mr. Madden.

Mr. MADDEN. Well, the Chamber of Commerce as an organization is limited in its attention to issues, to policy questions which have three characteristics; that they are national in scope, that they are general in their application to business and industry, and that they are timely. And on the basis of these three criteria, the National Chamber would not take a position on the question of the Lockheed matter as such. And, therefore, I can't comment on it.

I could add these remarks, from the background of the Chamber's thinking. The first of these is that as an organization which favors the enhancement of the free enterprise system, we have long recognized the appropriateness of George Stigler's commentary about the social value of bankruptcy. Bankruptcy, Stigler argues, is one of the great inventions of the free enterprise system. It allows for the reorganization of activities which are no longer sufficiently useful to remain liquid. And so I think support of the free enterprise system generally would require support of the institution of bankruptcy.

But, second, I think that the defense industry, as it has been studied by men like John Corson, in his book, "Business and Human Society," is a very difficult industry to interpret through the usual perspective of the free enterprise system as such. It is an industry in which major decisions of the management type are, in fact, made by Government. Perhaps, therefore, a line of approach that might be fruitful in examining a particular question as this, having in mind the situation of competitors in the defense industry to Lockheed, would be for the Congress to examine the general question of how to adapt industries of this type to new forms of activity, so that the treatment would be equal and the rules would be consistent among these various companies.

Senator PROXMIRE. The Chamber of Commerce isn't going to get in bed with Professor Galbraith, who proposes that the Federal Government just take over defense contractors.

Mr. MADDEN. No, we would not. We think there have been some advantages to the relationship between the Defense industries in private hands and the Government. We are also aware that there have been some difficulties. However, on balance I think that we would favor the principle which is being discussed more and more with respect, not only to defense but with respect to other public services, that contracting out these public services under a sound public policy basis might very well lead to economies in the production of services by private industry which are legislated as being social purposes.

Senator PROXMIRE. If I may just pursue that, Mr. Madden, you contract out the service of providing the planes and tanks and other things that are produced by a firm like Lockheed. We are not talking about that. If that were the question, I think you would have a very strong case for some kind of Government assistance. We are talking about something which is completely private, a commercial air bus sold in competition with other private firms. The fact is that Lockheed is a big Defense contractor, the biggest. But the guarantee is related directly to the L–1011.

Mr. MADDEN. I think this is the point at which the chamber of commerce would not comment.

Senator PROXMIRE. But it stands by the Stigler principle that bankruptcy can be a useful alternative?

Mr. MADDEN. Well, it certainly is expounded in the document that we provide to businessmen for their education.

Senator PROXMIRE. Very good.

Gentlemen, thank you. This has been most useful. I apologize for keeping you so long. But it has been very fine testimony.

Mr. GOLDFINGER. Excuse me. I want to explain that my comments on Lockheed were my own, and the AFL–CIO has not taken any position on the Lockheed issue.

Senator PROXMIRE. Very good.

The subcommittee will meet on Friday, a week from tomorrow, on May 14, in room 318, when we will hear Frank Schiff, Committee for Economic Development; Beryl Sprinkel, Harris Trust & Savings Bank; and Prof. Henry Wallich, Yale University.

(Whereupon, at 12:45 p.m., the subcommittee adjourned, to reconvene at 10 a.m., Friday, May 14, 1971.)

63-247—71——9

LONG-TERM ECONOMIC IMPLICATIONS OF CURRENT TAX AND SPENDING PROPOSALS

FRIDAY, MAY 14, 1971

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON FISCAL POLICY
OF THE JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The subcommittee met, pursuant to recess, at 10:05 a.m., in room 4221, New Senate Office Building. Hon. Martha W. Griffiths (chairman of the subcommittee) presiding.

Present: Representatives Griffiths, Widnall, and Conable.

Also present: John R. Stark, executive director; James W. Knowles, director of research; Loughlin F. McHugh, senior economist; Courtenay M. Slater, economist; George D. Krumbhaar, Jr., minority counsel; and Walter B. Laessig and Leslie J. Barr, economists for the minority.

OPENING STATEMENT OF CHAIRMAN GRIFFITHS

Chairman GRIFFITHS. This morning we have the third of four panels of experts coming before the Subcommittee on Fiscal Policy to give us their advice concerning the long-term economic implications of current tax and spending proposals. Every passing day provides new evidence that these longer-run implications may be of vital importance in the decisions to be made between now and the fall.

This morning we are especially fortunate in having three experts, not only with high qualifications, but also with different backgrounds. The lead-off witness, Frank W. Schiff, has had a highly distinguished career which has led up to his present assignment as the chief economist for the Committee for Economic Development.

Our second witness, Beryl W. Sprinkel, is one of the most able exponents of monetary school of general analysis, and he is now senior vice president and economist for the Harris Trust & Savings Bank.

The third of our experts in Henry C. Wallich of Yale University, formerly a member of the Council of Economic Advisers. He has been advising organizations in and outside the Government for many years, including the U.S. Treasury.

Gentlemen, we feel like we are welcoming you home again, in a sense. We are delighted to have you, and we will hear from each of you in turn and then proceed with the questions.

Mr. Schiff, you may lead off.

STATEMENT OF FRANK W. SCHIFF, VICE PRESIDENT AND CHIEF ECONOMIST, COMMITTEE FOR ECONOMIC DEVELOPMENT

Mr. SCHIFF. Thank you, Madam Chairman and members of the subcommittee.

I greatly appreciate the opportunity to appear before this distinguished subcommittee. The basic issue which you are considering today—how fiscal measures that may be needed for short-term stabilization purposes can best be reconciled with the longer-term requirements of optimal resource allocation and overall price stability—is of central importance in national economic policymaking. The subcommittee, in my view, deserves great credit for placing the spotlight of public attention on this issue and for exploring it in such a very careful and systematic manner.

I should like to stress at the outset that my comments this morning are made in a purely personal capacity and do not necessarily represent the views of the Committee for Economic Development. Also, it shall not be my purpose to propose a specific program for action. Rather, my focus will be on the procedures and criteria that should be used in choosing among alternative measures of fiscal stimulus, should these be required because of inadequate economic expansion or a need to improve the fiscal-monetary mix.

A basic consideration underlying all such choices, of course, is the fact that given present tax rates and existing commitments for Federal expenditures, the amount of Federal fiscal resources available for meeting additional needs over the next 5 years will be extremely limited. This has been forcefully demonstrated by the projections cited in the annual report of the Council of Economic Advisers and even more dramatically in the newly published study by Charles Schultze and associates of the Brookings Institution.

The latter study indicates that there will be no potential excess of full employment revenues over already committed expenditures between now and 1974, and that the margin of unallocated fiscal resources in 1976 will amount to only 1 per cent of gross national product.

The severity of the problem suggested by these figures is highlighted by the facts that a noninflationary budget at full employment is likely to call for a sizable surplus; that potential demands for new budgetary initiatives are enormous; and that the public is likely to demand not merely a continuation of current rates of expansion in a wide range of existing services at all levels of government but major efforts to make up for past and current deficiencies in the scope and quality of many of these services.

The solution to these problems clearly must involve much more than Federal budgetary allocation as such. There can be no doubt, however, that competition for available fiscal resources will be extraordinarily keen as the economy reapproaches full employment, and that decisions with respect to the use of short-term stabilization measures should take full account of their impact on long-term resource allocation.

THE FULL EMPLOYMENT BUDGET: A DYNAMIC APPROACH

Before turning to the relative merits of particular stimulative measures in the longer-range perspective, I should like to make some general comments on the contribution which use of the full employment budget concept can make in bridging the needs of short-term stabilization policy with longer-range economic priorities.

The administration's formal espousal of the full employment budget concept as the basic guide to fiscal policy constituted a major advance in rational fiscal management. As you know, this concept—which was initially evolved by the Committee for Economic Development in 1947—has essentially two broad aspects. First, it makes for better stabilization policy by allowing a distinction between the effects of the budget on the economy and the economy's effects on the budget.

Thus, the rule that fiscal policy should be geared to the budget position which the economy would achieve with given tax rates and expenditures if it were operating at full employment means that there needs to be no effort to offset deficits caused by revenue shortfalls associated with lagging economic activity.

Secondly, the concept makes possible the use of the rule that expenditure programs and tax rates should normally be set to produce a surplus or balance in the budget at full employment. This provides a needed element of discipline in the budgetary process.

It is essentially designed to assure that fiscal measures taken when the economy is at less than full employment will be consistent with the desirable long-term position of budget and will not lead to excessively expansionary pressures when full employment is reached.

While these are basically highly useful concepts, it must be recognized that an overly strict and static application of the second of these rules may pose a dilemma in terms of stabilization policy. Gearing fiscal policy to a given level of the full employment budget lets the so-called built-in fiscal stabilizers do their work; it does not necessarily mean that the economy is receiving sufficient fiscal stimulus at a time when overall activity is lagging.

If added fiscal stimulus is required, this calls for a change in the full employment budget from a larger surplus to a smaller one or from a surplus to a deficit. But since the proposed fiscal 1972 budget was designed to be virtually in balance at full employment, strict adherence to the disciplinary prescription in the budget message—that "except in emergencies," the full employment budget must never be in deficit—would seem to leave no room at all for even relatively modest discretionary actions to provide additional fiscal stimulus. In other words, the stress which the rule attaches to what might happen once full employment is actually reached may in fact serve as a major obstacle toward getting there in the first place.

How can this dilemma be resolved? One way would be to justify any additional move toward fiscal stimulus as an emergency measure. Another would be to define the full employment budget target in terms of the national income accounts rather than on the unified basis used in the January budget; in this case, the January budget can originally be said to have left room for $7 billion or more of additional fiscal stimulus. But while I do prefer the use of the national income accounts basis for measuring fiscal effects, neither of the possible solutions cited is really satisfactory for resolving the dilemma that I have posed.

In my view, the proper solution—and one that is entirely consistent with the basic rationale of the full employment budget principles—is to move away from a static and overly mechanistic interpretation of these principles and to interpret them in a more dynamic fashion.

To be more specific: The full employment budget concept shows what the budget results would be at any particular moment of time if existing tax rates and Government expenditures levels were maintained but the economy were operating at full employment. As I indicated in a recent speech before the American Academy of Political and Social Science:

> This instantaneous or "snapshot" view of the high employment budget is clearly a very useful first step in the development of an appropriate fiscal policy.
>
> It needs to be supplemented, however, by greatly increased focus on the course of events that are likely to occur on the path to full employment if various additional measures were taken.
>
> On this interpretation, a movement toward lesser surplus in the full employment budget—or even toward deficit—that may be needed to promote recovery should be considered appropriate provided that the means chosen are such as to assure a termination or reversal of the extra stimulative impact once this impact is no longer required.

In making this suggestion, I do not mean to imply that there may not be some economic circumstances which would call for stimulative measures that do not conform to the self-liquidating principle. Nor do I ignore the fact that a scheduled phasing out of particular programs at full employment may in practice not always be easy to accomplish. It does seem to me, however, that when additional fiscal stimulus is required, every effort should be made to place primary initial stress on the use of measures that contain the self-liquidating feature.

CHOOSING AMONG ALTERNATIVE "SELF-LIQUIDATING" STABILIZING MEASURES

The subcommittee is already fully familiar with the list of possible measures of additional fiscal stimulation that fall in this category. On the tax side, the list includes the already enacted postponement of scheduled increases in the social security tax base as well as acceleration to this year of the personal income tax reductions already scheduled for 1972 and 1973. Actions on the expenditure side encompass a speedier disbursement of some funds that have already been appropriated (assuming that they would be spent at a later time in any event); earlier than scheduled initiation of proposed new programs that still have to be passed into law, notably the family assistance plan; and initiation of a public service employment program that would vary in volume according to a trigger mechanism determined by the level of unemployment and that would be gradually phased out as the economy moves back to full employment.

Also in this category would be special emergency grants to States and localities—or temporary changes in grant matching formulas—that might be specifically geared to national economic conditions, i.e., that would essentially be designed to compensate these units of Government for part of the shortfall in revenues caused by the overall weakness in the economy. Finally, the list would presumably include proposals for initiation of a large-scale public works program of limited time duration.

The choice among these alternative self-liquidating measures must clearly be based on a wide range of criteria. How quickly can a particular measure be initiated? How large will be its impact relative to the amounts expended? How clear an assurance can be given that the measure will in fact be self-terminating once it is no longer needed? What is its likely effect on cost-push and on productivity? What is its likely contribution toward meeting longer-term social and economic needs?

Of the various measures cited, the initiation of a large-scale public works program would appear to fare poorest in terms of the range of criteria mentioned. Past experience suggests that it takes a very long time to initiate such programs. Moreover, they often tend to reach their peak activity only when they are no longer needed for stabilization purposes and may, in fact, be counterproductive.

Since cost-push pressures have been exceptionally strong in the construction sector, furthermore, large new public works programs might serve to aggravate such pressures substantially. To be sure, some selected releases of funds for particularly useful public works activities might perhaps have an appropriate place within a suitable overall program of fiscal stimulation, particularly where they involve assistance to already on-going projects that might otherwise have to be curtailed or abandoned. However, a really massive and nonselective public works program strikes me as quite unsuitable under current conditions. These criticisms, incidentally, probably apply at least in part to proposals for the release of so-called frozen funds that have already been appropriated, since a sizable proportion of these funds is apparently earmarked for new public works projects.

By contrast, acceleration to this year of already scheduled reductions in personal income tax exemptions and increases in the standard deduction would receive a high score in terms of many of the criteria cited earlier. Such a step could be initiated very promptly; the magnitude of its potential impact would probably be greater than that of any other single stimulative program that might be devised; and there would be full assurance that such a step would not involve an added revenue loss in later years (unless one were to assume that there is still a chance to defer the reductions scheduled for 1972 and 1973.)

It may well be that for the reasons cited, this type of a personal income tax reduction will have to play a key role within any overall program of fiscal stimulation that might be needed. Yet it would strike me as quite incongruous if personal tax cuts of the type described were to be used as the sole or the principal means of added fiscal stimulus at a time when unmet human and environmental needs are so enormous and when there are almost daily reports of cutbacks in vitally needed services by our States and cities.

For these reasons, I believe that every effort should be made to give first consideration to those new fiscal measures that fare reasonably well in terms of the other criteria cited but that also make a contribution toward meeting the country's higher-priority needs. It does not seem to me beyond the realm of possibility that a reasonably sizable package of such measures could be designed that would permit relatively speedy initiation and have a significant quantitative impact.

The package should certainly include a temporary public service employment program that is geared to the level of unemployment, and that is also associated with enlarged manpower programs—and particularly, with training and adjustment asssitance programs which would aid in promoting private employment as soon as this is possible.

A temporary public service employment program should not only provide productive job opportunities for persons of lesser skills who are unable to obtain private jobs, but should also make use of the talent of some of the high-skill unemployed who may be able to make particularly significant contributions to the solution of our urban and environmental problems.

Another element in the package might be a further extension of unemployment benefit periods and a more liberal system for triggering such benefits when unemployment rises. In addition, it would seem to me that there should be special stress on possible earlier initiation of desirable longer-term programs and on the types of temporary grants to States and localities—or changes in matching formulas—that are specifically geared to the level of unemployment or to shortfalls in tax receipts. To an important extent, the latter types of programs need not entail the initiation of entirely new activities, but would merely help prevent reductions in needed servics, such as lay-offs of policemen and other essential public employees.

Up to this point, I have not referred to possible measures to stimuate capital investment, since these generally do not fall into the "self-terminating" category. The case for such measures, it seem to me, needs to be viewed primarily in terms of their potential long term economic benefits rather than in relation to short term stimulative effects.

These long-term benefits are, of course, by no means unrelated to the achievement of adequate economic expansion. Excessive price increases stemming from cost-push pressures and balance of payments losses related to weakness in our competitive trade position tend to serve as major constraints on expansionary fiscal policies.

Such constraints can be significantly reduced through the encouragement of investment that raises productivity, reduces upward price pressures and strengthens our balance of payments. To the extent that new investment incentives are to be specifically employed in the context of a program of added fiscal stimulus, however, there is much to be said for use of an investment tax credit that allows for some variability in application.

THE NEED FOR GREATER FISCAL FLEXIBILITY

While reliance on automatic stabilizers and self-limiting fiscal measures should be of considerable help in preventing a deliberate policy of fiscal stimulation from overshooting its mark, there can be no complete assurance that the momentum of the expansion may not turn out to be excessive. A vigorous expansionary policy could be carried out much more readily if reasonable advance assurance existed that the needed fiscal brakes could be applied promptly and effectively once a reversal of gears was required.

For this reason, I believe that the Congress ought to give renewed consideration to the introduction of more flexible fiscal instruments that would make such a shift of gears possible. I particularly have in mind the 1969 proposal of CED's research and policy committee which called for Presidential discretion to raise or lower income tax payments by up to 10 percent for purposes of economic stabiliation, in a form to be decided by Congress and subject to its veto.

If this is not acceptable—and, admittedly, proposals for such discretionary executive powers have had little success in the Congress in the past—possible alternative arrangements that would involve adjustments in the Congress' own procedures might well be worth further exploration.

CONCLUDING COMMENTS

Achievement of high employment with reasonably stable prices will not only require judicious and flexible use of fiscal and monetary tools, but also calls for reliance on a wide range of other policy weapons. These should include the many structural measures to enhance productivity and competitiveness that were described in CED's November 1970 policy statement on "Further Weapons Against Inflation," as well as adoption of the kind of wage-price or "incomes" policies recommended in that statement.

While the administration has recently become increasingly active in the incomes policy area, its actions have to a large extent been on an ad hoc basis. With each new action, however, precedents are established and interindustry comparisons become inevitable. I believe, therefore, that there is now a major need for adoption of a more forceful and systematic incomes policy, backed up by the early establishment of the type of national wage-price review board proposed by both CED and Chairman Arthur Burns of the Federal Reserve last year.

One final comment. If stimulative fiscal and monetary policies are carefully designed with a view toward minimizing the risks of inflationary excesses at high employment, and if they are accompanied by really vigorous structural and incomes policies, the prospects for a strong economic recovery should be significantly enhanced. Paradoxical as it may seem, the American public is more likely to spend freely if it becomes convinced that the inflationary problem is being brought under control. It is for these reasons, as well as because of the need for viewing shorter-term politics in the perspective of long term national priorities, that the present inquiry of this subcommittee strikes me as particularly valuable.

Thank you.
Chairman GRIFFITHS. Thank you.
Mr. Sprinkel.

STATEMENT OF BERYL W. SPRINKEL, SENIOR VICE PRESIDENT AND ECONOMIST, HARRIS TRUST & SAVINGS BANK, CHICAGO, ILL.

Mr. SPRINKEL. Madam Chairman, and members of the subcommittee, it is indeed an honor and privilege to testify this morning. You have asked in my opinion highly relevant questions and I hope to respond in a responsible and useful manner.

I will attempt to summarize the paper which I have submitted. It seems clear to me that the economy is now emerging from a shallow but relatively long recession. There is widespread underutilization of resources with an unemployment rate of 6.1 percent and utilization of manufacturing capacity of only about 73 percent.

The questions that I want to discuss this morning are these:

1. Does the economy now, today, need additional stimulus?
2. What policy stance that we might follow today would be consistent with longer run economic performance? And
3. How can fiscal policy contribute to long run growth.

And finally, What is the relation between current economic policies and the strength of the dollar?

The need for stimulus depends at least partially upon your judgment about the nature of this recovery. If it is a vigorous recovery that promises to rise substantially and continue to rise the case for additional stimulus is indeed limited. On the other hand, if we are looking for a lethargic rise in economic activity with lingering unemployment for many months, then clearly we must think seriously about providing additional stimulus now.

What are the facts about this recovery up to this moment? If you compare the first 4 months of the recovery this time with the first 4 months of the three prior recoveries, it is about average. It is a little slower, in fact, in real terms, in terms of industrial production, real GNP, although that number was revised upward this morning, it is a little faster in sectors influenced by inflation such as dollar GNP, personal income, retail sales.

I think it is relevant to ask why has it been sort of an average recovery up to now? One important fact that has been obvious as a result of research by the National Bureau of Economic Research is the fact that the early phase of recoveries tend to be closely correlated with the severity of the preceding decline. That is, if you had a mild downturn you tend to get a mild upturn, and we have had either the first or second mildest recession of the 20th century in 1969 and 1970.

The second point that in my judgment deserves serious stress that is typically when a monetary policy becomes easy during a recession period it continues easy and perhaps gets even easier, as measured by monetary growth. That was not true in the second 5 months of an easier monetary policy this time.

In the first 6 months of shift toward expansive money, the money supply grew at an annual rate of 7.2 percent. In the following 5 months, that is, August through January, it dropped back to 3.4 percent.

Now, since monetary policy clearly works with a lag, I suspect that this resulted in a moderate recovery in the early part of this particular expansion.

But does that mean that that is the prospect ahead? In my judgment it does not. Chairman Burns and other members of the Federal Reserve Board have been quite specific, at least more specific than is usual, concerning objectives on the monetary front this year, indicating they expect to accomplish a 5- to 6- percent growth in the money supply and in fact in the last few months it has risen, quite rapidly.

Since January, for example, up until the present it has been rising at an annual rate of about 12.7 percent which is indeed much too much if it were to continue, but I look upon it as a catchup from the earlier period, and now since September we have enjoyed an expansion of about 5.1 percent.

Well, what kind of a rise in GNP would appear reasonable if we are indeed to have a 6 percent rise in money supply? It turns out that in recession periods velocity of money, that is, the turnover of money, tends to move down and also in recovery periods it tends to move up and it moves up relatively quickly in the early phase of recovery.

For example, in the past three recoveries the first year rise in turnover of money amounted to 3.4 percent. If you assume a 6 percent growth in the money supply and a rise in velocity of 3.4, you get a trillion, 1,068 billion GNP which happens to be slightly above the estimate submitted by the administration.

I feel quite confident that the 1971 GNP when the numbers are all in will be in excess of a trillion fifty billion dollars, perhaps $1,055 to $1,060 billion.

If we look at recent trends in economic activity it seems to me to be perfectly consistent with that sort of projection. Just today we are informed the GNP in the first quarter rose more rapidly than previously estimated. Furthermore, if you look at the state of leading indicators which tend to anticipate both the upward move and the downward move in economic activity they are quite firm.

Most of them are in a rising trend suggesting not only that the money supply is poised in a way to give a significant thrust but also other leading indicators of economic activity are looking in the same direction.

Furthermore, if we are to get this kind of a rise it must come from the consumer side and in my judgment it is so coming. The consumer improved his liquidity by saving a higher percentage of income, by reducing his contract in of debt. In the past he has responded to more money and the new figures this morning, also the figures on automobiles, figures on housing, and related expenditures, suggest that we are in a major upward move so far as consumer outlays are concerned and that the savings rate will be declining throughout this year.

A few days ago my good friend Arthur Okun testified before this committee, arguing that the economy was in effect stuck in the mud and was not acting as a jack-in-the-box. I disagree obviously with that conclusion and I think the important question is why?

Those that tend to rely on the Keynesian analytical framework argue I believe that the major stimulus to the economy comes from, one, capital spending, and, two, expansionary shifts in the full employment budget. If you look at those two inputs, you cannot be very optimistic about 1971 because in fact capital spending is going to be flat, slightly up, is my best guess, and at least the fiscal experts tell us that we cannot expect much stimulus from the fiscal side of the economy unless some changes occur.

Monetarists such as myself, argue that it is not really capital spending and the federal budget that provides the major impetus to either an expansion or a contraction but in fact changes in the money supply. The monetarist theory is a completely different theory, a completely different way of looking at what causes the economy to go up and down.

In view of the fact that money has in the past correctly anticipated major swings in the economy, I have a very high confidence that it is doing so against the present time. It is important that we have a policy stance in my judgment that is consistent both with our shortrun needs and also longer run stabilization, that is, economic growth with moderate or even less inflation.

The record of what I refer to as fine tuning that is adding inputs now and pulling back later, has not been a good one. We tried it from 1965 to 1970. We had go-stop economic performance and we had very sizable inflation.

Now, the intent was virtuous. There can be no denial of the fact that the objective was clear and in the public interest but the results left must to be desired.

The question I think that we should ask is why did those policies fail even though no one wanted to promote inflation. It was not that they wanted to stop economic growth. Just why did we get something that was not wanted. I think it is important to recognize at least three very difficult problems which none of us have been able to solve properly.

The most elementary one is how do we measure fiscal policy and how do we measure monetary policy? If we cannot agree on methods of measurement it is very unlikely that we can use the tools in a way that will stabilize the economy.

Turning to fiscal policy, first, for example, should we measure it by the actual change in the unified budget? Should we measure it by changes in the national economic budget? Should we measure it by changes in the full-employment budget?

There are great difficulties and these issues have not been completely solved in the profession.

Turning to monetary policy we have some of the same problems, that is, should we measure monetary change by changes in interest rates. Should we measure it by changes in free reserves. Should we measure it by changes in the narrow money supply? Should we measure it by changes in the broad money supply or something else?

Now, I have a judgment on how we should measure these series but the profession is not completely agreed. In my judgment it is changes in Federal spending that in the past have been most closely correlated with the fiscal stimulus or restriction and changes in the narrow money supply that have been most closely related to monetary effects on the economy. But that is a debatable issue.

Even if we could agree on how we measure fiscal and monetary change we still have some difficult problems to answer.

How long are the lags? Some would say that there are no lags, that effects are almost instantaneous. Others would say it takes several quarters before you get an impact. And furthermore, what kind of a multiplier should we apply? Should we multiply the fiscal change by some number and say the ultimate effect will be much greater, and the same question applies to money.

And finally, even if we could agree upon measures and even if we could agree upon lags and multiplier, we still have the very difficult problem of forecasting the need down the road.

How much stimulus will we really need a year from now if we take action today. The results of forecasts have left considerable to be desired and I personally would not like to see a policy that relied heavily on forecasts into the future.

Therefore, it is my judgment that the proper shortrun policy stance that provides both stimulus for the economy today and is consistent with longrun growth and continued reduction, in the rate of inflation, is what some refer to as a study-as-we-go policy, and that applies both to the fiscal and the monetary policies.

To be specific, on the money front in my judgment we should have a growth in the money supply at the present between 4 and 6 percent, certainly no more than 6 and hopefully no less than 4, and that we should also attempt to achieve something near a balance in the full employment budget. That is the policy stance that is now in effect and it is the one that I hope will continue into the indefinite future.

Monetarists argue that fiscal change has only minimal effect upon income creation but they do not argue that fiscal policy is unimportant. In fact, we argue it is very important. It has major effects upon the allocation of resources. Allocation of resources between the private sector and the public sector, allocation of resources within the public sector, and allocation of resource within the private sector.

I welcomes the tax cuts that have occurred, that did occur last year and those that are scheduled for next year, because that means to me that resources are going to be allocated towards the private sector of the economy and I personally believe that performance of the private sector has been somewhat superior to the performance of many of the programs in the public sector, especially the Federal public sector.

In this respect I also am strongly in favor of the revenue-sharing program which will tend to allocate resources towards the State and local sector of the economy.

If we turn to the impact of fiscal policy on the private sector, it seems to me that recent changes have tended to stimulate consumption.

Now, there are some pluses in that but it also means that it is stimulating consumption relative to investments. The tax cuts have been oriented primarily towards stimulating consumer spending. The suspension of the investments credit tended to reduce the incentive to invest.

In my judgment we must be very careful to maintain a reasonable balance between stimulus to investment and consumption because the longrun growth of this economy, the longrun creation of jobs, certainly turns on maintaining a high level of investment outlays.

There is a great temptation to argue that we should restore the investment credit and I do not prefer that, and the reason I do not prefer this device is that it has become accepted as a fine tuning, on-again off-again approach. I think that this changing of the rules at the time the game is being played does not stabilize private planning, that is corporate planning, nor does it stabilize economic activity.

I would much prefer to see an improvement in depreciation allowances which at least in the past have been considered a longrun change that would not be subjected to substantial removal in the future.

Also we should keep in mind that we want not only growth in physical capital. We want growth in human capital, an improvement in human capital, and I would respectfully suggest that some serious consideration be given to the possibilities of permitting deductibility of certain college expenses which indeed would stimulate the improvement in the quality of our youth.

Turning for a moment to the international scene, despite recent developments in the international monetary markets, the dollar has been, is today, in my judgment will remain, the premier currency of the world.

Now, in what sense? In the sense that most world trade is carried on in dollars and in the sense that most major countries do hold large amounts of dollars in their reserves, perhaps more than they prefer.

The U.S. Government in my judgment, recognizing the importance of our currency, has at least one major responsibility to the rest of the world, one which they have not discharged very well in the past 5 years. I refer to maintaining the purchasing power of our currency.

There is a real danger in my judgment that if we were to resort to additional stimulus today, that we would again ignite the fuel that feeds the inflation and hence would create additional international problems later.

Clearly we need a fundamental change in the entire international monetary system. This is almost trite to repeat after the experience of the past week. Yet there are those that propose no change is necessary. They contend that the problem is a temporary aberration that will shortly go away.

In my judgment, fixed exchange rates are clearly inconsistent with independent domestic economic policies. Countries have varying rates of inflation, varying rates of economic growth, varying rates of technological change, different tastes, so that an exchange rate that may be appropriate in the market today will not be appropriate tomorrow.

The conditions change. Yet from Bretton Woods we have a fixed exchange rate system which cannot readily be adjusted to change in market forces.

In fact, disequilibrium which occurs in the international market from time to time is not reflected today in a change in exchange rates. It is reflected in hot money flows, both general hedging for business purposes and clearly speculative—and it really was not much of a speculation. There are lots of people in this world that like sure bets and one of the surest bets is to bet on a currency that is under attack on the upside because you can be quite certain it will not be devalued and it may be revalued. Many dollars of speculative form clearly flowed into Germany and other countries in the last few weeks.

The alternative to the present system, that is the fixed exchange rate system, in my judgment is not to move towards controls which will reduce the international specialization in trade and investments, but rather to let the market work, let the exchange rates move when demand and supply conditions change.

I welcome the adjustments that occurred abroad recently. Clearly several major currencies were and perhaps a few more now are undervalued, hence money has flowed into those currencies. It is unfortunate that some rancor developed as a result of this particular flurry of events. Hopefully we can do a better job on that front in the future and moving toward greater flexibility in exchange rates in my judgment will help.

In conclusion, it is my view that the economy is in the beginning stage of a vigorous expansion. Additional stimulus is not needed and could do positive harm to the domestic economy as well as the international strength of the dollar. Unsuccessful experience with fine tuning adjustments of monetary fiscal stimuli suggest that a stable policy stance is more likely to promote both recovery now and stable economic growth and reasonable price stability in the future.

An income policy in my judgment would promise much more than it could deliver. In the present environment a steady monetary growth of 4 to 6 percent and the maintenance of a balanced or at least approximately balanced full employment budget are most likely to bring the kind of economy that we all want. Improved depreciation allowance will contribute to a longrun allocation of resources towards investment which will help assure real economic growth.

Partial tax deductibility of college expenses would result in greater investments in human capital which is also an important ingredient in economic growth and prosperity.

Thank you.

Chairman GRIFFITHS. I must say you are the most cheerful person we have heard in some time.

(The prepared statement of Mr. Sprinkel follows:)

Prepared Statement of Beryl W. Sprinkel

I. INTRODUCTION

The economy is now expanding following the mild recession of 1969–70. The recession, although mild, was relatively long and developed in response to anti-inflationary policies designed to dampen the excess demand which characterized the last half of the past decade. Serious inflation from 1965 until recently was due to excessive monetary-fiscal stimuli, especially the former. Although recovery is under way, under-utilization of resources, both labor and capital, is clearly evident. Unemployment amounts to 6.1% of the labor force and utilization of manufacturing capacity is only 73%. I plan to focus my remarks on three questions related to current economic problems and alternative policy prescriptions: (1) Does the economy need additional stimulus at the present time? (2) What kind of policy stance is consistent with promotion of long-term stability and growth? (3) Can changes in fiscal policies add to the probability of promoting real economic growth with attendant improvement in living standards?

II. RECOVERY—VIGOROUS OR LETHARGIC?

The correct answer to the question concerning the need for additional stimulus partly depends on the nature of the current recovery. If, in fact, the economy promises to rise only slowly, there is a presumption in favor of more stimulus. If a substantial recovery is imminent, additional stimulus courts the danger of renewing the inflation that is slowly but persistently coming under control.

It is indeed true that the increases in several major economic aggregates in the first few months of this recovery have been average as contrasted with the three prior recoveries. As indicated in the following table, industrial production, real GNP and employment increases have been below par whereas series most influenced by the recent inflation such as personal income, retail sales and current dollar GNP have been above average. Inflation and the non-recurring stimulus resulting from resumed auto production account for the stronger series while real economic aggregates lag.

PERCENTAGE INCREASE IN ECONOMIC AGGREGATES (ANNUAL RATE)

	November 1970 through March 1971	February 1961 through June 1961	April 1958 through August 1958	August 1954 through December 1954
Monthly series:				
Industrial production	+6.7	+21.8	+27.3	+12.3
Personal income	+8.7	+7.6	+7.8	+7.3
Retail sales	+16.5	+3.3	+5.8	+14.5
Employment	−0.3	+1.8	+1 8	+1.3
	4th quarter 1970 through 1st quarter 1971	1st quarter 1961 through 2d quarter 1961	2d quarter 1958 through 3d quarter 1958	3d quarter 1954 through 4th quarter 1954
Quarterly series:				
Real GNP	+6.3	+8.5	+10.2	+8.3
GNP (current dollars)	+11.5	+9.0	+12.0	+9.5

Source: Federal Reserve Board, Department of Commerce and Department of Labor.

Two factors help explain the moderate nature of the recovery so far. First, it has long been evident that the rate of recovery from recessions or depressions is positively correlated with the severity of the preceding decline. Although the 1969–70 recession lasted over a year, it was among the mildest in the 20th Century. The sizable expansion in the money supply beginning in March 1970 cushioned the economic decline then under way. But in contrast to most other periods of recession induced monetary increases, monetary growth declined sharply after the first six months' expansion.

RECESSION INDUCED RATES OF MONETARY GROWTH

[Percent]

	1st 6 months	Subsequent 5 months
1970–71	+7.2	+3.4
1960–61	+.8	+2.6
1958–59	+4.2	+4.8
1954–55	+4.6	+3.8

Source: Federal Reserve Board.

The slowdown in monetary growth extending from September 1970 through January 1971 contributes to an understanding of the moderate nature of the recovery up to the present time since monetary growth has a several months' lagged effect on spending and income creation. But the slowdown in monetary growth cannot be considered indicative of probable monetary growth in future months. In fact, due to several technical factors, especially the rapid growth in time deposits, the growth in most monetary aggregates has been much more rapid than the growth in the money supply. In February, March and April the money supply jumped so sharply that the average annual rate of rise since September 1970 now amounts to 5.1%. Furthermore, numerous public statements by Chairman Arthur Burns of the Federal Reserve Board suggest that the monetary growth rate target in the months ahead is 5% to 6%.

If we can count on a 5% to 6% growth in money supply this year, what can we expect for velocity? It is a well known fact that money turnover tends to decline during recessions as consumers and businessmen become more conservative in their outlook and rises during recoveries as expectations improve.

Average GNP velocity increases in the 3 prior recoveries

	Percent
Recession low to 4th quarter of recovery	+6.2
Yearly average ending in recession low to average of 1st year of expansion	+3.4

Source: Federal Reserve Board, Department of Commerce.

By the fourth quarter of recovery in the past three expansions, velocity rose 6.2% on average from the recession low. If the money supply increases 6% this year and velocity enjoys a normal cyclical increase, this would imply an annual rate GNP of over $1 trillion, 100 billion by the fourth quarter of this year, 12% above the year earlier. If the average increase in velocity between recession years and recovery years occurs, combined with a 6% increase in the money supply, GNP for 1971 would amount to about $1 trillion, 68 billion, slightly above the official target. If either the money supply grows less than 6% or velocity rises less than usual, the GNP numbers would be commensurately lower. Even if the money supply comes in a little low and/or velocity recovers a little less than in prior recoveries, an expectation of a vigorous expansion yielding a GNP of $1 trillion, 50 billion or more is a reasonably safe expectation. At worst, a 12-month $1 trillion, 65 billion GNP might be one quarter late in arriving.

Most recently the economy gives every indication of moving into a vigorous expansion. Not only is monetary growth adequate (Chart 1) but also the index of leading indicators of economic activity has strengthened significantly (Chart 2). Orders are rising in many lines although capital spending is still lethargic, reflecting the profit squeeze of last year. Retail sales continue to gain strength and recent surveys of consumer attitudes reflect growing optimism. Housing is headed for a vintage year as increased credit availability and demographic forces spur starts. These trends are likely to continue to improve in the months ahead and a corporate profit rebound, reflecting the sharp jump in productivity, will eventually strengthen capital spending plans. Most Keynesian economists, who rely primarily on changes in autonomous investment expenditures and changes in the full employment budget as economic motivators, predict lethargic growth in the year ahead. Monetarists, who rely on changes in money supply, tend to be much more optimistic. I subscribe to the latter view, although admittedly there is no way of being certain at this point which group is correct. Based on the recent predictive record of these competing theories, I am confident that vigorous expansion lies immediately ahead.[1]

In summary, it is my judgment that the economy is in the early phase of a vigorous expansion and that additional stimulus is neither needed nor desirable.

III. SHORT-RUN POLICY STANCE CONSISTENT WITH LONGER RUN GROWTH AND STABILITY

There is understandably a great temptation to add stimulus so long as the economy is operating below capacity production. Fine tuning proponents counsel adding fuel to the economic machine despite the clear and discouraging record of the late 1960's when such an approach yielded go-stop economic performance along with serious inflation. Policy intent was clear and in the public interest, but results left much to be desired. Only now is the recent serious inflation yielding to policy restraints and increased stimulus runs the real danger of sacrificing present benefits which were achieved only at the serious costs of decreased economic growth, higher unemployment and reduced short-run human welfare.

Why won't a flexible fine tuning economic policy promote stability and growth? Surely the intent is virtuous; why not the results? First, there is the very real problem of measuring policy change. Should the impact of the budget be measured by changes in (1) Federal spending, (2) Federal revenues, (3) the full employment unified budget, (4) the actual budget, (5) the national income budget, or something else?

Furthermore, should the impact of monetary policy be measured by changes in (1) interest rates, (2) free reserves, (3) the narrow money supply, (4) the broad money supply, or (5) other monetary aggregates? In my judgment, empirical evidence suggests that changes in Federal spending and changes in the narrow money supply are the best measures for judging fiscal and monetary impact upon total spending; needless to say, these matters are still open to professional dispute.

Even if we can agree on appropriate measures, we must still determine what kind of lags should be assumed and what size monetary and fiscal multipliers should be applied to the existing fiscal and monetary change. It is my opinion, based on what I consider to be the relevant empirical evidence, that monetary change is by far the most important factor determining subsequent change in total spending; but even so, monetary change works with a lag. Moreover, the size of the relevant multiplier varies over time, especially when the economy performs in a go-stop fashion in response to variable monetary stimuli.

Finally, even if we agree on how to measure policy change and use the appropriate multipliers and lags, a reliable forecast of the future is necessary in order to properly adjust the amount of current stimulus. Forecasting the future is difficult and hazardous and the record of the past several years suggests that policy makers have not been particularly adept at peering into the future.

Therefore, it is my judgment that instead of continuous fine tuning of policy inputs based on tenuous estimates of the economic impacts as well as needs, economic policy makers should attempt to achieve a short-run stance that is clearly consistent with the longer-run growth needs of the economy. Attempts to fine tune with recurring stimulus and restraint is likely to promote go-stop economic performance with all the consequent economic costs that characterized the past several years. It is my view that a stable policy stance consistent with vigorous and stable growth and reduced inflationary pressure presently calls for stable monetary growth no higher than 6% and preferably about 4%, accompanied by the maintenance of approximate balance in the full employment budget. Present policies are in line with this prescription and should not be changed toward a more stimulative stance.

IV. FISCAL POLICY AND STRUCTURAL CHANGE

Although monetarists, such as myself, contend that changes in fiscal policy exert only nominal effects on total demand as compared to the pervasive impact of changing monetary growth, we do not contend that fiscal policy is un-

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[1] See Beryl W. Sprinkel. *Money and Markets: A Monetarist View,* Dow Jones-Irwin, Inc., May 1971, especially Chapter 1.

important. In fact, fiscal policy is of major import not only because an inadequate fiscal policy can and frequently does interfere with achieving stable monetary growth targets, but also because it exerts important effects upon the allocation of resources. The larger the Federal budget, the greater the channeling of resources through the Federal sector of the economy. Many functions must be performed by the Federal Government, but the recent failure of numerous Federal programs to improve the welfare of our citizens has removed any presumption that the Federal Government can better solve many of the ills of society. Consequently, it is my opinion that every opportunity should be seized to re-channel resources through the private and State and local channels where performance has been better. In this regard, I firmly support the current revenue sharing proposal. Short-run programs designed to stimulate the economy, such as more spending on public works or a jobs program without training and other adjustment provisions, run the danger of working only with a long lag at the very time that help is not needed.

Attention must also be devoted to the effect of fiscal policy upon the allocation of resources within the private sector. Clearly, tax penalties can have the effect of shifting resources away from investment activities closely related to determinants of our long-run improvement in productivity. I welcome the elimination of the tax surcharge and the slated reduction in personal income tax rates and increased exemption allowances. These moves will release resources to the private sector and reduce the ever present temptation to spend more at the Federal level. But these reductions will have the effect of shifting the private sector toward consumer spending and away from investment just as the elimination of the investment credit reduced the incentive to invest. A balance should be maintained between consumption and investment incentives if long-run productivity improvements are to be encouraged.

Unfortunately, the investment credit is looked upon as a fine tuning tool always available to stimulate or restrain. Changes in the rules of the game at the time the game is being played do not promote prudent corporate fiscal management and planning nor stable economic performance. Hence, if incentive should be provided for capital investment, as I believe to be the case, reliance on more favorable depreciation allowances which becomes a permanent fixture of our tax system is preferable. Rapid technological change and serious inflation have resulted in inadequate recapture of investment and tend to reduce the incentive to invest. Long-run improvements in productivity, job creation, and living standards depend heavily upon high levels of investment in both physical and human capital. Liberalized depreciation allowances will aid the former. Partial deductibility of college expenses would be a considerable incentive for high level investment in education of the young generation.

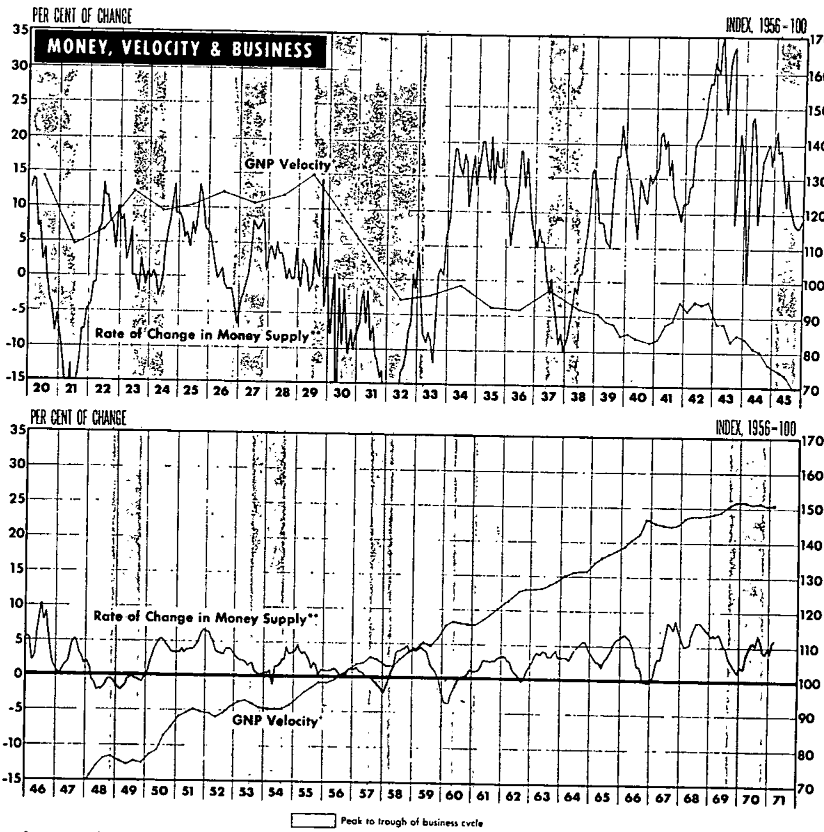
V. RELATION TO INTERNATIONAL DEVELOPMENTS

Despite recent weakness in the dollar relative to several foreign currencies, the dollar remains the premier currency of the world. Most trade is conducted in dollars and foreign governments hold sizable quantities of dollars in their international reserves. However, if the dollar is to retain its importance, the U.S. economy must grow and the purchasing power of our currency must be better maintained than in the recent past. Attempts to further stimulate the economy in the midst of a vigorous economic expansion run the real danger of restoring inflationary pressures that have been brought under control at considerable economic cost. Clearly, one of the prime international responsibilities of the U.S. Government is to maintain the purchasing power of the dollar. Nonetheless, our responsibility does not end there. The international money market developments of the past week once again underscore the obvious point that fundamental changes in the structure of the international monetary system are long past due. A fixed exchange rate system is clearly incompatible with independent domestic economic policies. Variation in national inflation rates, growth rates, tastes and technological change means that an appropriate exchange rate today is inappropriate tomorrow. Yet with fixed exchange rates, developing disequilibrium is evidenced in hot money flows rather than in movement of exchange rates. Would-be speculators welcome the sure bet of gain when an exchange rate can go in only one direction and money flows into an "undervalued" currency in massive quantities. Rather than resorting to controls which severely reduce the advantages available to all countries from freer international trade and investment, the obvious alternative is to allow the market for currencies, i.e. exchange rates, to respond to changing demand-supply forces. Hopefully, the recent floating of the mark will be followed by freer markets for other currencies accompanied by a dismantling of remaining investment and trade restrictions. In my view, the U.S. Government should aggressively exert its enormous influence toward promoting a more viable international monetary system. The free world can ill afford recurring world currency crises emanating from a system which has served the world well but is in dire need of repair and improvement.

VI. CONCLUSION

In conclusion, it is my view that the economy is in the beginning stage of a vigorous expansion. Additional stimulus is not needed and could do positive harm to the domestic economy as well as the international strength of the dollar. Unsuccessful experience with fine tuning adjustments of monetary-fiscal stimuli suggests that a stable policy stance is more likely to promote stable economic growth and reasonable price stability. In the present environment, a steady annual monetary growth of 4% to 6% and the maintenance of a balanced full employment budget are most likely to bring the kind of economy we all want. Improved depreciation allowances will contribute to a long-run allocation of resources toward investment which will help assure continued real economic growth with its attendant welfare benefits. Partial tax deductibility of college expenses would encourage greater investment in human capital which is also an important ingredient of economic growth and prosperity.

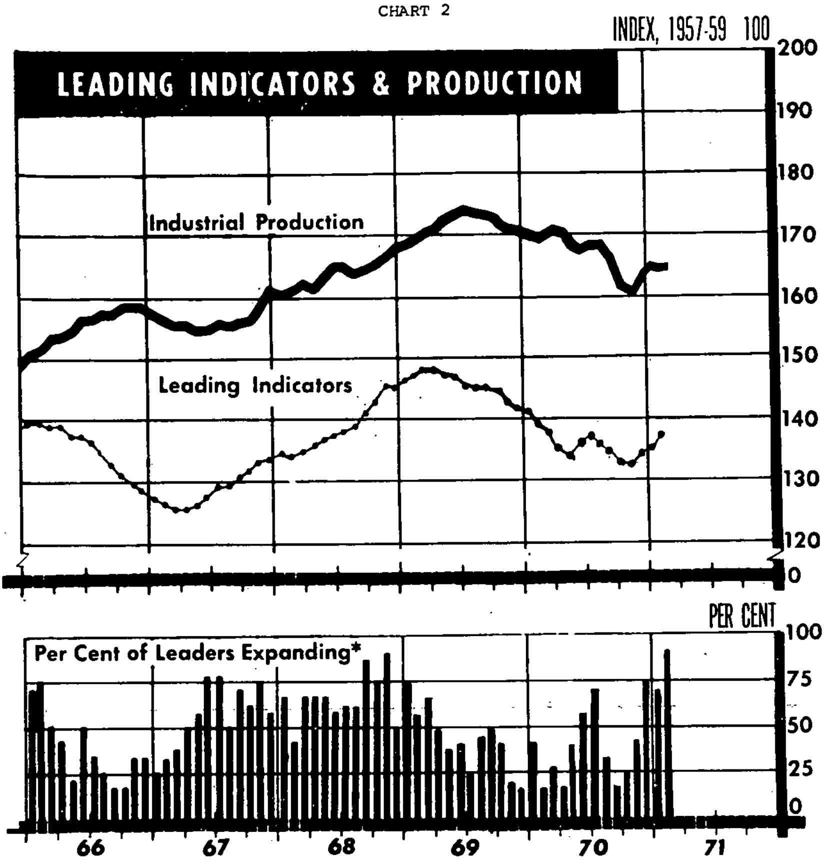
CHART 1



Source: Dept. of Commerce, Fed. Res. Bd., Nat'l Bureau of Econ. Research, Inc.
*All commercial banks demand deposits adj. + currency (seas. adj.)
*Annual rate of monthly change, 6-month moving average
†Annual data before 1939; quarterly since 1939

HARRIS BANK

CHART 2



Source: Statistical Indicator Associates, Federal Reserve Board
*Based on 2-6 month moving averages

Chairman GRIFFITHS. Mr. Wallich.

STATEMENT OF HENRY C. WALLICH, SEYMOUR H. KNOX PROFESSOR OF ECONOMICS, YALE UNIVERSITY

Mr. WALLICH. Madam Chairman, members of the subcommittee, I am honored to talk on a subject which represents an excellent choice. All my colleagues on the panel have said this. I do indeed believe that it is the medium run that we should look to rather than 1971 as we formulate today's policy.

The most important thing one can say about 1971 is that for policy purpose it is virtually over. Very little that we can do this year will have much effect in 1971. We should do nothing now that we do not want to be effective mainly in 1972.

It becomes very important, therefore, to analyze the behavior of the economy at this time. Beryl Sprinkel has examined it and to some extent I share his view.

Some months ago one could have argued that we were stuck on dead center; stagnant. In that case we would have been shooting at a stable target with expansionary measures and the measures would have been appropriate to get the economy unstuck. Meanwhile the economy has begun to move forward. The data for April were quite encouraging. The GNP has been revised upward. The target has begun to move.

If we shoot at it now with stimulative measures, we will find that we are erring, that we are making a very serious mistake. In fact we are likely to repeat the mistaken policies of the middle and late sixties. At that time, too, it was said that unemployment was still high, that therefore it was safe to expand. We were in no danger of inflation from expansionary policies, it was said, overlooking that these policies would not take effect immediately.

Unemployment today, at a very burdensome level of 6 percent, might be much lower by the time anything we can do today is enacted, is done, and takes effect. In that regard I am very much in agreement with Beryl Sprinkel's assessment of the situation.

It is, of course, possible that my assessment is wrong. A few months ago I held a different view. If it should turn out that we are stuck, that we are stagnant, and that unemployment will not diminish, or if it should rise, then we do need action. But the best assessment right now is that the economy is moving and will move increasingly. Under those conditions stimulation would produce the same effects that we suffered once before under the policies of 1964 and 1965 and that have led us to the present high rate of inflation.

We must visualize what that would mean. We went into the present inflation from virtual price stability, with all the habits and instincts of a public geared to stability, and all the assurance that comes from that. If we start a new demand-pull inflation from the present level of inflation, 4 percent or thereabouts, we will not have the protection of the habit of stability. We will go into a new inflation geared to inflation and it surpasses the imagination where we might land.

A few years ago none would believe that we could have interest rates of 10 percent and inflation as high as 6. I fear that we could not now imagine what would happen if we pour stimulus into a moving economy.

If we make that mistake we virtually guarantee ourselves a recession for 1973 or 1974. It could be a very serious one.

So everything we do today should be viewed in the light of 1972 and even beyond. Let us not repeat what we have done in the past and show that we have forgotten nothing, learned nothing, but let us stick by our existing policies.

Assuming that we solve this reentry problem correctly, there is a variety of measures we should take now, because they work slowly, that are of a more structural kind and that will affect the economy in 1972 and later.

Principally these are in the areas of unemployment and inflation. Basically, and I am sure everybody agrees, it is barbaric to fight inflation with unemployment just as it is barbaric to fight unemployment with inflation.

We have to find means of improving the relationship between unemployment and inflation. That is the job for the 1970's.

Today unemployment seems to be ineffectual. For whatever reason, 6-percent unemployment does not seem to do as much in holding down inflation as it used to. This experience is not ours alone. It has happened in Canada, it has happened in the United Kingdom.

I do not know what the reasons are. It could be that labor has become more militant. It could be that the composition of the labor force has changed, with more women and teenagers bearing the brunt of the unemployment. The people that really make the decisions on wage increases on the union side, the married males, are not suffering as high a rate of unemployment.

By the same token, I think we find today that aggregate demand is not as effective in curing unemployment as it used to be. During the sixties we had a long debate between the structuralists and the aggregate demand proponents, whether unemployment was structural or whether it would yield to an increase in aggregate demand. The aggregate demand side said they won the argument because unemployment came down to 3.3 percent as a result of an expansion of aggregate demand. The structural side said that they won the argument because, after getting unemployment down to 3.3 percent, inflation started and has not been fully brought under control to this day.

My own inclination is to say that while aggregate demand is certainly helpful, the core of the action has to be of a structural kind.

In the structural area there are a number of things that have already been done. More of the same needs to be done to improve compensation, to extend it, to widen the coverage, together with job training, labor market information, and labor mobility. These are the traditional devices.

But beyond that, and in contrast to at least one of my associates on this panel, I lean towards an incomes policy. For the immediate future I would say we should move forward on the road towards a wage-price review board. For the longer future which is our assignment here, I would like to repeat a proposal which I had the privilege of discussing before the Joint Economic Committee once before, a surtax on the profits of corporations granting excess wage increases. In corroboration with Prof. Sidney Weintraub of the University of Pennsylvania and of Waterloo University, I have since explored this technique somewhat further.

The way it would work is as follows: A guideline would be fixed for appropriate maximum wage increases, taking into account a part, maybe 50 percent, of the prevailing rate of inflation, plus productivity gains. This would make the guideline 5½ percent at the present time.

Corporations would be quite free to give wage increases in excess of the guideline. But they would pay a tax in the form of a surcharge, on the corporate profits tax, equal to one, two, or three times, in terms of percentage points, the excess of the wage increase over the guideline.

This would backbone them, as some people have said, in labor negotiations.

I think this is a reasonably fair arrangement. The restraint falls on labor but the tax is paid by business. It is an arrangement that is in conformity with free markets. It does not order people to do things. It does not distort the market by fixing prices and wages. It allows the markets to function. But it changes the relative advantages of doing one thing or doing another.

Most of the criticism of this proposal is not very weighty. I reject the idea that the penalty should fall all on labor, such as a tax on payrolls. On the other hand, I do not believe as some businessmen have said, that unions would pay no attention at all to a profits tax. If that were the case, one would have to conclude that unions today, where there is no such tax, are not extracting as much as they might from the corporations with which they bargain. In other words, they would not be doing a good job, on behalf of their members, and I have every confidence that they are doing a good job as they see their advantage.

Also, because the tax is on profits, I do not see much danger of its being shifted forward in higher prices. A payroll tax would be shifted forward. The evidence seems to show that a corporate profits tax, at least in the short run, is not easily shiftable.

From all points of view, I think this proposal stands up for the long run.

Whether it has a great deal of political appeal is not for me to judge. If business and labor find that it is not in their interests, it is at any rate in the interests of the consumer.

With this much said on the inflation front, I would like to address my concluding remarks to the problem of raising productivity. This will help with inflation. It is also what the economy needs. The immediate proposals before us are accelerated depreciation and the investment tax credit. I think there is something to be said for the investment tax credit. If it were a flexible device to be turned on and off cyclically we would have a powerful device. Its chances of being effective are better than turning on and off a surcharge on the personal income tax. An excise tax is harder hitting when one makes temporary changes. But the investment tax credit has a very unhappy legislative history, as you know, so I would put it aside in favor of accelerated depreciation.

Accelerated depreciation is criticized on a number of grounds that I think are mistaken. True, it is not going to work instantaneously. No measure is. But we are looking here at the medium run.

A second criticism is that, with industry operating at low operating rates, capacity utilization in the low seventies, why do we need more investment? The answer is that the greater part of investment is, not for expansion, but for modernization. That is very urgently needed in order to restrain inflation and offset the rise in labor costs.

It is also argued that modernization investment destroys jobs. If that were the case, unemployment would have to be a great deal higher. We would never have got down to 4 percent or 3.3 percent. It is clear that whatever modernization investment does it does not destroy jobs.

Finally, it is argued that accelerated depreciation is a giveaway to business. I would point to the change in corporate profits and in labor incomes of recent years to show that even if it were, it would merely correct in some measure the change in the distribution of income that has already taken place.

The data on profits are familiar. The data on labor income are confusing. We have heard a great deal about the fact that the American working man has not had an increase in take-home pay after taxes and inflation and reduction in hours since late 1964.

The statistical series is all right as far as it goes. But it is misleading because the series does not look at the individual job classifications, or the individual working man. It takes in the whole labor force, including the increasing proportion of women and teenagers.

The latter drag down the average. Allowing for this changed composition, there has not been an increase in take-home pay in over 6 years. But if you look at particular job classifications, it is quite clear there has been an increase in take-home pay.

Failure of take-home pay to increase, this much cited fact, just is a nonfact.

Finally, as to the effect on profits, and the give-away aspect of an accelerated depreciation, the fact is we are again underdepreciating, as we did in previous inflations. In other words, if a manufacturer wears out a machine and accumulates the money to buy a new one from depreciation allowances he will not be able to repurchase that machine at today's price. The money that accumulates will fall short by 15 percent.

One way of overcoming underdepreciation is to allow accelerated depreciation. If we do not in some way compensate for this underdepreciation, we simply fool ourselves as to the level of profits. Profits are overstated on today's base. And we are not providing enough to replace worn-out equipment.

In conclusion, I think a strong case can be made for adding to corporate investment today and for adding to the funds available for this purpose. If we do that, we help not only corporations and their investment. We will also help the homeowner.

When there is a shortage of investment funds it is not the corporation that loses out. It is the homeowner, typically, who gets squeezed out of the market, and so are State and local borrowers. One way, therefore, of helping the homeowner and State and local borrowers is to enable corporations to accumulate more funds through accelerated depreciation and let them get out of the market and leave more room for other people to borrow.

Under all these circumstances, we must be conscious of our new priorities. We have downgraded the cult of the GNP and upgraded quality of life. I think part of this quality of life is to have decent jobs, to have stable jobs, and I hope that part of this quality also is to have stable prices. That is the purpose of the policies I have discussed.

Thank you.

(The prepared statement of Mr. Wallich follows:)

Prepared Statement of Henry C. Wallich

I greatly appreciate this opportunity to appear before your Committee to discuss a topic that appears to me highly appropriate: the effect of policy action taken today upon our economy, not in the near future, but over what one might term the medium run. Since every long or medium run, however, consists of a succession of short runs—that is part of the problem—I would like to begin by addressing myself briefly to the more imminent future.

THE IMMEDIATE FUTURE

The most important thing to be said about the year 1971 is that, for policy purposes, it is almost over. Very few measures proposed about the middle of May are likely to be acted upon and to have their impact quickly enough to make a substantial difference to economic events in 1971. Even very short run measures, therefore, must look ahead into 1972 at a minimum.

If the economy were stagnant now, at a level of 6 per cent unemployment, with no visible prospects of acceleration, a strong case could be made for stimulative measures despite their prospective lag. Early this year, there were some indications that we had reached a dead center. Meanwhile, the outlook has changed significantly. To the early factors of strength in the economy—housing, and state and local expenditures—there has been added an upswing in consumer purchases. It is now possible to be confident that the economy is moving ahead. To these impulses there will be joined late in 1971 or during 1972, an upswing in business fixed investment and perhaps in inventory accumulation. With the exception of defense spending, all of the active forces in the economy will then be pulling forward. For 1972, this points to a very strong economy.

If we were to apply stimulation now, we would be in imminent danger of repeating the mistaken policies of the past. We would be accelerating as we approach the full employment ceiling. Ignoring this ceiling has cost us dearly. We are today paying the price for those mistakes. We must avoid the common temptation to step on the gas as the light turns yellow.

I shall cause no surprise by admitting that my analysis may be mistaken. If that were to be the case, if the current expansion were to stall, perhaps as the result of a prolonged steel strike, the case for stimulation would gain in plausibility. We must remain flexible. But for the time being, we should stick to our present policies.

On this calculation, we should be phasing gradually into the high employment growth path late in 1972 or early in 1973. If this "reentry problem" is handled correctly, there are good prospects that in the following years we can enjoy stable growth at high employment with inflation receding toward 2 per cent. Our principal problems would be of a structural kind—how to improve the performance of the economy, in particular how to increase productivity and lower the threshhold of unemployment at which inflation resumes. I shall turn to these problems presently.

Before contemplating that pleasant prospect, I would like to examine the situation that would confront us if, disregarding policy lags, we now engage in measures to reduce our very burdensome unemployment as if these measures could be effective overnight.

Six per cent unemployment in a stagnant economy is a signal for immediate action. Six per cent unemployment in an economy that is resuming speed means something very different. If sometime in 1973 we slam into the capacity ceiling at a 6 or 8 per cent real growth rate, the brakes will have to go on drastically, as they did in 1969. Our problems, however, would be a great deal more severe. We would have gone into a new phase of demand pull inflation, not from relative price stability, but from an inflation rate of about 4 per cent. The credibility of anti-inflationary efforts would have been greatly reduced. The effect upon interest rates, housing, the financial system, and eventually upon unemployment are hard to visualize. It would have been difficult to visualize 6 per cent inflation and 10 per cent interest rates before they happened. Whatever might occur on a second round, starting from a much higher level, might also surpass the imagination. We could hardly escape from such disorder without tight wage and price controls and a major recession. In the past, this used to be called the business cycle. Today we call it stop-go policy. By either name, it is eminently worth avoiding.

THE PERIOD 1972–76

Let me now examine the medium run under the assumption that our overall policies in 1971 will be such as to solve the reentry problem with reasonable adequacy. What measures can we take today that will then prove beneficial for the structural problems that will still be with us? I have in mind particularly the joint issue of unemployment and inflation.

It is barbaric to fight inflation with unemployment, just as it is barbaric to fight unemployment with inflation. In the long run, as we are increasingly becoming aware, this trade-off is not offered to us in any event. Expected inflation loses its effect. But today, even the short term trade-off seems to be vanishing. The scourge of unemployment seems to have lost much of its power to restrain inflation. That has been not only our own experience, but also that of Canada and Great Britain. I am unsure whether the reason for this is to be sought in a changed attitude of organized labor, or possibly in a more structural character of the unemployment. Certainly the higher proportion of women and young people in the labor force, whose unemployment now is 5.6 per cent and 16.7 per cent respectively (February 1971 data), is a new phenomenon, as various researchers have pointed out.

The same principle, unfortunately, applies also in the opposite sense. Unemployment that occurs in sectors, be they those of age, sex, occupation, or geography, is not easily removed by an increase in aggregate demand. Over-heating Detroit will not cure unemployment in Seattle. We must prepare, therefore, to meet these problems in more specific terms. Since action takes long to mature, we must start early.

UNEMPLOYMENT

Turning first to unemployment, I believe that substantial progress has been made in improving unemployment compensation, in matching the job structure with the skills structure through manpower training, and in increasing labor market information and mobility. More undoubtedly can be done. I would recommend a public employment program if I could see a way of turning make-work employment into self sustaining, full productivity jobs. As long as there is no clear way of accomplishing this, I think public employment schemes are distinctly a second best. In the long and even in the medium run, they are likely to drag down productivity. We must avoid a condition where public sector activity, instead of being treated by statisticians as having zero productivity gains, would become suspect of declining productivity. In any event, if the hypothesis of an increasingly fragmented and structural unemployment is correct, it would argue in favor of greater decentralization of efforts to deal with unemployment. We shall find it increasingly difficult to deal with this kind of unemployment from Washington.

ment, we must move toward an incomes policy. A form of incomes policy that

If we are to get away from the practice of fighting inflation with unemploy-

I suggested once before to the Joint Economic Committee and that, together with Professor Sidney Weintraub, I have examined in greater detail since, is the tax on corporations granting wage increases in excess of a guideline. Closer examination has revealed both potentialities and difficulties. The virtue of the proposal, if it has any, is that it works through the market and not through controls. A firm that for some reason wants to or must give an excessive wage increase, can do so at a cost. The penalty falls upon business, but the restraint is directed against wages. Thus the proposal appears to be reasonably even handed. The objection that, because labor asks for high wage increases, the penalty should fall upon labor I regard as both unfair and unrealistic. The objection that increasing the cost of a wage increase to the employer will not affect the outcome of the wage bargain seems implausible; it would imply that unions are not maximizing potential gains for their members since in the absence of the penalty tax they would not be asking for all the company can pay. The fear, finally, that the penalty tax would simply be shifted to the consumer in higher prices overlooks that this penalty is to take the form of a surcharge on the corporate income tax, rather than on the payroll; income taxes are generally regarded as hard to shift in the short run. The principal problems, in my view, are administrative.

Obviously, we have almost everything to learn in matters of incomes policy. Experience in Europe so far is by no means encouraging. Nevertheless, the problem of inflation is becoming more urgent all over the world. Some form of incomes policy seems to be the most likely candidate for its solution. I believe the surtax proposal deserves to be examined along with other contenders.

PRODUCTIVITY

Finally I turn to methods of increasing productivity. The principal proposal to that end before us is accelerated depreciation. It is often criticised on the grounds that it works slowly, that with a high excess capacity there is no need for more investment, that it is a "give-away" to business, and that labor savings investment may reduce rather than create jobs. These suppositions are for the most part refutable.

The slow impact of accelerated depreciation is probably a reality. I would view it as having effect more in 1972 than in 1971. That, however, applies also to the alternative means of stimulating investment, the restoration of the investment tax credit. That device has certain attractions if envisaged as a temporary instrument, to be turned on and off as needed cyclically. That would concentrate investment spending during the periods when the switch pointed to "on." Nevertheless, a device similar in principle with which Sweden has experimented seems to have proved rather less effective than might have been hoped. In our country, moreover, the investment tax credit does not have a happy legislative history. Therefore, I would put it aside in favor of accelerated depreciation.

The allegation that, with operating rates in the 70's, added manufacturing capacity is not needed and is not likely to be put in place ignores the nature of the larger part of investment. According to the McGraw-Hill Surveys, the larger part, in the foreseeable future, will be for modernization rather than expansion. In the longer run, moreover, capacity does not appear excessive. The rate of growth of the capital stock, on a net as well as a gross basis, and computed with varying assumptions as to depreciation, has been about in line with the growth of the potential of the economy during the 1960s. A similar conclusion emerges when one examines the rate of business investment in relation to GNP, which has been flat at the high level of 10.5 per cent since 1965, and will probably decline in 1971.

Concern that concentration on modernization will reduce rather than create jobs seems to be contradicted by long historical experience. Good part of investment has always been for modernization, else we would have little increase in productivity. It has not, however, destroyed jobs, else we would not have had over-full employment during the late 1960s.

The supposed gift to business is refuted by the fact that,thanks to inflation, we are today under-depreciating by about 15 per cent. That is to say, depreciation computed on the basis of original cost falls short by about 15 per cent of what it costs to replace the worn out equipment at current prices. Since a shift to replacement cost depreciation allowances seems impractical for many reasons, a simple way to compensate would be to accelerate original cost depreciation.

Numerous items in the business news underscore the benefits that could result from stimulation of investment spending. For instance,the machine tool industry has seen its orders cut in half and faces a difficult situation that would be aided by productivity oriented investment stimulation. The steel industry today must put 10 per cent of its total investment into pollution control that yields no direct return. This is significant in an industry whose profits in 1970 were $600 million and whose loss of income owing to the removal of the investment tax credit amounted to over $100 million.

As a broader argument in favor of some kind of stimulus to investment I would like to mention the shift that has taken place in the distribution of income, to the disadvantage of profits. During the early and middle 1960s, profits gained relative to GNP, although starting from the depressed level of 1961. In 1965, they run to the abnormal height of 11.4 per cent, giving labor a legitimate complaint. Since 1965 they have fallen, first relative to GNP, and in 1970 also absolutely. Retained profits, an important source of corporate financing, have been cut almost in half since 1966.

The cutback in profits may appear odd in view of the familiar fact that by late 1970 the American workingman had not had an increase in real take home pay, i.e. after allowing for changes in prices, taxes, and hours, since late 1964. Where has the income gone? The answer is that this fact is a non-fact. The well known series on "real spendable average weekly earnings of production or nonsupervisory workers in the private nonfarm economy" is misleading, because it does not allow for changes in the composition of the labor force. In recent years, the proportion of women and young people, as we know, has increased. The relatively lower pay for their types of jobs has pulled down the average. But for the individual worker, take home pay has of course increased substantially over the period.

An increase in corporate savings would be desirable, in the interest not only of business investment, but also of the economy generally, in view of the strong demand for capital that seems to lie ahead. During the 1960s, the principal loser, in the quest for accommodation in the capital market, has been the homeowner or renter. If the most obvious way of making room for him in the capital market—a federal government surplus and repayment of public debt—is not viable, cutting back corporate demands for external funds by increasing corporate retained profits seems the best route.

In conclusion, I would like to say this: Our priorities have changed, and our methods of meeting them must change also. The cult of the GNP has abated. It has given way to greater concern with the quality of life and of the environment, as part of which quality I would like to regard both a high level and a high quality of jobs as well as reasonable price stability. Nevertheless, the old problem remains how best to pursue our objectives: directly by spending more for consumption, or indirectly, by concentrating on investment and productivity and thus creating the means with which these objectives can be met on a larger scale. In the very short run, the direct way no doubt yields more. In the medium and long run, the advantage seems to be mainly on the side of the indirect approach which I have recommended here.

Chairman GRIFFITHS. Thank you very much, Mr. Wallich.

What if your tax on industry for increasing wages too much failed to hold them in line so that they did give too high a wage increase? Wouldn't the addition of the tax be further inflationary?

Mr. WALLICH. Madam Chairman, that depends on whether the tax can be shifted. If it were a tax on the wage increase itself, it would be like a payroll tax. That would be easily shiftable. But it is an increase in the income tax, as Sidney Weinbraub and I have worked it out. An increase in the income tax, say, for every percentage point excess wage increase, there might be 3 percentage points on the income tax, so a 3-percent excess wage increase would mean 9 percent on the income tax.

That is not easy to shift in the short run, according both to economic theory and I think the evidence that we have.

Chairman GRIFFITHS. Well, it seemed to me that there would be really a real desire on the part of management, though, to increase prices of their products right then.

Mr. WALLICH. Let me describe the reason why it is unlikely that they would be shifted. Profits differ widely among corporations. To name names, in the automobile industry—Chrysler does not have the same profit as GM.

When you levy a tax in proportion to profits, it is quite difficult for the management to figure that into prices if their competitors have quite a different burden in relation to their total sales.

General Motors would pay a high tax in relation to sales because their profits are high. Chrysler would pay a low tax in relation to sales because their profits are low. And without making invidious comparisons, the fact that one company pays relatively less tax than the other means that as a group they find it difficult to shift.

Chairman GRIFFITHS. I see. Thank you very much.

I take it, Mr. Sprinkel, when you were mentioning good performance of the private sector that you were not commenting on Penn Central, Lockheed, or Rolls Royce?

Mr. SPRINKEL. The performance has not been perfect and indeed one of the major reasons for the difficulty in Lockheed and also Penn Central was the fact that after getting a very serious inflation underway as a result of overexpansive economic policies, it clearly became necessary to squeeze and to slow down the economy. In the process, interest rates became very high, availability of capital was severely limited, companies that were highly marginal, some of them in fact did go into bankruptcy and many others were on the margin.

I am convinced we would have fewer bankruptcies if in fact we had stable economic performance both in terms of growth and stable prices.

Chairman GRIFFITHS. I think we would have had fewer bankruptcies if the companies would not switch their good assets out from under the control of the main organization. I really do not approve of that.

May I ask you also—Mr. Conable and I at least have been struggling for about 5 months now with the welfare bill. We find that, or at least are informed, that within a period of a few years, you are going to have 20 million women and children drawing ADC.

That would be about 5 million women and 15 million children, I would assume.

How can you do anything in the private sector to absorb those 5 million women?

Mr. SPRINKEL. Well, there are three kinds of things that I think will help and one, of course, I have alluded to. That is, we must have prosperity so that the marginal workers will be pulled into the labor force. That means we must have growing job opportunities, growing real GNP and hence growing human welfare.

But second, and I am not an expert on the bill which you mention —I have looked at it and thought about it, but there are many things I do not know. It is my understanding, at least, that within the bill are strong incentives for those that are capable of working to actually work. That is, in effect keeping the marginal tax rate low. In our present system, if I am correct, and I am told by expects that it is true, we find many cases where the marginal tax rate is as high as 100 percent and we refer to these people as lazy and unwilling to work. I assure you that if I paid a woman 100 percent marginal rate I would also be lazy and unwilling to work and produce.

So in my judgment in addition to economic growth, it is important at the margin to give them the incentive to improve their own welfare and thereby reduce the expense of the Federal Government.

Finally, avoid raising the minimum wage which would make it even more difficult for marginal workers to find a job.

Chairman GRIFFITHS. Well, the whole bill is an attempt to do just that.

Mr. SPRINKEL. Yes.

Chairman GRIFFITHS. But what do we do to create the kind of prosperity that is going to absorb them? Is there anything that the Government can do for the private sector that creates the type of prosperity that causes them to be employed?

Mr. SPRINKEL. Well, the major point I made today is that we are doing it. That is, we are only slightly off the low of a recession which means that we look around and we see a lot of things wrong. The important thing is that we are moving up and we are moving up rapidly, and in my judgment we are moving up rapidly because of things Government has done. That is, we have pursued an expensive monetary policy as we should have done and it has been about right in my judgment.

We have not panicked yet by what I would consider to be excessive stimulus. We permitted some tax cuts to occur. We have additional ones scheduled. I think over the long pull somewhat greater incentive to accomplish private investment would help but even without that, I am expecting over the next year or two or three, if we do not provide too much stimulus today which will cause us to restrict later and create the recession Henry referred to, then I think the jobs will be available. Not this year and next.

Now, I think it is important to recognize that it is very unfortunate in my judgment that unemployment is not one of the early areas to show improvement. This is not the first time this has happened. And the reasons I think are fairly clear, that as we come out of a recession, productivity which our real well-being depends on rises very sharply and we should welcome it. But it does mean that the incentive to hire additional workers is severely reduced so that we will not be at what I would consider full employment by the end of this year and I suspect we will not be even there by the end of next year, although we should be getting close.

Chairman GRIFFITHS. Well, let me say to you that we cannot just sit here and wait for full employment to pick these people up. An estimated 75 percent of the young people between 16 and 25 are unemployed in the city of Detroit. No matter what the economic theory is, we cannot humanly sit here and do nothing. There has to be something done and it has to be done right now.

I would like to ask you, if about mid-July, the second quarter data on the economy, particularly the GNP, will become available, would the outcome for the second quarter affect your recommendations as to whether the Nation needs a tax reduction and if so, how small an increase in GNP would you need to justify a tax reduction to stimulate the economy? Mr. Schiff, could you answer?

Mr. SCHIFF. Well, I would like to say to begin with that if the data for the second quarter were relatively unfavorable, I think there probably would be a need for further action. I do not really agree with my two colleagues on the panel in what I gather to be their judgment that we can be fairly—I do not want to say complacement—but fairly satisfied with the performance of the economy as long as we simply see some upward movement in the economy.

I do feel very strongly that in making such a judgment, one has to look at the overall goal in terms of reduced unemployment, easing of price pressures, and so on. Merely moving ahead does not necessarily mean that we are moving ahead enough.

I also think that Professor Wallich was right in indicating that it does take time for measures to take effect. You have to take actions well ahead of time. For what reason I think if you can foresee that the future situation will be unsatisfactory, you have to take some action early.

Simply to say that things are fairly satisfactory now and that we can therefore just wait indefinitely before acting is not a view I would agree with. I also do not really agree that one can avoid forecasting entirely. I think that those who would avoid forecasting are really forecasting that what is happening now will continue in the future. That may not always necessarily be true because in our econmy—and this is a very rough estimate—we need something like a growth rate of 4 percent or slightly more in GNP merely to keep the unemployment rate about where it is. And we need something better than that to reduce it.

That is not a very precise rule for any particular moment of time but over time I think it is widely accepted.

Now, I do believe that whenever measures are taken that would call for stimulus, one has to look at the possible risks, and one certainly should try to minimize the risks in these situations. This is why some of the suggestions that I made in my statement are related to how we can reduce the risk that we might overshoot the mark later on.

I do not have a precise judgment at this point myself as to what is needed because I do not know for sure what the first quarter figures mean, given all the distortions that we have because of the GM strike and the possibility of a future strike in the steel area. And I also do not know what the budget figures, the actual budget figures. are currently showing in terms of actual stimulus. But if at the time, as you say, there is a review and it shows we fall substantially short of the goals that the administration has suggested as desirable—and I am not looking so much at the 1,065 number for this year as at the mid-1972 goals in terms of desirable levels of reduction of unemployment and of changes in price levels—if we fall substantially short then I think action should be taken.

Chairman GRIFFITHS. Since Mr. Conable and I may have to vote on it, what evidence in the next few weeks ahead would cause you to choose to recommend a speedup of individual income tax reductions scheduled for the next 2 years, and what outcome would cause you to recommend some form of investment stimulus?

Mr. SCHIFF. That is a very different question. I do not know the precise evidence that will become available in the next several weeks. I thought you might have somewhat more time. As a matter of fact, I am not sure just when the initial GNP data for the second quarter would be available. But I think you have to look not at any one figure. One would have to assess a whole series of data on the trends in economy, evidence as to whether consumer spending—which seems to have been picking up—is really gaining momentum, what the evidence is with respect to inventories and in other areas.

I think if there were any beginning signs that the kind of momentum that the economy so far seems to have developed is not proceeding; if one could put these together and see that you come up with an overall economic result that will not really give you much improvement at all in terms of the capacity utilization of the economy and of the level of unemployment when the year ends and as we go into next year—then you may need some further stimulus.

Now, the implication of my earlier statement was that you will also have to see what the size of the stimulus is that you want. It may be that it is not a great deal. Moving up the scheduled tax reductions—if you do the whole thing I think amounts to a stimulus of something like $4½ billion. It may be that the total you need is less than that, especially if tax reductions were combined with other factors that have already come into the picture, for example, the postponement of the social security tax base increase which I think is adding something like $3 billion to the national income budget on a full employment basis. If the total amount of needed extra stimulus is not very large, my preference would be to take the kind of measures that are useful in the long run rather than measures, like the tax measure of that type I have cited, that would simply add to consumer spending immediately. I would give some preference to the kind of things that I mentioned in my statement that might help some of the immediate problems of our cities. Public services employment is one of these. Measures to foster greater job mobility, et cetera, are among other.

There are problems with these kinds of measures in terms of how quickly they would be effective. I think you would have to take a very hard look as to just how quickly you would need these measures. But I think a very possible situation is that we would be in a kind of middle ground, that we would not have a situation where it is obvious that the economy is doing very badly but where we might be convinced it is not doing well enough and ought to have some further stimulus. In that sort of situation, I think the kind of the measures I mentioned might be preferable to a substantial tax reduction of the type that is implied in the increase in exemptions and in the standard deduction.

Chairman GRIFFITHS. Thank you.

Mr. Conable.

Representative CONABLE. Mr. Schiff will you refresh my memory. The others have spoken somewhat disparagingly this morning of the possibilities in the short term anyway about the possibilities as a policy instrument for fine tuning by using the investment credit. Did you take a position on that? I know you referred to some other measures here. We have had a lot of problems with the investment credit. The history of it is certainly not a good one or one to inspire confidence. I wonder if you have a feeling about that?

Mr. SCHIFF. Well, I indicated in the statement, and I think Prof. Wallich has expressed a somewhat similar view, that there is merit in the notion of using the investment credit with some variability. I do not really like the term "fine tuning" in that connection, or almost any other connection, I also think most businessmen would not be very happy if there were an investment credit that varied a great deal to effect short term changes. What I had in mind, however, was that there might be some merit if there were an investment credit and there were some possibilities of a variation.

For example, if the economy moved toward full employment over a period of years, then at some point close to that goal there might be some variation in the credit; but it should not be a very frequent variation in my view.

Representative CONABLE. There is a great temptation to use it for fine tuning, that is the problem. It has an immediate impact. You can shut off machine tool purchases almost instantly by suspending it. Even though there may be only a 7-percent credit involved, purchases will hold back until such time as they think it will be reinstated in order to get that particular fillip in the year of their purchase.

We have had a bad time with it and there is quite a bit of pressure to reinstate it now because of the very slack machine tool industry right now. As a matter of fact, talk about its possible reinstatement probably is having some impact on machine tool orders right at this point because there are people saying, "Well, let us hold off a little and see if we do not get it back again if things get bad enough."

The big problem, politically, with the acceleration of the depreciation schedules, is that the changes that are being proposed have a much larger term impact.

Mr. SCHIFF. Well, Mr. Conable, I think you alway do have this kind of conflict with stabilization policies. For example, the proposal that the Committee for Economic Development has made for flexible authority to change income tax rates also can create problems for business because it makes for some uncertainties. But you have to weight these against the uncertainties that are created by changes in the economy and by changes in interest rates. So, business firms face a whole series of uncertainties.

The main reason for trying to use these somewhat variable devices is to reduce the variability in the economy, I do think, as I said before, that you do not want to use this kind of measure as a very frequent instrument of change and that in any event there is a real benefit from long-range measures to encourage investment.

I might say that my organization, the Committee for Economic Development, has had a long history of favoring incentives for productive investment. I personally would not rule out the possibility of allowing some variability in these incentives if the need should arise. This has more to do with how often they are applied than with what should be the basic formula for the way they are first instituted.

Representative CONABLE. Before our committee, the 1-trillion-165 billion-dollar GNP has been a great topic for discussion. Of course, the consensus among the economists at the beginning of the year was that this was far too high. Arthur Burns said that it was an admirable target but an optimistic prediction. Maurice Mann, who I know is going to be here on Monday, said in effect that it was not an admirable target because in order to achieve $1,065 billion we might have to press so hard that there will be a very substantial element of inflation present, a greater degree of inflation than was acceptable, and I am wondering if the studies you gentlemen are making, from the first quarter figures it appears that we are likely to find—I know your comparatively optimistic analysis of the first quarter figures, Mr. Sprinkel. I wonder if we are likely to find an unhappy inflationary element involved, assuming we wind up in the upper range of your prediction at this point. What do you think?

Mr. SPRINKEL. Well, I think it is indeed true that the more rapid the rise, the less the chance of significantly reducing inflation. So if I thought of that $1,075 or $1,085 billion were a real possibility I would be very worried about inflation.

On the other hand, I think it is fairly important to recognize that in past recessions, we tend to get the worst of all worlds during the recession. That is, we get the reduced unemployment and all of the woes that accompany a downturn in the economy but we also get the inflation and we get more this time than in the past because we had it for a longer period of time and it was larger.

The real progress in the past that has been made on bringing an inflation under control is late in the recession and in the first year or so of the recovery. Fortunately we are at that point at the present and as I would interpret the numbers, and they are somewhat ambiguous, I admit, it is my judgment that the rate of inflation has indeed receded significantly, and is very likely to reduce further this year.

Representative CONABLE. Your are saying this on the basis of increased productivity?

Mr. SPRINKEL. Yes, sir.

Representative CONABLE. And high level of unemployment, in effect?

Mr. SPRINKEL. Yes, sir; and I agree with Henry's observation, that is very barbaric to have to fight inflation with unemployment but I would turn that around slightly and say that it is barbaric to follow policies likely to induce serious inflation which will inevitably lead to a restraining policy later and the creation of widespread unemployment. And then the last time we had unemployment about this high, a little higher in fact, was in 1961 but the labor force was not growing as rapidly. It took us four and a half years to get back to full employment which was much too long.

Representative CONABLE. Do you agree with Prof. Wallich that it is possible to fight inflation with anything but unemployment, then?

Mr. SPRINKEL. I know of no evidence that argues that there is any other way. I know we should try and maybe some day we will know how.

Representative CONABLE. He has an interesting proposal here, to backbone industry in this area. It is a gimmick certainly, but it might be one that should be studied further.

Mr. SPRINKEL. May I make a brief observation on the proposal? I agree with almost everything Henry said. The only thing I did not agree with perhaps was that particular statement.

In my judgment it is fairly clear that every inflation we have ever had in this country or in any other major country—and I have a book which came out yesterday that documents this argument—the real cause of the inflation was excessive growth in the money supply per unit of output.

Each time you get a rapid increase in the money supply you inevitably get inflation.

This has happened in our country when we really let the money supply grow very rapidly relative to the economy's production. In the late sixties we did get serious inflation. It has happened to South America, it is now happening in the United Kingdom, and it is happening in Germany at long last.

So I do not believe that taxing business because of excessive wage increases will really get the inflation under control if you continue to pump in fuel.

Representative CONABLE. Chicago is a real hotbed for your monetary types, isn't it?

Mr. SPRINKEL. Well, it is sort of spreading around the world now.

Representative CONABLE. Excuse me. You had something you wanted to say. I interrupted you.

Mr. SPRINKEL. One of the problems I think with the proposal is establishing the proper guidelines, productivity I can understand but why productivity plus 50 per cent of the inflation. Why not 60 to 40 or 75 percent.

Representative CONABLE. Mr. Sprinkel referred to the floating of European currencies with some approval and I take it that economists generally favor the steps that have been taken over there although there is some dismay about it in political circles in this country.

I am wondering, despite the comparative optimism of the statements you gentlemen made here this morning, at least in relation to some of the previous statements that have been made here before the Committee, if you do not think nevertheless that our chronic balance of payments problem can be a real fly in the ointment, damaging to confidence and to the psychology for recovery that is so necessary if the economy is to have a comfortable time over the intermediate term ahead.

I wonder if any of you would like to comment on that.

Mr. Wallich, first of all, would you——

Mr. WALLICH. I agree with this, Congressman Conable, in the sense that the balance of payments surely is a very important matter and anyone who thinks that it can be treated with benign neglect is vastly mistaken.

I think also that the present situation is one that results primarily from interest rate differentials and only to a lesser extent from inflation.

The origins of our balance of payments problem do have their roots in past inflation and in that sense, past inflation and lesser competitiveness of our goals have contributed to what happened in the last few weeks.

Representative CONABLE. Isn't it only aggravated by our interest rate differential? Is that really the basic problem?

We actually mitigated our balance of payments problems last year because of the condition of interest rates in this country, and we are having a short run outflow now of funds again because of interest rates. But that is not the basic problem, is it?

Mr. WALLICH. One can have two fatal diseases at the same time. One long run, and that is the competitive problem, the price inflation problem. Another acute one; that is, the interest rate differential.

Had we in the past solved the competitiveness problem as we were very close to doing by 1964 when we got that large surplus had we not blown that advantage by subsequent inflation, we could still have had the kinds of things that happened in the last few days.

We generate these interest rate differentials because the volume of funds that can move internationally has been growing very rapidly. People have been learning of their opportunities. In the long run we can no more have a different monetary policy in New York and in Frankfurt than we can have in New York and Chicago.

Representative CONABLE. Mr. Schiff.

Mr. SCHIFF. I think I agree with Prof. Wallich that we certainly should not follow a policy of benign neglect. But I would also stress that the balance of payments problem is not just our balance of payments problem. It is a mutual problem that involves countries on both sides of the ocean. It involves adjustments not only here but there.

I think to some extent the kinds of adjustments that are currently being made are desirable from that point of view. In relation to domestic policy, however, there are several issues.

One that I think is particularly relevant to the subject of this Committee, is related to the fact that there is a constraint on our monetary policy, on the degree to which we can expand through monetary measures, and on the movement of interest rates. This constraint exists mainly because of international considerations. I do not think it should go so far as to stop our recovery. But I think it is an important reason for thinking more about fiscal measures, and about the monetary fiscal mix.

It is one reason why if we want a given degree of expansion, we may have to do more with fiscal measures than just with monetary policy. But if the implication of what some people say is that the way for us to solve this international problem is to stop growth in this country and to have a very inadequate and slow recovery with large unemployment, then I think that is not the answer. It is not even the answer in terms of other countries in the world because they depend on American growth to a very considerable degree.

So I would think we cannot go too far in that direction.

Representative CONABLE. One last question for you, sir, in the area of constraints on fiscal policy.

I note your approval generally of the full employment budget and your statement that we may have to redefine it in a way so that we can get adequate stimulus where otherwise a surplus may be indicated, but as a politician who has to face the folks back home pretty regularly who have some fairly rigid views on the need for discipline in government spending, I am just wondering how we are going to ever persuade people that a balanced budget is a possibility or that it is possible even in the long run to keep our national debt under sufficient control so that they will not be paying an increasing proportion of their taxes on a dead horse.

There is this terrible feeling about Government waste to begin with because people tend to view the Government as they might an unruly offspring, a profligate son of some sort, and if we do not accept a formula which has built into it and kind of discipline that will keep the national debt from getting out of control, how can we avoid constantly increasing estrangement between the Government and the people?

I look at these young folks that are coming in nowadays and one thing that concerns them is that we are reducing their capacity to solve the problems of their generation all the time by adherence to short-term measures, lack of discipline, unwillingness to look ahead and establish long term patterns that have some relevance for a period that encompasses more than our one generation.

Well, I do not know. I guess I am expressing a political concern. I must say that I have not found many economists who are terribly excited about the national debt but it is a real political concern for anyone who has to deal with what admittedly is frequently an unsophisticated public view of this debt institution, through which we are paying now over $20 billion annually that does not necessarily have much relevance to present solution of problems, only to the past.

Mr. SCHIFF. Sir, I fully share your concern about the need to have discipline in the budget. I certainly do not want to give any impression that I personally and my organization are not extremely concerned with this matter. But the whole purpose of the way I tried to formulate this was really to develop a more realistic way to get at that problem.

I personally think that it is very likely that when we reach something like full employment we ought to have a sizable surplus, not just a balance in the budget. This is so for many reasons: to help prevent inflation, to help produce an adequate flow of financial resources to the private sector, to the States and cities and to housing; and so forth. So we need really to aim at a surplus at high employment.

Now, the difficulty I was referring to, and it is in a sense a theoretical difficulty but one that gets quite practical in terms of the way the President and the Administration look at the budget currently, is that if you say the rule ought to be that you have to have at least balance in the so-called full employment budget—and this was the rule that was described in the budget issued in January—you have a theoretical rule which does not say that what will happen at actual full employment; it merely tells you what would happen if we were at full employment right at this minute.

The problem you get into is that if you come into a situation where there is some real reason for saying you need some further stimulus—and since we started out in January being exactly at balance, anything you do now to give further stimulus beyond that means you have got to break the rule—should the Administration then say, well, we have to break the rule and we cannot think about the long term now because we have to stimulate. Or should they say: Can we find a way to take extra measures that is within the spirit of the rules? Can we have a rule that we ought to take the kind of measures that would not give us the wrong kind of budget results when we are actually at full employment?"

This would then mean that we are going to choose, if we possibly can, the sort of things that are not going to build up a great deal of future trouble, even though they do the right job now in terms of stimulating.

What I am saying, this is really a more realistic and practical way of looking at the problem because with this approach, you really have to ask yourself not just theoretically what these numbers mean at any one point of time but you have to look at particular proposals and say, well, is this something we can really stop when the economy moves further ahead?

For example, if you decide on a very large public works program, when can you start it and when is it going to be completed? And is it still going to give you a very great stimulus at the time when the economy is at full employment?

Now, in a sense it is unnecessary for me to make these points since these are embodied in the very good questions that your Committee raised in calling these hearings. But I think these points can be fitted into the concept of the full employment budget to make more sense out of this concept and to emphasize in a realistic way what it means to have discipline in the budget. It really means looking at actual expenditures and to test them in terms of what happens once you start them and how readily you can stop them.

Representative CONABLE. Madam Chairman, I have used a good deal of time.

Chairman GRIFFITHS. Mr. Widnall.

Representative WIDNALL. I have read your statements although I came in late. I find them most interesting. I am pleased that you are here before the panel to give your views.

Mr. Wallich, in your statement you suggest that late in 1971 or during 1972 there will be an upswing in business fixed investment, and perhaps in inventory accumulation.

On what data do you base this conclusion?

Mr. WALLICH. I base it on historical precedent, Congressman Widnall. The usual pattern of investment tends to lag somewhat behind general cyclical developments. I would expect that after a relatively slow beginning, investment would begin to catch up with the rest of the economy.

If I am mistaken in my belief that the economy is moving forward and will move forward more strongly, then investment might not pick up. But for the time being we can take the evidence as saying the economy is accelerating.

The measures of stimulation that I propose therefore are not addressed to affecting investment this year. They are addressed to the longer run.

Representative WIDNALL. On the same page you suggest that if we were to apply stimulation to the economy now, we would be in danger of accelerating as we approach the full employment ceiling. Since unemployment stands at 6 percent now, how likely is it that we will come even close to a full employment ceiling within the next year or two, even if additional stimulation were applied to the economy?

Mr. WALLICH. I think the chances are very good that by early 1973 we will be in the full-employment zone. We would be repeating the pattern of 1964, 1965, and 1966, if in a rapidly moving economy we went out for stimulation. We must look at the economy not as it is now but as it will be when that stimulation really becomes effective. It will be early or mid-1972 and later, depending on the measures that are taken. Then when stimulation has become effective, and when the economy is moving forward, let us say, at 8 percent, then it is too late to prevent crashing into the full employment ceiling.

Then we cannot phase into it and solve our reentry problem. We will do exactly as we did last time. We crashed through that ceiling, we jammed on the brakes and we guaranteed ourselves a recession.

Representative WIDNALL. How likely is it that we may achieve this 6 or 8 percent real growth rate in 1973 in light of our historic growth rates in the periods since the end of World War II?

Mr. WALLICH. At some point in this recovery we must go faster and will go faster than our historic growth rates. Otherwise, as you know, we would never catch up to full employment.

My concern is that as we approach full employment we should not be much above the historic growth rate because it would be too brusque a change.

The catching up has to be done in a way that allows us to approach full employment at not too high a rate of growth is we want to stay at full employment. This is my concern. How are we going to have full employment, not in 1971, which I realize we will not, or in early 1972, but how are we going to have it in 1973, 1974, and 1976?

Representative WIDNALL. Then in your statement, with regard to the Wallich-Weintraub income policy, you suggest that the penalty tax would not easily be shifted to consumers by corporations in the short run. Why not?

Mr. WALLICH. That point is very well taken, sir. The reason why I think I am right in expecting no shifting is that it is a tax on corporation profits rather than a tax on the excess payroll that would be paid. Payroll taxes are shifted relatively easily. Profits taxes are not shifted easily, at least not in the sort run. The bulk of the evidence that we have shows that even in the long run, corporate property taxes are of doubtful shift ability. That is what I was relying on.

Representative WIDNALL. I take it from that that you also say a surcharge on corporation income tax is more difficult to pass along to the consumers than other costs of doing business?

Mr. WALLICH. Yes.

Representative WIDNALL. Mr. Schiff, in your statement you have outlined generally the principles which you feel should govern fiscal policy in the future. You have also discussed a number of stimulative measures which might be taken to revive economic activity.

Based upon the economic results of the first quarter of 1971, do you believe that the Federal Government should apply additional stimulative measures in order to move us back to full employment in 1971 and 1972?

Mr. SCHIFF. Will, I indicated earlier that I have not really made a detailed study of these data—they just came out yesterday—or of the current state of legislation in the Congress that determines what actual budgetary spending will be, a matter which is a very major element in determining whether you need any measures going beyond that. So my own feeling is that one probably ought to wait somewhat further before making a determination regarding the need for additional stimulative measures.

I think it is quite difficult to tell what the data imply at this point because we had this unusual situation in the first quarter of catchup, a catchup from a strike, with not a terribly big net advance from the quarter before the strike but nevertheless indications of a revival. So I would—my kind of general instinct would be to say that one would have to wait somewhat further before making a judgment on this.

I have not made a precise enough study to give a more specific answer.

May I make a comment on the Wallich proposal?

Representative WIDNALL. Certainly.

Mr. SCHIFF. I would like to disagree somewhat with the notion that it is entirely accepted among the economics profession that taxes on corporate incomes would not be shifted. My feeling, and I have heard a good many discussions of experts on this, is that this is certainly not a settled question and there is a good deal of disagreement.

I think businessmen generally feel that there might be a shifting of the tax and at least, that its impact may differ depending on different industries. I guess my own feeling is that this is one major reason why this type of proposal really has very severe drawbacks.

I might say I was delighted to see that Professor Wallich can now be welcomed to the group of those who feel that as far as the practical and immediate future is concerned, one ought to move to the kind of thing that we in CED have proposed, which is a wage-price review board rather than his particular kind of proposals.

I think one of the issues in the case of an automatic proposal of the kind he mentioned is whether you can really rely on a purely automatic mechanism of this kind for getting guide-lines established in particular cases that will be broadly regarded as fair to both sides. The logic of the review board is that you need a hard look at particular circumstances in many cases, and that you cannot really get around that by having an automatic system that works purely through the tax system.

I feel that you probably do need something like a wage-price review board to have a strong incomes policy. In the past, other kinds of voluntary control devices that relied on mechanical baselines often showed that you ended up having a need for a great deal of administrative determinations in any case and for that reason I think the proposal for a review board is really a preferable one.

Representative WIDNALL. Do you have any comments to make concerning the accelerated depreciation guidelines?

Mr. SCHIFF. My general comments, and I have not studied that in detail, is simply that this is something that ought to be judged as a long-term matter. I do not really know the details of this proposal well enough, but I think there is a general presumption that there should be policies that encourage productive investment over the long term.

I do not view that proposal as something that necessarily ought to be looked at as a short-term stimulative measure. It ought to be reviewed in the light of possible alternative ways of achieving long-term improvement. I do not know enough about the details to give you a precise judgment.

Representative WIDNALL. Thank you.

Mr. Sprinkel, how can you draw conclusions about 1971 GNP while examining only the money supply growth and velocity? Isn't this a somewhat simplistic approach?

Mr. SPRINKEL. It is a first approach but I do not stop there, of course, and in fact I make detailed GNP projections as others do. But there is a persistent trend over time with a lag effect of national income and GNP moving in the direction of the money supply and for a certain systematic movement in velocity, so that the first question I think that should be asked when someone makes a projection, is it consistent with what you might expect looking at money only? And I do not look at money only. Looking at money, $1,055 billion, $1,060 billion, GNP in my judgment is reasonable, maybe even $1,065 billion. If I look at the individual sectors I come up with the same answer. It has to come from the consumer side and if I read what is happening correctly, it is now coming.

For example, the numbers are up but I have talked to many retailers in the past few weeks, on purpose; to determine whether the numbers are for real, whether they detect a real significant swing in consumer psychology. Inevitably I get the same answers; namely, that all of their surprises have been on the positive side of late instead of negative as last year. They cite homebuilding which is stimulating many of the consumer durables related to a new home like rugs, drapes, stoves, refrigerators. They cite women's dresses, not because of the recovery perhaps but because of some resolution as to the debates over which way the skirts are going to go. Retailers are beginning to sell and all of the evidence that I can find is consistent with what I would expect based on money. But I would agree with that, that is not enough. That is merely the first step, but a very important one.

Representative WIDNALL. Just one further question. What is your opinion of purchasing power bonds, that is, Federal bonds paying a relatively low rate of interest plus a subsidy equal to the rate of inflation so as to insure that the investor improves the purchasing power of the dollar he invests. The principle has been endorsed by another famous monetarist, Milton Friedman. What is your opinion?

Mr. SPRINKEL. I am rather favorably disposed. I can only see one possible disadvantage of major import, that I would hope if we were to move in that direction, it would not reduce the incentive for the Federal Government to pursue policies to keep the inflation under control. There would be a danger I think that they will say, well, we are not hurting our bondholders anyway because we are going to pay them for this inflation that is coming about as a result of the easy money monetary fiscal policies. Therefore, we do not have to worry about keeping those policies under control.

That, I think, is the major concern I would have.

In terms of equity there is much to be said for it. I would prefer a stable price level but if we are not going to get one then there is certainly no reason why we should, in effect, extract a serious penalty out of those investors who do help finance the Federal Government.

Of course, that applies to other bonds as well, not just the Federal Government.

Representative WIDNALL. Professor Wallich, would you comment on that?

Mr. WALLICH. I have always been skeptical of this proposal, but not for the reason that Beryl Sprinkel mentioned. It is not the Government that I see becoming unrestrained in its expenditure when as a result of inflation it is penalized by having to pay a higher interest rate. It is the bondholder whose restraint I see crumbling if he no longer is hurt. He will then, in his political and other decisions, be less inclined to fight inflation.

It is true, however, that in this last terrible bout with high prices and high interest rates we got to the point where bondholders exacted protection in terms of the interest rate, at 9½ percent for corporate bonds. We were close to getting, at least for nontaxable bondholders, full protection against the inflation, if you think of the real rate as being somewhere around 3 or 4 percent. It makes no great difference, then, whether we have a purchasing power bond with a low real rate and a supplement to cover inflation, or pay the penalty of having bonds in inflationary times at very high interest rates.

As an experiment, I would say it may be interesting to float such a bond, perhaps not by Government, to see what its rate would really be and what investors would be willing to pay for a bond if they were guaranteed against inflation.

Representative WIDNALL. Thank you very much.

Chairman GRIFFITHS. I would like to ask each of you—last week Arthur Okun testified the unemployment rate will still be 6 percent at the end of this year and James Duesenberry estimated unemployment might be 5 to 5½ percent at the end of 1972.

Would each of you estimate what you think the unemployment rate will be at the end of this year and then at the end of next?

Mr. Wallich, would you like to start?

Mr. WALLICH. I think the unemployment rate will be lower by the end of this year, and while I do not think I can put an exact number on it, I would not have said what I said here, that we should stick with existing policies, if I thought the unemployment rate would stay at 6 percent.

In that case we would have had a fixed target and we should have been shooting at it. I am assuming that no serious disturbance will remain at that time from the steel situation.

Now, for the end of 1972, I think we ought to be approaching the full employment zone, as the term now goes, that is to say, we should be at 5 percent or even below.

Chairman GRIFFITHS. What would you think, Mr. Sprinkel?

Mr. SPRINKEL. Picking a precise number is very difficult but in general I would agree with Henry's estimate, that by the end of this year I would expect it to be somewhere in the 5 to 5½ percent range which I would consider excessive unemployment and by the end of 1972 I think there is a good possibility that we could be down to 4½ percent, 4¾-percent range, which is approaching, as I view it, this full employment level.

Chairman GRIFFITHS. What do you think, Mr. Schiff?

Mr. SCHIFF. Well, it depends, of course, on how one forecasts the economy generally and on any added stimulus that might be given. If you assume the way the economy is now going; that there are no further actions, and that this will get you to a gross national product this year of a trillion fifty or in that neighborhood, I think that that would probably give an unemployment rate at the end of this year that is perhaps just somewhat below the 6-percent rate but not a great deal. It might even be 6 percent. That is not impossible.

As to the level of unemployment at the end of 1972, I think that depends upon what forecasts one makes for the degree of expansion next year. If with the kind of momentum I described for this year; and perhaps with some further stimulative actions we get to a relatively good rate of growth next year, then I think you could bring the unemployment rate down to the neighborhood of 5 percent or somewhere below by the end of next year. But I think the thing that has to be kept in mind—and while there are variations in this there is some stability in that relationship—for the economy just to grow in line with its potential will not really get the unemployment rate down a great deal. We would have to raise the rate of economic expansion above the growth in potential for a while to get the unemployment rate somewhat below where we have been; that is, we have to move fairly fast just to catch up with the output gap.

Chairman GRIFFITHS. I would like to ask you, Mr. Wallich, on what do you base your contention that an upswing in consumer purchases is occurring? Percentage consumption expenditure in real terms has grown at less than a 3-percent rate in the past two quarters. The savings rate is still 7 percent. Retail sales in April were 6 percent above a year earlier which means they just about kept pace with inflation. Sales of nondurables which exclude autos have grown at only a 4-percent annual rate for the past 6 months, and this rate did not accelerate in April. The increase in personal income in April has been widely interpreted as being disappointingly small.

What are the figures that you are using?

Mr. WALLICH. I looked at the succession of months and I find that whereas the year started very weak, it has improved, particularly in April. I take the disappointing personal income figures for April as an indication more of the strength of consumer spending because out of a relatively low income, a fairly good purchasing performance came.

There has been a drop in the savings rate from 7.6 to 7.2 and I expect it will go down further.

The stock market is an indicator, to some extent, of what is expected by people in different industries. One of the strongest groups of stocks has been the retail stocks. This is one of the numbers to which I have looked.

Chairman GRIFFITHS. If at the end of the second quarter the GNP showed about 1,040 billion, would you want more stimulation then, Mr. Sprinkel?

Mr. SPRINKEL. The revised figues for the first quarter, if you would help me, were $1,021 billion, is that correct?

Mr. KNOWLES. $1,020 billion.

Mr. SPRINKEL. $1,040 billion would be a $19 billion increase approximately. I would be unpleasantly surprised if second-quarter GNP were that low, for two reasons. One, there is clearly an additional one-shot stimulus occurring this quarter. This last quarter it was the end of the auto strike and the resumption of the sales. This quarter it is the steel inventory accumulation whether we get a strike or whether we don't, we are accumulating steel today. But secondly, and more importantly, because it is not one shot, is what I believe is happening in the consumer area.

We cannot expect a continued rise in sales and a continued liquidation in inventories, in fact, I would expect stocks to begin to accumulate either this quarter or next.

So that I would expect the GNP to come in at a rise somewhat in excess of $19 billion in the second quarter.

Chairman GRIFFITHS. But what would you do, Mr. Schiff, if it does show $1,040 billion? Would you then feel additional stimulation was necessary?

Mr. SCHIFF. I think I would. It sounds to me as though this is rather a weak performance. But as I said earlier, I would need to know more about the details of the GNP results and about the actual behavior of the budget to give a definite answer.

Chairman GRIFFITHS. What about you, Mr. Wallich? Would you assume it is necessary?

Mr. WALLICH. On $1,040 billion?

Chairman GRIFFITHS. Yes.

Mr. WALLICH. I would like to examine how the quarter had gone. If it were something that looked like it was going down from what I now consider some strength, that would give me considerable concern. If I thought it was a rising pattern, I think I would be willing to await developments. It would depend, also, on what happend to final sales.

Chairman GRIFFITHS. Mr. Conable, do you have any questions you would like to ask?

Representative CONABLE. No.

Chairman GRIFFITHS. I would like to express our appreciation to all three of you. You have been very kind and very helpful and I am sure that it has taken a lot of your time and effort and we appreciate it very much.

This subcommittee will at this time adjourn, to meet on Monday, May 24, in room G-308 of the New Senate Office Building, at which time we will hear Prof. Dale Jorgenson, Maurice Mann, and Prof. Daniel B. Suits.

Thank you very much.

(Whereupon, at 12:10 p.m., the subcommittee adjourned, to reconvene at 10 a.m., Monday, May 24, 1971.)

LONG-TERM ECONOMIC IMPLICATIONS OF CURRENT TAX AND SPENDING PROPOSALS

MONDAY, MAY 24, 1971

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON FISCAL POLICY
OF THE JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The subcommittee met, pursuant to recess, at 10:05 a.m., in room G–308, New Senate Office Building, Hon. Martha W. Griffiths (chairman of the subcommittee) presiding.

Present: Representatives Griffiths, Moorhead, and Conable; and Senator Percy.

Also present: John R. Stark, executive director; James W. Knowles, director of research; Loughlin F. McHugh, senior economist; Courtenay M. Slater, economist; Lucy A. Falcone, research economist; George D. Krumbhaar, Jr., minority counsel; and Leslie J. Barr, economist for the minority.

OPENING STATEMENT OF CHAIRMAN GRIFFITHS

Chairman GRIFFITHS. This subcommittee will be in order.

This is the fourth and final session of the hearings on long-term economic implications of current tax and spending proposals being conducted by the Subcommittee on Fiscal Policy of the Joint Economic Committee. The testimony to date in these hearings suggests some disagreement about the magnitude of the additional fiscal stimulus needed this year, if any, and leaves a serious question as to the economic effect of some of the investment incentives.

We are, therefore, particularly fortunate in the availability of three outstanding witnesses. The first is Prof. Dale Jorgenson of Harvard. He will provide us with some particularly pertinent material on the timing and magnitude of the effects of investment incentives—a field in which he is one of the Nation's outstanding experts.

The second witness is Maurice Mann, who is executive vice president of the Western Pennsylvania National Bank, and a former official of both the Federal Reserve System and the Office of Management and Budget.

Our third witness is one of the outstanding quantitative experts in the Nation, Prof. Daniel B. Suits of the University of California at Santa Cruz, and formerly of the University of Michigan. We will hear from each one of the three in turn and then ask questions.

Professor Jorgenson, you can lead off in your own way.

STATEMENT OF DALE W. JORGENSON, PROFESSOR, HARVARD UNIVERSITY

Mr. JORGENSON. Thank you very much, Madam Chairman.

My remarks are going to be concentrated on the question of investment incentives. This is an important issue in assessing current fiscal policy. As you know, the President has announced a new system of regulations for calculating depreciation allowances for tax purposes on assets. The asset depreciation range system will be implemented by the Internal Revenue Service. At least partly in response to the President's announcement, alternative proposals have been suggested, including reinstitution of the incentive tax credit, repealed in 1969.

For the purpose of this hearing I have prepared a detailed study of the economic impact of investment incentives concentrating on these basic alternatives. The study begins with a brief review of the history of investment incentives in the post-war United States and the role that investment incentives played in fiscal policy. It then attempts to project the likely experience of the American economy over the next 5 years in the absence of any change in fiscal incentives for investment. With that as a backdrop it attempts to assess the impact of both proposals that have been suggested; namely, the ADR system which is currently under consideration by the Internal Revenue Service and the Treasury Department, and the incentive tax credit which could be viewed as an alternative for or supplement to the ADR system.

The basic conclusion is that there is a serious problem for American fiscal policy; the current level of unemployment, at an average of around 6 percent, will persist for some time in the absence of any change in fiscal policy. According to the projections which are included in the study, based on an econometric model developed by Data Resources, Inc., the 5-year outlook for the American economy is for substantial levels of unemployment. The projected outlook is for high rates of unemployment, that is, rates above 4.5 or 4 percent through 1974, 4 years from now. This is a serious problem from the point of view of economic policy because of the waste of social resources, and because of the tension which is always associated with high levels of unemployment. Let me emphasize that the projected rates of unemployment assume stimulus to the economy in the form of changes in fiscal policy. The basic conclusions from that table is that the American economy is going to be operating below its potential for a considerable time to come, and that some kind of fiscal stimulus is clearly in order.

With regard to the problem of investment incentives, I think one can divide the outlook into two separate categories. The first question is this: If we view the levels of unemployment projected here for 1974 at 4.5 percent as intolerably high, as I do, will investment incentives have the impact of putting more people back to work and bringing the economy back into line with its potential? The second question is: Can investment incentives such as the ADR system or reinstitution of investment tax credit have a short-term impact that would speed the return of the economy to a full employment situation? Again, taking say 4.5 percent now as a benchmark; would it be possible to achieve this earlier than 1974 by means of reinstituting investment incentives or is it necessary to have an additional fiscal stimulus?

The basic conclusions in my study are that, first, investment incentives such as the ADR system or a comparable tax credit, could make a very important contribution to returning the American economy to its full potential by 1974 and will make, if these investment incentives are adopted, some contribution toward reducing the level of employment by as much as say 0.3 percent as early as 1973. Neither investment incentive would have the impact of reducing unemployment to levels like 4.5 by 1972. The basic conclusions of previous studies of investment incentives is that there is a substantial lag in the effective impact of these policy changes, running perhaps six to eight quarters. According to the projections we have made, the effects of proposed changes, either the ADR system or reinstitution of the investment tax credit, will not be felt until well into 1973, and will not reach its maximum until say 1974 or even 1975.

Another question that might be asked is this: Suppose that some short-term change in fiscal policy is adopted in order to return the economy to full employment sooner, such as speeding up a reduction in personal income tax rates, now scheduled to take full effect in 1972 and 1973, what will the impact of investment incentives be with the impact of these changes fully worked through the system? Would investment incentives produce an inflationary situation like the one following the Vietnam buildup? Would we, in other words, return to a system of overly full employment which would tend to defeat the effort to reduce the level of inflation? The answer to that question appears to me to be no; the ADR system would have the impact of reducing levels of unemployment say in 1974 from 4.5 to 4.2 or 4.1 and that would not lead to any substantial inflationary pressure. Quite the contrary, this would be the final step in closing the gap between actual and potential gross national product in 1974 and 1975; by that time the economy would, in fact, be on a full employment path, and we could turn to other problems than eliminating unemployment and dealing with problems of inflation which result from overly full employment.

In comparing the two different investment incentives that are currently under consideration, namely the ADR system, which is essentially a change in the depreciation rules, and reinstitution of a comparable tax credit, I have found that tax credits such as those that existed before 1969, or have been currently proposed, namely tax credits in the range of say 7 to 10 percent, would produce an inflationary situation in 1974 and 1975. In other words, the stimulus, which is again a delayed one, would by that time be so substantial that we would find ourselves by 1974 and 1975 in a situation of overly full employment with an investment boom that would pull the level of unemployment well below 4 percent, perhaps down to 3.7 or 3.6 percent. However, if one considers an investment tax credit comparable in stimulus to the proposed change in the depreciation rules, about 3.3 percent, then, the impact of the depreciation change and the tax credit would be roughly comparable.

With this as basic background, let me describe the method used in the study to assess the impact of the different investment incentives. The method is this: Incorporate each change in the investment incentives into the rental price of capital. In making decisions about capital investment businessmen may be regarded as deciding how much capital to acquire and use in their businesses on the basis of how much it costs to rent capital. This is an idea which is very familiar to students of the national accounts. In the national accounts, owner-occupied dwellings are weighed into the national product essentially at their implied rental value. A change in investment incentives has the effect of reducing the rent that businessmen have to pay after taxes for the purpose of using capital; this gives them an incentive to invest. We phase the incentive effect into the econometric model in two steps. First, we trace through the direct impact of the change in incentives on the amount of investment that people actually undertake; second, in a multiplier analysis we trace out the impact of this investment on all other aspects of economic activities. The results of this kind of exercise are given in tables 4 and 5 for each of the changes in investment incentives under consideration.

We have broken down the impact of investment into the impact on producers' durables investment which would be directly affected by the investment incentives currently under consideration. Second, we have tabulated the effect in the change in these investment incentives on investment in structures and investment in housing. Then, to indicate what the effect would be from the point of view of inflation, we have traced through the effects of changes in investment on the consumer price index, the GNP deflator and then various price indexes that are specific to investment goods such as the structures index, and residential and nonresidential, and the producer durable equipment price index.

Going beyond that, one would expect that incentives to investment will exert some pressure on financial markets; we have traced through the impact of this change in investment incentives on money rates of various kinds, including the yields on U.S. Government securities, and yields on corporate bonds. Then, finally to measure the aggregative impacts, we have traced through the effect on employment, GNP, and the rate of unemployment. An important consideration from the point of view of the Government is what will happen to Federal Government receipts under various tax incentives. The effect of a change in depreciation rules is to cost the Government some revenue. On the other hand, an increase in the level of economic activity increases the base for all of the different tax programs of the Government, particularly income taxes. The direct impact will be negative, and it will reduce receipts. The indirect impact would be positive, since a higher level of overall activity will increase Government receipts.

The technique of assessing the impact of the ADR system or any other investment incentives is to see what the direct impact is, and then to feed the direct impact into the econometric model. This enables us to project the impact, as I have indicated, on investment GNP, employment, Government receipts, and the Government deficit. The results are given in table 4 for the ADR system and in table

5 of my prepared statement for a tax credit of 3.3 percent. Turning back to table 3 of my prepared statement, let me indicate that I have analyzed only two possible changes in investment incentives; of course, there are many others under discussion.

I have indicated the direct impact on the ADR system to producer durables spending on table 3, and I have separated out the two aspects of the system, the 20 percent reduction on lifetimes and the modified half-year convention in the second and third lines in table 3. The modified ADR system, which is given in line 4, is based on a proposal made by the President's Task Force on Business Taxation. This modified ADR system involves a 40-percent reduction of lifetimes, so it represents a considerably greater stimulus. Turning to the investment tax credit, I have considered an investment tax credit of 3.3 percent, which is comparable in its direct incentive impact to the ADR system, and a tax credit of 7 percent, which was in force until 1969.

All six of these investment-incentives can be compared with regard to the overall magnitude, but detailed studies of the indirect impacts are limited to the ADR system, the first entry there in table 3, and the investment tax credit of 3.3 percent. The basic conclusions then, reading through table 4 of my prepared statement, would be the following: First, there will be a substantial impact on investment. Let us look at just producers durable equipment. In constant 1958 dollars the impact is at the maximum in 1974 and there will be something like $5.3 billion more investment in producer durables than there would have been in the absence of the ADR system. There is also an impact on investment on structures, although it is much less substantial, and investment on housing, which is negative. This is a relatively minor effect; housing is not going to be much affected by the change.

There is not much impact on the level of prices. The greatest impact, which is just as one would expect, is going to be on the level of prices in the investment sector itself, including the price of housing and the price of structures. There will also be an impact on consumer goods generally, but the overall impact on the GNP deflator will on the order of one percentage point. There will be some impact on interest rates. They are going to go up, but not substantially.

The impact that would be of the greatest interest for the purposes of this hearing has to do with unemployment and GNP; and we can see that the level of unemployment beginning in 1973, first quarter, and extending throughout 1975, the period covered by our study, runs at about 0.3 percentage points below what it would otherwise be. What does this mean for potential GNP? Going back to our original projection, we project the level of unemployment in 1972, first quarter, will be 5.6 percent. The level in 1973, first quarter, is 5 percent. The level in 1974 is 4.8 percent. All these figures will be shaved by three-tenths of a percentage point, which is a substantial gain; by 1975, first quarter, we will be at a level of unemployment of something like 4.2 percent, which is close to full employment.

If we look through the impact on Federal Government receipts we see the impact is substantial and negative for 1971, negative, but not very substantial for 1972, and positive for subsequent years. If we add these figures from 1971 through to 1975, government receipts are unaffected, and the Government deficit is essentially what it would otherwise be.

The results are very much the same for tax credits as they are for ADR system. Government receipts are considerably higher under a tax credit comparable in its stimulus to the ADR system than under the ADR system itself. The negative impact on Government receipts from the tax credit of 3.3 percent is over by 1972, or early 1973; the positive impact will be much greater during the subsequent years, so there is a much greater positive impact on total government receipts through the reinstitution of a tax credit. This projection is based on a tax credit of 3.3 percent. If we reinstitute a tax credit of 7 percent, there will be an impact on Federal Government receipts that is roughly twice the order of magnitude of the levels indicated here. So far as unemployment is concerned, the impact would be roughly double; of course, by 1974 that means we will be down at a level of unemployment of say 3.9 or 3.8 percent, which could be an inflationary situation.

So far as recommendations for policy are concerned they would be two. First, it is extremely important to have in mind the long-term problem of eliminating the unemployment associated with the current recession. According to our studies, this is not something that will go away naturally. Investment incentives, whether we take a tax credit or the ADR system, represents one feasible solution to this problem and will bring us back to full employment, but not before 1974 or 1975. That leads me to my second recommendation for changes in fiscal policy. It is very important to think now, that is to say, immediately, of measures which can be adopted now that could lead to full employment sooner. Short-term measures such as extension of unemployment benefits and speeding up of revision of the personal income tax reduction would have an important contribution to make. These, would have no long-term impact, and, that being the case, a combination of fiscal policies composed of these short-term measures and some sort of a change in the investment incentives could result in a return to potential GNP or return to full employment, if you like, in 1973 or late 1972 and persistence of full employment without inflation throughout the next half decade through 1975.

Thank you.

(The prepared statement of Mr. Jorgenson follows:)

PREPARED STATEMENT OF DALE W. JORGENSON

THE ECONOMIC IMPACT OF INVESTMENT INCENTIVES

1. INTRODUCTION

The purpose of this study is to assess the economic impact of changes in the taxation of business income for the purpose of stimulating investment expenditures. On January 11, 1971, President Richard M. Nixon announced a new system of regulations for calculating depreciation allowances for tax purposes, the Asset Depreciation Range System. The objectives of the ADR System, as stated by President Nixon, are: (1) to reduce unemployment, (2) to promote economic growth, (3) to strengthen the balance of payments, (4) to simplify depreciation provisions of the Internal Revenue Code. Walter Heller and Arthur Okun, former chairmen of the Council of Economic Advisers, have proposed re-institution of the investment tax credit in order to stimulate investment expenditures.

In this study we consider the economic impact of the ADR System and a comparable tax credit on unemployment, economic growth, and the balance of payments. In addition, we consider the impact on the level and composition of investment expenditures, including business investment and private housing. Finally, we consider the impact on inflation, credit conditions, and Federal government revenue. Given the basic objective of stimulating the economy the alternatives for fiscal policy are to increase government expenditure or to reduce taxes. Tax cuts may be aimed at stimulation of consumption or investment; among tax measures that stimulate investment, re-enactment of the investment tax credit and adoption of the ADR System are alternative policy measures. In these comments we focus on the economic impact of tax measures that stimulate investment. The consideration of tax measures to stimulate consumption or possible increases in expenditure is outside the scope of the impact study reported below.

We begin with a brief history of tax incentives for business investment in the United States during the postward period. The principal incentives are the adoption of accelerated depreciation in the Internal Revenue Code of 1954, the reduction in initial asset lifetimes for calculating depreciation allowances over the period from 1954 to 1962, and the adoption of the investment tax credit in 1962. The ADR System represents a further reduction in lifetimes allowable for tax purposes and additional acceleration by a "modified half-year" convention to be described in detail below.

The economic impact of investment incentives adopted in the United States during the postwar period has been analyzed exhaustively by econometric methods.[1] The general conclusion of these studies is that incentives have a considerable impact on the level of investment, but that the investment process is governed by a substantial lag. The direct impact of a change in incentives requires between one and two years to take effect. The "multiplier" effects of expenditures induced by a change in incentives requires even longer. In view of these lags investment incentives are not a useful tool for short-run economic stablization.

Investment incentives do have a considerable long-run impact on the rate of capital accumulation. It is notable that each of the major changes in investment incentives in the postward period—accelerated depreciation in 1954 and shorter asset lifetimes and the investment tax credit of 1962—was followed by an investment boom. The pattern of these major investment booms is an increase in investment followed by high levels of economic activity that induce further increases in investment. The lag between the change in tax policy and the full impact on investment expenditures is considerable.

Our conclusion is that the economic impact of the ADR System will be to provide substantial stimulation for the level of investment and the general level of economic activity. Relatively little of this impact will be felt during the first year of the new system, 1971; the maximum impact on investment, gross national product, and unemployment will occur in 1974. The total impact will be similar to the response of the economy to adoption of fiscal measures to stimulate investment in 1954 and 1962 but somewhat smaller in magnitude.

2. POSTWAR INVESTMENT INCENTIVES IN THE UNITED STATES

Tax policies for stimulating investment expenditures by providing incentives through tax credits and accelerated depreciation are a permanent part of the fiscal policies of the United States and many other countries.[2] Major changes in investment incentives in the United States were made in 1954 with the adoption of accelerated depreciation, in 1962 with shortening of asset lifetimes for calculating depreciation allowances and adoption of the investment tax credit, and in 1969 with the repeal of the investment tax credit. All of these changes in investment incentives have had substantial economic impact.

Prior to the Internal Revenue Code of 1954 essentially only one depreciation formula was permitted for tax purposes, the straight-line formula. Under this

NOTE.—See footnotes at end of article.

formula depreciation allowances over the lifetime of an asset for tax purposes are constant at an annual rate equal to unity divided by the lifetime of the asset. Beginning in 1954 three depreciation formulas were allowed for tax purposes—straight-line, sum of the years' digits, and double declining balance. Both sum of the years' digits, and double declining balance. Both sum of the years' digits and double declining balance formulas begin with depreciation allowances substantially greater than the straight-line rate for the first year with the level declining over the life of the asset. These depreciation formulas are referred to as "accelerated" formulas since the depreciation allowances are accelerated in time.

The critical parameter in determining depreciation allowances for tax purposes is the period over which the asset is depreciated. In both straight-line formula and accelerated formulas, the initial depreciation allowance is inversely proportional to the period. From this it follows that a reduction in asset lifetimes represents an acceleration of depreciation allowances and provides an added incentive to investment. Before 1954 asset lifetimes allowable for tax purposes were based essentially on Bulletin F of the Bureau of Internal Revenue, first issued before World War II. Beginning in 1954 lifetimes were gradually reduced by negotiations with individual taxpayers. An attempt was made to standardize lifetimes for equipment in the Depreciation Guidelines of 1962; these Guidelines represented a reduction of almost fifty percent in Bulletin F lifetimes.

In 1962, a new tax incentive for investment was introduced in the form of an investment tax credit for equipment. From an economic point of view the investment tax credit is a subsidy to the purchase of equipment. Instead of paying the subsidy directly to the purchaser, the Internal Revenue Service permitted the purchaser of equipment to reduce his tax payments by an amount proportional to the value of equipment purchases. At the initiation of the investment tax credit in 1962, the credit claimed by the taxpayer was deducted from the value of the asset used as a base for calculation of depreciation allowances. In 1964, this provision of the tax credit, the Long Amendment to the original legislation, was repealed resulting in a further increase in investment incentives. In 1964, a general cut in personal and corporate income tax rates was introduced that reduced the corporate tax rate from fifty-two to forty-eight percent over a two year period. In the ensuing rise in the general level of economic activity, investment incentives were dampened through temporary suspension of the investment tax credit from October 1966 to March 1967. In 1969, the investment tax credit was repealed. Both the initial suspension of the credit and its final repeal had the effect of reducing the level of investment activity from what it would otherwise have been.

3. THE ECONOMIC ANALYSIS OF INVESTMENT INCENTIVES

The range of possible fiscal policy measures for the control of investment activity is very considerable. To analyze and compare the impact of these alternative measures economists have developed the concept of a rental price of capital services.[3] In this approach to the analysis of investment incentives businesses are divided into two activities—an activity that rents capital, hires labor, buys materials, and sells output and an activity that buys capital goods and rents capital services. Although rented capital is an important part of many businesses, the separation of the activity of owning assets and the activity of renting them for productive purposes amounts to putting all capital services onto a rental basis. This fiction has often been useful for analytical purposes, as in the conversion of home ownership to a rental basis for measuring housing services. This conversion is used in estimating U.S. gross national product.

Conversion of capital services to a rental basis requires representation of a complex tax and financial structure in a highly simplified manner. This representation is, nonetheless, capable of reducing the vast range of investment incentives, both those that have been adopted and those that are contemplated, to a common unit of account. This unit is the rental price for an asset associated with a given or proposed tax structure. Rental prices are like space rent-

NOTE.—See footnotes at end of article.

als or equipment rentals and represent the cost of using an asset for a stipulated period of time.

An expression for the rental price, say c, useful in analyzing the impact of investment incentives in the following:

$$c=\frac{1-k-uz}{1-u}q(r+\delta)$$

In this formula u is the corporate tax rate, currently forty-eight per cent. The parameter z is the present value of depreciation allowances, the value today of the stream of depreciation allowances resulting from the acquisition of one dollar's worth of an asset. Of course the value of depreciation allowances over the lifetime of an asset is one dollar. But the value today can be calculated by discounting future depreciation allowances back to the present. The present value of z is higher for accelerated depreciation formulas than for straight line. It is also higher for short asset lifetimes than for long lifetimes. Finally, the parameter k is the investment tax credit. Between 1962 and 1969 the tax credit was set at three percent for most utilities and seven percent for other businesses; with suspension during 1967–1968 and final repeal in 1969 the tax credit dropped to zero.

The remaining elements in the formula for the rental price of capital reflect economic forces outside the tax system. The variable q is the price of an investment good. As inflation proceeds this price rises. The variable r is the real rate of return after taxes. Finally, the parameter δ is the economic rate of depreciation, which may differ from the rate of depreciation for tax purposes.

In analyzing the impact of a change in tax incentives our method is, first, to translate the change in tax incentives into a change in the rental price. Adoption of accelerated depreciation formulas in 1954 resulted in an increase in the present value of depreciation allowances. For producers' durables the adoption of accelerated depreciation formulas raised the present value of depreciation allowances from 39.7 cents on a dollar of investment to 54.3 cents on a dollar, a very substantial change. This change had the effect of reducing the effective rental price of capital and providing an incentive to investment.

All of the changes in investment incentives we have discussed can be translated into a change in the rental price of capital services. Changes in depreciation formulas, asset lifetimes for tax purposes, and modifications in depreciation allowable during the year the asset is acquired can be translated into a change in the present value of depreciation allowances z. Changes in z in the investment tax credit k or the income tax rate u can be incorporated into the rental price of capital services c. The impact of the change in tax incentives can then be analyzed by tracing out the impact of the change in the rental price of capital services on the level of investment expenditures.

Our method can be applied directly to contemplated change in investment incentives such as the ADR System and the "modified half-year convention." Both of these changes in tax policy can be translated into a change in the present value of depreciation allowances. These changes result in further acceleration of depreciation allowances and a further increase in the present value of depreciation allowances claimed for tax purposes. An increase in present value of depreciation allowances results in a reduction in the rental price of capital and an addition to investment incentives.

The first step in tracing out the impact of a prospective change in investment incentives is to establish a benchmark representing the development of the economy in the absence of the policy change. In the impact study to be described below we take a five year projection of the United States economy for the period 1971–1975 prepared by Data Resources, Inc., on the basis of the DRI econometric model. This projection includes the intermediate-range outlook for the overall level of economic activity and the level of employment along with the projected development of consumption and investment expenditures, prices, government activity, the balance of payments, and credit conditions.

The second step in our analysis is to develop an alternative five year projection of the development of the economy assuming that a change in tax policy takes place and that other economic policies are adjusted so as to maintain the same general level of economic activity, but to provide for an increased level of business investment. Obviously, this implies a reduction in government and foreign purchases of goods and services, consumer expenditures, and other components of investment. We refer to the resulting change in investment as the direct impact of the change in investment incentives.

The third step in our analysis is to allow the change in investment expenditures to feed back through the economic system allowing the general level of economic activity to vary with the change in investment. The total impact of a change in investment incentives includes both the direct effect on business investment and induced effects on other expenditures, including further changes in the level of investment expenditures induced by changes in the general level of activity. These effects include changes in the level of unemployment, the level of consumption, the development of prices, the level of government receipts and the government deficit, the balance of payments, and credit conditions.

Assessment of the total impact of tax policy involves the interaction of business, government, and household receipts and expenditures. The full effects of this interaction require a considerable period of time to be worked out. To assess the full impact a detailed econometric model like the DRI system is indispensable. As a point of reference for measuring the impact in quantitative terms a projection of economic activity for at least five years is required.

4. CURRENT POLICY ALTERNATIVES

The Asset Depreciation Range System provides additional options for business in depreciating equipment for tax purposes. The essential changes are:

(1) Guideline lifetimes for equipment are reduced by as much as twenty percent.

(2) The reserve ratio test is abolished. Under this administrative provision of the Internal Revenue Service, lifetimes employed for tax purposes are tied to actual retirement experience. Lifetimes for equipment acceptable to the IRS are both longer and shorter than the depreciation Guidelines adopted in 1962. Shorter lifetimes must be justified by a reserve ratio test. Abolition of the reserve ratio test makes the likely impact of the new Guidelines equal to a twenty percent reduction in lifetimes relative to existing depreciation practices.

(3) Depreciation allowances are governed by a "modified half-year convention". Under the current convention, assets acquired during any tax year receive approximately half the first year's depreciation allowance in the year of acquisition. Under the modified convention, assets receive approximately three-quarters of the first year's depreciation allowance.

In addition to these three changes, there are other provisions of the new regulations such as those relating to the treatment of repairs and retirements for tax purposes. In our impact study, we neglect these provisions of the proposed regulations in order to focus attention on how the reduction in Guideline lifetimes and the modified half-year convention act as incentives to undertake investment. To apply our method of analysis to these changes in incentives, we first compute the impact of each change on the present value of depreciation allowances. In 1970, the present value of depreciation allowances was 69.8 cents for a dollar of investment in producers' durable equipment. The modified half-year convention increases this present value to 71.5 cents per dollar. The twenty percent reduction in Guideline lifetimes increases the present value to 74.4 cents per dollar. Both changes together increase the present value to 76.2 cents per dollar of investment. The President's Task Force on Business Taxation has proposed a forty percent reduction in Guideline lifetimes for equipment.[4] This would result in a present value of depreciation allowances of 81.4 cents per dollar of investment.

For the purpose of stimulating investment in producers' durable equipment, an alternative policy change is re-enactment of the investment tax credit. To analyze the impact of an investment tax credit, we employ the same method of analysis as for accelerated depreciation allowances. An incentive to investment equivalent to the ADR System, including both reduction of lifetimes by twenty percent and a modified half-year convention, would be provided by an effective

NOTE.—See footnotes at end of article.

investment tax credit of .032. With a statutory tax credit of .07, the effective rate was .067 in 1969, the last year of the investment tax credit. Re-enactment of an investment tax credit at a statutory rate of .033 would be equivalent in incentive effect to adoption of the ADR System.

To assess the economic impact of the ADR System we consider the effects of the changes in tax policy on the rental price of capital. We then assess the direct impact of the change in rental price on the level of investment expenditures. Since this impact requires considerable time we trace out the direct impact of the change in tax policy over a five year period beginning with 1971. We assume that the ADR System is adopted for all assets acquired on or after January 1, 1971. Finally, we assess the total impact of the ADR System by permitting the change in investment expenditures to feed back through the economic system. We then estimate the total impact of the change in tax policy on business investment, housing, prices, international trade, government revenue and the government deficit, credit conditions, and the overall level of economic activity and employment.

As a complement to our assessment of the impact of the ADR System we consider some alternative policies for increasing incentives to invest. Either of the two main provisions of the ADR System—twenty per cent reduction in asset lifetimes and modified half-year convention—could be adopted separately. We analyze the direct impact of each of the two provisions by itself and compare the results with the impact of the two provisions together. Second, it would be possible to adopt shorter guideline lifetimes for tax purposes, as recommended by the President's Task Force on Business Taxation. We consider the impact of a modified ADR System with lifetimes forty percent rather than twenty per cent less for producers' durable equipment. Finally, an alternative policy for stimulating investment is to re-enact the investment tax credit. We consider the impact of investment tax credits of statutory rates of .033 and .07. The second measure represents a considerably greater investment incentive than the ADR System; the first is equivalent in incentive effect to the ADR System.

The main alternatives for economic policy to be compared are then:

(1) the ADR System;
(2) twenty percent reduction in Guideline lifetimes alone;
(3) modified half-year provision alone;
(4) modified ADR System with forty percent reduction in Guideline lifetimes;
(5) investment tax credit, statutory rate of .033;
(6) investment tax credit, statutory rate of .07.

We assess the direct impact of each of these six alternative policy measures.

It is possible to consider the total impact of any of the six policy measures listed above. The most important of these measures is the ADR System itself. As a basis for comparison, we also tabulate the total impact of investment credit with a statutory rate of .033, which has an equivalent incentive effect.

The first step in our analysis is to translate a given change in investment incentives into a corresponding change in the rental price of capital. The results are tabulated in Table 1.

5. DIRECT IMPACT

As a benchmark for the development of the U.S. economy in the absence of changes in investment incentives, we employ a five-year projection for the period 1971, first quarter, through 1975, fourth quarter. The projected development of the overall level of economic activity and the level of employment together with consumption and investment expenditures, prices, government activity, the balance of payments, and credit conditions are given in Table 2. In this projection, expenditures on producers' durable equipment fall in proportion to output over the first two years of the period. During the remaining three years, producers' durables rise in proportion to output eventuating in a rise of investment relative to output over the five-year period.

In real terms, gross national produce rises from a level of 721.3 billions of 1958 dollars in the fourth quarter of 1970 to 926.6 in the fourth quarter of 1975. The level of unemployment is projected to decline from 5.8 percent in the fourth quarter of 1970 to 4.4 percent in the fourth quarter of 1975. In making these projections of the overall level of economic activity and the rate of investment expenditures tax policy is assumed to remain as it was at the end of 1970, before the ADR System was announced. The projections serve as a starting point for assessing the impact of the ADR System and alternative policy measures for stimulating investment.

Given the benchmark provided by the DRI five-year projection of the U.S. economy, the next step in assessment of the impact of the ADR System is to assess the direct impact of the System on producers' durable equipment expenditures. We first trace out the effect of the ADR regulations on the rental price of equipment services. The results are given for the ADR System and for alternative policy measures in Table 1 above. Next, we project the direct impact of the change in the rental price on the level of investment expenditures. For this purpose, we employ an investment equation fitted to the historical record for 1956 to 1970; this equation is described in detail in the Technical Appendix to these comments. The period for which we have fitted the equation includes the period of major impact of earlier changes in investment incentives. The proportion of variance in producers' durable equipment expenditures explained during the historical period, measured by R^2, is .9875. The average lag between changes in investment incentives and changes in the level of expenditures is 6.4 quarters.

In our investment equation, the level of investment in producers' durable equipment depends on the rental price of capital services, the price output, and the level of output. We have described the rental price. We measure output as real gross national product in 1958 prices and its price as the implicit deflator for gross national product. To project the direct impact of the ADR regulations, we assume that gross national product and its implicit deflator develop as in the DRI five-year projection for 1971, first quarter, to 1975, fourth quarter. We alter the rental price of capital to reflect the change in investment incentives resulting from the ADR regulations. Our projections of the direct impact of alternative policy changes are carried out by the same method. The results for the ADR System and the five alternative policy measures we consider are given in Table 3.

For our model of investment, no changes in producers' durables spending occur until the third quarter of 1971 for tax incentives that take effect on January 1, 1971. The direct impact of alternative policy measures is roughly proportional to the change in investment incentives. The ADR System is equivalent to a statutory investment tax credit of .033 in its direct impact. Adoption of either of the features of the ADR System—shorter lifetimes or the modified half-year convention—in the absence of the other feature would represent reduction in investment incentives. If lifetimes were reduced by forty percent rather than twenty percent, as in the modified ADR System we consider, the impact on investment is more substantial than the impact of the ADR System itself. Finally, a statutory investment tax credit of .07, the level that prevailed for the period 1962–69, would constitute roughly double the investment incentive represented by the ADR System.

6. TOTAL IMPACT

The final step in our assessment of the impact of the ADR System is to allow the projected direct impact on investment expenditures to feed back through the economic system, allowing the general level of economic activity to vary with the change in investment. Although this analysis could be carried out for all six of the alternative changes in tax incentives we consider, our study is limited to an assessment of the total impact of the ADR System and a statutory investment tax credit of .033, which provides a direct stimulus to investment expenditures comparable to that provided by the ADR System. For any of the alternative policies we have described above, a similar analysis of total impact could be made. Since these changes are either changes in depreciation rules or changes in the tax credit, the time pattern of the total impact will be similar to the total impacts we analyze here. Of course, the differences in total impact will be roughly proportional to the differences in direct impact.

The projected economic impact of the ADR System is given in Table 4 for the period 1971, first quarter, to 1975, fourth quarter. The total impact of the equipment expenditures in the absence of the change. In current prices of

1958 rises from zero in the first quarter of 1971 to a maximum of 5.3 billions in the last three quarters of 1974. The total impact on producers' durables in current prices rises from zero to a maximum of 7.7 billions in the last two quarters of 1974 and the first two quarters of 1975. These impacts are very substantial measured relative to the projected level of producers' durable equipment ejpenditures in the absence of the change. In current prices of 1975, the level of expenditures in the fourth quarter of 1975 is projected at 102.5 billions; in constant prices of 1958, this figure is 73.0 billions.

The total impact of the ADR System on the overall level of economic activity may be assessed by tracing out the effects on gross national product in current and constant prices. In constant prices of 1958, the projected impact rises from 0.1 billions in the first quarter of 1971 to a maximum of 8.9 billions in the last quarter of 1973 and the first quarter of 1974. In current prices, the impact rises to 20.7 billions in the fourth quarter of 1975. The total impact of the ADR System on the implicit deflator for gross national product rises from zero in the first two quarters of 1971 to .011 points on a base projection of 1.609 in the fourth quarter of 1975. This is less than one percent of the price level projected for 1975, fourth quarter, in the absence of a change in investment incentives.

The total impact of the ARD System on business investment, investment in residential housing, the overall level of economic activity and employment, prices, credit conditions, government receipts and the government deficit, and the balance of payments are also given in Table 4. The total impact of an investment tax credit at a statutory rate of .033 is given in Table 5. These Tables may be interpreted along the lines outlined above for the total impact on producers' durable equipment expenditures and the gross national product.

7. CONCLUSION

Our overall conclusion from an assessment of the economic impact of the ADR System is that the effect on producers' durables spending is likely to be very substantial over the five year period 1971–1975. The impact in real terms builds up slowly reaching a maximum in 1974; the impact in current prices continues to rise into later 1974 as prices go on rising in response to the higher level of activity. This pattern is comparable to the investment increases that followed the adoption of accelerated depreciation in 1954 and the Depreciation Guidelines and tax credit in 1962. Since the change in investment incentives associated with the adoption of the ADR System is smaller than in the two previous changes, the economic inpact is more moderate.

TECHNICAL APPENDIX

The investment equation used in assessing the direct impact of investment incentives is:

$$
\begin{aligned}
I_t = 7.86678 &+ .00091\frac{P_{t-2}}{c_{t-2}}Q_{t-1} + .00154\frac{P_{t-3}}{c_{t-3}}Q_{t-2} \\
&+ .00193\frac{P_{t-4}}{c_{t-4}}Q_{t-3} + .00211\frac{P_{t-5}}{c_{t-5}}Q_{t-4} \\
&+ .00211\frac{P_{t-6}}{c_{t-6}}Q_{t-5} + .00198\frac{P_{t-7}}{c_{t-7}}Q_{t-6} \\
&+ .00174\frac{P_{t-8}}{c_{t-8}}Q_{t-7} + .00143\frac{P_{t-9}}{c_{t-9}}Q_{t-8} \\
&+ .00108\frac{P_{t-10}}{c_{t-10}}Q_{t-9} + .00072\frac{P_{t-11}}{c_{t-11}}Q_{t-10} \\
&+ .00041\frac{P_{t-12}}{c_{t-12}}Q_{t-11} + .00015\frac{P_{t-13}}{c_{t-13}}Q_{t-12} \\
&- .06476K_{t-1}
\end{aligned}
$$

where I_t is Producers' Durable Equipment expenditures in constant prices of 1958, Q_t is Gross National Product in constant prices of 1958, K_t is Capital Stock, Producers' Durable Equipment, in constant prices of 1958, p_t is the implicit deflator for Gross National Product, and c_t is the rental price of Producers' Durable Equipment services. For this equation $\bar{R}^2$ is .9875, the Durbin-Watson ratio is .5812, and the average lag is 6.43089 quarters.

The rental price of capital services is:

$$c_t = \frac{1 - k_t - u_t z_t}{1 - u_t} q_t (r + \delta)$$

In this formula u_t is the statutory corporate income tax rate, z_t is the present value of depreciation allowances discounted at the annual discount rate of .10, k_t is the effective rate of the investment tax credit, q_t is the implicit deflator for Producers' Durable Equipment expenditures, r is the discount rate, and δ is the economic depreciation rate for Producers' Durable Equipment, an annual rate of .138.

The assessment of total impact for each of the investment incentives we consider involved the use of the programs EPL, MODEL/DRI and MODSIM. The first step was to fit the investment equation by EPL, using a polynomial distributed lag over twelve quarters. The equation was then evluated in the program MODSIM, using projections of Gross National Product in constant prices of 1958, the implicit deflator for Gross National Product and the implicit deflator for Producers' Durable Equipment expenditures from the DRI five-year projection of the U.S. economy. The first evaluation assumed no change in investment incentives. The equation was next evaluated in the program MODSIM, using the same projections as before, but altering the investment incentives to provide projections of investment for each of the six alternative policies we consider. The difference between the results with no change in policy and the results for each change in tax incentives is tabulated as the direct impact of the policy change in Table 3.

The final step is assessing total impact was to enter the DRI/MODEL program with the direct impact of each change in tax incentives as an add factor for investment in Producers' Durable Equipment expenditures in constant prices of 1958. Add factors for the change in capital consumption allowances were entered for the changes in depreciation rules. Add factors for the investment tax credit were entered for policy changes involving the tax credit. Capital consumption allowances are increased by a change in depreciation rules while tax receipts are reduced for either increased depreciation or an investment tax credit. The results of these five-year simulations of the DRI model are presented in Tables 4 and 5.

The investment equation for Producers' Durable Equipment in the DRI model is similar in form to the equation given in this Appendix, but it is not suitable for the assessment of the impact of changes in depreciation rules. In this equation economic depreciation is treated as identical with the tax depreciation allowances. As an example, a twenty percent reduction in asset lifetimes would have two effects. The first is to lower the rental price of equipment capital and the second is to reduce the economic lifetime of equipment.

TABLE 1.—*Rental price of capital services, 1971, 1st quarter*

1. No change in investment incentives	0.377
2. The ADR system	.359
3. 20 percent reduction in lifetimes	.364
4. Modified half-year convention	.372
5. Modified ADR system	.345
6. Investment tax credit 0.033	.359
7. Investment tax credit 0.07	.339

TABLE 2

DRI CENTRAL PROJECTION:

1971, FIRST QUARTER TO 1975, FOURTH QUARTER

71:1 71:2 71:3 71:4 72:1 72:2 72:3 72:4 73:1 73:2
73:3 73:4 74:1 74:2 74:3 74:4 75:1 75:2 75:3 75:4

Investment in private nonresidential structures, current $:

35.5 36.0 36.5 36.8 37.4 38.3 39.4 40.5 41.6 42.9
44.2 45.6 46.9 48.5 50.2 51.8 53.5 55.5 57.4 59.3

22.2 22.2 22.2 22.1 22.2 22.4 22.7 23.0 23.3 23.8
24.2 24.6 25.0 25.5 26.0 26.4 26.9 27.5 28.0 28.6

Fixed private, nonresidential investment, current $:

102.9 103.1 104.2 104.8 107.7 110.6 113.9 117.2 120.5 123.8
127.0 130.2 133.5 137.3 141.3 145.2 149.2 153.5 157.6 161.8

Fixed private, nonresidential investment, constant 58$:
77.0 76.1 76.0 75.6 76.9 78.1 79.6 81.0 82.5 84.0
85.4 86.8 88.3 90.2 92.1 93.9 95.8 97.8 99.7 101.5

Investment in producers' durable equipment, current $:

67.4 67.0 67.7 68.0 70.2 72.3 74.6 76.7 78.9 80.9
82.8 84.6 86.6 88.8 91.1 93.4 95.7 98.0 100.2 102.5

Investment in producers' durable equipment, constant 58$:
54.7 53.9 53.8 53.5 54.7 55.7 56.9 58.0 59.2 60.3
61.3 62.3 63.4 64.7 66.1 67.5 68.8 70.3 71.6 73.0

Housing

Investment in residential structures, current $:

34.3 35.3 36.4 37.2 38.6 40.2 41.6 42.6 43.3 44.1
44.9 45.5 46.8 48.2 49.4 49.7 50.3 51.3 52.0 52.1

Investment in residential structures, constant 58$:
23.4 23.9 24.4 25.0 25.9 26.8 27.4 28.0 28.4 28.7
28.8 29.2 29.9 30.5 30.8 30.9 31.2 31.4 31.4 31.4

Housing starts, private--total

1.621 1.662 1.716 1.763 1.824 1.852 1.888 1.924 1.947 1.966
1.969 2.043 2.097 2.126 2.146 2.147 2.188 2.185 2.183 2.184

71:1 71:2 71:3 71:4 72:1 72:2 72:3 72:4 73:1 73:2
73:3 73:4 74:1 74:2 74:3 74:4 75:1 75:2 75:3 75:4

Prices

Consumer price index
1.384 1.396 1.410 1.420 1.427 1.440 1.455 1.465 1.473 1.486
1.500 1.511 1.519 1.533 1.547 1.559 1.568 1.582 1.598 1.609

Implicit price deflators for GNP:

1.385 1.393 1.407 1.417 1.430 1.440 1.451 1.463 1.474 1.486
1.498 1.510 1.522 1.533 1.545 1.557 1.570 1.582 1.595 1.607

Implicit price deflators for private nonresidential structures:
1.597 1.623 1.645 1.667 1.689 1.713 1.737 1.760 1.783 1.807
1.830 1.855 1.880 1.906 1.933 1.960 1.989 2.018 2.047 2.077

Implicit price deflators for fixed private nonresidential structures:
1.337 1.355 1.371 1.387 1.401 1.417 1.432 1.447 1.460 1.474
1.487 1.499 1.511 1.523 1.535 1.546 1.558 1.570 1.582 1.593

Implicit price deflators for producers' durable equipment:

1.231 1.245 1.258 1.271 1.284 1.298 1.311 1.323 1.333 1.343
1.351 1.359 1.366 1.372 1.378 1.384 1.389 1.395 1.399 1.404

TABLE 2 CONTINUED

Implicit price deflators for residential structures:
1.464 1.479 1.491 1.487 1.488 1.503 1.520 1.520 1.524 1.540
1.557 1.558 1.565 1.583 1.604 1.607 1.615 1.635 1.656 1.659

Interest Rates

Money rate, commercial paper, 4-6 months:
6.11 6.05 6.17 6.28 6.32 6.38 6.54 6.56 6.74 6.84
6.77 6.68 6.58 6.56 6.62 6.64 6.63 6.59 6.56 6.54

Yield on U. S. government bonds, long term (10 years or more):
5.94 5.88 5.83 5.78 5.76 5.76 5.72 5.72 5.68 5.62
5.54 5.51 5.49 5.48 5.48 5.44 5.41 5.37 5.35 5.31

Yield on U. S. government bonds, short term (3 months):
5.03 5.13 5.26 5.34 5.36 5.42 5.61 5.54 5.82 5.80
5.70 5.61 5.52 5.54 5.62 5.60 5.60 5.54 5.53 5.52

Yield on Moody's AAA corporate bonds, seasoned:
7.37 7.30 7.31 7.31 7.11 7.12 7.11 7.11 6.91 6.88
6.83 6.80 6.60 6.60 6.61 6.59 6.36 6.34 6.31 6.29

Yield on Moody's AAA corporate bonds, new issue:
7.74 7.66 7.60 7.54 7.49 7.41 7.36 7.32 7.31 7.23
7.16 7.09 7.06 7.04 7.03 6.95 6.88 6.81 6.75 6.68
71:1 71:2 71:3 71:4 72:1 72:2 72:3 72:4 73:1 73:2
73:3 73:4 74:1 74:2 74:3 74:4 75:1 75:2 75:3 75:4

Employment and GNP

Rate of unemployment--all civilian workers:
5.9 5.7 5.6 5.7 5.6 5.3 5.1 5.1 5.0 4.9
4.8 4.8 4.8 4.6 4.5 4.5 4.5 4.5 4.4 4.4

GNP, current $:
1018.3 1041.0 1054.4 1074.0 1105.8 1133.0 1157.2 1179.9 1204.5 1229.2
1253.0 1276.3 1304.1 1333.1 1359.5 1383.6 1409.9 1436.9 1463.1 1489.4

GNP, constant 58$:
735.4 747.3 749.1 757.8 773.5 787.0 797.3 806.5 816.9 827.1
836.3 845.2 857.1 869.6 880.0 888.5 898.3 908.0 917.1 926.6

Government

Federal government receipts:
204.7 210.4 212.2 216.8 221.1 228.0 233.7 238.8 243.3 249.1
254.5 259.8 256.8 264.0 270.2 275.6 281.1 287.4 293.5 299.5

Government deficit, Federal:
-12.7 -7.7 -11.7 -9.6 -15.9 -10.8 -7.4 -4.8 -8.2 -6.2
-4.3 -2.7 -11.4 -8.2 -5.9 -2.8 -4.5 -1.7 0.3 2.4

Government deficit, State and local:
-1.0 -2.0 -0.2 -0.7 -0.1 -0.1 -0.1 0.0 0.5 0.7
0.5 0.6 0.6 1.0 1.2 0.7 1.0 0.6 0.9 1.2

International

Imports, current $:
60.2 61.0 61.6 62.5 63.8 65.1 66.5 67.9 69.4 71.0
72.6 74.2 76.0 77.9 79.8 81.7 83.7 85.7 87.8 89.9

Imports, constant 58$:
49.9 50.0 49.9 50.0 51.8 52.7 53.6 54.5 55.5 56.6
57.6 58.6 59.8 61.1 62.3 63.6 64.9 66.2 67.5 68.9

Exports, current $:
SAME
SAME

Exports, constant 58$:
SAME
SAME

TABLE 3

DIRECT IMPACT OF CHANGES IN INVESTMENT INCENTIVES

ON PRODUCERS' DURABLE EQUIPMENT EXPENDITURES

(billions of dollars, annual rates)

	71:1	71:2	71:3	71:4	72:1	72:2	72:3	72:4	73:1	73:2
1. The ADR System										
Current $:	0.000	0.000	0.2707	0.7363	1.332	2.002	2.696	3.366	3.976	4.500
Constant 58$:	0.000	0.000	0.2152	0.5793	1.037	1.543	2.057	2.545	2.983	3.352
2. Twenty per cent reduction in lifetimes										
Current $:	0.000	0.000	0.1920	0.5221	0.9445	1.420	1.912	2.387	2.819	3.191
Constant 58$:	0.000	0.000	0.1526	0.4108	0.7355	1.094	1.458	1.805	2.115	2.377
3. Modified half year convention										
Current $:	0.000	0.000	0.0694	0.1889	0.3417	0.5135	0.6915	0.8635	1.020	1.154
Constant 58$:	0.000	0.000	0.0552	0.1486	0.2661	0.3957	0.5275	0.6528	0.7651	0.8598
4. Modified ADR System										
Current $:	0.000	0.000	0.5108	1.389	2.513	3.777	5.087	6.352	7.502	8.491
Constant 58$:	0.000	0.000	0.4060	1.093	1.957	2.911	3.880	4.802	5.628	6.324

	73:3	73:4	74:1	74:2	74:3	74:4	75:1	75:2	75:3	75:4
1. The ADR System										
Current $:	4.924	5.241	5.459	5.601	5.698	5.797	5.898	6.001	6.107	6.215
Constant 58$:	3.644	3.857	3.997	4.082	4.133	4.188	4.244	4.303	4.364	4.427
2. Twenty per cent reduction in lifetimes										
Current $:	3.491	3.716	3.871	3.972	4.040	4.110	4.182	4.255	4.330	4.407
Constant 58$:	2.584	2.735	2.835	2.894	2.931	2.970	3.010	3.051	3.094	3.139
3. Modified half year convention										
Current $:	1.263	1.344	1.400	1.437	1.461	1.487	1.513	1.539	1.566	1.594
Constant 58$:	0.9346	0.9893	1.025	1.047	1.060	1.074	1.089	1.104	1.119	1.135
4. Modified ADR System										
Current $:	9.289	9.888	10.30	10.57	10.75	10.94	11.13	11.32	11.52	11.73
Constant 58$:	6.875	7.277	7.542	7.701	7.799	7.902	8.008	8.119	8.233	8.352

71:1 71:2 71:3 71:4 72:1 72:2 72:3 72:4 73:1 73:2
73:3 73:4 74:1 74:2 74:3 74:4 75:1 75:2 75:3 75:4

	71:1	71:2	71:3	71:4	72:1	72:2	72:3	72:4	73:1	73:2
5. Investment tax credit .033										
Current $:	0.000	0.000	0.2707	0.7363	1.332	2.002	2.696	3.366	3.976	4.500
Constant 58$:	0.000	0.000	0.2152	0.5793	1.037	1.543	2.057	2.545	2.983	3.352
6. Investment tax credit .07										
Current $:	0.000	0.000	0.6263	1.703	3.081	4.631	6.236	7.788	9.198	10.41
Constant 58$:	0.000	0.000	0.4978	1.340	2.399	3.569	4.758	5.888	6.900	7.754

	73:3	73:4	74:1	74:2	74:3	74:4	75:1	75:2	75:3	75:4
5. Investment tax credit .033										
Current $:	4.924	5.241	5.459	5.601	5.698	5.797	5.898	6.001	6.107	6.215
Constant 58$:	3.644	3.857	3.997	4.082	4.133	4.188	4.244	4.303	4.364	4.427
6. Investment tax credit .07										
Current $:	11.39	12.12	12.63	12.96	13.18	13.41	13.64	13.88	14.13	14.39
Constant 58$:	8.429	8.922	9.247	9.442	9.562	9.688	9.819	9.954	10.09	10.24

TABLE 4

TOTAL IMPACT OF THE ADR PROPOSAL ON THE ECONOMY

(NET CHANGE FROM THE DRI CENTRAL PROJECTION)

	71:1	71:2	71:3	71:4	72:1	72:2	72:3	72:4	73:1	73:2
Investment										
Investment in private, nonresidential structures, current $:	0.0	0.0	0.1	0.2	0.4	0.7	1.1	1.5	1.9	2.3
Investment in private, nonresidential structures, constant 58$:	0.0	0.0	0.0	0.1	0.3	0.4	0.6	0.8	1.0	1.2
Fixed private, nonresidential investment, current $:	0.0	0.1	0.5	1.2	2.2	3.4	4.6	5.9	7.2	8.3
Fixed private, nonresidential investment, constant 58$:	0.0	0.1	0.4	0.9	1.6	2.4	3.2	4.1	4.9	5.5
Investment in producers' durable equipment, current $:	0.0	0.1	0.4	1.0	1.8	2.6	3.5	4.4	5.3	6.0
Investment in producers' durable equipment, constant 58$:	0.0	0.1	0.3	0.8	1.4	2.0	2.6	3.3	3.9	4.3
Housing										
Investment in residential structures, current $:	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Investment in residential structures, constant 58$:	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Housing starts, private--total	0.001	0.002	0.003	0.004	0.004	0.004	0.003	0.001	-0.002	-0.007

	73:3	73:4	74:1	74:2	74:3	74:4	75:1	75:2	75:3	75:4
Investment										
Investment in private, nonresidential structures, current $:	2.7	3.1	3.4	3.7	3.9	4.1	4.2	4.4	4.5	4.6
Investment in private, nonresidential structures, constant 58$:	1.4	1.5	1.6	1.7	1.7	1.8	1.8	1.7	1.7	1.7
Fixed private, nonresidential investment, current $:	9.3	10.1	10.8	11.2	11.5	11.8	12.0	12.1	12.1	12.2
Fixed private, nonresidential investment, constant 58$:	6.1	6.5	6.8	6.9	7.0	7.0	7.0	6.9	6.8	6.7
Investment in producers' durable equipment, current $:	6.6	7.1	7.4	7.6	7.7	7.7	7.7	7.7	7.7	7.6
Investment in producers' durable equipment, constant 58$:	4.7	5.0	5.2	5.3	5.3	5.3	5.2	5.2	5.1	5.0
Housing										
Investment in residential structures, current $:	0.1	0.0	-0.1	-0.1	-0.2	-0.3	-0.4	-0.4	-0.4	-0.4
Investment in residential structures, constant 58$:	-0.1	-0.2	-0.3	-0.3	-0.4	-0.5	-0.6	-0.6	-0.6	-0.6
Housing starts, private--total	-0.012	-0.019	-0.026	-0.034	-0.041	-0.047	-0.051	-0.053	-0.053	-0.049

	71:1	71:2	71:3	71:4	72:1	72:2	72:3	72:4	73:1	73:2
Prices										
Consumer price index	0.000	0.000	0.000	0.000	0.000	0.001	0.001	0.002	0.002	0.003
Implicit price deflators for GNP:	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.001	0.001
Implicit price deflators for private nonresidential structures:	0.000	0.000	0.000	0.000	0.001	0.001	0.002	0.003	0.004	0.006
Implicit price deflators for fixed private nonresidential structures:	0.000	0.000	0.000	0.000	-0.001	-0.001	0.000	0.000	0.001	0.002
Implicit price deflators for producers' durable equipment:	0.000	0.000	0.000	0.000	0.000	0.001	0.001	0.002	0.002	0.003

	73:3	73:4	74:1	74:2	74:3	74:4	75:1	75:2	75:3	75:4
Prices										
Consumer price index	0.004	0.005	0.006	0.008	0.009	0.010	0.011	0.013	0.014	0.015
Implicit price deflators for GNP:	0.002	0.003	0.004	0.005	0.006	0.007	0.009	0.010	0.010	0.011
Implicit price deflators for private nonresidential structures:	0.008	0.011	0.013	0.016	0.019	0.023	0.026	0.029	0.032	0.035
Implicit price deflators for fixed private nonresidential structures:	0.003	0.004	0.005	0.007	0.008	0.009	0.011	0.012	0.013	0.014
Implicit price deflators for producers' durable equipment:	0.003	0.004	0.004	0.005	0.006	0.006	0.006	0.007	0.007	0.007

TABLE 4 CONTINUED

Implicit price deflators for residential structures:

0.000 0.000 0.000 0.000 0.001 0.002 0.002 0.003 0.005 0.006
0.008 0.010 0.011 0.013 0.015 0.016 0.018 0.019 0.020 0.021

Interest Rates

Money rate, commercial paper, 4-6 months

0.00 0.00 0.00 0.02 0.04 0.06 0.09 0.12 0.19 0.23
0.23 0.23 0.24 0.25 0.25 0.25 0.25 0.25 0.25 0.24

Yield on U.S. government bonds long term (10 years or more):

0.00 0.00 0.00 0.01 0.01 0.02 0.02 0.03 0.04 0.05
0.06 0.07 0.08 0.09 0.10 0.11 0.12 0.13 0.14 0.15

Yield on U.S. government bonds short term (3 months):

0.00 0.00 0.01 0.02 0.04 0.06 0.09 0.11 0.20 0.21
0.20 0.20 0.21 0.21 0.21 0.21 0.21 0.21 0.21 0.20

Yield on Moody's AAA corporate bonds seasoned:

0.00 0.00 0.00 0.01 0.01 0.02 0.03 0.04 0.05 0.06
0.08 0.09 0.11 0.12 0.13 0.15 0.16 0.17 0.18 0.19

Yield on Moody's AAA corporate bonds , new issue:

0.00 0.00 0.00 0.01 0.02 0.03 0.04 0.06 0.08 0.10
0.12 0.14 0.16 0.18 0.20 0.22 0.23 0.25 0.26 0.27
71:1 71:2 71:3 71:4 72:1 72:2 72:3 72:4 73:1 73:2
73:3 73:4 74:1 74:2 74:3 74:4 75:1 75:2 75:3 75:4

Employment and GNP

Rate of unemployment--all civilian workers:

0.0 0.0 0.0 0.0 -0.1 -0.1 -0.2 -0.2 -0.3 -0.3
-0.3 -0.3 -0.3 -0.3 -0.3 -0.3 -0.3 -0.3 -0.3 -0.2

GNP, current $:

0.1 0.3 0.9 2.1 3.6 5.3 7.3 9.3 11.3 13.2
14.8 16.1 17.1 17.9 18.5 19.1 19.5 19.9 20.3 20.7

GNP, constant 58$:

0.1 0.2 0.7 1.5 2.6 3.8 5.0 6.2 7.2 8.1
8.6 8.9 8.9 8.7 8.4 8.0 7.5 7.1 6.6 6.3

Government

Federal government receipts:

-2.5 -2.5 -2.4 -2.2 -1.7 -1.2 -0.7 -0.2 0.3 0.7
1.0 1.3 1.4 1.4 1.4 1.4 1.3 1.2 1.1 1.0

Government deficit, Federal:

-2.5 -2.5 -2.4 -2.2 -1.6 -1.1 -0.5 0.0 0.5 1.0
1.4 1.6 1.8 1.8 1.8 1.7 1.7 1.5 1.4 1.3

Government deficit, State and local:

0.0 0.0 0.0 0.1 0.1 0.2 0.2 0.2 0.3 0.3
0.3 0.3 0.2 0.2 0.2 0.1 0.1 0.1 0.1 0.1

International

Imports, current $:

0.0 0.0 0.0 0.1 0.2 0.3 0.4 0.6 0.8 1.0
1.3 1.5 1.8 2.0 2.2 2.5 2.7 2.9 3.1 3.3

Imports, constant 58$:

0.0 0.0 0.0 0.1 0.1 0.2 0.4 0.5 0.7 0.8
1.0 1.2 1.4 1.6 1.8 1.9 2.1 2.3 2.4 2.6

Exports, current $:

SAME
SAME

Exports, constant 58$:

SAME
SAME

63-247 O - 71 - 13

TABLE 5

TOTAL IMPACT OF THE TAX CREDIT PROPOSAL ON THE ECONOMY

(NET CHANGE FROM THE DRI CENTRAL PROJECTION)

	71:1	71:2	71:3	71:4	72:1	72:2	72:3	72:4	73:1	73:2
Investment										
Investment in private, nonresidential structures, current $:	0.0	0.0	0.1	0.2	0.4	0.7	1.1	1.5	2.0	2.4
Investment in private, nonresidential structures, constant 58$:	0.0	0.0	0.0	0.1	0.3	0.4	0.6	0.8	1.0	1.2
Fixed private, nonresidential investment, current $:	0.0	0.1	0.5	1.2	2.2	3.4	4.7	6.1	7.5	8.8
Fixed private, nonresidential investment, constant 58$:	0.0	0.1	0.4	0.9	1.6	2.4	3.3	4.2	5.1	5.8
Investment in producers' durable equipment, current $:	0.0	0.1	0.4	1.0	1.8	2.6	3.6	4.6	5.5	6.3
Investment in producers' durable equipment, constant 58$:	0.0	0.1	0.3	0.8	1.4	2.0	2.7	3.4	4.0	4.6
Housing										
Investment in residential structures, current $:	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.2	0.2	0.2
Investment in residential structures, constant 58$:	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Housing starts, private--total	0.001	0.001	0.001	0.002	0.003	0.004	0.004	0.002	0.000	-0.004
Prices										
Consumer price index	0.000	0.000	0.000	0.000	0.000	0.001	0.001	0.001	0.002	0.003
Implicit price deflators for GNP:	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.001	0.001
Implicit price deflators for private nonresidential structures:	0.000	0.000	0.000	0.000	0.001	0.001	0.002	0.003	0.004	0.006
Implicit price deflators for fixed private nonresidential structures:	0.000	0.000	0.000	0.000	-0.001	-0.001	0.000	0.000	0.001	0.002
Implicit price deflators for producers' durable equipment:	0.000	0.000	0.000	0.000	0.000	0.001	0.001	0.002	0.002	0.003

	73:3	73:4	74:1	74:2	74:3	74:4	75:1	75:2	75:3	75:4
Investment										
Investment in private, nonresidential structures, current $:	2.8	3.3	3.6	4.0	4.2	4.5	4.6	4.8	4.9	5.0
Investment in private, nonresidential structures, constant 58$:	1.4	1.6	1.7	1.8	1.9	1.9	1.9	1.9	1.9	1.9
Fixed private, nonresidential investment, current $:	9.9	10.9	11.6	12.2	12.7	13.0	13.2	13.3	13.4	13.4
Fixed private, nonresidential investment, constant 58$:	6.5	7.0	7.4	7.6	7.7	7.7	7.7	7.6	7.5	7.4
Investment in producers' durable equipment, current $:	7.0	7.6	8.0	8.3	8.4	8.5	8.5	8.5	8.5	8.4
Investment in producers' durable equipment, constant 58$:	5.0	5.4	5.6	5.8	5.8	5.8	5.8	5.7	5.6	5.5
Housing										
Investment in residential structures, current $:	0.1	0.1	0.0	-0.1	-0.2	-0.3	-0.4	-0.4	-0.5	-0.4
Investment in residential structures, constant 58$:	-0.1	-0.1	-0.2	-0.3	-0.4	-0.5	-0.6	-0.7	-0.7	-0.7
Housing starts, private--total	-0.010	-0.017	-0.025	-0.034	-0.042	-0.049	-0.054	-0.058	-0.058	-0.056
Prices										
Consumer price index	0.004	0.005	0.006	0.008	0.009	0.011	0.012	0.013	0.015	0.016
Implicit price deflators for GNP:	0.002	0.003	0.004	0.005	0.007	0.008	0.009	0.010	0.011	0.012
Implicit price deflators for private nonresidential structures:	0.008	0.011	0.014	0.017	0.020	0.024	0.027	0.031	0.034	0.038
Implicit price deflators for fixed private nonresidential structures:	0.003	0.004	0.005	0.007	0.008	0.010	0.011	0.013	0.014	0.015
Implicit price deflators for producers' durable equipment:	0.003	0.004	0.005	0.005	0.006	0.006	0.007	0.007	0.008	0.008

TABLE 5 CONTINUED

Implicit price deflators for residential structures:

0.000 0.000 0.000 0.000 0.001 0.001 0.002 0.003 0.005 0.006

0.008 0.010 0.012 0.014 0.016 0.017 0.019 0.020 0.022 0.022

Interest Rates

Money rate, commercial paper, 4-6 months

0.00 0.00 0.00 0.02 0.03 0.06 0.09 0.12 0.19 0.23

0.24 0.24 0.25 0.26 0.27 0.27 0.27 0.27 0.27 0.27

Yield on U.S. government bonds, long term (10 years or more):

0.00 0.00 0.00 0.00 0.01 0.01 0.02 0.03 0.04 0.05

0.06 0.07 0.08 0.10 0.11 0.12 0.13 0.14 0.15 0.16

Yield on U.S. government bonds, short term (3 months):

0.00 0.00 0.01 0.02 0.04 0.06 0.09 0.11 0.20 0.21

0.21 0.21 0.22 0.23 0.23 0.23 0.23 0.23 0.23 0.22

Yield on Moody's AAA corporate bonds seasoned:

0.00 0.00 0.00 0.01 0.01 0.02 0.03 0.04 0.05 0.06

0.08 0.09 0.11 0.13 0.14 0.16 0.17 0.18 0.19 0.20

Yield on Moody's AAA corporate bonds new issue:

0.00 0.00 0.00 0.01 0.02 0.03 0.04 0.06 0.08 0.10

0.12 0.14 0.17 0.19 0.21 0.23 0.25 0.27 0.28 0.29

71:1 71:2 71:3 71:4 72:1 72:2 72:3 72:4 73:1 73:2

73:3 73:4 74:1 74:2 74:3 74:4 75:1 75:2 75:3 75:4

Employment and GNP

Rate of unemployment--all civilian workers

0.0 0.0 0.0 0.0 -0.1 -0.1 -0.2 -0.2 -0.3 -0.3

-0.3 -0.4 -0.4 -0.4 -0.4 -0.3 -0.3 -0.3 -0.3 -0.3

GNP, current $:

0.1 0.2 0.8 1.9 3.4 5.2 7.3 9.5 11.6 13.7

15.5 17.1 18.4 19.3 20.1 20.7 21.2 21.6 22.0 22.4

GNP, constant 58$:

0.1 0.2 0.6 1.4 2.5 3.7 5.0 6.3 7.5 8.5

9.2 9.6 9.7 9.6 9.3 8.8 8.3 7.8 7.3 6.9

Government

Federal government receipts:

-2.1 -2.0 -1.9 -1.5 -1.1 -0.7 0.0 0.4 1.0 1.5

1.9 2.2 2.5 2.6 2.6 2.6 2.5 2.5 2.4 2.3

Government deficit, Federal:

-2.1 -2.0 -1.9 -1.5 -1.1 -0.6 0.1 0.6 1.2 1.8

2.3 2.6 2.9 3.0 3.0 3.0 2.9 2.9 2.7 2.7

Government deficit, State and local:

0.0 0.0 0.0 0.1 0.1 0.1 0.2 0.2 0.3 0.3

0.3 0.3 0.3 0.2 0.2 0.2 0.2 0.1 0.1 0.2

International

Imports, current $:

0.0 0.0 0.0 0.1 0.2 0.3 0.4 0.6 0.8 1.1

1.3 1.6 1.8 2.1 2.4 2.6 2.9 3.1 3.3 3.6

Imports, constant 58$:

0.0 0.0 0.0 0.1 0.1 0.2 0.3 0.5 0.7 0.8

1.0 1.2 1.4 1.6 1.8 2.0 2.2 2.4 2.6 2.7

Exports, current $:

SAME

SAME

Exports, constant 58$:

SAME

SAME

FOOTNOTES

1. See Robert E. Hall and Dale W. Jorgenson, "The Quantitative Impact of Tax Policy on Investment Expenditures," in G. Fromm (ed.), *Tax Incentives and Capital Spending*, Amsterdam, North-Holland, 1971, and the references given there. See also: Hall and Jorgenson, "Tax Policy and Investment Behavior," *American Economic Review*, Vol. 57, No. 3 (June 1967), pp. 391–414, and "Tax Policy and Investment Behavior: Further Results," *American Economic Review*, Vol. 59, No. 3 (June 1969), pp. 388–401.
2. For a review and comparison of tax measures adopted in the U.S. and European countries see O. Eckstein, "Discussion," *American Economic Review*, Proc. Vol. 52 (May 1962), pp. 351–352.
3. The effects of tax policy on investment behavior are analyzed by E. C. Braun, "The New Depreciation Policy Under the Income Tax: An Eoonomic Analysis," *National Tax Journal*, Vol 8 (March 1955), pp. 81–98 and "Tax Incentives for Investment," *American Economic Review*, Vols. 52, No. 2 (May 1962), pp. 335–345; by N. B. Ture, "Tax Reform: Depreciation Problems," *American Economic Review*, Proc. Vol. 53, No. 2 (May 1963), pp. 334–353, esp. pp. 341–345; by S. B. Chase, Jr., "Tax Credits for Investment Spending," *National Tax Journal*, Vol. 15 (March 1962), pp. 32–52; and by R. A. Musgrave, "Effects of Tax Policy on Private Capital Formation," in Commission on Money and Credit, *Fiscal and Debt Management Policies*, Englewood Cliffs, Prentice-Hall, 1963, pp. 45–142, esp. pp. 53–54 and 117–129. Many other references could be given.
4. President's Task Force on Business Taxation, *Business Taxation*, September 1970.

Chairman GRIFFITHS. Thank you very much, Mr. Jorgenson.

Mr. Suits.

STATEMENT OF DANIEL B. SUITS, PROFESSOR, UNIVERSITY OF CALIFORNIA, SANTA CRUZ

Mr. SUITS. Madam Chairman, in evaluating the role of Government in regulating the economic system, it is important to recognize that every government fiscal action has three broad consequences. First, it influences the overall level of total output and employment. Secondly, it affects the composition of output, and finally it helps to determine which members of the community enjoy the benefits of our economic activity.

Spending and taxation influence the level of output and employment by altering the total demand for goods and services. Since Government spending is, itself, an important component of total demand, production and employment tend to rise when Government outlays increase and to decline when they are reduced.

Taxation, on the other hand, regulates private spending by the amount of purchasing power it extracts from the taxpayer. Naturally, the net impact on output and employment depends on how spending and taxation are combined, rather than on the amount of either alone. Nor can the net influence of fiscal action be determined by the difference between expenditures and tax receipts. After all, once tax rates have been legislated, the total number of dollars of tax yield will depend on economic conditions as they are reflected in taxable incomes and corporate profits. Indeed, it can be estimated that from 15 to 20 percent of each additional dollar of GNP accrues to the Federal Treasury as additional tax revenues. Thus the budget surplus or deficit is, itself, as much a consequence of overall economic conditions as total output and employment. This fact underlies the logic of the so-called full-employment deficit, by which outlays are compared not with expected tax revenues, but with those that would be received if the economic system were operating at some minimum level of unemployment.

But even the full-employment deficit or surplus is a seriously misleading guide to the effect that Government fiscal action is exerting on the economic system. There is nothing about the alleged fact that the Federal budget would be balanced at high employment to indicate whether present Government tax and expenditure patterns are appropriate to present economic conditions. The only proper criterion by which to judge fiscal performance is, I submit, by its fruits in terms of the present level of output and employment. When over 6 percent of American men and women ready, willing, and able to work are unable to find jobs and when the largest growth component in the gross national product results from the termination of an automobile strike, it is perfectly clear that existing policy is inadequate for the job to be done and is in urgent need of revision.

Our present sad state of affairs cannot be attributed to the natural reaction of the American economy to a transition from war to peace. Reduction in military spending and cutback in the aerospace program naturally mean fewer jobs in certain industries and certain areas. There is necessarily some dislocation as returning veterans seek civilian employment and as displaced workers find new openings. But in an economy in which new jobs are opened up as rapidly as old ones are shut down, the necessary transition could be accomplished with only a modest rise in unemployment. What we see today, however, is a policy of expenditure and taxation by which the number of jobs is permitted to grow more slowly than the number of job seekers. What is called for is an expansion in the number of jobs.

There are many combinations of increased spending and tax reduction that will encourage more rapid economic expansion. An additional dollar of Government outlay tends to increase the gross national product about $2 and to create new jobs at about the rate of about one job per every $13,000 increase in GNP, pretty much regardless of the type of expenditure initially undertaken.

But the kind of goods and services provided, and the way these goods and services are distributed among the population depends heavily on exactly what the outlay buys. Dollar for dollar, the aggregate economic impact of expenditure for military hardware or supersonic transport is about the same as outlays for education or urban transit but in the one case we end up with more missiles and increased international tension or with an uneconomical mode of transportation for a few rich people, and in the other we receive benefits in the form of better educated children, and lower internal social tensions, or from an economical way for poor people to get to work.

On the other hand, the overall economic impact of tax reduction depends on whose taxes are reduced. Reduction of corporate profits taxes increases the cash flow available to investors and can be expected, ultimately, to stimulate the rate of investment in new plant and equipment. Once such investment outlays are made, they have about the same stimulating effect on output and employment as Government spending, but the number of dollars of tax reduction as Government spending, but the number of dollars of tax reduction needed to get a dollar of new investment is an open question.

In any event, the investment that is ultimately realized will be the type to increase the outpouring of goods and services already abundantly provided by private business firms, and will do nothing to provide low-cost urban housing, or food to people with inadequate diets. Much the same thing is to be said for reduction in personal income taxes. It can be estimated that it takes about $1.35 in personal tax reduction to provide the same overall economic stimulus as a dollar of government outlay and, in addition, the result is again to expand the amount of employment and resources devoted to the already fat-private sector of the economy.

In view of these facts, it is clear that a tax reduction would only further reduce the manpower and resources available to the already seriously deprived public part of our economic system. Lower tax rates should be out of the question, at least until the staggering burden of our military budget can be brought under control and ultimately reduced. As an immediate policy, work can begin almost at once on a number of programs that have received congressional approval and are already fully funded.

In the longer run we must begin a serious and systematic effort to devise new approaches to the important areas of malfunction in our society. This does not mean merely pouring more money and more resources into enlarged versions of existing programs, but fundamentally new methods of attack. The family assistance program presently before Congress is an example of the kind of new ideas that are needed. So, to a degree, is the revenue sharing proposal, although it is shamefully small and in the proposed allocation of funds on the basis of assessed valuation is designed to channel funds where the per capita need is the least. Support of education must mean more than merely more dollars, it must mean dollars directed on a basis more conducive to accomplishment of the real objectives of the program—perhaps delivered to parents or prospective college students in the form of educational vouchers to be spent for the kind of educational program that most nearly corresponds to individual needs. The problem of low-income housing cannot be met merely by more dollars for houses in the same place, but must be closely coordinated with public transportation systems and with the location of new jobs.

In all this, I do not mean to imply that government taxation and outlay alone can bring about social perfection. In point of fact, it is important to recognize that they are not even sufficient to insure economic stability. If there is any clear lesson in our experience of the last decade it is this, that in our economic system an adequately low level of unemployment is incompatible with price stability. This incompatibility does not arise from monopolistic distortions in output prices nor from the power of organized labor, neither of which is new to the scene, but from the natural reaction of a vigorously competitive economic system to a reduction in the number of workers available to fill job vacancies. Our inflation is not the result of distortions in the economic system, nor of a particularly rapid or somehow disorderly rise in aggregate demand, but the natural and normal concomitant of high employment. Once such an inflation is underway it develops a certain inertia of its own, and as we see today, continues for a time even after the underlying competitive pressure has been removed. But restoration of a socially acceptable level of job opportunities with the accompanying decline in unemployment will restore the inflationary pressure unless special means are taken to head it off.

In part, the reason that the American economy is subject to inflationary pressure at relatively high levels of unemployment is that so large a proportion of those out of work consists of hard-core unemployed, workers without marketable job skills, located where jobs are difficult to reach, and without capital or experience to move to more promising areas. Because such structurally unemployed workers make up such a large portion of the total when overall unemployment reaches say 3.5 to 4 percent, competition for more highly qualified employees tends to drive up wages, costs, and prices rapidly. The level of inflation reached in the United States at this level of unemployment is not reached in an economy like that of West Germany until the unemployment rate falls below 1 percent.

It follows that much can be done to mitigate the inflationary tendencies of the U.S. economic system by a long-run program designed to provide hard-core unemployed workers with improved work skills, greater mobility, and better access to the job market. Thus the kind of government expenditure we undertake now, not only affects the general level of economic activity today, but likewise will exert an important influence over how much inflation we can expect in the future. This is, however, a long-run policy.

For the short-run, before new training and mobility programs can take hold, it is necessary to resort to outside control over wages and prices as a temporary expedient.

This is an unpleasant prospect. Nobody likes wage and price controls. They are difficult to administer, and agonizing for business and labor alike. But it may be the least of all the evils before us. Increasingly of recent months I have heard the suggestion that we must accept a higher level of unemployment as the price of economic stability. But I have yet to hear any of the advocates of this position volunteer for the ranks of the unemployed.

In any case, I can think of nothing that would add as much to the tensions of our already troubled society as the notion that some people must remain out of work and cut off from the benefits of our great productive power in order to protect the economic position of the rest of us.

Thank you.

Chairman GRIFFITHS. Thank you, Mr. Suits.

Mr. Mann.

STATEMENT OF MAURICE MANN, EXECUTIVE VICE PRESIDENT, WESTERN PENNSYLVANIA NATIONAL BANK, ACCOMPANIED BY DAVID L. SMITH, VICE PRESIDENT

Mr. MANN. Thank you, Madam Chairman.

First I should like to commend the Chairwoman and the members of this committee for taking the time to evaluate the various fiscal policy proposals currently before the Congress. It is particularly propitious that such an evaluation is being conducted at this time. The economy is presently in the early stages of what, we all hope, will be a strong, suitable, and sustainable economic recovery. The actions taken by the Congress in this legislative session will go a long way in determining that strength, suitability, and sustainability.

I should also like to thank this subcommittee for inviting me to testify. Hopefully, the combination of my earlier long and rewarding association with the Federal Reserve System, my nearly 2 years as a member of the Nixon administration, and my relatively short, but exciting, tenure as a commercial banker will permit me to make a modest contribution to your deliberations and evaluation. In any event, whether I am to be considered as a nonpolitical activist or as a political nonactivist, I am prepared to allow the chips to fall where they may.

At the present time, in most quarters, there is a great deal of concern and uncertainty regarding the health of the economy. But this is really nothing new. There is always concern and uncertainty about the economy. This year, concern and uncertainty perhaps are less misplaced, in view of the inflation problem, the sharp rise in unemployment over the past year and a half, and the critically adverse balance of payment situation.

Fortunately, despite possible political differences, we all share the same goal—namely, to return the economy to a growth path that will provide high employment, reasonable price stability, and significant improvement in the Nation's balance of payments. In the short run, this means that we need to provide a mix of fiscal and monetary policies that will assure a sufficiently strong, orderly, and well-balanced economic expansion—an expansion that is clearly now under way. Perhaps most importantly, short-run public policies must attempt to guarantee the strength and staying power of the expansion. In the long run, this means that our economic policies must come to grips with the structural shortcomings, the supply constraints, and the institutional rigidities that produce a serious inflationary bias even before the economy reaches full employment.

Before offering my evaluation of the economic implications of the various tax and spending policies currently being considered by the Congress, I would like to share my thoughts with you on where I think the economy is presently headed, given the flow of current economic information and current economic policy.

There is little doubt in my mind that the economy has turned the corner from recession and is in the early stages of recovery. However, the economic information currently available suggests that the recovery is still somewhat fragile, and that the ultimate strength and durability of the recovery are still open to question. Up to now, the only really significant areas of strength in the economy are in housing and in spending by State and local governments. While the numbers for the first quarter were unquestionably big and impressive, a large portion of the gain in GNP must be ascribed to the rebound from the automobile strike. I do not expect the GNP gains in either the second or the third quarters will be as dramatic as in the first quarter. Moreover, I do not expect any significant and widespread strength in the economy to appear before the fourth quarter. For the year as a whole, given present policies, I expect that GNP will rise about 7 percent, to the $1,045 to $1,050 billion range, and that real GNP will rise about 3 percent. This implies that the unemployment rate probably will not change significantly over the next several quarters, and at yearend, it is unlikely that unemployment will be much lower than at present.

Unfortunately, in the present environment we cannot and, in my opinion, should not attempt to push the economy much faster than the foregoing numbers imply. I have suggested previously that it would not be the best of all possible worlds if the economy were literally pushed to a GNP level considerably in excess of the range that now seems destined to be achieved. To bring about a much higher GNP would imply that the floodgates had been opened and that either monetary policy or fiscal policy—or both—had become much too easy. This does not mean that public policy cannot do more than it is doing.

However, if we were to press relentlessly for an unreasonably high GNP, it is likely that inflation would dominate even more the composition of the advance at the expense of real growth, which would only create more problems. As you know, the administration's original game plan to solve the inflation problem called for a gradual slowdown in the economy that would ease demand and then cost pressures—hopefully, without excessive unemployment. Although unemployment rose somewhat more than expected, I think the policy of gradualism was right and proper. At the present juncture, it is important that we resist the temptation to pump up the economy too fast. Specifically, in my opinion, we should adhere to a policy of gradualism on the upside.

My major concern at the moment is that public policy should do enough—but not too much—to assure the strength and durability of the expansion. Unfortunately, too much of the burden of the recovery has been placed on monetary policy; fiscal policy could be doing a little more than has been programmed up to now. In my view, monetary policy has done about all that it can or should be expected to do, and the economy could afford a little more fiscal policy.

I am willing to have a little more fiscal policy, mainly because I am deeply disturbed about the unemployment problem, a concern that is obviously shared by many others. Despite this concern, we cannot afford, as a Nation, to become complacent about inflation. Unfortunately, our economy is riddled with serious supply constraints and institutional rigidities that produce an inflationary bias as the economy approaches full employment.

Inflation is and will likely remain a serious problem, which is likely to become even more serious in the years ahead, unless significant steps are taken now to remove the impediments and blockages in the economy. Many of these impediments are man made and artificial and they can be removed, if we have the will. As I said on many occasions, we must do something about import quotas, restrictions on the supply of labor, the Davis-Bacon Act, resale price maintenance laws, the Robinson-Patman Act, the buy American policy, and the numerous restrictions on banking and financial institutions, among others.

In the short run, we must buy the time that is needed to move forward on the structural and institutional aspects of the inflation problem. This is why I believe that we must resort to whatever type of action is necessary to slow the rate of wage and price advance. It is fitting and proper that the administration has taken steps to slow inflation in the lumber, oil, construction, and steel industries, among others. I think the administration should be commended for resorting to a form of incomes policy.

On the other hand, the administration's approach—though somewhat more activist in recent months—continues to be mainly piecemeal in both form and substance. It would seem appropriate—mainly for reasons of equity—to have a more all-encompassing approach that would cut across different kinds of income as well as different kinds of economic activities.

The administration's recent willingness to accept standby authority to impose a wage and price freeze suggests, to me at least, a willingness to buy the time to work out the structural problems and difficulties that are binding the flow of economic activity. In my opinion, short-run monetary and fiscal policies to curb inflation are destined to eventual failure if successful efforts are not made on behalf of structural and institutional reform.

The administration has made a start in the right direction. All that needs to be done is to keep going—and faster—on the same track. As the President has stated— "The Government has a responsibility to prevent misuses and imbalances of market power which impede orderly operation of our free economic system." He has also stated: "I intend to use all the effective and legitimate powers of government to unleash and strengthen those forces of the free market that hold prices down."

I find less and less people who would fail to support the President in such an undertaking. Indeed, it seems to me, that a literal implementation of the kinds of steps suggested in the President's statement would go very far in restoring the type of confidence on the part of business and consumers that is indispensable to getting the economy to move forward at a more desirable pace. We should not overlook the fact that confidence is frequently an effect—a result of something—not necessarily a cause.

In evaluating the various tax and spending programs currently before the Congress, extreme care must be taken to recognize explicitly the full impact of each of the proposed actions on the Federal budget this year as well as several years down the road. The long-range projections contained in the last two budgets clearly indicate that there will be very great and unrelenting pressures on the resources projected to be available to the Federal Government throughout the fiscal 1972–1976 period.

Indeed, as I have said before, it is patently obvious that it will be extremely difficult for the Federal Government to do even a portion of the tasks that are being suggested it should do over the coming years. In view of the slimness of projected available revenues, if major new initiatives are to be undertaken, existing Federal programs will have to be appreciably reduced in order to release resources, or taxes will have to be raised in order to provide additional resources. The only other option—one that does not seem to meet with much favor in most quarters—is for the Federal Government to refuse to assume a large responsibility for meeting many additional and new social and economic needs.

The serious unfavorable nature of the fiscal forecast in the period ahead is underscored by a recent study of the 1972 budget by the Brookings Institution, as well as by the implications of the budget document itself. The Brookings' projection of revenues and expenditures under current laws shows that there is no extra room in the 1972, 1973 or 1974 budgets.

The growth of Federal expenditures under existing programs and those proposed in the 1972 budget will be as great as the growth of full-employment revenues over the next 3 years, even after taking into account further reductions in the costs of the Vietnam war.

The critical nature of the longrun fiscal outlook suggests—actually demands—that the administration and the Congress take full and explicit account of the effects of proposed tax and spending programs on both the budget and the economy not only this year, but over the next several years.

I would like to offer two criteria for evaluating the economic and fiscal implications of the proposed tax and spending programs in the current environment:

1. The programs should be truely stimulative in the short run in order to assure the strength and durability of the present expansion —but should not be overly stimulative a year or more from now when the economy is expected to be moving toward the full-employment zone.
2. The programs should not cut too deeply into the Federal budget base, so as to remove completely the remaining budget margin in fiscal years 1975 and 1976, or throw the fiscal 1972–1974 budgets into excessively large full-employment deficits.

With these criteria in mind, I would like to turn to the specific proposals now before the Congress:

1. ACCELERATED DEPRECIATION AND THE INVESTMENT TAX CREDIT

The Congress presently has before it two proposals that purportedly will stimulate business investment—accelerated depreciation and the investment tax credit. Both proposals would cost about $4 billion annually, would have a positive impact on business investment, and would be essentially longrun measures. Their principal difference appears to be one of timing—with accelerated depreciation, the tax savings would accrue over a long period of time, while under the investment tax credit, the tax savings would occur in the period in which the asset is purchased.

Neither proposal is likely to stimulate business investment very much in the short run, given the present level of excess capacity. On the other hand, they would both cost a lot of budget dollars. On the basis of the first criterion established earlier, I do not think that either proposal should receive serious consideration as a shortrun stimulative tool.

These proposals, however, have merit within a long term framework. As a longrun matter, I believe it is appropriate for the government to attempt to stimulate business investment, even though plant and equipment spending did not drop sharply last year—as it did in previous recessions—and is currently running at more than 10 percent of GNP—a moderately high proportion by historical standards. I think it is important that, as a Nation, we place strong emphasis on business investment for plant and equipment as a means of increasing productivity.

A major challenge of the 1970's will be to realize productivity gains that offset gains in unit labor costs. This challenge will be increasingly hard to meet as the trend toward a service-oriented economy accelerates. It is a simple fact of economic life that gains in compensation must be offset by gains in productivity or prices will continue to rise and/or profits will fall. The need for additional investment clearly stems from a pressing need to increase productivity. As an aside, it should be remembered that increases in productivity will play a major role in permitting U.S. exports to compete more favorably in overseas markets and thus make a major contribution to the Nation's balance of trade.

If it is agreed that investment stimulus is a desirable longrun national policy—and I have no quarrel that it is—on purely economic grounds, I would prefer the investment tax credit over accelerated depreciation. The available evidence suggests that the investment tax credit is a quicker and more direct way of stimulating favorable investment decisions. If we were to legislate an investment tax credit, however, it should be adopted permanently—and not treated like a ping-pong ball. It simply is not appropriate public policy to turn investment on and off.

2. PERSONAL INCOME TAX CUTS

The Tax Reform Act of 1969 provides for personal income tax cuts to take effect in both 1972 and 1973. Moving those cuts forward would provide some shortrun stimulus to the economy at a time when I believe it is needed. Moreover, such a step would not cut into the budget base in the out years—it is already built into the budget. Thus, it meets both criteria perfectly. Most importantly, as a shortrun stabilization policy. I believe that moving up the personal income tax cuts would help to assure the strength and durability of the still-embryonic economic expansion. It would also help to create a better mix of fiscal and monetary policies.

3. PUBLIC WORKS PROGRAM

Available empirical evidence indicates that public works programs are, unfortunately, a very poor shortrun stimulative tool. They are slow to get started and take too long to be implemented. More importantly, their major impact is usually felt when the economy least needs it. For example, an accelerated public works program was enacted in 1962. It took more than 2 years for half of the money to be spent and money was still being spent in fiscal 1966, precisely when it should not have been. In short, in my opinion, public works programs should rank at the bottom of the list as shortrun stimulants to the economy.

4. PUBLIC SERVICE JOBS

Although a program of public service jobs may have some obvious political advantages in the short run, I am somewhat skeptical that such a program would efficiently solve the present unemployment problem. The program would probably take a long time to become fully implemented, and more importantly, it would make it harder to get the proper people in the proper jobs as the economy returns to full employment.

ANOTHER CONSIDERATION

Much of the earlier discussion has been concerned with the economic and budget effects of proposals that are currently being considered by the Congress as a means to stimulate the economy. Ironically, at the very time that some members of the Congress are considering stimulative proposals, others are considering proposals that would completely neutralize these stimulative actions. I refer specifically to H.R. 1, which provides for social security tax rate and base increases next January that amount to more than $6 billion. A tax increase of that size would more than offset the stimulative actions being considered here today.

For too long, the budget and economic effects of the Nation's social security system have been virtually ignored. Moreover, we have operated under the myth that our social security system is an insurance system. It is not. In reality, it is a transfer system, whereby the current working population is taxed to provide support for the current retired population. Pretending it is an insurance system has, for years, lead to the practice of first raising taxes, finding an "unexpected" surplus in the trust funds, and then raising benefits. In addition, as H.R. 1 demonstrates, all of this occurs without any consideration of the economic and budget effects.

Continued increases in social security taxes, coupled with the scheduled personal income tax cuts, reduce the progressivity of the Federal tax structure. In my view, it is a sad state of affairs when low and moderate income families end up paying more in payroll taxes than they do in income taxes. I strongly urge the Congress to reevaluate completely the present method of financing our social security system.

In summary, I think that some additional fiscal stimulus is necessary at this time to assure that the present embryo of an expansion does in fact become the economic reality that we all expect and look forward to. It seems to me, in short, that a slightly more stimulative budget, accompanied by an appropriate incomes policy, would be helpful to the economy and would provide a better mix of fiscal and monetary policies. This, in turn, is more likely to provide a more vigorous, balanced, and sustainable economic recovery.

A comparison of alternative fiscal actions is shown on the last page of my statement. Moving the scheduled personal income tax cuts forward ranks at the top of my list because it would provide the economy with about $4 billion of extra purchasing power at exactly the time it is needed and because it would not worsen the already bleak long-run fiscal outlook.

Although a program of public service jobs ranks second on my list, I do not think it is a very effective way to solve the unemployment problem. Granted, a large-scale public service jobs program would create immediate employment, but it would also hamper the labor market as we return to full employment. Parenthetically, I might note that the real pressing need is for an overhaul of the Nation's unemployment compensation system, so that adequate benefits are provided to those temporarily out of work.

In the short run, neither the investment tax credit nor accelerated depreciation should be adopted to stimulate investment since they would not have very much effect over the next year or so. On the other hand, the matter of stimulating investment takes on a different cast when considered in the longrun framework. I find myself sympathetic to the possible longrun benefits, with my personel preference for investment tax credit.

There is very little that is favorable to be said about public works as a short term stimulus to the economy. In fact, the less said, the better. Public works projects should be adopted on their own merit and not be considered as a possible device for stimulating the economy in the shortrun. Be that as it may, we must take extreme care not to lose sight of the Nation's longrun fiscal problems. The Federal budget is already overcommitted in fiscal years 1973 and 1974, and the small margin currently projected for the fiscal 1975 and 1976 budgets will evaporate quickly unless we pay much more attention than we have in the past to the longrun implications of shortrun decisions.

(The following table was attached to Mr. Mann's statement:)

SCORECARD FOR ALTERNATIVE TAX AND SPENDING PROPOSALS

[Dollars in billions]

Proposal	Economic impact — Shortrun	Economic impact — Longrun	Longrun budget Cost (annually)	Flexibility
1. Personal income tax cut	Favorable	Favorable	None	Self-liquidating.
2. Public service jobs	Moderately favorable.	Unfavorable	Small	Somewhat self-liquidating.
3. Accelerated depreciation	Very small	Favorable	$4	Difficult to reverse.
4. Investment tax credit	do	do	$4	Do.
5. Public works	do	Unfavorable	$1 to $2	Do.

Mr. MANN. Thank you.

Chairman GRIFFITHS. Thank you.

Mr. Mann, what do you expect the unemployment rate to be next year, at the end of next year?

Mr. MANN. The unemployment rate should be just under 6 percent at the end of this year and over 5 percent by the end of next year.

Chairman GRIFFITHS. Next year?

Mr. MANN. Under present fiscal policy.

Chairman. GRIFFITHS. Well, do I understand then that what you are really saying is that better than picking up any of these people would be to sort of lengthen this out so that we do not upset the applecart for those who are now employed?

Mr. MANN. No, Madam Chairman. As I said, I would prefer to see somewhat more fiscal policy to bring that number down somewhat.

Chairman GRIFFITHS. How far?

Mr. MANN. It is very difficult to pinpoint with any sense of precision. It would depend upon the amount of fiscal stimulus.

Chairman GRIFFITHS. You know, I agree with Mr. Suits. I do not really see how the rest of us can ask the unemployed to take the full burden so that it does not bother us too much.

Mr. MANN. Philosophically, I have no problem. To the extent we get some sort of incomes policy, the more fiscal stimulus I am prepared to accept. Because there is the problem of inflation, and because I am deeply concerned about the unemployment problem, I would obviously like to see the unemployment rate come down. I believe, however, in the absence of an incomes policy there is a serious risk of reinvigorating inflation.

Chairman GRIFFITHS. We have two members of the Ways and Means Committee here, so I would be glad to hear how you would finance social security.

Mr. MANN. The point I would make, Madam Chairman, is that I think the record shows we have gone for repeated social security tax increases because of the nature of the financing of the program, and this has led to fairly sizable surpluses, which in turn lead to rising benefits, and then we go through the entire cycle again. I think there are many things that can be done with the program to improve the financing. I am disturbed, in addition, that it often works at cross-purposes with fiscal policy. For example, if the proposed increases were to go into effect as of the first of the year, they would have a restrictive effect at the very time we are attempting to get the economy moving, and could have a depressing effect on the economy.

Chairman GRIFFITHS. Right, but you are going to have a tremendous expenditure of funds out of social security. It comes closer, it seems to me, than other tax measures of being neutral because you are putting out just as much money as you are taking in. In the first year although, of course, you are correct, we find an accumulated surplus there.

Mr. MANN. Also, Madam Chairman, because the tax is not nearly as progressive as the Federal income tax it has an adverse effect.

Chairman GRIFFITHS. Would you suggest we tax a full salary? I think that is a great idea.

Mr. MANN. I would be glad to study it.

Chairman GRIFFITHS. Would you also suggest part of the social security be financed out of general revenues?

Mr. MANN. No, Madam Chairman.

Chairman GRIFFITHS. I once questioned on why there was originally a $3,000 base, and originally we had the $3,000 base which went into effect and it covered 97 percent of all salaries paid, so that today it would have been up into the $16,000 or $17,000 panel to do it.

Mr. Jorgenson, from your statement do I understand that you feel that if we have an investment tax credit or increased depreciation that it would speed up the purchase of machine tools from abroad?

Mr. JORGENSON. It would certainly speed up the purchase of machine tools. Whether they would be purchased abroad or in this country is a very difficult thing to say. We do not have any evidence one way or the other on that subject in the study. I suspect that the impact would be mostly on domestic production simply because there is plenty of unemployment and considerable excess capacity in the capital goods industry in this country. I suspect that would give capital goods producers a lot of incentive to compete for new business.

Chairman GRIFFITHS. One of the largest of America's machine tool producers happens to reside in my district, and he has told me that even the thirties were not as bad in this industry as at present. He suggested in place, although, that he thinks the credit might have some effect, but he does not hold out that much hope. He suggests that one of the real fields for machine tool producers is in the industrializing nations of the Communist bloc, and we will not permit American machine tool producers to sell there.

Mr. JORGENSON. Well, I hope that kind of barrier is eliminated. I think though that it is very difficult to interpret the evidence that is coming in today about the development of the machine tool industry as completely unaffected by the change in tax policy that took place in 1969. You recall by that time there was a 7-percent tax credit in force; because of the fact that we were in an inflationary situation people decided that it would be a good idea to throw in a repeal of the tax credit with a lot of other changes that were being made; of course, the impact is that the level of production, new orders and so on in the machine tool industry, the capital goods industry has declined catastrophically; recent figures show that there has been, within the last year, reductions of something like 34 percent in the level of new orders for machine tools.

Now, this is precisely what we would expect on the basis of the kind of analysis we have done here of the ADR system or of a tax credit of 3.3 percent. It takes a while to hit you. The basic message these figures suggest is that it takes about six to eight quarters; that being the case, the collapse of activity in some of the capital goods industries is a delayed response to a change in fiscal policy that took place 2 years ago.

Now, that leads me to the conclusion that I think Mr. Mann would concur in, that measures like this, the investment tax incentives we have been discussing really should not be used for short-term stabilization purposes. They do not have much effect in the short term, certainly not over, say, the next 2 years. Looking back to 1969, not until now do we really see the major impact in the change in the investment incentives. With regard to accelerated depreciation in 1954, and the new tax guidelines and tax credit in 1962, these changes generate a capital goods boom. If we expect to revive investment expenditures from the current slump, we have no prospect for revival for at least a couple of years. If we expect to get that to full employment, we should act now. That is the basic message, I think.

Chairman GRIFFITHS. Mr. Suits, would your recommendations for fiscal stimulus add up to full employment deficit for fiscal year 1972?

Mr. SUITS. I expect, and I have not made a careful calculation of this, Madam Chairman, but I expect that they do. Certainly it is clear that since we are currently running a very near full employment balance budget, and since we now have substantial need for fiscal stimulus, that if this stimulus were provided that we would have a full employment deficit in view for 1972.

Chairman GRIFFITHS. How large a full employment deficit would you think appropriate?

Mr. SUITS. Madam Chairman, I would rather not use that concept. I think that is a concept that is not particularly valuable as a yardstick for policy, and it is for that reason that I have not made those calculations. I really honestly do not see the merit of comparing the expected outlays of the Government with tax revenues that might conceivably be received under some circumstances other than those in which we are now operating. I would prefer simply to look at the results.

Chairman GRIFFITHS. I see. Would you care to comment, Mr. Mann?

Mr. MANN. Well, I am a little more sympathetic, Madam Chairman, to the full employment concept. But I think we run the risk of too heavy reliance on it. I think the danger here is comparable to the danger of relying only on one thing to accomplish the results, as looking at monetary policy. There are a lot of things we ought to be looking at. I think as a possible restraint on the expenditure side the full employment concept has some merit. I think there are other things. But again, I do not think we can aford the risk to be overoptimistic on just fiscal policy. But I share some of his concern.

Chairman GRIFFITHS. Senator Percy, would you care to question?

Senator PERCY. Mr. Conable was here first.

Representative CONABLE. Go ahead.

Senator PERCY. From a personal standpoint, I would like to say that very few people, Madam Chairman, have been as helpful to me in the executive branch of the Government as Mr. Mann was, and I am delighted to have him back this morning. And I trust I will see a good deal more of Mr. Suits. My daughter is one of the happiest young ladies in America today because she had been accepted for advanced registration at Santa Cruz, so we will be on the campus quite a bit in the next 4 or 5 years.

Despite my gratitude, Mr. Mann, for all of your assistance and help to me, I find a few of the areas that you have touched on here worthy of pursing further. I am delighted that you feel some permanence in the business investment and productivity in the long term must be found, but I have yet to find anything that will be more permanent than a change in the depreciation schedule as now proposed by the Treasury. And I just wondered, you point out that accelerated depreciation and the investment credit are costly, and that they are not stimulating in the short term, and that is true. But I am convinced that that would not happen, because the cost accelerates over time. The cost this year would be less than a billion, and I just wondered if you cared to expand on that, or do you oppose or support the new Treasury schedule?

Mr. MANN. Well, Senator, first let me thank you for your kind words.

As a general matter, I would lean very heavily toward something to stimulate investment in the long run. I think, in terms of the kinds of works Professor Jorgenson has done, that the evidence suggests that the investment tax credit might be a little better. If I cannot have it that way, then I am prepared to take it the other

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way. I think we ought to do something, and that is the important thing, so I am fully sympathetic.

Senator PERCY. Well, I think today I would support the investment tax credit. Just having come from this weekend in Rockford, Ill., one of the machine tool centers, I know we are very depressed out there right now, and having also seen, I think, some columnists who commented yesterday on Peterson's presentation to the Cabinet, the outlook for American enterprise is dismal unless we find a way to update increasingly obsolete plant and equipment. When you look at the incentives for investment that we offer against those of every other industrialized nation, it is clear we can do more. So I hope that we can look at the long term as well and the short stimulant.

In looking at the present state of the economy, you do mention housing and local, State, and Government spending as being fairly strong now. Are there other areas where you see some signs of strength? How would you classify the automobile field today?

Mr. MANN. As you know, the numbers were very large in the first quarter, which was basically a rebound from the strike situation. Our estimates show that we can expect very little more than this from the automobile industry on an incremental basis, and given the nature of expectations about the economy, automobiles will not contribute anything more than is being contributed now.

If I might add a word, in our policies generally there is some cause for concern about housing and State and local government spending. As you know, we have gone through a couple of periods where credit became particularly tight, interest rates particularly high. One of the reasons I think we have to do everything we can to stay on the right track to stop this recurring situation of holding back on housing and State and local government spending is not only because they have much to catch up, but because they provide much of the force behind the economy.

In further answer to your question, there is some evidence of a modest quickening of consumer activity, although nothing ebullient at this point. We have a long way to go before consumers provide the kind of thrust I think the economy needs.

Senator PERCY. How would you interpret consumer purchasing in the month of April? It would seem to me that there was some optimism expressed by big mail-order houses and retailers in April, and the people were really starting to draw out savings and starting to spend, which is an indication of a growing confidence factor that could really cause the economy to move ahead. What are your own feelings about consumer spending now?

Mr. MANN. There is no question that consumer spending is a little better than it was previously, but it is in no way a dramatic increase, but it is getting better. As Professor Suits was saying earlier, some of the surveys in the universities are beginning to show a slight increase in confidence, but again nothing really enough to suggest that we are in for a surge of consumer spending. Things are getting better. They could be an awful lot better. This is one of the reasons, for example, some of us feel that perhaps the right thing to do at this time is to move up the personal income tax cut which would put it in some additional spending power to add to improving confidence, and the confidence factor is a real problem. I do not pretend to be a behavioral scientist, but whatever the reason, that confidence is coming back. When you see a 6.1-percent unemployment rate, and prices still rising at a very rapid rate, people just do not have enough confidence, and we have to make some improvement.

Senator PERCY. Taking into account that so much of the condition of the economy depends on psychological factors, and that fiscal and monetary policies are just as much an art of science if not more the former, I wonder what effect would be on the American public if we reduced taxes? This would be for the fourth time in 4 years. If we reduce taxes and accelerate the reductions which are already in the law by a year or so, at a time when the public really knows that we are going to have a deficit of some $15 to $20 billion, would that really restore confidence and cause people to spend more of that money? Or would it cause people to see that we are really worried about the economy and, therefore, we are going to try to pump up their spending power, even though every penny of it, unless the economy really moves ahead, is added to debt, which is already the worst?

Mr. MANN. I would like to comment if I could. First let me say, as we look at the economy, it is still a fragile recovery. I think the tradeoff is terribly important, especially for those of us who believe strongly that some additional consumer buying power would be helpful, and also because of the fact that the personal tax cuts are already built into the budget. It might add, of course, to the deficit somewhat this year, but we are already going to have a fairly sizable deficit. I think it is terribly important, at least as I read the newspaper and talk to my Federal Reserve friends, to be doing something more on the fiscal side rather than the monetary side. It would take some of the pressure off of the Federal Reserve with respect to the international situation. In other words, what I am saying is that I think we need some additional public policy stimulus. I do not want to see it come from monetary policy for a number of reasons. One is the short term interest rate situation, and that the Fed has already been fairly liberal. I think personal tax cuts could do a little more in view of the criteria established earlier. It has a very quick short term impact, and also it would cost us no budget dollars in terms of the base.

Personally, if I may say, I share with the Senator the well-known and shared view that 3 or 4 years out we have got some real budget problems, and I think we ought to think in terms of not lowering taxes, but perhaps raising taxes if we are going to finance the kind of things we want and respond to the demands being placed on the Federal Government.

Senator PERCY. I notice that you did make a comment that even with Vietnam expenses reduced there would be little money left for new programs. I was with Mr. Schultze in Chicago yesterday afternoon at the First National Bank where we held a Brookings Institute conference on priorities for the future with the League of Women Voters. He made a statement yesterday that if we just keep spending for present programs, even in peacetime, there will not be a penny for any new programs, so we have to get the "new" money out of cuts in present programs.

We spent the afternoon on the kind of programs we should be cutting, or trying to cut.

You do indicate that you approve the administration's efforts to try selectively to control price increases. I support what the President did in regard to steel industry prices. What other incomes policy measures do you think would be appropriate now?

Mr. MANN. Well, I guess I have said it before, so I may as well say it again. I think we are at a very critical point, Senator, and, having great respect and admiration for the Office of the Presidency, I think we ought to use that Office to whatever extent we possibly can in intervening in whatever way we can in all kinds of wage and price decisions. It is a serious problem, and to the extent we want to hold indicated before, I would be quite pleased to see the Preisdent intervene down unemployment we have got to hold wages and prices, and as I indicated before, I would be quite pleased to see the President intervene actively in all cost and price issues by using the full power and authority and prestige of the Government, short of outright controls.

Senator PERCY. Thank you.

Chairman GRIFFITHS. Representative Moorhead.

Representative MOORHEAD. First I would like to welcome all of you to this subcommittee hearing, but especially Mr. Mann whose bank is headquartered in my congressional district. Welcome.

Following up this incomes policy that Senator Percy was raising, I gathered from this you say that you do not believe that the President should exercise the power which the Congress granted to have across the board freezes on wages and prices. Is that my understanding?

Mr. MANN. No, I did not say that, Representative Moorhead. First quarter wage settlements were excessively high. They were in the order of 8½ percent. We cannot afford to live with these kinds of wage settlements and hope to get prices under control. If this is the pattern that is going to prevail, I think I would be prepared to see a wage and price freeze. This is the only way we are going to get at the real problem. Despite the recent favorable showing in the consumer price index, which is in a large part explained by mortgage interest rates, I do not expect the increase in the CPI to fall much more. I would not even expect as favorable performance out of the CPI as some months ago, and it looks as though maybe the time has come to look seriously to the use of the authority given by the Congress to freeze wages and prices.

Representative MOORHEAD. Do you have any comments on that, Mr. Suits? Do you think the time has come for a real incomes policy and exercise of the power that Congress granted?

Mr. SUITS. Yes, I think that is so. This is not anything that anybody wants, anybody that has had any——

Representative MOORHEAD. I quite agree.

Mr. SUITS. That is, when we look at the agonizing alternatives, I feel that I cannot ask somebody else to be unemployed in order to protect my own position. If this is so, then we must see to it that we can operate at a level where there are plenty of jobs for people who want to work, and protect ourselves in some other fashion from what is really, it seems to me, the basic dynamic competitive process by which our economy functions. But, if we must choose it seems to me that we must choose to go the road of an incomes policy or price and wage controls if this is ultimately necessary.

Representative MOORHEAD. Mr. Jorgenson, do you have any views on that subject?

Mr. JORGENSON. Well, I think it would be far more effective to take some of the measures which Professor Suits was suggesting in the way of removing impediments to competition. I would not, in fact, favor an incomes policy. I think that the Government could take important steps that would have a favorable impact on prices. Just in the present situation, as I am sure you are aware, there is quite a bit of upward pressure on agricultural prices. This could provide an ideal opportunity in my view to reduce the agricultural price supports further, and to key the level of price supports to say changes in the family assistance plan. Insofar as price supports are intended to be some kind of way of maintaining incomes, they should be reduced by other means, through the tax system being employed. A second thing would be on liquidating the so-called strategic stock piles, and in that way exert further downward prices on material prices. I think there are other things that can be implemented before we attempt to fool around with wage and price controls. I do not think they are very likely to be affective and I do not think they have been very affective in the past.

Representative MOORHEAD. Thank you.

Mr. Mann, I noticed that you put on your score card as a first thing in advance in the personal income tax cuts. The thing that bothers me is that there we are benefiting people with jobs at a time when there is high unemployment. How can I justify that?

Mr. MANN. I have to make the assumption, Representative Moorhead, that this would stimulate additional economic activity, which would help with the problem of unemployment. Again, and it is difficult to talk this way, I just do not like to see us in a situation of creating employment for a sake of creating it. Let us do it in a productive and healthy way. Unemployment bothers me as much as anything else. I just do not want to see us go into the kind of situation where we will be sorry for it later on, and to the extent we are moving tax cuts to get the economy moving somewhat more quickly, hopefully we will have a better flow into jobs. But, I recognize the problem.

Representative MOORHEAD. Number four on your scorecard is the investment tax credit, as I understand your testimony, and you believe that this should be a permanent part of our tax system, is that correct?

Mr. MANN. Yes, sir. The major criticism I think I would make is the way the investment tax credit was handled in the past. As many people attest, investment is not a shortrun decision, and there are many long-run implications. You cannot turn it on and off, and I think it is improper public policy to put it in, and take it out, and put it back in. I think it certainly should be a permanent part of our tax system largely because of the competitive problem of American industry.

Representative MOORHEAD. I will ask a couple of more questions on that, but with the idea of Mr. Suits and Mr. Jorgenson commenting on it then. You would make the tax investment credit a permanent part of the tax structure as much as possible as it is to write a law that is permanent. Is there any, would it be possible to have changes of rates? I do not mean drastic ones but, you know, as the economy went down you might increase the rate, as it went up you might decrease the rate keeping of course, the investment credit, or is this just as bad as having it, taking it off, and putting it on?

Mr. MANN. I would defer to Professor Jorgenson on this, because he knows the numbers and can give the implications, but I think we ought to set a rate and leave it there since it is not a short-term kind of thing. To change the rate as the economy changes would not work, and I think it would seem, if the evidence is correct, and I would assume it is, it would again be out of phase with the business sector. By the time the National Bureau got around to determining there was a recession it would be after the fact, and if you change it, it might be perhaps months, or a year or two before it hit your credit or whatever you are doing would take effect. My judgment is again it is almost as bad as putting it on and taking it off, the credit, and I would defer on that.

Representative MOORHEAD. Let me ask another question, and then we will ask Mr. Jorgenson and Mr. Suits to comment. On the problem that Mrs. Griffiths mentioned about the investment credit going to bring in foreign machine tools, and presumably other things, would it be possible, and second, advisable to say limit the investment credit to investments in American assets as opposed to foregin assets?

Mr. MANN. I had not thought about it. It is an interesting question. If the evidence were fairly conclusive that this would stimulate additional tools from overseas, I guess there might be some merit. Again, I would have to look at it, and it depends on how conclusive the evidence is. I suspect that one could consider applying it only to domestic producers, but I think you would have to have fairly conclusive evidence and decide this is what you want to do, and then there might be some merit. But, I would have to think that one through.

Representative MOORHEAD. I would like to have Mr. Suits and Mr. Jorgenson comment on whether we should have investment credits as a permanent thing; two, whether it can be made flexible or should be; and three, whether it can be limited to investments in U.S. assets?

Mr. SUITS. I think my view, Representative Moorhead, would be to concur that an investment tax credit should not be made highly flexible. Of course, there has to be some variation in tax rates from time to time, but I would think that merely from the standpoint of business planning that it would be better to have the businessman in the position where he knew what he had or where he stood. We would not want investment purchasers, in timing of their outlays and similar decisions, to base them primarily on anticipation of whether the rate would be higher next year or lower next year. This makes a temporary, primarily shortrun element much too large in what it seems to me is a very important longrun business decision. I would, however, feel that there was no particular reason why the tax credit should be the same on all types of investments. I originally had in mind not the differentiation between investment in American made assets versus foreign made assets, so much as I did in the type of outlay itself. It has been proposed, and I do not know the current congressional status of the proposal, that a substantial tax credit, or a substantially different depreciation schedule be applied to purchases of pollution control equipment and similar items. I would think that would certainly be highly in order; that is, a special additional tax credit to be made available for investments in socially necessary assets of this kind.

Now, as to the foreign components, what with foreign machine tools, foreign steel, foreign textiles, foreign automobiles, foreign so many other things today, what with our very substantial balance of payments deficit, it seems to me that there is a strong possibility that the dollar is over valued in relation to foreign currencies. The German revaluation, that is upward evaluation of the mark, and the upward evaluation of the Swiss franc is, to that degree, a reduction in the international value of the dollar, and perhaps what we need to do is attack all of these problems as a group, rather than singling out investment assets vis-a-vis the automobiles, for example; or steel, vis-a-vis the textiles, would be to have an overall program in which we would have greater flexibility in the international value of the dollar.

Mr. JORGENSON. I wonder, Representative Moorhead, if I could comment just briefly on the question that you have addressed to Mr. Mann, how one could reconcile reduction of personal income taxes with the need of the unemployed. I think it would be advisable to adopt two measures rather than one, and meet that problem head on by extending unemployment benefits and reducing personal income taxes. From the longer term point of view more people would be put to work sooner by these measures than the other measures we have been discussing.

Turning to your question about the investment tax credit, I think that the history of the use of this measure suggests that it is very difficult to use it in a flexible way. The two historical circumstances that I can recall are first the 1969 removal of the investment tax credit; looking at it from the vantage point of 1971 I think this was a serious mistake. It was done at a time when we can see it would not have much affect, when there was an immediate need for reduction in the pressure on the economy. It has now come around to haunt us 2 years later when, in fact, there is no need for any further deflation of the economy. The other historical experience that I could refer to would be the experience in 1966 where an inflationary situation was perceived in late 1965 and early 1966, and it was decided that it would be a good idea to suspend the investment tax credit and also to suspend accelerated depreciation on structures. That action was first considered in April of 1966. It was finally enacted in October of 1966, after a great deal of discussion, and although it had originally been intended to be in force for a period of 15 months, it was reinstituted in March of 1967.

The reason for this sequence of events is that it is very, very difficult to perceive just what the state of the economy is and that being the case, it is very difficult to take actions of this sort which will have a substantial economic impact.

It seems to me this illustrates beautifully the fact that the investment tax credit has very little short-term impact. It takes about 2 years or so for it to have an impact. That being the case, it is not very useful as a tool for a short-term economic stabilization, and certainly not as useful as a variation in the personal tax or a variation on unemployment benefits or things of that nature which have an immediate impact and should have some kind of flexibility built into them so that it will be possible to respond more quickly to needs for changes in fiscal policy.

With regard to the long-term question about whether these tax measures are desirable, I think that is a very complicated issue, and one which ought to be studied very carefully. As Professor Suits has suggested, it is clear that there would be some cause for differentiating between say pollution and other kinds of investments, simply on the grounds that reducing pollution is to everybody's benefit, and the people who create this pollution should not bear the cost alone, but should have some kind of tax incentive to help out.

With regard to the question about investment in U.S. assets. I think that there is a question that is a very difficult one and it comes out in the following way: It certainly is possible to discriminate between machine tools that are produced abroad and machine tools that are produced in the United States. But, what about machine tools that are produced in the United States that have say Japanese steel? Automobiles raise other problems, for example, in our relations with Canada where we have very complicated legislation and international agreements to stimulate the international trade from which both countries have benefited in automobiles and automobile parts. I feel, therefore, that having a tax credit that makes this kind of discrimination would, in fact, involve a host of difficulties, probably which would not be very desirable and, therefore, probably should not be considered as part of a renewed investment tax credit.

Representative MOORHEAD. Thank you.

Chairman GRIFFITHS. Representative Conable.

Representative CONABLE. Thank you, Madam Chairman, I think, Professor Jorgenson, that you have made a contribution here in pointing out the history of the investment tax credit. Whether or not it has had any major short-term economic impact, certainly Congress has used it as though it does, without regard to the need business has to plan. The history of the investment tax credit has not contributed to a great deal of confidence in its use. I do not think we can distinguish the investment tax credit from its history at this point in considering its desirability. I wonder if you might not think, however, at this point, with the machine industry so very severely depressed, as reported in the New York Times this morning, that one factor in this depression is anticipation of the reinstitution of the investment tax credit on the basis of all of the discussions we have been having here in Congress? Certainly anyone who is going to buy a machine tool right now would have to think twice about committing himself when there is a possibility that he could get a 7-percent credit later or something comparable. Do you think that this might not be a factor?

Mr. JORGENSON. I think it might be a factor on the new order situation. Investment tax credits and depreciation rules are based on the time, or have been in the past, that the order is actually made. It may be that the reduction in machine tool orders reported in the

New York Times this morning did contain an element of waiting to see, waiting to see whether the new depreciation rules are going to be implemented or not, waiting to see whether a tax credit is going to be implemented or not, so it may be that the reduction in new orders is not a real one. Also it may be that since machine tools are generally depressed, the costs of not putting in an order are somewhat less than they otherwise would be. There is some excess capacity in the industry and people, I think, would anticipate somewhat less delay than if the industry were operating at full capacity.

Representative CONABLE. I think that the interesting thing about the suspension in 1966 is that orders ground to a halt, rather than just slowing down. Is that not correct?

Mr. JORGENSON. Yes, that is right. During this period I have mentioned, the 6 months between roughly April, and I think that the consideration of the suspension became public sometime in May.

Representative CONABLE. Of course, that was the reason in the Tax Reform Act of 1969 we repealed the credit rather than suspending it. We made it clear that we were repealing it. Do you see any problem of credibility here if we now reinstate it at this point?

Mr. JORGENSON. Well, I think it depends very much on the way in which the subject is discussed, both in the Congress and in the press. In other words, it seems to me it is very important to take into account the kind of experience that you have suggested, and to assure businessmen that this is not going to be used as a tool for short-term stabilization. There is a credibility problem here because any attempt to change these rules, whether depreciation rules or tax credits, raises the possibility that whenever any short-term crisis arises there is a temptation to throw everything in, so to speak, including the kitchen sink. And I think serious consideration should be given by this committee as to how it should bring these historical lessons home within the Congress, to the Senate Finance Committee and the House Committee on Ways and Means where these decisions have to be considered.

Representative CONABLE. Certainly the investment credit has a greater short-term impact—it may not still be a very considerable one—than the reduced depreciable life that is being proposed.

Mr. JORGENSON. Yes, I think so. I think that should be the basis.

Representative CONABLE. Mr. Mann, at the time we held the hearings in the full committee on the present economic methods you were quoted as saying that the $1,065 billion GNP was neither an accurate prediction or an admirable target. I think Mr. Burns said it was an admirable target but not a good prediction, and you indicated, or at least you were quoted as saying that you thought it was not an admirable target either because if we achieved it there would be such an element of price instability in the economy that we would be quite unhappy about the resurgence of inflation. Now, since that time have you had any change in your view of the reasonableness of this figure? Have you reassessed the probable GNP for this year in an upward direction? Do you have anything further to say on the subject?

Mr. MANN. No. unfortunately, Representative Conable, the story is pretty much the same. I think the matter is really rather a matter of words and semantics. I could argue that it would be a wonderful thing if we could achieve as a target a GNP of one trillion 65 billion dollars if it reflected a composition of GNP that would be desirable, and my point is that it is not a desirable target in that the result would be more, much more, inflation that I think would be desirable. So, a $1,065 billion number which reflected 6 or 7 percent growth and 2 or 3 percent inflation would be fine. But this is sort of the difference of attitude about the target. You know, it is a fine target.

The second point is that it is not achievable. I did not believe it was achievable, and I think that was in February, and I do not believe it is achievable now. Our present forecast is still $1,045 billion or $1,050 billion. Most forecasts have been raised slightly, not represent much of a difference between then and now. A number of things have happened since January. The first quarter numbers were big, dominated again by autos, and the Congress has acted on social security which increased the size of it or the number. But, we do not expect real growth this year to be much more than 3 percent.

Representative CONABLE. There has been some upward estimate in the consensus of economists since February.

Mr. MANN. Well, yes and no. Again, you know the danger of a consensus is that some of us have been around this business long enough to know that if anyone agrees it may not come out that way. I think it has gone through two stages. I think initially there was a downgrading of the number. I think the number is now higher than a month or 6 weeks ago reflecting the social security contribution, and some quickening on the retail consumer side, but again not very much different than what some of us were talking about 3 or 4 months ago.

Representative CONABLE. Well, could I summarize your position at this point as being that it would still involve substantial price instability if we were to follow a monetary policy that brought us to $1,065 billion, but that you would prefer to see greater fiscal stimulus. Do you think it is possible with greater fiscal stimulus to achieve $1,065 billion without price instability?

Mr. MANN. No, sir. Almost no matter what we do now we are not going to reach $1,065 billion. The point I would make here is there are still some of us, Representative Conable, old fashioned enough to believe that there are lags between the implementation of monetary policy and fiscal policy, and given these lags, no matter what you did with money on the monetary side, or what you did say with the personal income taxes on the fiscal side we still would not approach the $1,065 billion. If the number is $1,050 billion now, and if we were to go say the personal income tax reduction route you might pick up $3, $4, or $5 billion of additional GNP to take you closer to the mid-$1,050 billion.

Representative CONABLE. I did not realize it was old fashion to think there were lags. I thought it was becoming more and more current, that belief, that there were serious lags between implementation of changes and the economic statistic results.

Mr. MANN. I was being a little facetious.

Representative CONABLE. But do you see more peril in increased monetary stimulus now than in increased fiscal stimulus?

Mr. MANN. Yes. I agree. I think monetary policy has come fairly far. I think the Federal Reserve has followed the type of a policy that is consistent with the short-term and the long-term needs of the economy. I think it would be wrong in terms of policy for the Federal Reserve to go much farther than it has already. The dangers, of course, are of pumping up more money and credit at a time when our needs are not in terms of satisfying demands for money and because of the international situation, I think it would be preferable for stimulus on the fiscal side.

Representative CONABLE. Thank you.

Chairman GRIFFITHS. Mr. Jorgenson, what would be your first choice of ingredients in a program of fiscal stimulus?

Mr. JORGENSON. Well, again, distinguishing between the short and the long term, I think my first choice would be to reduce personal income taxes much more rapidly. In other words, move these changes that are now scheduled for 1972 and 1973 back to 1971, and at the same time to extend unemployment benefits. That is, I think that is what should be done in a short run.

With regard to the longer term, it would seem to me there would be a serious unemployment problem even with the changes I have suggested, which are temporary in nature, and would not have a substantial long term impact. This problem with unemployment, getting the economy back to full employment, is likely to persist in the absence of fiscal stimulus, all the way to 1975, which is the length of time over which these projections that I have reported on here extend. I would favor some kind of increased fiscal stimulus in the form of a tax reduction for this whole period. Now, the kind of stimulus that is required, it seems to me, should take into account social priorities, but if we simply confined ourselves to investment incentves, it seems to me something like the ADR system, or as an alternative, a 3- or 4-percent tax credit would have the desirable affect of not costing a great deal of revenue, moving the economy to a higher plane of activity, and generating additional revenue. They would also have the desirable affect, in the long-term affect of getting the economy back to full employment without inflation and, therefore, I would favor one or the other of these measures.

Chairman GRIFFITHS. Thank you. Is it not really true that the reason we are competing against foreign nations who have an investment tax credit is that that investment tax credit was given in those countries originally perhaps to rebuild industry after World War II, but additionally because they really did not have customers? You cannot spread the price of a $100,000 machine tool quite as easily among a million customers as you can two million customers.

Mr. JORGENSON. Well, there is that element in that. I think the leading countries in experimentation with fiscal measures really are the small countries like Sweden; Sweden is always cited as an example when these things are discussed. But, of course, the major European countries within now the Common Market, say France, Germany, and countries like Belgium where there is a substantial international market also now have adopted these measures.

Chairman GRIFFITHS. I think it is too, but this is really what you are competing against. I mean, it was not an unfair competition originally at all. There was not anything unfair about it. Time has made it unfair.

Mr. JORGENSON. I think that is true.

Chairman GRIFFITHS. For American industry.

Mr. JORGENSON. I think that is true, and I think that is one thing that ought to be taken into account in longer term considerations about tax policies generally, and that is in comparing, say, the burden of a tax, say, the corporate tax with all of these different provisions we have been discussing, we also have to take into account trade restrictions, quota and barriers, and looking at it from the point of view of the capital goods industry. That being the case, in considering international policy with regard to tax incentives such as, say, a value added tax with rebates at the border, this whole issue ought to be gone into much more carefully.

Chairman GRIFFITHS. You mentioned, Mr. Suits, the problem of very long-term unemployment, lacking of skills and so forth. Would you think that probably one of the proper things for the Federal Government to do would be to set up some trade schools and give these children an opportunity as children to learn some trades?

Mr. SUITS. I think so, Madam Chairman. The problem, of course, is very complex, and there is no easy soluton. To a substantial degree it may simply be a matter of broadening the neighborhood base or better integration in our housing system. Let us say, removing areas where people with low incomes and low educational opportunities and low job opportunities are all herded together in one place.

Chairman GRIFFITHS. Would you support, for instance, a requirement in the Federal Government that if there were FHA-insured mortgages in your community, or if the Federal Government ran roads through that area, or put in any other Federal money that in return for it that community had to accept so many low cost housing units?

Mr. SUITS. I think I would, yes. I think I would.

Chairman GRIFFITHS. It would put those people close to the places where the jobs are.

Mr. SUITS. That is right. I think if we analyze the kind of expenditure, and especially Federal spending expenditures that we have undertaken in the last 30 or 40 years, a great deal of it has been directed toward making it easy for highly skilled, affluent people to move out to the suburbs and still commute to the cities; and we have made it very difficult for people without their own transportation to even go across town. Somebody remarked that it is easier to get a man to the moon than it is to get across town in the traffic. If we use the powers that we have available, and you have suggested a number of direct controls that one has over community sentiment, to encourage a more integrated housing arrangement in which people could live closer to their jobs, I think it would go a long way towards solving these problems.

Chairman GRIFFITHS. A young man suggested to me recently that one of the things that would be comparatively simple to do would be to institute classes in mechanics, the repair of cars and automobiles in Army bases. He said the biggest waste of time in the whole economy is at Army bases. They do not have anything to do, really, and many of them would love to learn how to repair a car. And he just thought, not in these particular terms, but he said so many of those young men could learn some sort of a craft as training, you know, and it is very easy to get money for defense. It seems to me that is good defense.

Mr. SUITS. I think so too.

Chairman GRIFFITHS. I would like to ask you, Mr. Mann, and I would advise you to appear only before committees after this on which you have no friends, I would like to ask you, however, to explain this remarkable statement that it would be harder to get the proper people in the proper jobs as the economy returns to full employment if we had a public service jobs program.

Mr. MANN. I think I would refer to such factors as mobility. Assuming you had a more active economy it would not necessarily be the easiest thing in the world to move people out of jobs, public service kinds of jobs into jobs perhaps where the productivity may be higher, as a case in point.

Chairman GRIFFITHS. Why would it be difficult to move them out?

Mr. MANN. They do not want to leave. I think you run the risk that you are building up a public sector as a short term measure, and the long run thing may not be desirable.

Chairman GRIFFITHS. Well, I am shocked at your impression that the Ways and Means Committee does not really consider the impact of tax, the social security tax, so I think that you would be real pleased to learn that we have considered this public sector in full detail. And what you are talking about in these jobs, just bringing people into the employment market who really do not understand how to get up and come to work at 8 o'clock. You send somebody around to knock on the door and they get them to work or you remind them for weeks on end that they are to be there at 8 o'clock. Now, we have checked with various companies that have tried this individually and they have told us that it requires at least 6 months to get a person trained to come to work on time every day and these are the people, really, that we are reaching out to train. It is not somebody that is immediately available for private employment. You are sort of training them to work, just to get there, and that is a major undertaking.

Mr. MANN. I would never quarrel with the intention of the thrust, Madam Chairman. May I make two additional points with respect to something that was said earlier?

Chairman GRIFFITHS. Sure.

Mr. MANN. I thought Mr. Jorgenson was doing just great, and I was very pleased to hear what he was saying until the very end. I would like to take issue with him as a matter of record. I do not think there are enough of us who are worrying about the long-range budget problems and the long-range measures to get employment up. Those of us who have been exposed to the Federal budget and its process, I would suggest as an example the work done by Charles Schultze, recognize that we are in very serious long-range budget trouble in this country. To do the kind of things I would like to see, and many of us would like to see, the things we think we ought to do, the matter, if anything, should be not to cut taxes, but to raise taxes to do many of the things I think a lot of people would like to see the Government do. I think again the dangers of looking only at the shortrun implications and stimulus is that we forget what will happen 2 or 3 years down the road. As the chairman knows, Federal programs have a way of getting bigger and bigger and multiplying over the years, and programs sort of get out of hand. On the other side, if any of us would like to do some of the things we want to do socially, economically, on welfare or pollution, I think we have to seriously consider what kind of a tax burden the American people are going to bear in the future, if we want to do all of those things. I think we have got to come out with a fairly decent list of the kind of problems that we want to solve in this country. I do not think there would be many people who would quarrel about what to put on that list. We might quarrel which should be first or second, but I would remind the Chair that there is an old rule in economics that we cannot do everything at the same time and have the simultaneous satisfaction of all of these wonderful things. It is just impossible, and if we do not think seriously about what we are going to be doing 3, or 4 or 5 years out, we are going to have serious problems, and the present budget deficits would look pale in comparison.

Another point is that I would commend the chairman for suggesting training in the Army bases. As all of us know, the American economy is becoming increasingly service oriented, and one of the problems is a need for much greater productivity in the services area. This is one of the reasons we have the wage-cost problem and I think in large part it is simply a supply and demand problem. Anyway we can increase the supply of service-type people, whatever the service may be, will be helpful. I am sure you have had occasion to call a plumber or an electrician, and it is very difficult, and anything they do in this area would not only make more people available to take some pressure off, but it might go a long way in solving price problems.

Chairman GRIFFITHS. There is a very limited field for training automobile mechanics, and it really amounts to being trained at the corner filling station, and yet the end pay in some cities on some jobs is as much as $9 an hour.

Mr. MANN. I think that is one of the arguments that is a sort of a fault of our society that just puts a high premium on some people doing this sort of thing, and there are some things that are perhaps not as desirable to be done, and we have to drift away from this.

Chairman GRIFFITHS. We insist that everybody go to college, and yet I was present in the room the other day when there was a $29,000-a-year plumber.

Mr. MANN. I am not surprised at the hourly rates they charge.

Chairman GRIFFITHS. Mr. Conable.

Representative CONABLE. I would like to express some doubt about the panacea that you gentlemen have been feeding us on tax cuts. First of all I think increasing personal exemptions is a very bad way to cut taxes and that is what we are talking about here. The increase is worth a good deal more to a man with a high income than it is to a man with a low income, with the same number of children, and that is what you are advocating, when you advocate this tax speedup.

Second, I think there is a very serious question as to whether the graduated income tax is the kind of tax we want to cut. We have a very serious burden on our regressive taxes at the local level. I do not know how we can handle this. I would prefer, of course, some sort of revenue-sharing proposal to transfer the graduated income tax in such a way that progressive taxes could pick up more of the tax burden at the local level. But, I think you have a very real problem of cutbacks following in local government effecting not just the basic services involved but employment, and the total amount of public expenditures, unless we can find some way of sustaining local services. Thus, I would like to express that doubt about your panacea of cutting Federal taxes. I realize that the amount of money left in the taxpayers pocket has an effect on stimulation of the economy. I still think we have to concern ourselves very much about what type of taxes we cut. Do you have any comments on that?

Mr. MANN. Let me have a crack at that. As a philosophical matter, Mr. Conable, I think I would agree with you. However, I would expect those of us who are suggesting an advancement of what in effect is a cut in the personal income tax is merely a reflection of the fact that it is already on the books. It is a law, and it has been done, and whether it was an appropriate change in the law, I think that is a separe question, and I think I might agree with you. But, given the fact that it is scheduled to come into effect, it is already programed in the Federal budget, so it would not cut into the base, and since it is a very quick way of putting funds in the hands of potential spenders, and since some of us feel that the recovery is not as strong as might be desirable, it is a very effective way of doing it. I think there is a dichotomy there, that it is coming upstream whether we like it or not, and unless we change the law, which I suspect we are not going to do, and all I can say is let us move it up a little bit, and since it has already been taken into account it could have a favorable effect.

Mr. JORGENSON. I would like to agree with that completely. I agree with the philosophical position that the increase in the personal exemption is always bad, it is regressive. This is something that should not have been done in the Tax Reform Act of 1969 and it ought to be repealed as soon as possible. There ought to be movement in the other direction, possibly at the same time as the family assistance program is adopted. It seems to me there is a very good chance to do away with the regressive features of the personal income tax.

With regard to regressive property taxes, the only solution I can see is to substitute income taxes for property taxes at the local level, that certainly would be a very desirable thing to do. It is hard to imagine what the Federal Government could do to stimulate State and local authorities to make this kind of substitution, but if any steps could be taken they certainly would be desirable.

Representative CONABLE. Mr. Suits, can you tell me when in the history of this country major wage and price controls have worked, and can you tell me whether it is reasonable to assume that imposing wage and price controls at this point would be consistent with your desire to reduce unemployment?

Mr. SUITS. As to the latter, yes they would. As to the former, certainly wage and price controls were effective during World War II. Now, by effective I may not mean that there were no changes and no adjustments, and I certainly do not mean that there were no problems. Anybody that had lived through that period remembers all of the agonies that were associated with it. Presumably what we are talking about here is at least several orders of magnitude different from the full, all out war type situation in which half of the gross national product was going into the military.

But, given the tremendous inflationary pressure that existed at that time we did manage to hold the price level reasonably stable and wage levels reasonably under control.

Representative CONABLE. Does not the imposition of wage and price controls have a tendency to crystalize the economy though? If you have a lot of people coming into the labor market who is going to generate the new jobs unless you have the kind of dynamics implicit in a free economy?

Mr. SUITS. I think that the entry of young workers particularly, and housewives returning to the labor force——

Representative CONABLE. And the underprivileged?

Mr. SUITS. And the underprivileged is primarily guided by where the jobs are rather than what the rates are within any kind of reasonable range. But, what we are talking about here is a basic relation of the overall average level of wages and prices. Within that there has to be a mechanism for relating the structure of wages and prices to guarantee that developing supply bottle necks can be met, and that areas where there is excess supply can be cut back.

Representative CONABLE. If we were to impose wage and price controls at this point do you think that conceivably we would ever remove them?

Mr. SUITS. I really do not know. My position is this: First of all, that I do not advocate wage and price controls on their own for their own sake. Let us put it this way, that I strongly believe that we should provide employment opportunities for everybody who wants to work, that I strongly suspect that this is incompatible with stable wages and prices, and that if I am wrong in this, so much the better. If we do not need price and wage controls, so much the better. But, I am willing to proceed to try to provide a job for everybody who wants to work, and if it costs me and the rest of the community wage and price controls, then this is too bad, but so be it.

Representative CONABLE. By "we" you mean the Government?

Mr. SUITS. By "we" I mean the entire community, everyone that is going to be annoyed and going to have problems with wage and price adjustments under a wage and price control system.

Representative CONABLE. Thank you.

Chairman GRIFFITHS. Thank you very much. Thank all of you for being here. You have been very kind and very helpful and we hope we can rely upon your again when we have hearings.

Thank you very much.

(Whereupon, at 12:15 p.m., the subcommittee was adjourned, to reconvene subject to the call of the Chair.)

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