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THE 1972 ECONOMIC REPORT OF THE PRESIDENT

HEARINGS

BEFORE THE

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CONGRESS OF THE UNITED STATES

NINETY-SECOND CONGRESS

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FEBRUARY 18, 22, AND 23, 1972

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THE 1972 ECONOMIC REPORT OF THE PRESIDENT

FRIDAY, FEBRUARY 18, 1972

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

The committee met, pursuant to recess, at 10 a.m., in room 1202, New Senate Office Building, Hon. William Proxmire (chairman of the committee) presiding.

Present: Senators Proxmire, Javits, and Pearson; and Representatives Reuss and Brown.

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

OPENING STATEMENT OF CHAIRMAN PROXMIRE

Chairman PROXMIRE. The committee will come to order.

This morning we continue our annual hearings on the President's Economic Report by turning to a distinguished panel which will assess the economic outlook and give their views on monetary and fiscal policy.

Our witnesses are Prof. Saul Hymans, Prof. Henry Wallich, and Mr. Okun.

Gentlemen, I observe, from reading your statements, that the forecasts you will present this morning depart from the $100 billion GNP increase which earlier was dubbed the consensus forecast. The GNP you forecast is in the range of $85 billion to $95 billion. This is less than that predicted by the Council of Economic Advisers.

You also anticipate a higher level of unemployment than the administration. Both your forecasts and the evidence of the recent indicators, retail sales and industrial products, suggest to me that there remains cause for grave concern over the sluggishness of the economy and the continued high rate of unemployment.

I am looking forward to hearing your views on the outlook and adequacy of current policies. I will ask the witnesses to make their presentations in alphabetical order.

Our first witness will be Mr. Saul Hymans, Codirector of the Research Seminar in Quantitative Economics at the University of Michigan, where he has helped develop their econometric model.

He was a senior staff economist at the Council of Economic Advisers in 1967 and 1968. He also specialized in economic forecasting and fiscal policy.

We are very glad you can be here with us this morning.

I am going to ask all witnesses to limit their presentation to about 15 minutes.

STATEMENT OF SAUL H. HYMANS,[1] PROFESSOR OF ECONOMICS AND CODIRECTOR OF THE RESEARCH SEMINAR IN QUANTITATIVE ECONOMICS, THE UNIVERSITY OF MICHIGAN

Mr. HYMANS. Thank you, Senator.

I. INTRODUCTION

The forecast of economic activity which I shall present today is based on the quarterly econometric model of the Research Seminar in Quantiative Economics (RSQE) of the University of Michigan. This model is the subject of a continuing research effort under the joint direction of Prof. Harold T. Shapiro and myself and is in continual use as a tool for forecasting and policy analysis at the RSQE. While our forecasting operation is organized around the model, the model by itself is little more than the best statement we currently have of the logical and behavioral connections in the economy.

The generation of an actual forecast requires considerable judgmental input which is then processed through the logic of the model.

In the process of my discussion I shall attempt to convey to you the considerations which preceded the "button pushing" stage in the generation of our current forecast.

II. THE CURRENT STATE OF THE ECONOMY

In the second half of 1971, the economy continued its recovery from the 1969–70 recession on a growth track very close to that suggested by my colleague, Professor Shapiro, in his testimony before this committee last July.

At that time he forecasted that real GNP would rise by $15.1 billion (1958 dollars)—an annual rate of 4.1 percent—in the second half of 1971 and that the unemployment rate would end the year at about 6 percent.

According to preliminary Commerce Department estimates, real GNP rose by $15.9 billion—an annual rate of about 4⅓ percent—in the second half of 1971, as is well known, the unemployment rate did end the year at about 6 percent.

The testimony of last July preceded the President's new economic policy by several weeks and thus overestimated the rate of inflation in the second half of 1971. Compared with the 5 percent annual rate then forecast for the GNP deflator during the latter half of the year, prices in the aggregate rose at an annual rate of only 2 percent as the price freeze put a temporary halt to most price increases in the economy.

The principal elements supporting economic growth during the past 6 months have been:

—the continued buoyancy of residential building;

—a turnaround in Federal Government spending following several years of little or no real growth;

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[1] I would like to acknowledge the assistance of Prof. Harold T. Shapiro and Mr. Charles Roehrig in the preparation of this statement. The forecast presented here is based on the quarterly econometric model of the Research Seminar in Quantitative Economics (RSQE) of the University of Michigan. The RSQE research program is financed, in part, by a grant from the National Science Foundation.

—a modest recovery of inventory building in the closing months of the year; and

—a steady growth of consumer spending, particularly for automobiles, in the wake of price rollbacks and the removal of the auto excise tax.

It is my belief that the economy is well settled into a pattern of economic growth that will continue in a natural way for, at the very last, the 18-month horizon of this statement.

Within a rather broad range of possible fiscal and monetary policies, this growth can be expected to persist and to make some headway against the excessive unemployment we are currently experiencing.

The exact pattern and vitality of the growth and reemployment process will, however, depend crucially on the stance of governmental policies. I would like to turn directly to these issues now.

III. FISCAL POLICY

In my view the Federal budget, as officially released a few weeks ago, is unrealistic and would be poor policy if it were realistic. Table 1, attached to my statement, contains a compilation of Federal expenditures in the national income accounts for fiscal years 1972 and 1973, both as contained in the latest budget documents of OMB and as revised by RSQE in the light of our own judgments.

I find the lack of realism in the official budget stemming from several factors.

1. Based on the budget data already known for the first half of fiscal year 1972, an unusually strong upsurge of expenditures would be required during the first half of calendar 1972 in order to make the official totals. For example, even after including the $4½ billion (annual rate) proposal for revenue sharing, the added expenditures on a volunteer army resulting from the Economic Stabilization Act, and the $2 billion or so (annual rate) which can be released for pollution control, highways, and so on, by the administration, I still come up several billion dollars (annual rate) short of being able to make the administration's total expenditure figure of $247.8 billion for fiscal year 1972.

2. Given the expenditure rates that would have to be reached in the spring of 1972 in order to make the fiscal year 1972 totals, virtually no growth in Federal purchases could take place in the subsequent four quarters if the Government were really going to stick to the projected totals for fiscal year 1973. And this would even mean no Federal pay increase in fiscal year 1973, a hardly likely eventuality.

3. Unemployment insurance benefits rose by $1.9 billion between 1970 and 1971. Given the employment prospects for the coming year and a half, OMB's projection of a $1.4 billion decline in unemployment benefits in fiscal year 1973 seems somewhat out of line.

4. After allowing for the grant-in-aid increases required to make the fiscal year 1972 total, there seems to be no room for any normal program growth in the fiscal year 1973 total.

Even if the budget totals were considered to be realistic, I would regard them as unwise for several reasons.

1. I cannot believe that the crash expenditure program represented by the fiscal year 1972 budget will lead to efficient use of the funds so released. State and local programs cannot be initiated or speeded up to

the required extent on such short notice. The grant increases envisioned are likely to find their way into net increases in State and local spending only very slowly. There is a vast need for greater Federal funding of social programs, but this should be done with coordinated planning, not by the sudden announcement of crash funding.

2. The official budget outlook for the coming 18 months represents too much of an on-again, off-again approach to stabilization policy. For the next 6 months we get a torrent of new Federal spending, only to have it choked off for the following 12 months. Matters of efficiency aside, the economy is first to be given a swift kick forward and then to be dragged down. Table 4 attached to my statement, shows this implication of the official budget most clearly.

Finally, I do not find the official projections of the Federal deficit to be consistent with the economic implications of the expenditure projections. Using the official expenditure totals in the budget document, I arrive at deficits of about $31 billion for each of the fiscal years 1972 and 1973, not the $35 billion and $28 billion, respectively, contained in the official projections.

The RSQE forecast of 1972–73 is based on the revised budget totals shown in table 1 attached to my statement. Our revisions involve expenditure totals $3.3 billion below the OMB propection for fiscal year 1972 and nearly $8 billion above the official projection for fiscal year 1973.

In our model this produces deficits of nearly $28 billion in fiscal year 1972 and $36½ billion in fiscal year 1973. These are very close to the official projections, with the dates reversed.

The RSQE budget estimates in table 1 attached to my statement, contain $4 billion revenue sharing program beginning in fiscal year 1973, a drop in unemployment benefits of about $¾ billion in fiscal year 1973, a Federal pay increase in January 1973, an increase in social insurance benefits in mid-1972, and normal program growth.

We have provided for no tax changes other than a further increase in social insurance rates in January 1973.

IV. MONETARY POLICY

According to the Federal Reserve Bank of St. Louis, the (narrowly defined) money supply has reversed its no growth trend of late 1971 and has been rising at an annual rate of about 9 percent since early January.

I believe the Fed will continue this support process, but not with all that enthusiasm, throughout the coming year and a half.

The RSQE forecast embodies an assumed 10 percent rate of growth of the (narrowly defined) money supply through mid-1972, followed by money growth trailing down to 5 percent by yearend and remaining at that rate through mid-1973.

In the context of the forecast, this permits the financing of large public and private credit demands at the cost of rising short-term interest rates, particularly after mid-1972, but the corresponding increases in long-term rates should be far less than those at the short end of the market.

It is, of course, possible that the Fed will feel constrained to provide even more credit than we have assumed, especially in view of the

Treasury's financing needs. If so, short-term rates could be considerably lower than in the present forecast, but this is unlikely to be of any real economic consequence until after mid-1973.

V. THE FORECAST

I will be happy to discuss other aspects of our judgmental inputs in subsequent questioning, but let me turn now to the forecast itself. Table 2, attached to my statement, contains substantial quarterly detail regarding our forecast of the period 1972–I through 1973–II. We are not members of the "$100 billion club."

Our forecast is for an increase in current dollar GNP of about $90 billion for the year 1972. This amounts to an increase of 8.6 percent which breaks down to a 5¼ percent rate of real growth (GNP in 1958 prices) and a 3.2 percent rate of inflation. The principal categories leading the 5¼ percent growth rate are:

Residential building, forecast to rise by 12½ percent in real terms, with housing starts totaling 2⅓ million in 1972, compared with 2 million now estimated for 1971.

Inventory accumulation, forecast to rise to over $5 billion (1958 dollars) compared with $2 billion in 1971, and

Government purchases rising by more than 7 percent in real terms, after declining by 4 percent in 1970 and holding flat for 1971.

The unemployment rate, which has hovered at 6 percent for well over a year, is forecast to average 5.7 percent for 1972 as a whole, and to decline to 5.3 percent in the fourth quarter of 1972.

Several other features of the forecast are worth noting:

Compensation per man-hour (private nonfarm) up by 6 percent for the year as a whole, compared with nearly 7 percent in 1971 and 7.6 percent in the first half of 1971 before the wage freeze was instituted.

Output per man-hour—private nonfarm—up by 3.9 percent compared with 3⅓ percent in 1971.

Personal income up 7.3 percent in nominal value and 3.9 percent after taxes and inflation.

Corporate profits before taxes up by 13 percent.

While the year-to-year comparisons are of interest, I believe we can get a better picture of the forecast of activity over the coming year and a half from the calculations presented in table 3 attached to my statement.

Although the forecast calls for a 5¼-percent growth in real GNP for the year as a whole, there is a strong uptrend during the period. From the fourth quarter of 1971 to the fourth quarter of 1972, real growth should total 6.2 percent, to be followed in the first half of 1973 by real growth at an annual rate of 6⅓ percent. This pattern is forecast to bring the unemployment rate to 4.8 percent in the second quarter of 1973.

All categories of private investment will be leading the rise in the growth rate, particularly inventory accumulation and business capital spending, the latter showing the impacts of the investment tax credit and the steady growth of final demand which has been building for several quarters.

Government spending, as we project it, will continue to stimulate growth throughout the period, with the State and local sector providing increasing support as it mobilizes the projected grant increases and continues to benefit from a supportive monetary policy.

In our forecast, consumer spending is not a stimulant to the growth process. Consumer spending is seen to do little more than move up in pace with consumer disposable incomes and, indeed, to lag somewhat behind the growth of income after mid-1972. I shall return to this very shortly.

As shown in table 3, attached to my statement, the rate of inflation is forecast to be 3½ percent between the end of 1971 and the end of 1972, and to be at an annual rate of 4 percent in the first half of 1973. The latter is misleading, however.

In the absence of the assumed Federal pay increase in January 1973—and such a pay increase goes directly into the government component of the price deflator—the annual rate of inflation in the first half of 1973 would have been forecast as 3.6 to 3.7 percent.

VI. ALTERNATIVES

I would like to give brief mention to the data shown in table 4 attached to my statement. It is my view that the most likely alternative to the forecast which I have just presented is an outlook involving stronger growth in consumer spending.

The columns headed "RSQE No. 2" in table 4, attached to my statement, summarize an alternative forecast in which I forced the econometric model to lower the personal saving rate by about half a percentage point after mid-1972.

At an annual rate, this amounts to additional consumer spending of about $4 billion—current dollars. This speeds the real growth rate from 5¼ percent in 1972 to 5.6 percent, raises the growth rate in the first half of 1973 from 6⅓ to 6.7 percent, and drives the unemployment rate down to 4½ percent in the second quarter of 1973.

In this process, this raises the inflation rate at the end of the period by about one-tenth of a percentage point and reduces the fiscal year 1973 deficit by some $3 billion.

As I mentioned earlier, I am in substantial disagreement with the wisdom of the official budget scenario for the coming 18 months. An alternative forecast employing the official budget estimates—and no change in monetary policy from that already discussed—is summarized in the third set of columns in table 4 attached to my statement.

For the year as a whole, 1972 looks nearly the same whether one uses the official budget or the RSQE budget, but the pattern through time is considerably different. By the end of 1972 the real rate of growth is declining under the impact of the official budget projections, and is down to 4.1 percent— annual rate—for the first half of 1973, compared with 6⅓ percent in the "control" forecast presented earlier. This difference implies a 5.2-percent unemployment rate in the second quarter of 1973, compared with 48 percent in the RSQE forecast.

I can find nothing worthwhile that will have been purchased at the expense of higher unemployment and an unsteady growth process.

Abstracting from the effects of a Federal pay bill—which I have included and the official budget does not—the inflation rate is virtually the same in either case. Productivity behavior is somewhat worse with the official budget pattern and profit growth in the first half of 1973 is reduced from an annual rate of 15 percent in the control forecast to only 4 percent under the impact of the official budget scenario.

Chairman PROXMIRE. What are you talking about when you say a 15-percent growth?

Mr. HYMANS. A 15-percent annual rate of growth of corporate profits in the first half of 1973.

True, the official budget forecast involves a deficit which is reduced by about $6 billion in fiscal year 1973—compared with the control forecast—and implies a Treasury bill rate lower by 20 basis points in the spring of 1973, but that appears to be very little gained at very high expense.

VII. CONCLUDING COMMENTS

I realize that this discussion of the economic outlook has been far from complete. The included tables provide some results which I have not mentioned at all. The phase II program of restraint against inflation has not even been alluded to. In the interest of making a reasonably brief presentation, I have been very selective in my choice of topics. I trust that will not stop you from raising whatever issues you wish to discuss, and I thank you for the opportunity to air my thoughts before you.

(The tables referred to in Mr. Hymans' statement follow:)

TABLE 1.—FEDERAL GOVERNMENT EXPENDITURES IN THE NATIONAL INCOME ACCOUNTS

[Billions of current dollars]

		Fiscal 1972		Fiscal 1973	
	Fiscal 1971 [1]	OMB [1]	RSQE [2]	OMB [1]	RSQE [2]
Purchases of goods and services	95.3	103.0	102.7	107.0	111.9
National defense	73.0	73.3	73.1	76.7	77.3
Nondefense	22.4	29.7	29.6	30.4	34.6
Transfer payments	69.9	79.8	79.8	87.4	88.3
Grants-in-aid	27.0	36.2	33.2	40.6	42.8
Net interest paid	14.2	13.4	13.4	14.8	14.8
Subsidies less current surplus of Government enterprises	5.9	5.4	5.4	6.0	6.0
Wage accruals less disbursements	.1				
Total expenditures, national income basis	212.4	237.8	234.5	255.9	263.8
Surplus (+) or deficit (−)	−18.4				
OMB [1]		−35.0		−28.0	
RSQE [2]		−31.0		−30.9	
RSQE, control [3]			−27.8		−36.5

[1] "Special Analyses of the United States Government, Fiscal Year 1973," p. 17.
[2] Estimates by RSQE.
[3] Estimates by RSQE, corresponding to control forecast in table 2.

TABLE 2.—RSQE CONTROL FORECAST OF 1972-73

[Except as noted, figures are in billions of dollars, seasonally adjusted annual rates]

	1972				1973		Calenda ryears	
	I	II	III	IV	I	II	1971	1972
(A) CURRENT DOLLARS								
Gross national product	1,099.3	1,120.1	1,146.9	1,179.3	1,212.8	1,240.1	1,046.8	1,136.4
Personal consumption expenditures	688.4	699.8	715.1	731.6	747.2	762.3	662.2	708.7
Gross private domestic investment	161.3	164.1	169.4	176.8	183.8	189.6	150.8	167.9
Business fixed investment	111.9	112.5	114.9	118.8	122.4	125.9	108.1	114.5
Residential construction	46.3	47.2	48.2	49.3	50.7	52.1	40.6	47.7
Inventory investment	3.1	4.4	6.3	8.7	10.7	11.6	2.1	5.6
Net exports	—.5	.5	1.0	1.5	2.0	2.5	.7	.6
Government purchases of goods and services	250.1	255.7	261.4	269.4	279.8	285.8	233.1	259.1
Federal defense	75.2	75.5	75.9	76.6	78.3	78.5	71.4	75.8
Federal nondefense	30.6	31.4	32.2	33.5	35.7	37.0	26.2	31.9
State and local purchases	144.3	148.8	153.3	159.3	165.8	170.3	135.4	151.4
(B) CONSTANT DOLLARS (1958 PRICES)								
Gross national product	761.6	770.1	782.6	798.4	812.8	823.3	739.5	778.2
Personal consumption expenditures	503.0	507.3	514.3	521.9	528.5	534.3	491.9	511.6
Gross private domestic investment	112.8	114.0	116.9	121.3	125.3	128.1	107.8	116.3
Business fixed investment	80.1	79.7	80.6	82.5	84.0	85.5	78.8	80.7
Residential construction	29.9	30.3	30.6	31.0	31.6	32.1	27.0	30.4
Inventory investment	2.8	4.0	5.7	7.9	9.7	10.5	2.0	5.1
Net exports	0	1.0	1.5	2.0	2.5	2.5	.5	1.1
Government purchases of goods and services	145.7	147.8	149.9	153.2	156.4	158.4	139.3	149.2
(C) SUPPLEMENTARY DATA								
Unemployment rate (percent)	5.9	5.8	5.7	5.3	5.0	4.8	6.0	5.7
Gross national product deflator (1958=100)	144.35	145.45	146.55	147.70	149.21	150.62	141.56	146.01
Private nonfarm sector:								
Compensation per man-hour (1967=100)	136.1	137.5	140.5	142.2	144.7	147.1	131.2	139.1
Output per man-hour (1967=100)	109.5	110.3	111.6	113.0	114.2	114.9	106.9	111.1
Manufacturing sector:								
Index of industrial production (1967=100)	107.0	107.6	109.5	112.3	114.7	115.9	104.7	109.1
Capacity utilization rate (percent)	73.9	73.6	74.1	75.1	75.9	75.8	74.5	74.2
Incomes:								
Personal income	894.4	906.5	927.4	950.0	971.6	991.3	857.0	919.6
Corporate profits before tax	90.2	94.1	97.5	103.3	108.5	111.0	85.2	96.3
Interest rates:								
3-month treasury bills (percent)	3.52	3.62	4.31	5.20	5.76	6.30	4.35	4.16
Corporate Aaa (percent)	7.15	7.18	7.31	7.49	7.60	7.78	7.39	7.28

TABLE 3.—SUMMARY OF PERCENT CHANGES IN RSQE CONTROL FORECAST

	Percent changes		
	1971-72	1971.4-1972.4	1972.4-1973.2 (annual rate)
(A) CURRENT DOLLARS			
Gross national product	8.6	9.9	10.6
Personal consumption expenditures	7.0	7.9	8.6
Gross private domestic investment	11.3	13.0	15.0
Government purchases of goods and services	11.2	11.8	12.5
(B) CONSTANT DOLLARS (1958 PRICES)			
Gross national product	5.2	6.2	6.3
Personal consumption expenditures	4.0	4.5	4.8
Gross private domestic investment	7.8	9.9	11.5
Government purchases of goods and services	7.1	7.2	6.9
(C) SUPPLEMENTARY DATA			
Gross national product deflator	3.2	3.5	4.0
Private nonfarm sector:			
Compensation per man-hour	6.0	6.3	7.0
Output per man-hour	3.9	4.2	3.5
Unit labor cost	2.1	2.0	3.3
Incomes:			
Personal income	7.3	8.4	8.9
Corporate profits before tax	13.0	21.4	15.5

TABLE 4.—COMPARISON OF RSQE CONTROL FORECAST WITH ALTERNATIVES FOR 1972-73

		RSQE control forecast				RSQE No. 2 control with lower saving rate				RSQE No. 3 control with OMB budget			
			Percent changes				Percent changes				Percent changes		
	Level, 1971	Level, 1972	1971–72	1971.4–1972.4	1972.4–1973.2 (annual rate)	Level, 1972	1971–72	1971.4–1972.4	1972.4–1973.2 (annual rate)	Level, 1972	1971–72	1971.4–1972.4	1972.4–1973.2 (annual rate)
Gross national product (billions of current dollars)	1,046.8	1,136.4	8.6	9.9	10.6	1,140.3	8.9	10.7	11.0	1,136.5	8.6	9.7	7.8
Personal consumption (billions of current dollars)	662.2	708.7	7.0	7.9	8.6	712.1	7.5	9.0	8.9	709.0	7.1	7.9	6.9
Gross national product (billions of 1958 dollars)	739.5	778.2	5.2	6.2	6.3	781.1	5.6	7.1	6.7	778.3	5.2	6.0	4.1
Personal consumption (billions of 1958 dollars)	491.9	511.6	4.0	4.5	4.8	514.0	4.5	5.6	5.1	511.8	4.0	4.5	3.2
Unemployment rate (percent)	6.0	5.7		[1] 5.3	[2] 4.8	5.6		[1] 5.1	[2] 4.5	5.7		[1] 5.4	[2] 5.2
Private nonfarm deflator (1958=100)	135.1	138.6	2.7	3.4	3.7	138.6	2.7	3.5	3.8	138.6	2.7	3.5	3.7
Gross national product deflator (1958=100)	141.56	146.0	3.2	3.5	4.0	146.0	3.2	3.4	4.1	146.0	3.2	3.5	3.6
Personal saving rate (percent)	8.2	8.1		[1] 8.4	[2] 8.4	7.9		[1] 7.9	[2] 7.9	8.1		[1] 8.4	[2] 8.0
Federal surplus (fiscal year)	−18.4	−27.8			−36.5	−27.8			[3] −33.5	−31.0			[3] −30.6

[1] Level in 1972.4. [2] Level in 1973.2. [3] Fiscal 1973.

Chairman PROXMIRE. Thank you very much, Mr. Hymans.

Our next witness is Mr. Arthur Okun, senior fellow at the Brookings Institution and former Chairman of the Council of Economic Advisers, a valued friend of this committee.

Mr. Okun, it is always a delight to welcome you here. You are one of the country's experts on fiscal policy and employment. We are very anxious to get your views on what we should be doing about our current fiscal and unemployment problems.

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

Mr. OKUN. The year 1972 presents a great opportunity for beginning the long journey toward a sustainable, noninflationary prosperity. Behind us is the dismal record of 1971; in view of its high unemployment and rapid inflation, last year, on the whole and on the average, produced the most unsatisfactory economic situation in the era of the Employment Act. Starting from that position, it is inconceivable that the Nation can reach the destination of prosperity in 1972. But we have every reason to hope and to believe that we will take a step in the right direction. It is important that this first stride be firm and strong; it is even more important that we chart in 1972 a sound course for continuing the journey toward full prosperity in 1973 and 1974. I am particularly concerned about the longer run horizon and will focus on it. Also, I shall dwell at length on the significance and nature of the Nation's crucial unemployment problem.

THE 1972 OUTLOOK

In its appraisal of the 1972 outlook for GNP, the Council of Economic Advisers leans a bit—but only a bit—on the optimistic side. I would prefer $1,140 billion to their estimate of $1,145 billion as a down-the-middle, round-number judgment for GNP in 1972. But a difference of that size is well within the range of forecasting error. Whether at $1,140 or $1,145 billion, such a prediction portrays a broad-based recovery, but not a rapid one by past standards. In the years of initial recovery from the previous three recessions, real GNP grew 7.6 percent in 1955, 6.4 percent in 1959, and 6.6 percent in 1962. The Council's forecast for 1972 implies a growth rate near 6 percent, while my estimate would be about one-half of 1 percentage point lower. My point estimate of the unemployment rate in the fourth quarter of this year would be 5.4 percent, while the Council puts the unemployment rate in the "neighborhood of 5 percent at yearend." This is an important difference, unless the Council is using an unusually broad definition of the word "neighborhood."

FISCAL AND MONETARY POLICY

The prospect for economic recovery rests heavily on the expansionary stance of fiscal and monetary policy. This year, the administration is pursuing a stimulative fiscal program; but I have doubts that the

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

expansionary effectiveness of that program is adequate to achieve the goals. In my view, we could improve our chances of reaching the Council's target of 6 percent real growth—and incur no significant risk of a runaway advance—by taking additional prompt and temporary fiscal measures—for example, the enactment of a $100 income tax credit per family payable on the settlement of 1971 tax payments between now and April 15.

I see no economic risk in applying more stimulus to the economy now or in the next few months. At this point, the overwhelming need is to insure a brisk advance and the overwhelming risk is that of doing too little as well as being too late. Consumer spending and consumer attitudes continue to underline the anxieties and lack of confidence felt by the American public, and to highlight an important downside risk in the outlook for this year.

As I read history, it reveals that never have we made the fiscal error of doing too much too soon. When the economy has been overheated by fiscal policy it has been the result of continuing to pile on fuel when full employment is neared. Avoiding that error will be essential at some time in the future, but that is not the problem of February 1972.

Additional fiscal stimulus would help now, even though the deficit is gigantic. It should be no surprise that, with the economy frozen, the furnace has to run full blast in order to thaw it out. Moreover, I believe that we have not used all the extra fiscal fuel wisely or efficiently. In particular, as I told this committee last September, I believe the tax cuts of 1971 overstressed incentives to investment. But that decision has been made and I realize it is not going to be unmade. Because the Congress has acted so recently on the major tax proposals of the administration, the course of fiscal policy has probably been essentially determined for 1972. Despite my misgivings, I suppose that we must wait to see the full effects of the tax prescription that the administration wrote and that the Congress accepted.

I suppose we must also wait to see whether the administration can carry out its ambitious aims for accelerating Federal expenditure programs in the first half of this calendar year. According to administration estimates for the entire 1972 fiscal year, Federal outlays on a national income basis must be scheduled to rise from a $227 billion rate in the last half of 1971 to $248½ billion in the current half year, more than doubling the pace of advance in the last 2 half years. This is a remarkable change from the administration's stance last fall, when it continued to urge a holddown on Federal outlays. I welcome the administration's recent recognition that private take-home pay can be bolstered by Federal outlays as well as by tax reductions. But the delay has been costly, and it has turned the implementation of stimulus for the current fiscal year from a routine assignment to a herculean task. Although the Federal Government can rearrange its unified budget deficits by determining when to pay its bills, it will be far more difficult to accelerate massively the pace of genuine income-creating activity.

Monetary policy has a key role to play in 1972. I view the words and deeds of the Federal Reserve as appropriately expansionary. Although the Federal Reserve has made funds readily and inexpensively available in recent months, there has been little appetite for increased demand deposits or bank loans. It has therefore faced a dilemma: To maintain stable short-term interest rates would have probably entailed a decline in the money stock; to maintain healthy growth in the money stock would have required extremely low short-term interest rates. Given this choice, the Federal Reserve has compromised, settling for a smaller-than-desired growth of money and accepting a larger-than-desired drop in short-term interest rates. As a result, the Federal Reserve has been criticized for overly aggressive ease by those who regard the Treasury bill rate and other money market rates as the basic indicators of monetary policy. On the other hand, monetarists have complained that the Federal Reserve has not worked sufficiently hard to make the money supply grow. I believe that both quantities and interest rates are relevant, and I regard the compromise strategy as sensible and appropriate.

I suspect that the Fed's dilemma will change rather than disappear in the next few months. The demand for money is likely to perk up; and above-average growth of money will be needed to prevent a sharp, destabilizing rebound of short-term interest rates. I would hope and expect that, under those circumstances, the needed additional money will be provided and allowed to average out with the sluggish monetary growth of the past half year.

Credit demands for 1972 can and should be accommodated with only a gradual and gentle upward drift in short-term interest rates. In that environment, the bond market should continue to thrive, narrowing the extraordinarily large current differential between bond yields and interest rates on bank loans.

CHARTING THE FISCAL COURSE

On the most probable scenario for 1972, the year will have the second highest unemployment rate in a decade, and a $65 billion shortfall of output below our productive capacity. On the other hand, it should be a year of distinct improvement, with more growth and less inflation than in any recent year. But the most probable scenario for 1972 is far from a certainty. We cannot count in that respect on a repetition of 1971, when the forecasts of most private economists turned out to be exceptionally accurate.

Contingency planning

If that should not be the case this year, any important deviation from the scenario should be a signal for action. In particular, the danger that the consumer might continue to refuse to climb on the bandwagon toward recovery is sufficiently serious to warrant contingency planning at this time. If consumption remains sluggish in the face of rising business investment, the resulting imbalance would endanger the prospects for advance in 1973 and 1974. Businessmen will keep expanding and modernizing capacity only if consumer demand provides a strong ultimate market for their products.

Beyond contingency planning for 1972, now is the time to erect safeguards and institute procedures to improve the future performance of fiscal policy. We should act to insure that the budget will never again act as an engine of inflation, as it did between late 1965 and mid-1968, and that it will never again merely register passively a recession and mounting slack, as it did between November 1969 and August 1971.

Improving fiscal flexibility

Several actions taken in 1970 and 1971 will affect the future conduct of fiscal policy. Our system has been strengthened by the institution of automatic formula flexibility in the public service jobs program and in extended unemployment insurance benefits. This innovation insures that some of the stimuli operating now will automatically turn off and phase out as prosperity is restored. On the other hand, the permanent tax reductions enacted in 1971 create stimuli for all seasons and reduce the elbow room for the fiscal restraint that should become appropriate as the economy approaches full employment.

One major improvement in built-in fiscal flexibility was recommended by this committee last summer. Your proposal for cyclical revenue support grants to States and cities would relieve the squeeze on their budgets created by a recession and prolonged period of slack. Because those Federal outlays would automatically shrink and disappear as full employment is regained, the program would reduce overall economic fluctuations as well as insulating essential public services from them.

Now is an excellent time to renew consideration by the Congress of instituting appropriate procedures for a legislative-executive partnership to implement prompt, temporary tax increases and cuts for economic stabilization. The inadequacy of present procedures was underlined by a subcommittee of the Joint Economic Committee in 1966; events since then have dramatized the need for reform.

Reform of the appropriations process

I wholeheartedly share the President's desire for "a more orderly and more rational budget process." Even though congressional actions in recent years have done little—probably too little—to change the near-term expenditure totals, it remains evident that present procedures do not insure adequate control on those totals. But I do believe that the objectives would be best pursued through the enactment of a specific ceiling on total outlays; in setting an expenditure ceiling, the Congress would essentially abdicate responsibility for making the sum of the parts equal the whole and would shift that burden, along with the de facto powers of an item veto, to the President. A more promising route might be the institution of a new overall review at the end of each congressional session to evaluate the total expenditure program in terms of fiscal policy objectives, leaving all appropriations actions tentative until that summary review.

Although I would hope the need is remote, I would also urge the Congress to consider the development of a fail-safe device against a repetition of the Vietnam fiscal fiasco. Steps could be taken now to insure that, if the President and the Congress see a sufficient national security threat to warrant a significant military buildup, they will be obligated to ask Americans to forgo the butter in order to finance the guns. As an example of the kind of procedure I have in mind, Congress could determine now that any future request for a supplemental military appropriation in excess of $2 billion or any increase in the defense budget from one year to the next in excess of $5 billion would have to be accompanied by a presidential recommendation as to the appropriateness of a tax increase for financing such outlays, and that recommendation would be referred to Ways and Means for deliberation.

Action on the package of fiscal reforms that I have outlined would demonstrate to the Nation and the world our determination to use Federal fiscal policy wisely and efficiently to promote sustainable and noninflationary economic growth.

CHARTING WAGE-PRICE POLICY FOR THE LONG RUN

Most important of all, now is the time to shape our longer term national effort to achieve full employment without inflation. Indeed, decisions taken this year are likely to determine whether this Nation will strive for solutions to the agonizing unemployment-inflation dilemma or whether it will settle for excuses. If we are serious about combining full employment and reasonable price stability, we must be prepared to reexamine some cherished doctrines, to undertake some politically painful institutional reforms, and to explore uncharted economic territory.

First, we need to discuss and to determine tentatively the proper role of the Federal Government in the wage-price process over the longer run. It would be wonderful to believe that our present wage and price controls will operate as shock therapy, permitting a cured economy to achieve noninflationary full prosperity. But history does not encourage such optimism; rather, it reveals an inflationary bias in our wage-price determination process, whereby inflation begins long before demand matches overall supply. Although a longer run program of wage-price restraint should be tiny in scope compared to the present system, I would judge that some program will be essential. If the Government scraps all wage-price restraints, it would also scrap any realistic hope of achieving reasonable price stability and full employment simultaneously.

Second, we need to review and reform institutions that introduce inflationary bias into our economic system. Arthur Burns and Gardner Ackley, among others, have offered personal menus for such institutional reforms, and their lists overlap remarkably. None of these reforms would be politically easy, and most would encounter strong opposition from one or more groups of producers. It is not surprising that the executive branch and the Congress are both unenthusiastic about treading into this territory. But it is disappointing. Can an administration with serious concern for noninflationary prosperity be on the verge of proposing a value-added tax, the cost-pushiest tax conceivable? Can a Congress with its eye on the ball of noninflationary prosperity be serious about proposals for import quotas that would effectively ban foreign competition from ever curbing inflation?

As I read the annual report of the Council and other recent pronouncements by administration economic officials. I fear that we may ultimately abandon the battle for noninflationary full employment and seek shelter in a redefined devalued concept of full employment. A 4-percent target for unemployment was accepted by the Eisenhower, Kennedy, and Johnson administrations. The first economic report of the Nixon administration implied an even more ambitious target, using a 3.8-percent unemployment rate as its base for the economy's potential. But in the 1972 annual report, I read that 4 percent is "a highly uncertain estimate" which "became solidified * * * as a result of repetition" (p. 114). I am informed that the minimum unemployment rate would not be expected to be stable over time. To draw proper inferences from these propositions, I should like to put unemployment into perspective, covering recent experience and the near-term future as well as the longer run.

UNEMPLOYMENT IN PERSPECTIVE

Recent experience

The Nation has been stuck on the plateau of a 6-percent unemployment rate for some 15 months. Once the recession ended in November 1970, the unemployment rate stopped rising, but it has not yet begun to decline. That behavior of unemployment poses no paradox or mystery; it is readily explained. Although economic activity has been expanding, it has simply expanded too slowly to reduce unemployment. Real GNP has not grown faster than the trend rate of about 4.3 percent needed just to generate enough jobs to match normal growth of the labor force (about 2 percent a year) and to allow for the normal advance in output per man.

Let me briefly review the course of output, employment, and unemployment from the beginning to the end of 1971.[2] Over that interval, real GNP grew at an annual rate of 4.6 percent, essentially matching the potential growth rate of 4.3 percent. That growth of output generated an increase in employment (civilian and military) of 1.1 million jobs; meanwhile, the total labor force increased by about 1.3 million (an annual rate of 1.8 percent). Proportionately, the rise in employment just about kept pace with the growth in the labor force, and the unemployment rate ended just about where it began, at 6 percent.

The experience of last year illustrates how the movement of employment can be a misleading indicator of the changing state of labor markets. Unless employment raises rapidly enough to match the growth of the labor force, unemployment keeps rising. In the same way that, with a rising population, heroin addiction can be a growing problem even though the number of nonaddicts continually increases, so unemployment can be a growing problem while the number of jobs is increasing.

Neither the unemployment plateau during 1971 nor the unemployment upsurge from 1969 to 1971 was a consequence of the outflow of manpower from the Armed Forces or defense industries. This is an important and much misunderstood proposition in both economics and social philosophy. The cutback in military and defense plant personnel was thoroughly and carefully anticipated by the administration; indeed, in that area, official budgetary estimates have been admirably accurate. The administration chose deliberately and consciously to use the defense cutback as a vehicle for fiscal restraint in order to fight inflation, and worked hard to insure that it was not offset by increased civilian expenditures. As it were, the reduction in the

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[2] Because of the distortions caused by the strike and the poststrike rebound at General Motors in late 1970, I am using an average for the fourth quarter of 1970 and the first quarter of 1971 as the benchmark for beginning-of-the-year calculations. From that benchmark to the fourth quarter of 1971 is a period of seven-eighths of a year, and annual rates are adjusted accordingly.

fiscal calories from defense spending was converted by discipline and determination into a national reducing diet. The economic malnutrition that resulted was a consequence of that overall fiscal decision and not of the defense cutback.

To be sure, the defense cutback has affected the composition of unemployment. If we had had the same overall fiscal policy but no defense cutback, surely Seattle would have lower unemployment today, but Detroit and Chicago would have higher unemployment. With job scarcities in nearly all labor markets, there is no reason to believe that a different distribution of unemployment would have changed the total. To be sure, Vietnam veterans have had to make a transition to civilian employment. The unemployment rate of young men who have returned from the Armed Forces since 1964 has been roughly 1½ percentage points higher than for men in the same age group who have not been in service during that period. Even if that differential is entirely attributed to the transition back to civilian employment, it could not account for even as much as 0.1 percentage point in the Nation's overall unemployment rate. And it should be recognized that returning veterans are a highly mobile group geographically and occupationally, who would go where the action is in the labor market, if there were any action anywhere. It is also worth noting that the men who lost jobs in defense plants have been especially high-wage and high-salary workers. An equivalent degree of fiscal restraint which was more generally diffused would thus have created more unemployment per billion-dollar loss in GNP than did the cutback of aerospace.

As I review the arithmetic on this entire issue, I conclude that the defense cutback, holding fiscal policy constant, did not perceptibly affect the Nation's overall unemployment rate in the past 2 years. To the credit of the Council of Economic Advisers, its interpretation and analysis of the effects of the defense cutback on total unemployment have been carefully guarded, not necessarily inconsistent with my own conclusion, and professional in tone. No professional sailor who has gone off course would blame it on a breeze.

Near-term prospects

In 1972, real GNP should grow more rapidly than its trend rate of 4.3 percent, and additional jobs should be created at a sufficiently rapid rate to begin to reduce unemployment. Besides creating more jobs, an economic rebound is also normally accompanied by an above-normal growth of productivity, increased participation in the labor force, and a lengthening of the workweek as the result of reduced part-time and increased overtime. As a result of these other factors, an output gain 3 percent above the 4.3-percent trend is required, on the average, to reduce the unemployment rate by 1 percentage point. If output grows at a 6-percent rate during the course of 1972, the extra 1.7 percent above trend should translate into a decline in the yearend unemployment rate of approximately 0.6 percentage points, to 5.4 percent. With growth at that pace, it would be the third quarter of 1973 before we could expect unemployment to fall even to 5 percent.

These relationships are imperfect and not fully reliable, even though they held up well in 1971. In contrast, during 1969, unemployment barely rose until yearend despite sluggish growth of output. But, in all such important deviations in the post-Korean era, an acceleration or deceleration of output growth has generated an even smaller (or slower) change in unemployment than the 3-to-1 relationship would have predicted.

The journey downward from today's 6-percent unemployment rate is bound to be long, slow, and gradual, at best. Of course, fluctuations in the unemployment rate from month to month can be large, but when they are large, they are likely to be erratic and misleading, like that of June 1971. Dramatic changes in the fundamental labor market situation simply do not happen overnight.

Longer-term targets

Against this background, the recent discussions of whether the ultimate destination of the unemployment rate ought to be 4 or 4½ or 5 percent may seem premature. It reminds me of an old favorite topic in college bull sessions of whether a man ought to plan to retire after making his first million or his second million dollars. Like the participants in the college bull session, we have not begun to make a dent in our first million. Nonetheless, the dialog is of great importance for the long run, and I should like to contribute to it. Recently, when the Secretary of Labor referred to unemployment as the hole in the doughnut, I was reminded that, a decade ago, I wrote that unemployment was just the tip of the iceberg in a cold economy. Let me explain why I prefer my metaphor.

The difference between today's economy and one that would be operating under conditions of 4-percent unemployment is enormous; it goes far beyond the reemployment of 1.7 million people who are now jobless. Millions of other workers are now underemployed in a variety of ways: through enforced part-time work, loss of opportunities for overtime work, or loss of promotions, and other steps up the career ladder that would be possible in a world of prosperity. A full-employment economy would mean an extra 2 million jobs in the higher paying manufacturing industries. It would bring into the labor force an additional group of about 1 million people who are not actively seeking work today. While the absence of a job may not be as great a hardship to such people, the opportunity to produce gainfully would be a joint benefit to them and to society. Full employment would lift roughly 2 million people above the line of poverty income. All in all, full employment would add approximately $35 billion to annual real payrolls, a sum obviously far greater than the wages and salaries of the reemployed.

Workers are not the sole beneficiaries of a full-employment economy. Machines as well as men would be put to work; productivity would be strengthened; and business overhead costs would be spread over a larger volume of output. The result would be an addition of nearly $15 billion to corporate profits after taxes. Meanwhile, as the administration's budget estimates point out, the Treasury would gain some $27 billion in added annual revenues. I would estimate that the Treasury would also save roughly $8 billion in outlays now required for unemployment compensation, social security benefits, welfare, and the like. The iceberg associated with the tip of 6-percent (rather than 4-percent) unemployment is about $75 billion of lost production and lost income.

Indeed, the unemployment rate is the most revealing single indicator of the state of the American economy. Tell any economist the unemployment rate for any year and he can tell you whether productivity is strong or depressed, whether the profit share of GNP is ebullient or weak, whether the disadvantaged are making their way into good jobs, whether poverty is on its long-term downward path, whether the welfare rolls are abnormally swollen. He can judge whether the Nation is being plagued by protectionist proposals, pressures for restrictive work rules, and plans to spread work artificially through early retirement and short workweeks. He can probably even make a good estimate of what Government economic officials are saying publicly about the significance of unemployment.

The traditional acceptance of 4 percent as an appropriate unemployment target reflects the recognition that much unemployment is transitional, frictional, and even essential for the purpose of shopping between jobs. Understandably, at full employment, a disproportionate share of unemployment is borne by the young, by groups of women who are casually attached to the labor force, by people interested only in part-time work, and by those who are either newly entering or reentering the labor force. Most of the unemployment at full employment reflects movements into the labor force or between jobs.

However, the preponderant fraction of the extra unemployed in a 6-percent world consists of adult men, people who have lost their jobs, and full-time workers. These facts are illustrated in table 1 attached to my statement, which uses a two-quarter period when unemployment averaged 3.9 percent (1969: 4 and 1970: 1) as a benchmark for measuring changes to the fourth quarter of 1971. Unemployment among adult males during that period rose 81 percent, while that of teenagers rose about half as rapidly. Adult males accounted for 50 percent of the 1.9 million extra unemployed, while they had been initially 37 percent of the jobless. Similarly, job losers accounted for 58 percent of the increase in unemployment, but only 39 percent of the unemployment initially. Because it took longer to find new jobs, people who had left their last job or who had entered the labor force experienced some increase in unemployment, although the number of people quitting jobs fell sharply and the number of people entering the labor force slowed down. The unemployed victims of recession and slack constitute a quite different group from those who remain unemployed at full employment; and the policy prescriptions for aiding the two groups are also different. The former need the help of fiscal-monetary stimuli; the latter need aid from manpower programs.

As my colleague, George Perry, has demonstrated, the relatively rapid increase of women and teenagers in the labor force has made a 4-percent unemployment target more difficult to achieve today than it was in the midfifties. I interpret Perry's findings as a challenge and a demand for action on the manpower front. The Employment Act's call for "useful employment opportunities * * * for those able, willing, and seeking to work" is not limited to Americans who are male and above 20 years of age. It is important whether a recent high school graduate entering the labor market for the first time is greeted by a society eager for his contribution to the productive process or rejected because of a shortage of jobs. It is relevant whether a woman in her forties who has sent her youngest child off to college and wants to reenter the labor force finds something productive to do.

Heaven does not create men's jobs and women's jobs, or adults' jobs and youths' jobs. Employers do; and they adapt to relative supplies, and they can be given incentives and help by the Federal Government to make an extra adaptation. And they can be helped to capitalize on a very important favorable force that should ease our task of getting down to 4-percent unemployment today.

Compared to the midfifties, today's labor force has a much higher educational attainment. That educational trend, which should reinforce our ambitions and strengthen our determination, deserves greater recognition, along with the appropriate increase in attention to demographic trends. In its 1972 Annual Report, the Council focuses on an important aspect of the changing demographic composition of the labor force; it demonstrates that a return to 1956 unemployment rates for each age-sex group in the population would yield a global unemployment rate of 4.5 percent rather than the 4.1 percent actually achieved in 1956. This unfavorable shift reflects the reduced share of the labor force made up of men, 25 years and over, who have especially low unemployment rates at full employment; and the correspondingly increased share of young people, both male and female, who have above-average unemployment rates.

As the Council correctly points out, its calculation does not reflect "any offsetting factors arising from increased education. * * *" Indeed, a focus on the changing composition of the labor force by educational attainment yields impressive results in a favorable direction. As table 2, attached to my statement, illustrates, the fraction of the adult labor force lacking a complete high school education fell from 53 percent in 1957—1956 data unavailable—to 35 percent in 1970. The unemployment rates of workers without high school diplomas have been, and remain, much higher than those of more highly educated workers.

At full employment, the less educated workers generally get jobs, but they get those types of jobs that involve less employer-employee attachment and, consequently, greater turnover. The higher unemployment rates of the less educated are, in some ways, analogous to those of younger people and women. Using detailed data underlying the summary numbers in table 2, a calculation that combines the March 1957 unemployment rate for each and every educational group and the 1970 proportions of the labor force by educational attainment yields a reduced hypothetical global unemployment rate of approximately 3.5 percent, compared to the actual 4.1 percent of March 1957. Or, to put it another way, to tolerate more than 4-percent overall unemployment would mean settling for much higher unemployment rates at each educational level than prevailed in the midfifties. The focus on education raises questions rather than answering them. But we should be asking questions about favorable as well as unfavorable trends in the labor force.

I can understand all the temptations to redefine full employment as the highest level of employment that is easy to achieve. But a retreat to a target of 5-percent unemployment would cost us some $35 billion per year of production and income. Moreover, it would sacrifice the job security of countless American families and the opportunities for the young and disadvantaged to climb career ladders to good jobs.

These are enormous costs; and half of those costs, such as would be associated with an unemployment target of 4½ percent, would still be large. I know no evidence that we need retreat. To be sure, the target of 4-percent unemployment without inflation is an ambitious one; it has not been attained before; and no one can offer a guarantee of success. But it is worth a serious dedicated effort combining fiscal-monetary, wage-price, manpower, and institutional reform policies. This is the time for innovation and determination, not for excuses and retreats.

Thank you.

(The tables referred to in Mr. Okun's statement follow:)

TABLE 1.—CHANGES IN UNEMPLOYMENT

	Unemployment (thousands of persons)				Percentage of—	
	Start of 1970[1]	End of 1971[2]	Change	Percent change	Unemployment at start of 1970	Change in total unemployment
By demographic group:						
Males, aged 20 and over	1,167	2,117	950	81	37	50
Females, aged 20 and over	1,089	1,670	581	53	34	30
Teenagers, both sexes	935	1,314	379	41	29	20
Full-time versus part-time work:						
Seeking full-time jobs	2,423	4,125	1,702	70	76	87
Seeking part-time jobs	768	1,025	257	33	24	13
Reason for unemployment:						
Lost last job	1,234	2,357	1,123	91	39	58
Left last job	457	613	156	34	14	8
Reentered labor force	1,067	1,474	407	38	33	21
Never worked before	443	694	251	56	14	13

[1] Average of 4th quarter of 1969 and 1st quarter of 1970.
[2] 4th quarter.

Source: "Employment and Earnings," January 1972.

TABLE 2.—EDUCATIONAL ATTAINMENT AND UNEMPLOYMENT, 1957 AND 1970 (PERSONS 18 YEARS OLD AND OVER)

Education level	Percentage distribution of the labor force		Unemployment rates	
	1957	1970	1957	1970
Less than 12 years	52.7	34.8	5.5	5.6
12 to 15 years	38.1	52.3	3.0	3.9
16 years or more	9.1	12.9	.7	1.5
Total	100.0	100.0	4.1	4.2

Sources: "Manpower Report of the President," April 1971, pp. 244–45; "Educational Attainment of Workers, March 1969, 1970," Special Labor Force Report 125, U.S. Department of Labor, 1970; Denis F. Johnston, "Educational Attainment of Workers, March 1962, "Monthly Labor Review, May 1963, p. 507. All data represent March 1957 and March 1970.

Chairman PROXMIRE. Thank you very much.

Last, but by no means least, is Prof. Henry Wallich, of the Department of Economics at Yale University.

He is a member of the Council of Economic Advisers from 1959 to 1960, and is presently serving as a consultant to the Department of the Treasury.

It is good to see you again.

STATEMENT OF HENRY C. WALLICH, SEYMOUR H. KNOX PROFESSOR OF ECONOMICS, YALE UNIVERSITY

Mr. WALLICH. Thank you, Mr. Chairman. I am happy to have this opportunity of addressing this distinguished committee.

I would like to bring to your attention a composite forecast for 1972, collected by the American Statistical Association and processed by the National Bureau of Economic Research, containing the forecasts of some 70 economists. It arrives at a median estimate for 1972 GNP of $1,140. In other words, it arrives at a figure $5 billion below the figure on which the budget is based, but one not out of line with what has been discussed here.

The interesting part about this composite forecast, however, is that the rather close consensus of the 70 or so economists is the result of offsetting differences among the components of the GNP. One estimator will have a high defense estimate and low consumption; another will have the reverse, and so on for many other components. When one takes these apart and makes up a synthetic GNP estimate of all the low elements and all the high elements, the consensus becomes considerably less pronounced.

This would be a logical thing to find at full employment when the capacity of the economy is limited and a little more of one thing necessarily means a little less of another. When the economy is operating with excess capacity, one would ordinarily expect that a little more of one thing would also lead to a little more of everything else. That is not borne out by a more detailed look at the forecasts. While I have not seen the individual forecasts, I have seen enough to be able to conclude that what we have here is a consensus resulting from offsetting differences. That reduces my confidence in the consensus, even though I realize these forecasters have done an excellent job in forecasting GNP for 1971, and that indeed they have made tremendous strides in improving their techniques.

Next, I would like to address myself to the high rate of unemployment.

There seems to be a revival of the structuralist versus aggregate demand debate that we experienced during the 1960's. As you know, Mr. Chairman, the structuralists said that full employment at 4 percent could not be reached because of structural changes in the labor force, and the other side said the opposite. The other side clearly won their case because the economy did go to 4-percent unemployment and it subsequently went to 3.5 percent. However, the experience showed that these unemployment levels were inflationary, and we are today still struggling with the consequences of pushing the economy so far.

Today that same debate is reviving. The principal source is the work of George Perry, from whom you will hear later, that of Robert Hall, of MIT, and Charles Holt of the Urban Institute and Robert Gordon of Chicago: These are some of the men who have done intensive research. They seem to come up with a finding that there has been a structural change. Four percent today doesn't mean what it would have meant 15 or 20 years ago.

This goes beyond the computations of the Council of Economic Advisers which show that, given the present structure of the labor force, full employment would mean something like one-half percent more unemployment than in the past. There are other elements involved such as a wider regional dispersion of unemployment. The principal element seems to be the bottleneck created by the position of married males. I hate to use a sexist interpretation of the statistics, but that is the way they come.

Today at 4-percent unemployment, the unemployment level of that crucial group would be substantially lower than it has been in the past. My reaction to these facts is not to suggest that we redefine full employment. I would much prefer to do something about the situation. But I don't think we should do it by simply expanding the economy and hoping that we reach 4 percent without inflation. Four percent today is the equivalent of 3.5 or less a number of years back. If we say that 4 percent is the rate that we should reach simply by increasing aggregate demand, we are saying that we should have aimed at 3.5 or thereabouts in the past.

The concrete proposals I would make in this area are these:

Deal with the tremendous excess unemployment in particular areas, principally teenagers. Teenage unemployment is at a level of 17 percent of teenagers in the labor force. Black teenage unemployment is an unbelievable 30 percent plus. These clearly are pathological conditions of the economy that are not going to be remedied by expansion. They have to be dealt with on a different basis.

I would propose a massive training program. Many other devices have been proposed by others. This, I think, is a high priority.

If we act along those lines, and if additionally we remove some teenagers and women from unemployment through public service jobs, 4 percent will become meaningful again. It will mean that at 4-percent unemployment the married males will have a somewhat higher unemployment rate, one that does not create the labor market pressures that have given us these high wage settlements.

An alternative procedure, if it is not possible to institute the structural reforms, would be to focus on some of the subcomponents of the unemployment statistics and to use married males—I again hesitate to take a criterion like that—and take 2.5-percent unemployment among married males as the critical point, or take male and female workers of 25 years and over where the critical area might be 3 to 3.5 percent.

These would be redefinitions and I don't like redefinitions—but it would be realistic if we want to look at unemployment as a criterion for excess capacity. Unemployment statistics were never designed as a criterion for social distress. We have to rid ourselves of the idea that an unemployed teenager is the same as an unemployed head of a family.

But today the overall unemployment rate doesn't even measure capacity properly any more. We have to recognize that rather than bemoan it.

I turn to fiscal policy. In principle, I find the budget strategy a good one. We should have a flexible full employment-surplus-deficit balance and not simply a fixed full-employment surplus which stays the same through good times and bad times.

When we have this fixed full-employment budget, all we are relying on are the automatic stabilizers. In other words, we are forswearing a flexible anticyclical policy.

That was the strategy of the Council apparently in the early days of this administration. That strategy has been given up. It is a wise decision. We should operate flexibly. To be sure, I would prefer flexibility to come from tax changes rather than from expenditure changes. Expenditure changes tend to work with a lag, both the inside lag of enactment and getting the money to where it can be spent, and the outside lag of getting the work done. Tax changes would work more quickly.

In general, I would argue that we need to revitalize the fiscal process. I am very much in agreement with my colleague, Dr. Okun, on this. We have argued about this and pleaded with the authorities for 10 years and more, and nothing has happened. Hence I am ready to abandon the approach of suggesting that the President should be given discretionary flexibility over taxes.

I suggest instead that we turn back to something explored over a far longer period, an automatic trigger mechanism. He examined but eventually abandoned the notion that at *x* percent unemployment taxes should automatically be cut by *y* percent, because such a trigger might at times throw off wrong signals. It undoubtedly might. Perhaps that could be remedied by providing for a veto power, both for Congress and for the administration, in this trigger mechanism.

One could also build in some caveats, such as to cut taxes when unemployment has risen to the critical level, only provided inflation has behaved in some particular way—for instance, if it has not increased or is not going at a high rate.

In any event, we have reached the point where we really must try a new approach rather than keep arguing about the pros and cons of one that the Congress has rejected for many years.

Today we need fiscal policy more badly than we have needed it in the past because we know what happens to the international monetary system if we focus monetary policy exclusively on the domestic economy and treat the balance of payments with a lower priority.

On the subject of tax policy in particular, I have inserted a few tables into my prepared statement which I think speak for themselves. The general point I wanted to make is simple. We hear a great deal about how we have given away revenue through tax cuts. The fact is that we have had two conflicting forces. Inflation has pushed people into higher brackets, even without an increase in real income. Tax cuts in 1964, 1969, and 1971, however, have reduced the burden. The net effect is almost a standoff. If you look at the two effects jointly, at constant real incomes, there is very little change in the tax burden except in the lowest bracket where it has declined significantly. When you look at the effect of inflation by itself, or the effect of tax changes, you see that there seem to be great forces at work. The net change is very small. That suggests to me that we will carry a heavy tax burden. It also suggests to me that the weak structure of the budget derives from what has happened on the expenditure side, not what has happened on the revenue side.

To wind up, I would like to say a word about monetary policy. I think it is a cause of real preoccupation that today we rely very heavily on monetary policy without being at all agreed on how it works, whether it works through interest rates or through changes in the money supply, and if the latter, which version of the money supply.

I find myself going back to the old game of finding out what would happen at different definitions of the money supply. I have always been a partisan of including, for instance, Government deposits in the money supply. I see no difference between, let us say, General Motors and the U.S. Treasury in the handling of their cash balance. Neither entity is constrained in its expenditure behavior by how much cash it has. Both can borrow easily when they need more cash. The real effect on the economy from a shortage of cash of either the Treasury or General Motors comes from the effect of borrowing on interest rates. That squeezes out some other borrower who would have to pay a higher rate of interest. That effect is the same whichever of the two would borrow. So I would treat their deposits alike.

When we include the Treasury's deposits in the money supply, we see that the great concern about excessive money creation in the spring of 1971 was quite unnecessary. The revised M–1 rose at 8 percent, not at 12 percent.

The concern about stagnation of the money supply late in 1971 was unnecessary. The combined totals rose at 3 percent and we could have spared ourselves that concern.

The lesson I would draw from this is that we ought to pay less attention to M–1. I would also argue that when we do find changes in the demand for money, as Mr. Burns has pointed out we did experience last year, we should stick to an interest rate target and not worry about the money supply. This is a respectable economic finding.

If we had done that in the spring we would not have acted differently from what we did. The Federal Reserve aimed at keeping interest rates low. In the fall, however, they tried to expand the money supply when it would not expand, driving interest rates down very sharply and creating problems in the international area that perhaps could have been kept in check better.

Finally, where do we go with respect to phase III? I expect phase II will end favorably. I expect inflation will be reduced though not ended. We will then have to ask ourselves what comes next. I doubt very much that we can go back to an idyllic freedom of markets in the complete sense. I have taken the time of this committee before urging a tax device to reward wage restraint and penalize excessive settlements. I don't want to take your time any more. But if nothing of that sort is done, then I strongly urge that we find some other device, hopefully oriented toward the market and not oriented toward controls, so that we can expand the economy a little further, and, as Mr. Okun said, get some of the benefits of a higher rate of employment and lower unemployment.

Thank you.

(The prepared statement of Mr. Wallich follows:)

Prepared Statement of Henry C. Wallich

It is a great privilege to appear before this distinguished Committee to discuss the nation's economic plan for the period ahead. I believe that this plan, as expressed in the President's Budget and in his Economic Report, represents an appropriate and feasible approach to the problem of returning the nation to full employment, rapid growth, stable prices and balance of payments equilibrium. If realized, this plan should advance us a long way toward our objectives, and should make the year 1972 a very prosperous one.

THE RETURN TO FULL EMPLOYMENT

The Economic Report projects a Gross National Product for 1972 of $1,147 billion. This forecast is in line with many independent forecasts, and certainly it is within the capacity of the economy. It is worth noting that, for 1971, independent forecasters did an excellent job in predicting the GNP.

I should like to bring to the Committee's attention a composite forecast, based upon the individual forecasts of some 70 professional forecasters, which does come out at a somewhat lower figure than either the Economic Report or what may be called the consensus of the best known forecasters. When published in January, 1972, this composite forecast arrived at a GNP for 1972 or $1,140 adjusted for the recent revision of the national accounts. The range of GNP forecasts that are averaged in this composite forecast is narrow, indicating a high degree of consensus.

It is worth noting, however, that the prevailing high consensus does not pertain to all the separate sectors of the GNP that the experts attempt to forecast, such as business, fixed investment, housing, inventories, etc. If one takes, for each GNP sector, the lower and the upper quartile of the forecasts and from there sectoral forecasts constructs a synthetic GNP forecast consisting of all the lower quartile values and another of all the upper quartile values, the consensus becomes less pronounced. This would be understandable if the economy were operating at full employment. Then, a little more output in one sector would tend to imply a little less in another. This constraint however, is not operative now. It appears, therefore, that the consensus with regard to the overall GNP figure results from compensating differences in the forecasts of particular GNP sectors. I would not fault the forecasters for this. Forecasts are not made mechanically by running models through a computer. But my exercise shows that, if computer models give good results, it is because the models are operated and adjusted by men of experience and good sense. At the same time, the underlying diversity of views concerning particular GNP sectors does leave me with some uneasiness about the meaning of the overall consensus.

My personal view is that the consensus is a little on the high side, and that a forecast of $1,132 billion has greater plausibility.

THE FULL-EMPLOYMENT LEVEL

In today's writings and discussions about the causes of and remedies for our high unemployment, I seem to note an echo of a debate of the early 1960's. It was the debate between the structuralists, who argued that the then prevailing high unemployment was partly of a structural character and to that extent could not be remedied by an expansion of aggregate demand, and the believers in aggregate demand, who disputed this point of view. The believers in aggregate demand seemed to have won their case when the economy achieved 4 percent unemployment and subsequently achieved an annual average of 3.5 percent in 1969. It was a Pyrrhic victory, however, because the economy was caught in a rapidly accelerating inflation. Today's high unemployment is the consequence of the effort to cure that inflation. Now again there is a structuralist school that argues that a change for the worse has taken place in the structure of the labor force. This change, involving a higher proportion of teenagers and women who are more prone to unemployment than married males, has two implications. First it shows that during the period of lowest unemployment the labor market was even tighter than appeared from the overall unemployment figures, because unemployment of married males was disproportionately lower. Second, the 4 percent full employment level no longer has the significance that it used to have. Today, 4 percent unemployment unfortunately is more inflationary than in the past.

The first and foremost conclusion to be drawn from this situation is to take direct action to reduce the incidence of unemployment where it is highest, namely among teenagers, and secondarily among women. Some years ago, I proposed a massive job training program to that end. Others have proposed a great increase in temporary public service jobs, as well as a variety of manpower and labor market programs.

If in this way a part of the structural unemployment were removed, the traditional 4 percent full employment level would once more achieve realism. It would imply a relatively higher proportion of unemployment for married males, and a lower proportion for women and teenagers not absorbed by training programs or public sector jobs. This solution, it seems to me, would be preferable to redefining "full employment" as 4.5–5 percent unemployment. Alternatively, we might focus on some part of the labor force that was regarded as critical for inflationary pressure. If it were not for the sexist implications of the statistics, I would suggest that an unemployment rate for married males of say 2.5 percent could serve as a signal of approaching excess demand in the market for skilled labor and hence of inflationary danger. Alternatively, an unemployment figure for workers of both sexes over 24 might serve as such an indicator.

In any event, we must rid ourselves of the implication attached to the overall unemployment figure that the part-time unemployment of a high school teenager has the same social significance as the unemployment of a head of a family. The unemployment figure was never designed as an indicator of social distress. Its purpose was to indicate unused labor capacity. Today, when it has become an average of such irreconcilable components as the rate for married males and the catastrophic rate for Black teenagers, it has ceased to serve even for this latter purpose.

FISCAL POLICY

The basic strategy of the budget is to inject a high degree of stimulation into the economy while unemployment is still high, by means of a full employment deficit. As the economy advances, this full employment deficit is to give way to full employment balance. I believe that a flexible policy of this kind is desirable in principle. A budget structure that retains full employment balance throughout a recession and recovery implies exclusive reliance in the automatic stabilizers built into the budget. There is then no deficit other than that which results from the recession itself. This implies rather weak stimulation.

At the same time, I would have preferred more of the flexibility to come from the tax side. It has often been observed that the variation of expenditures tends to operate with long lags. There is a danger that the stimulus derived from an increase in expenditures may take effect too late, and last too long. Stimuli resulting from tax cuts can be made effective more quickly and turned off more easily. It is true that temporary cuts in income tax seem to suffer from a reluctance of people to spend temporary windfalls. Much of the effect, therefore, may be lost if the temporary nature of the measure is known. But this effect does not adhere to tax changes such as an excise tax cut or a change in the investment tax credit. A temporary measure of either sort is more powerful than a permanent one, because it induces buyers to make their purchases during the favorable period.

Quite apart from the needs of the present year, I believe it is urgent to reexamine our instruments of fiscal policy, because of the excessive weight thrown upon monetary policy in the absence of a flexible fiscal policy.

To recondition and make operational our fiscal policy today is an urgent task if we want to have stable international monetary relations. Recently, the Federal Reserve with its monetary policy has had to do much of the stabilization work that fiscal policy has failed to accomplish. In consequence, interest rates have tended to move up and down rapidly, causing international capital flows that disturb the balance of payments. International coordination of monetary policies, which is necessary to produce international stability, becomes impossible when monetary policy is oriented exclusively toward domestic ends. This orientation, nevertheless, is practically unavoidable so long as monetary policy remains our principal if not only instrument of achieving domestic stability.

The recent tax changes proposed by the Administration and enacted, with some modifications, by the Congress show that we have made progress in the handling of anti-cyclical fiscal policy. But much more is needed. The recent tax changes went through Congress with reasonable dispatch, but certainly not fast enough to assure good timing of stabilization policy. Moreover, these changes involved tax cuts. For a tax increase, the likely lag would be longer. Finally, we again mixed up reform and stabilization. This inevitably slows the process and also makes it irreversible. What we need, as has been pointed out many times, is a simple up and down mechanism that acts much like changes in the Federal Reserve's discount rate.

Ten years of pleading with the Congress to give the President limited discretionary power to vary income tax rates temporarily have produced no results. Neither have suggestions that Congress reorganize and expedite its own anticyclical tax cutting or increasing procedures. It may be timely, thereore, to examine once more a mechanism much discussed in the early postwar period, but since abandoned because of its obvious defects. I refer to the automatic trigger mechanism designed to raise or lower the income tax rate when some indicator or set of indicators have reached a critical level. The defect which caused discussion of this device to be abandoned was the prospect of false signals, i.e, signals that would trigger a policy inappropriate under the circumstances. No trigger mechanism, no indicator, can be set so as to foresee all possible situations. Nevertheless, we have now built a trigger mechanism into two important anti-cyclical measures on the expenditure side—the extended unemployment compensation program and the temporary public sector jobs program. The purpose of these programs, to be sure, is very closely related to the indcator itself, which is the unemployment rate. A tax cut or increase would have to take into account factors other than unemployment. Nevertheless, it may be worthwhile to reexamine the possibility of constructing an indicator or set of indicators that would trigger appropriate anti-cyclical tax changes. To guard against false signals, the Congress and the President should retain the right to veto such changes. This method would be a second best, but probably better than our present methods. The appropriate tax to which the mechanism should apply might very well be the investment tax credit.

TAX POLICY

The budget projections for future years show that there is virtually no leeway for new expenditure programs. The existing program promise to absorb all but a negligible margin of future increases in revenues. This is the result, partly of major increases in programs, and partly of the tax cuts instituted during the '60's and '70's. The possibility that new taxes will have to be levied must therefore be considered.

In doing so, it will be helpful to gain some perspective on the development of the tax burden. Considering the personal income tax only, two counteracting forces have been at work for taxpayers with a constant income in dollars of a constant purchasing power. The tax cuts of 1964, 1969, and 1971 have reduced his burden, with a temporary bulge owing to the surcharge of 1968. Inflation, on the other hand, has shifted the taxpayer into a higher income class in current dollars and, under the progressive income tax tended to raise his real burden. I have inserted tables showing these effects at different income levels. The results are interesting. The effect of inflation in raising the burden of taxes relative to a constant income has been almost as great as the sum of all the tax cuts since and including 1964. Only for the lowest bracket in the table, of $5,000, has there been a really substantial reduction in the effective tax rate. Since, in fact, most families' real income did rise substantially during this period, their effective tax rate for the most part would also have risen. For the nation as a whole, the effective tax rate, measured as the ratio of the revenue from the personal income tax to personal income, today stands at almost exactly the same level as it did in 1963. Nevertheless, in the interim, there have been major ups and downs.

Ia. INCOME TAX AT SAME REAL INCOMES, 1963-71 [1]

	1963	1965	1969	1970	1971
Adjusted gross income	$4,935	$5,085	$5,910	$6,260	$6,530
Total tax/adjusted gross income (percent)	8.3	6.0	7.9	7.7	6.4
Adjusted gross income	$9,870	$10,170	$11,820	$12,520	$13,060
Total tax/adjusted gross income (percent)	13.6	11.2	13.3	12.7	12.3
Adjusted gross income	$14,805	$15,255	$17,730	$18,780	$19,590
Total tax/adjusted gross income (percent)	16.5	13.8	16.4	15.6	15.3
Adjusted gross income	$19,740	$20,340	$23,640	$25,040	$26,120
Total tax/adjusted gross income (percent)	18.9	15.9	18.9	18.0	17.8
Adjusted gross income	$24,675	$25,425	$29,550	$31,300	$32,650
Total tax/adjusted gross income (percent)	21.1	17.8	21.3	20.5	20.3

[1] Hypothetical situation: Married couple with 2 children (4 exemptions); itemized deductions amount to 10 percent of adjusted gross income; the standard deduction is used if it exceeded the value of itemized deductions; adjusted gross income is exclusively wages and salaries, standardized for 1964 at $5,000, $10,000, $15,000, $20,000, and $25,000 respectively.

Ib. INCOME TAX AT SAME MONEY INCOMES, 1963-71 [1]

	1963	1965	1969	1970	1971
Adjusted gross income	$5,000	$5,000	$5,000	$5,000	$5,000
Total tax/adjusted gross income (percent)	8.4	5.8	5.8	5.6	3.6
Adjusted gross income	$10,000	$10,000	$10,000	$10,000	$10,000
Total tax/adjusted gross income (percent)	13.7	11.1	12.3	11.2	10.5
Adjusted gross income	$15,000	$15,000	$15,000	$15,000	$15,000
Total tax/adjusted gross income (percent)	16.6	13.7	15.1	13.9	13.3
Adjusted gross income	$20,000	$20,000	$20,000	$20,000	$20,000
Total tax/adjusted gross income (percent)	19.0	15.8	17.4	16.1	15.4
Adjusted gross income	$25,000	$25,000	$25,000	$25,000	$25,000
Total tax/adjusted gross income (percent)	21.3	17.6	19.4	18.0	17.3

[1] Hypothetical situation: Married couple with 2 children (4 exemptions); itemized deductions amount to 10 percent of adjusted gross income; the standard deduction is used if it exceeded the value of itemized deductions; adjusted gross income is exclusively wages and salaries, standardized for 1964 at $5,000, $10,000, $15,000, $20,000, and $25,000 respectiively.

Ic. INCOME TAX AT 1963 RATES AT SAME REAL INCOME, 1963-71 [1]

	1963	1965	1969	1970	1971
Adjusted gross income	$4,935	$5,085	$5,910	$6,260	$6,530
Total tax/adjusted gross income (percent)	8.3	8.6	9.9	10.3	10.6
Adjusted gross income	$9,870	$10,170	$11,820	$12,520	$13,060
Total tax/adjusted gross income (percent)	13.6	13.8	14.7	15.2	15.6
Adjusted gross income	$14,805	$15,255	$17,730	$18,780	$19,590
Total tax/adjusted gross income (percent)	16.5	16.7	18.0	18.5	18.8
Adjusted gross income	$19,740	$20,340	$23,640	$25,040	$26,120
Total tax/adjusted gross income (percent)	18.9	19.1	20.7	21.3	21.8
Adjusted gross income	$24,675	$25,425	$29,550	$31,300	$32,650
Total tax/adjusted gross income (percent)	21.1	21.5	23.3	24.2	24.8

[1] Hypothetical situation: Married couple with 2 children (4 exemptions); itemized deductions amount to 10 percent of adjusted gross income; the standard deduction is used if it exceeded the value of itemized deductions; adjusted gross income is exclusively wages and salaries, standardized for 1964 at $5,000, $10,000, $15,000, $20,000, and $25,000 respectively.

2. EFFECTIVE INCOME TAX RATE

(Ratio of Federal personal income tax collections to personal income, fiscal years 1963–71.)

	Percent		Percent
1963	10.5	1968	10.5
1964	10.1	1969	12.1
1965	9.5	1970	11.6
1966	9.8	1971	10.4
1967	10.1		

This quick review of the burden imposed by the personal income tax gives by no means the full picture. It leaves out the corporate income tax, payroll taxes, and excises, to say nothing of state and local taxes. Given the fact that payroll taxes have mounted drastically, the conclusion is justified that the budget squeeze comes principally from the expenditure side, and very predominantly from the government's civilian expenditures. If a taxpayer were minded to ask what he was getting for this tremendous increase in expenditures, it would be difficult to give him an answer. With a large part of the incremental expenditures going to the aged for social security and health, and another good slice to the young for education, aid to dependent children, and job training, "fiscal middle America" consists of the taxpayers of the nation standing between two groups that are the favored recipients of government services or transfers. Any proposal to raise taxes must take into account the position of this group.

MONETARY POLICY

It is a matter for deep concern that, at a time when we are so heavily dependent upon monetary policy for most of our economic stabilization efforts, we should be so unsure about how monetary policy really works. During the past year, the money supply at one time increased so rapidly as to occasion inflationary fears in the market. At another time, it grew so slowly as to occasion alarm of another sort. A comment on these experiences may be useful as a guide to the future.

In the first place, the observation that during the months of February-July 1971 the money supply was rising at a rate of 11.6 percent, and that during the months August–November 1971 it was almost stagnant at a growth rate of 0.5 percent, rests on the fact that government deposits at commercial banks are excluded from the demand deposits which are counted as part of the money supply. A closer look at the two periods in question shows that a good part of the alarming vagaries of the money supply were in fact due to accumulation and decumulation of balances by the Treasury. When Treasury balances are added back into the money supply, it appears that the growth rate of the money supply during February–July was 8.1 percent, and that during August–November it was 2.9 percent. The modified growth rates are not far from the range which this Committee has regarded as desirable under ordinary circumstances. I do not want to enter into the theoretical argument for and against including Government deposits in the money supply. A good case can be made for either. I simply would like to draw attention to the evidence. When the money supply behaves in a manner that, by the existing definition, predicts a serious disturbance in the economy, but, by another definition, does not predict a serious disturbance, and when in fact no serious disturbance occurs, this seems to argue for giving the alternative definition serious consideration.

A second observation pertains to the appropriate choice between the growth of the money supply on one side and the level of interest rates on the other as a target for monetary policy. A respectable view holds that this is not a choice to be made once and for all, along the lines of the discussion between monetarists, who lean toward the growth rate of the money supply, and Keynesians, who prefer interest rates as targets. Instead, the choice should depend on whether the source of instability seems to be located in the real sector of the economy or in the monetary sector. When the source of instability is located in the real sector, the proper course of action, with some qualifications, is to adhere to a money supply target. If that is done, interest rates will rise if the real sector is expanding and will fall if it contracts. In either case, the movement of interest rates will be of a stabilizing kind—higher rates restraining excessive expansion, lower rates counteracting contraction. On the other hand, if the source of instability is in the monetary sector, for instance in the form of an increase or decrease in the demand for the money unrelated to economic activity, stable interest rates will be the appropriate target for monetary policy. That will prevent the disturbance in the monetary sector, whatever its causes, from affecting the real sector.

Last spring, as Dr. Arthur Burns has pointed out, the demand for money seemed to expand suddenly without clearly visible reasons. The Federal Reserve accommodated this demand by rapidly expanding the money supply, taking advantage at the time of the reduction in the Treasury's cash balance. In this way, interest rates were kept reasonably stable and the disturbance in the monetary sector, whatever its cause may have been, was prevented from affecting the real sector. By this interpretation, then, the money supply in any of its versions was under the circumstances an inappropriate guide to policy. The Federal Reserve did right in ignoring it and sticking to an interest rate target.

This was not its policy, however, during the subsequent period of stagnation of money supply growth. Here, again, the disturbance seems to have originated in the monetary sector, in the form of a decline in the demand for money. Again, the proper policy would have been to stick to interest rates as the target for monetary policy. Instead, the Federal Reserve seems to have become seriously concerned about the failure of the money supply to rise. In its attempt to "get the money supply going again" it seems to have pushed short-term interest rates down to levels that created some uneasiness in international financial markets and raised questions about the durability of the new exchange rate structure.

I must add that the spectacle of a money supply that will not rise in the face of efforts by the central bank to keep it rising has something alarming not only for monetarists. A similar phenomenon occurred in the early part of 1960. As we know now, it was the signal of an approaching recession. The Central Bank was unable to expand the money supply because the economy was too slack to want the money. In late 1971, however, such an interpretation would have flown in the face of a strong consensus forecast pointing to a vigorous expansion in 1972. To interpret the failure of the money supply to rise as evidence of recession ahead, instead of as simply a fluctuation of liquidity demands of business, would have meant to side with this single indicator against strong evidence pointing in the direction of expansion.

The year 1972 may bring opportunities to apply the lessons of the past. In a nutshell, I would say that the principal lessons of 1971 have been these:

1. Less emphasis should be placed on one single concept of the money supply, even though alternative concepts as a group deserve close attention and considerable respect as indicators and targets of policy.

2. In deciding whether to maintain stability in the growth of money or in the level of interest rates, the nature of the disturbance should be taken into account.

3. While monetary policy must serve primarily the needs of domestic stability so long as fiscal policy continues relatively inflexible, the international repercussions of our domestic monetary policies should be given some weight.

During 1972, monetary policy will have to operate in an environment of very large and also rapidly shifting credit demands. In the long term sector, demand for funds is likely to be lower than in 1971. Corporate liquidity has been increased very substantially by last year's bond issues, and corporate retained profits should rise considerably given the restraint on dividends. Hence, new corporate bond flotations are likely to decline below last year's record level. The same can be expected of state and local securities. As a result, there is a good possibility that long term interest rates, which have been coming down countercyclically, will continue in their present range for some time. Accommodation of the strong demand for short-term and medium term credit, however, including the heavy needs of the Federal Government, will require a considerable expansion of commercial bank credit. That will be the case especially if short-term funds flow back from abroad, and if the foreign central banks which received these funds and have invested them in U.S. Treasury bills are consequently compelled to liquidate those holdings. The Federal Reserve will have to operate skillfully to balance the accommodation of demands for short and medium term credit against the need to avoid overexpansion as we move closer to the capacity ceiling of the economy.

PHASE II AND PHASE III

We have learned that, just as it is unwise to talk of wage and price controls before they are imposed, it is unwise also to talk about their removal before it occurs. The first induces labor and business to raise wages and prices "just in case." The second makes for diminishing compliance with the existing regulations. These two lessons of experience unfortunately make it difficult for the government to plan ahead publicly. At the present time, one of the forums where a discussion of the transition from Phase II to Phase III can take place with more freedom than elsewhere is the Joint Economic Committee, and I would like to recommend to the Committee that attention be given to the subject.

My own view is that, for the long run, we have to choose between some direct form of intervention in the wage/price process, and an indirect form. Direct methods could run the gamut from very moderate intervention, such as toothless guideposts, to quite rugged approaches, such as compulsory arbitration. Indirect methods might take the form of tax penalties for destabilizing wage and price behavior. I have taken the time of this committee too often in detailing proposals of this sort to venture a repetition. I would simply say that these tax devices can be cast in numerous forms and that this may increase their appeal. In the interests of a free market economy and of keeping the Government out of wage and price setting, I believe that the indirect approach, if an acceptable version can be found, is much to be preferred.

Chairman PROXMIRE. I thank all of you gentlemen.

I would like to ask you gentlemen to give me the arithmetic again before I get into other questions with respect to growth and on unemployment.

As I understand, Mr. Hymans, you estimated a growth of about $90 billion in GNP, Mr. Okun about $95 billion, and Mr. Wallich about $85 billion.

The unemployment figures were about 5.3 for Mr. Hymans, 5.4, I think, for Mr. Okun, and Mr. Wallich——

Mr. WALLICH. I would like to get away from the overall average. I would much prefer to go to the married males rate, if I may, and that I would see at about 3 percent.

Chairman PROXMIRE. What does that mean? You don't think it is as important, but what would you see?

Mr. WALLICH. The relationship is not precise. It means overall in the range of 5 percent to 5.5 percent, but I have not been able to establish a permanent relationship of those numbers.

Mr. HYMANS. I can give a comparable figure, if you are interested, that goes along with our forecast, which is 5.3 percent for the fourth quarter of 1972 in the aggregate unemployment rate and that goes along with 3.6 percent in the same quarter for males 20 and over.

Mr. WALLICH. This is a different category.

Chairman PROXMIRE. So it would go down to around 5 percent?

Mr. HYMANS. This is not all males. This is males 20 and over.

Chairman PROXMIRE. Married males would be less than males?

Mr. WALLICH. Married males is 3.4 percent and 20 and over is 4.4 percent.

Mr. HYMANS. Our forecast for males 20 and over would be 3.6 percent in the fourth quarter.

Chairman PROXMIRE. My alert staff points out that married males was 3.0 percent in January. That is not much of an improvement.

Mr. WALLICH. That rate has risen more recently than the overall rate.

Chairman PROXMIRE. You are not looking to any unemployment decrease at all? It was 3.0 in January of this year and you say it will be 3.0 at the end of the year. Where is the improvement?

Mr. WALLICH. It is now 3.4 percent for married males.

Chairman PROXMIRE. Let me get into something else right now and we will come back to that. It seems to me on the basis of any reasonable estimate of the labor force increase, any estimate of the productivity, and any estimate of any increase in hours per week—and we are now looking at 1971 being the lowest hours per week worked since the depression year of 1938, 37.0—on any basis of estimating it seems to me you will have a very difficult time with the relatively anemic growth you project of reducing unemployment at all.

Take the arithmetic and work this out for me, starting with Mr. Hymans. If you have a labor force increase of, say, 1.5 percent, if you have a productivity improvement of 4 percent, if you have the hours per week increased by a half hour a week which would be a fairly substantial increase but still in line with what we have had in recent reasonably good years, doesn't this add up, on the basis of your projections to no improvement in unemployment?

Mr. HYMANS. If I take your figures and add an output increase of about 6⅓ percent, which is our output increase from the end of 1971 to the end of 1972, there is still room from improvement.

Chairman PROXMIRE. Not much.

Mr. HYMANS. Well, we don't have much. We have it going from the present 6 percent down to 5.3 percent.

Chairman PROXMIRE. That is much more than I thought you would get.

Mr. Okun.

Mr. OKUN. I think 4 percent is a rather high side estimate for output per man-hour on the total GNP basis. We normally cite productivity figures which are associated with the private sector, and they tend to be higher partly because of the way we measure productivity in the public sector.

Chairman PROXMIRE. Productivity increased on that basis 3.6 percent in 1971, is that correct?

Mr. OKUN. Yes.

Chairman PROXMIRE. And Mr. Hymans estimates 3.9 percent for this coming year.

Mr. HYMANS. 3.9 percent is for the private nonfarm sector in 1972 compared to 3⅓ percent in 1971.

Chairman PROXMIRE. That would bring it up to 4 percent.

Mr. HYMANS. But you would have to knock about a point off that once you put in the sector in which you and I are employed.

Chairman PROXMIRE. Go ahead, Mr. Okun.

Mr. OKUN. It is precisely because the public sector does not generate productivity increases. State, local, and Federal employees bring down the average productivity gain when you apply it to total GNP.

You are pointing out correctly that there is some room for uncertainty. I think I would still put my nickel on the proposition that a 6-percent rate of growth of output if we get it, will create some downward drift in the unemployment rate over the course of the year.

It may take a microscope to tell that it has happened until late in the year, but I suspect that it will be happening. It will be in the right direction although at the wrong rate of change.

Chairman PROXMIRE. Mr. Wallich.

Mr. WALLICH. I, too, would think that 4 percent productivity for the whole economy, while fine if we could get, is very high. I can't say anything meaningful about hours.

On labor force, I have been looking at the percentage of people who are looking for a job.

Chairman PROXMIRE. Four percent isn't really that unprecedented or unusual, is it?

Mr. WALLICH. Three percent long-term I think is the average.

Chairman PROXMIRE. This is supposed to be a recovery period. Nearly everybody who has appeared before us has indicated they are optimistic about productivity. They say this is the heart of being successful, that we are going to improve our standard of living, that it has to be increased, and we have to find incentives for meeting it. You still would say it is not going to be very much above the long-range productivity growth?

Mr. WALLICH. I would think with the growth of services and with the relatively moderate expansion and a not very zippy expansion, it is not likely to be much above long-term average. I am impressed by the high proportion of people who are looking for a job without having lost a job. I have not pursued these figures back into the past, as Mr. Okun has in his testimony, but I am impressed by the fact that the number of people who are looking for a job because they lost their job is still less than one-half.

Chairman PROXMIRE. It has greatly increased, though, since 1969.

Mr. WALLICH. Percentage-wise, yes. But it still seems to say that a large number of people are looking for a job in a rather vague way. That seems to be what one sees as one talks to people, at least academics. Everyone thinks he ought to be working and it turns out when the job of the husband is safe again, then the intention of working disappears.

I suspect this may press against the high rise in the labor force. Without being able to say anything very firm, the 1.5 percent increase in labor force strikes me as possibly on the high side, too.

Chairman PROXMIRE. We just had a very large number of administration witnesses appear before the committee and they have all given the argument that there has been a change, relying on the Perry thesis, that there has been a significant change in the makeup of the labor force, and we have to make adjustments.[1]

I think Mr. Okun's emphasis this morning is very, very welcome. It goes right to the heart of it. What the dickens are we talking about? The fact that somebody is black or female shouldn't really have any bearing on whether they are employable. It is the degree of education, the degree of training, the degree of specific skill they have. It is higher now, not lower than in the past.

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[1] See also article entitled "The Unemployed: Who, Where, and Why," beginning on p. 376, pt. 2, these hearings.

There is one other element, of course, and that is discrimination against females and against blacks. This is something we are making progress on. Senator Javits is leading a very gallant fight on the floor. We still have a distance to go on that, but it is certainly better now than it was 10 or 15 years ago by far.

So if we pack that into the equation, recognizing we have more people with less discrimination, more people who are skilled, more people who are trained, more people who can do the work, it seems to me this notion that because there are more women or more teenagers isn't really as compelling. The 18-year-old today is likely to be better educated, more skilled, certainly, than the 25-year-old, the married male, of 20 years ago. I think that is easily demonstrable, isn't it?

Mr. WALLICH. There are other factors, Senator. We have minimum wage legislation, which works against teenagers more than it did in the past when the rates were lower. We have nondiscrimination legislation which, however desirable, will also contribute to female unemployment. As against the greater schooling of teenagers, which is certainly a fact, isn't there a more demanding job structure? So while labor force quality has improved, the level of preparation needed has also increased.

Chairman PROXMIRE. If you put emphasis on that, you certainly have something, that is true. But by and large, there is the notion that somehow women, teenagers, and blacks don't have the skill or education.

I would like to ask each of you to comment briefly on the Government as the employer of last resort. We have had a lot of debate on the guaranteed annual income approach, welfare reform. I think there is far more support in the country and the Congress for the notion that we have a substantial number of people who need work and can't find it and the Government has an obligation some way to find jobs.

Should we do it through a massive public service employment program or through a program that I have been proposing, just hiring 100,000 people a month until we get unemployment down below 5 percent, that direct, that specific.

Mr. HYMANS. I agree with the statement that there is an obligation on the part of Government. I am not sure that obligation should be fulfilled through the job route rather than something like the guaranteed income route.

I have no particular qualms about any policy which would identify useful employment opportunities in the public sector and employ people who need jobs in such tasks.

In the absence of such a demonstration, however, I would prefer an income route rather than an employment route because I think with the income route the economy as a whole would be better able to provide the job opportunities rather than have a lot of make-work projects set up in the Federal sector.

Chairman PROXMIRE. Mr. Okun.

Mr. OKUN. I would favor further accelerated action in expanding the public service employment program and, indeed, developing the Government as a last resort employer concept.

Mr. Hymans has pointed to an important question; if you are prepared to alleviate the human cost of unemployment, can you get something efficient both to the society and the worker by putting him to work rather than by giving him an unemployment check.

I suspect that the answer is that a well designed program can capitalize on his availability to do something productive and can also provide him with experience and training. But we ought to keep our eye on that ball to make sure we get something out of the program. It would be foolish to have people come to work merely to collect a paycheck. We can just as easily pay the unemployment benefit.

Over the longer run the major emphasis of such a program should be on people who would be left behind rather than those who would normally be fully employed in a full employment world.

The main emphasis from where we are today ought to be on creating stronger markets to strengthen the incentives and the desire for private employers to take on additional workers, because much of the submerged part of the iceberg that I talked about—the opportunity to climb career ladders, the opportunity to move up to better paying jobs—depends upon the vigor of the private economy and the general state of firmness in the labor market. I think that is agreed upon by everybody who proposes and promotes the objective of some kind of public service employment. It should serve as a transition in the short run, because we can't get unemployment down fast enough, and as an effort to deal with some of the harder core problems in the long run.

Chairman PROXMIRE. Mr. Wallich.

Mr. WALLICH. My preference would be for training, aimed particularly at teenagers. This training would imply that they achieve the status of being employed. Public service jobs, I think, yes, and expansion of that program, if necessary, provided it is temporary.

I would not like to see public service jobs of this kind converted into a permanent form of employment.

The bulk of the effect has to come from an expansion of the economy. We are not talking about absorbing 2 percent unemployment by these routes. But at the teenage level a very substantial number could be involved in these programs.

Chairman PROXMIRE. I think a terrible weakness of our training program is that they are not being trained for the right jobs.

Senator Javits.

Senator JAVITS. I would like to take that up because it is one of the things that interests me most about the presentation. You all agree that governmental stimulus for employment is essential, the minute you accept the proposition that decreasing unemployment is not necessarily a condition precedent to the improvement in the economic health of the country. Do I understand that that is your thesis?

Mr. WALLICH. If I understand you correctly, Senator Javits, an increase in employment or a reduction in unemployment?

Senator JAVITS. A reduction of unemployment is not a necessary condition precedent to a continuance of the economic improvement of the country.

Mr. WALLICH. My view on this is that unemployment will be reduced this year, and as a result of the growth of GNP somewhat above its long-term trend, we will get this improvement. We will not get as much as we would like. We will have, I think, a good year, good expansion. So one can say yes, the economy will be prosperous without having fully achieved its employment goals. That would not lead me to say that we shouldn't aim at pursuing the employment goals.

But I think it is fair to say that the economy will not have at all, in any way, a depressed aspect. It will be a prosperous economy.

Senator JAVITS. Because this unemployment continues at roughly the 5.5- to 6-percent rate, is that right?

Mr. WALLICH. I would hope that we would get into the 5- to 5.5-percent range, and by the end of the year hopefully closer to the lower figure.

Senator JAVITS. Do you agree with that, Mr. Okun?

Mr. OKUN. I agree that a rapid expansion, more rapid than the kind of figure we use for a trend growth of 4¼- to 4.5-percent real growth, can be expected to push the unemployment rate in the right direction, although probably at a slow pace. I suggested that with a 6-percent real growth during the course of this year, 5.4 percent would be my point estimate of unemployment for the fourth quarter. That is not as large an improvement as we ought to have, nor as we could have, if we were willing to augment the recovery with specific job-creating efforts.

Senator JAVITS. I might as well state my purpose to see if we are thinking together. The reason for reducing unemployment is not because it is an absolutely indispensable condition to the resumption of recovery or to the continuance of the recovery, but rather that it is socially essential.

Are we agreed on that? In other words, you can have a good recovery even if you don't reduce the unemployment rate outside this range, but you should reduce it because of the social consequences of not reducing it.

Mr. OKUN. I don't think that the kind of recovery that would not reduce unemployment would be called a good recovery, except perhaps in political speeches. We have never had an occasion where the economy moved ahead rapidly without bringing unemployment down. We have never had a situation where the economy moved sluggishly without eventually bringing unemployment up.

I continue to be impressed that, despite all the structural changes, unemployment remains a very good indicator of the general state of economic activity. The social consequences, in my view, really reinforce the general conclusion that an economy with high unemployment is not only socially unjust and oppressive, but also very wasteful and inefficient.

Senator JAVITS. Mr. Okun, what I am reaching for is this: If it be a fact that something new is happening, to wit, greater automation, and so forth, and which reduces the need for this size working force, should we not, therefore, direct ourselves toward governmental action, which is what I believe in, such as effective manpower training, plus a job at the end of the road?

I think the opportunity industrialization centers have done the best job on that, far better than Government or public service jobs in order to take up the unemployment slack. Why are we kidding ourselves in trying to move a mountain in order to achieve these results which are marginal in numbers, 80 million employed and 5 million unemployed, and spending oceans of money, when 1 billion, 2 billion, or 3 billion intelligently directed can do far more to stimulate the economy? That is what I am asking you.

Mr. OKUN. I would agree with a lot of the conclusions but not with the premise. I see no evidence that anything drastic has happened to the basic relationship between the demand for goods and the demand for labor.

If employers find strong markets for their goods, they will, after a time, turn around and generate strong demand for additional workers. They will provide incentives for promotion and for better jobs. Consequently, the basic way to stimulate job creation is to move the mountain.

One of the reasons for moving the mountain is that it yields a tremendous payoff. For example, $75 billion of output last year was sacrificed through the idleness of men and machines. This country is not so affluent, at least in its provision for some of its priorities, to take that sacrifice lightly.

Added demand to insure full recovery would have a huge payoff in the form of more production and more incentives for investment and technological advance. The best way to strengthen productivity this year is to create more demand for goods and labor.

Senator JAVITS. Isn't it a fact that it is charged by our friends, many of our friends, in labor, that if we increase productivity we are going to cut the number of workers, because we are going to automate and increase productivity at their expense?

Mr. OKUN. Every time the unemployment rate is stubborn because the economy is sluggish, we hear about the terrors of automation. I can give you quotations from 1961, 1962, and 1963, arguing how impossible it was to generate full employment because automation made labor expendable. Labor is still essential to the productive process, and when the economy gets moving, jobs get created.

I suspect we will find exactly the same thing happening this year. But it is essential to speed up the process, because we can't move the mountain all at once. But the basic connection between full prosperity and full employment remains a terribly important factor, which deserves recognition in our longrun thinking about the economy.

Senator JAVITS. Mr. Wallich.

Mr. WALLICH. It seems to me we have to recognize that some changes in the structure of the labor force have occurred. To say 4 percent is full employment just as it always was does not recognize the situation today. Furthermore, there is really no particular sanctity to the 4-percent figure even if it were equally achievable as before. It is arrived at on the basis of all kinds of conventions, an 8-hour day, time and a half for overtime, and so on.

If we were greatly concerned about the level of production we could change all those things. We could work longer, we could remove overtime premium. Employers then would hire people for more overtime. I think we make a mistake in focusing on this loss of production as something foregone.

I would much prefer to say that there is a loss which we cannot define. The principal problem is the social one of having a million or two people who are unhappy and for whom something needs to be done. This is a changing group of people, of course not always the same.

Senator JAVITS. Mr. Chairman, my time is up, but I think Mr. Hymans would like to respond.

Mr. HYMANS. I think, Senator, answering your question in terms solely of demand and employment is probably the wrong way to go about it. There is no doubt at all that from a purely physical point of view, with enough stimulation of aggregate demand, we could get the unemployment rate well below the 6 percent it is at now, well below the 5.3 I have forecasted for the end of next year, well below 4 percent, the old target. Whether we could get it below 2 percent, I don't know.

But that is not the question. It is not the physical relation between output and employment that is solely relevant in answering this question.

There is another aspect which is left out when the question gets answered in that way. That is the question of what you are willing to pay in terms of inflation. If you want to say that we can get down to 4 percent, but that would involve more inflation than society is willing to tolerate, then you have to do a great deal more on the training aspect of things in order to produce a less inflationary consequence or accompaniment to the 4 percent unemployment rate figure. I think you can't answer this question solely in terms of the physical relation between output and employment because clearly we can get the unemployment rate down to a third of what it is today, if we are willing to pay the price of the accompanying inflation.

So it is inflation which is at the heart of this issue. I think it is also quite easy to delude ourselves regarding what it would mean in terms of the inflation rate if we used aggregate demand measures to obtain a 4-percent unemployment rate by some realistic, orderly process.

I think we didn't get there by a realistically orderly process when we were down in the 3.5 to 4 percent range a few years ago. I think we got down there as a result of horrible blunders in stabilization policy, and as a result we generated a tremendous inflationary spiral which we are paying for now and trying to get rid of now.

I think it is possible to get rid of that, and I don't think we should extrapolate the kind of inflationary rates we experienced 1½ to 2 years ago as necessary accompaniments of reducing the unemployment rate by some orderly process of stabilization policy in the future.

Chairman PROXMIRE. Mr. Okun's response to Senator Javits indicated that we shouldn't have the feeling of apprehension about automation in productivity. I want to say that there is nobody in the years that I have been in Congress on this committee who has worked harder and more effectively to provide legislation that would encourage improved productivity and improved automation, and so forth, than has Senator Javits.

I think he recognizes, as we all should, that this is the very heart of improving our standard of living. I am sure Mr. Okun recognized that.

Congressman Reuss.

Representative REUSS. Thank you, Mr. Chairman. I will be brief with these wise men before us.

Mr. Wallich, I was delighted to hear you say as forthrightly as you did that, "The first and foremost conclusion to be drawn from this situation"—meaning the unemployment situation—"is to take direct action to reduce the incidence of unemployment, particularly among the teenagers and women."

I think you are the first Republican economist to recognize this truth and I congratulate you for saying to so forthrightly. I am a little disappointed that when asked what we do about it, you say your preference is for a massive job training program. Haven't we been down that road for the last 5 or 6 years? Isn't it simply a frustrating thing for the unemployed to be given job training and there is no job at the end of the program? Isn't the important thing the making of jobs, not that we need to dump our training programs, of course?

Mr. WALLICH. The analysis of the causes of unemployment includes as one possible cause the mismatch of the structure of skills to the structure of jobs. I would think since the structure quality of jobs tends to keep going up, training will be helpful and is important. This is one aspect.

Another fact is if you can give these young people a steady and long training period, you reduce unemployment. Just as the unemployment of young people is reduced by students being in college, so the unemployment of these people would be reduced by being in a training program.

But there are people who have done much more detailed work on many phases of what can be done. One comes down, as Charles Holt of the Urban Institute has done, to a whole structure of different programs. I don't necessarily agree with each detail of this, but it is an oversimplification to say that the whole problem of youth unemployment should be handled by one massive training program.

Representative REUSS. We have 5,200,000 unemployed. Have you 5,200,000 jobs so that we can cure this mismatch? I honestly think all you have is very, very few jobs that are now going begging for want of an applicant to take them. How many do you think we have now? 100,000?

Mr. WALLICH. I thought in terms of a training program for maybe 800,000 people. This would bring the rate of unemployment down by something like 1 percent.

Representative REUSS. What do these poor fellows live on? Are you going to pay them $6,000 a year while training them?

Mr. WALLICH. I hope not quite. They are young. Some of them can live at home. I realize training programs are not cheap. Clearly, jobs need to exist and be created. I would think as a result of a better prepared labor force you can have a lower unemployment rate in the long run. That means more expansion and over the years, certainly, faster and longer expansion than you are going to get without giving this preparation to the labor force.

I didn't mean to say that the economy should just go on at its present level of activity, or growing only at 4 percent per year.

Representative REUSS. Mr. Wallich, you spoke of certain disincentives to employment. I think you mentioned the minimum wage and I think you mentioned welfare. Do you consider our unemployment compensation system a disincentive to employment?

Mr. WALLICH. In the technical sense, Congressman Reuss, I think one has to say yes. That is not to say that I am against unemployment compensation, but one has to recognize that it does increase the threshold at which an individual will seek work.

There are many things that reduce incentive—greater welfare, greater family income, the ability of teenagers to live with their families. All these things make for more unemployment. In some instances one can perhaps say that some of the unemployment is not always bad, such as the fact that the teenager can now look at different jobs rather than take the first thing that comes along. But I favor extended unemployment compensation and I favor a high rate of unemployment compensation so that if we throw the burden of stabilization policy partly on this group, which is, of course, a revolving group, they at least would be compensated for that.

Representative REUSS. I would ask Mr. Okun or Mr. Hymans whether they believe the compensation program can lead to greater unemployment, can act as a disincentive?

Mr. HYMANS. I think surely it can, in theory, lead to greater unemployment for the reasons that have been mentioned, but on balance I can't see how one could realistically assign any greater unemployment to the existence of unemployment.

I think by far the greatest impact of unemployment compensation is to keep a weak economy from going down as far as it otherwise would by keeping demand up and, therefore, shortening periods of unemployment.

I think its importance as a stabilizer of the economy is far greater than its importance as a threshold effect in terms of increasing unemployment.

Representative REUSS. Would you agree with that, Mr. Okun?

Mr. OKUN. Yes.

Representative REUSS. Mr. Hymans on the timing of budget expenditures made quite a point of the enormous increase in expenditures, something like $20 billion as you go from 1971 into 1972. Mr. Hymans pretty much indicated opposition to this enormous, sudden rush of expenditures and its tapering off later on in 1972.

The general point I got out of Mr. Hymans' observation was that the administration was sort of doping the race horse, giving it a needle, and the race horse would dash madly on for a few furlongs but then collapse along about November 8th.

Mr. HYMANS. I stopped short of saying that.

Representative REUSS. Mr. Okun, on the other hand, if I read him right, advocates giving the horse an even greater shot right now.

Can't I stir up a little argument here, gentlemen? Maybe Mr. Okun first.

You do suggest, in addition to everything else, a tax credit of $100. How much would that put into the spending stream?

Mr. OKUN. $5 billion or $6 billion.

Representative REUSS. How do you answer Mr. Hymans?

Mr. OKUN. I am not concerned about overstimulation in the near future. There are valid concerns about whether the ambitious targets for expenditures that the administration has now set are feasible and whether they can be carried out efficiently. But I see little basis for concern about the possibility of overstimulation in the near term. Even the targeted expenditures would not create—in the Michigan model or any other forecast—a runaway boom.

It is the change of pace that is the central issue. It is taking off the stimulants that by rapidly getting up to a high rate this spring and then having to level off abruptly in fiscal 1973. That seems to produce the dangers that the Michigan model sees that the economy may poop out, as it were, somewhere along the line in late 1972 or early 1973.

There are some real questions about the desirability of taking a given amount of ammunition and shooting it all off in the next few months. It is not clear why we are limited to any particular quota of ammunition. But this kind of ammunition does not have a social cost in and of itself. Of course, we should be heading toward a less stimulative fiscal policy sometime in the future. But for the near term we should surely maintain a degree of fiscal stimulation that is well above average.

I might say that I think a better designed package of stimulation last fall might have given us more stimulus with less misleading or perhaps frightening budget deficit estimates.

Representative REUSS. Thank you. My time is up.

Chairman PROXMIRE. Let Mr. Hymans reply also.

Mr. HYMANS. I can reply very briefly, since Mr. Okun pretty much said what I would say. I don't mean to imply that the increase in spending at the present time under the official budget is overstimulation from the point of view of the need for getting the unemployment rate down and a more rapid growth of GNP. I think it is an inefficient use of funds. I don't think it will produce as much as you would get for that much extra spending if you spread that extra spending out a little better.

I think the push-pull kind of pattern that is in the budget is very wasteful as an approach. You can't get all that much more productivity growth out of this rapid shot of stimulation in the short run, but you can retard it a good deal after the end of 1972 by slowing the economy. I think that is going to be the effect of this. You will not be as well off, though. For a short time you will get indicators that will look a little better but they will not last under this kind of budget policy.

Representative REUSS. They would last, however, through November 8?

Mr. HYMANS. Give or take a short amount of time, yes.

Chairman PROXMIRE. Congressman Brown.

Representative BROWN. Your forecast of the GNP in 1972, Mr. Wallich, is $1,132 billion. That is about $15 billion lower than the Council of Economic Advisors forecast. The difference is more than one percent of the overall figure. I think it might be considered significant. What real growth do you project in 1972 and what inflationary growth? How do you break that out?

Mr. WALLICH. About 5 percent real and about 3 percent prices.

Representative BROWN. Your 3 percent is about in line with the Council of Economic Advisors.

Mr. WALLICH. I feel frustrated at trying to project decimals. If you figure out what the $85 billion increase amounts to, broken down between price and real increases, it is either little more real growth or a little more price increase. I would prefer to say 5 percent and 3 percent.

Representative BROWN. Let's talk about the growth part of it. Which sectors of the forecast you made are lower than those the Council of Economic Advisers made, and why do you have these variations?

Mr. WALLICH. It takes very little to bring about a difference of $10 billion, for instance. The difference is $13 billion, actually. If you assume $1 or $2 billion less on inventories, which I think is plausible because with the ending of inflation one reason for carrying large inventories disappears, and if you are a little——

Representative BROWN. The inventories are not exactly on the high side now, are they?

Mr. WALLICH. They have come down relative to the Vietnam period, but over the long trend they are still high relative to pre-Vietnam. I realize during a period of expansion it is usual for inventories to grow more than the economy, but I would suggest, Congressman, that arguing about $1 billion or $2 billion of inventories, and, likewise, $1 billion marginally of plant and equipment, and $1 billion State and local spending, which is where I get my less optimistic estimates, is arguing about things that we really lack the instruments to be precise about. Yet when you take $3 or $4 billion off these nonconsumption expenditures, and when you apply a normal multiplier, and therefore take two or two and a half times that amount from consumption, you end up with a reduction of the order of $10 billion or a little more in the estimate. The surprising thing really is not that the difference is large. The surprising thing is that with the margin of error so great the forecasts all come out so close.

As I said earlier, the reason for that is that they make countervailing, different assumptions about the components. If you take the pessimistic components and the optimistic components and apply the same multiplier, the spread between the high and low forecasts becomes wider.

Representative BROWN. Are there any things in the administration prediction with reference to Federal programs, which you assume are incorrect or are not a fair assessment for what may be done or accomplished?

Mr. HYMANS. What I have done is to look at the preliminary data that now exist to tell us half of fiscal 1972 already. We know what the spending rates are there. We can project what is being asked or suggested in addition to that. Once I do that, I come up with a residual which I can't explain. I don't know where that spending is going to come from. I don't know what programs they are going into. I am just not sure what it is. I have some $2 billion or more in budgeted Federal expenditures for fiscal 1972 that I can't account for. I made a forecast allowing those to be spent some place, though I am not quite sure where or on what programs.

Assuming that they get spent, then you have the kind of scenario I have in table 4, attached to my statement, comparing my forecast with what would be implied by the official budget. But I can't see where that money is going to be spent, and I can't see how it will produce efficient results, in terms of how much you are going to get for that money being spent.

Mr. OKUN. I hesitate to compete in the forecasting field. There was a day when I took my forecasting very seriously and thought of myself as a worker in that area. One of the pleasures of private life is that I haven't had to put together a complete worksheet. In my basic thinking about the year, I have been willing to assume that the administration would achieve its spending targets with one possible exception, namely revenue sharing. A reasonable legislative assumption would be that the funds allocated to revenue sharing will not occur during the first half of this year.

Representative BROWN. In your testimony you certainly take a good strong stand for revenue sharing. I assume, then, that is a criticism of what? The Congress for not moving with more dispatch on revenue sharing? Your statement says that you support the committee in its approach to revenue support grants being tied to the cyclical nature of the economy. Of course, we have had that proposal for revenue sharing kicking around for 2 years. If we had some revenue sharing authority, I suppose that the Federal Government could move rather rapidly in this field and local governments might be stimulated accordingly to move in the field.

Is this an area that you would like to see the Congress move more rapidly in?

Mr. OKUN. The issue of revenue sharing, while it has been around for a long time, is a complicated and difficult one, and I must confess that I don't have a comprehensive definitive view on it. It is quite different from the cyclical revenue issue.

In terms of the question of whether more purchasing power would be put into the economy this year by enacting permanent revenue sharing, the answer is clearly "Yes, it would."

Mr. HYMANS. I agree.

Representative BROWN. If you had it so that at least the faucet could be adjusted on a fiscal year basis, within that fiscal year, as to what you could do, and if you had a bad beginning, pumping out Federal revenues could move a little faster, could they not?

Mr. HYMANS. Yes.

Representative BROWN. On the other hand, if the economy was being stimulated too rapidly, you might slow it down some, simply by administrative distribution of funds.

Mr. Wallich, what did you anticipate with reference to revenue sharing and one other field which is quite large, in which the Federal Government has fairly tight control, military spending, defense spending?

Mr. WALLICH. One has to recognize, I think, that there is a mechanical relationship between the administration's decision to ask for a certain thing from the Congress and its need to assume in the budget that Congress will do it on time. The political judgment that may raise questions about that sequence of events cannot go into the budget projections. The maker of the projections is a prisoner of his assumption. He may well be skeptical of the speed with which revenue sharing may be enacted. If so, that will have its reducing effect on the speed with which the money can get out.

Representative BROWN. I just want to summarize that comment. Aren't you saying if we do not pass revenue sharing we overlook one rather significant method for stimulating the economy? Do you all agree on that? And doing it on a continuing and controlled basis.

Mr. HYMANS. But there is no reason to assume that a revenue sharing program is automatically going to be a stabilization program.

Representative BROWN. We can assume it if it was used wisely. Mr. Wallich calls for legislative-executive partnership, tying it to the cyclical nature of the economy. I think it is just as well to assume that as it is to assume a legislative-executive partnership of any kind.

Mr. HYMANS. I agree. If it is used that way, fine. It is not obvious that that is the way it has to be used. It is quite possible to foresee that there is an assignment of funds for revenue sharing and that assignment of funds is going to take place in the short run regardless of whether the economy is overheating or whether the economy is depressed.

Representative BROWN. I guess really the point I am trying to get to is whether or not we wouldn't have been a lot better off right now if we had had revenue sharing passed last year. Would you concur in that?

Mr. WALLICH. I would.

Representative BROWN. Mr. Hymans?

Mr. HYMANS. I think having that as enabling legislation which might have been used appropriately, and if it had been, we would have been better off.

Representative BROWN. Mr. Okun?

Mr. OKUN. Assume all the actions that the Congress in fact took and add revenue sharing to them and you would have a better economic outlook today. Of course, one could make the same statement about a number of other types of stimulative measures that could have been taken or could have been taken sooner.

Representative BROWN. My time is up.

Chairman PROXMIRE. Mr. Wallich, I would like to refer you to the Bureau of Labor Statistics release dated February 4. In their table A-3, Major Unemployment Indicators, married men is 3 percent for January 1972, seasonally adjusted rate.

Mr. WALLICH. Then it has fallen by 10 percent since December. It must have been revised for December. I am relying on economic indicators which showed 3.3 percent for December. What this shows is the considerable looseness of the relationship between the overall rate and the married males. It also shows, apparently, that employers are hiring and moving into the skilled market, that these people are being called back.

Chairman PROXMIRE. I do this because you made your fundamental forecast on unemployment of married men at the end of the year being 3.0. Would you like to revise that?

Mr. WALLICH. I think so. As I say, the relationship is loose but it might be that we could do somewhat better and get down to 2.7 or thereabouts.

Chairman PROXMIRE. Mr. Hymans, you think the administration budget pattern is neither likely nor desirable. You responded in part to this. When you put the official budget estimates in your model you get a decline in real growth rate by the end of the year. This would not be desirable with unemployment still above 5 percent. You say the administration wants to step too hard on the accelerator and then wants to slam on the brakes. Are you saying they should step hard on the accelerator and keep their foot down?

Mr. HYMANS. I think there is room over the horizon of 18 months from this point for a very stimulative policy.

Chairman PROXMIRE. Are you saying also they will have their foot on the floor anyway because they can't spend money as fast as they say they are going to spend it in the first half? Are you saying that?

Mr. HYMANS. Yes. I believe that the budget that we have put into our forecast, shown on table 1, attached to my statement, seems to be, to me, a more realistic projection of what the Federal budget is actually going to look like.

Chairman PROXMIRE. I am not so sure. We have had President Nixon and President Johnson—we have had people who are expert spenders. Every President seems to be a bigger spender than the one before. When they want to spend, it seems to me that they can find ways of getting this money out, especially when they come up for election in a few months. Why can't they spend the money? What is there, if they ask for the budget and the Congress gives it to them? They have enormous authority to spend now.

Mr. HYMANS. There are several aspects of that. One is that even if they succeed in spending it, a good deal of it is going to come through grants and that doesn't mean that it is automatically going to get spent at the same rate out the other end on the State and local side. I don't think that the kind of grant speedup that is implied over the period of the first half of 1972 is going to make all that much——

Chairman PROXMIRE. We have an unusual situation now, I think even more likely to provide for spending than in the past. State and local governments have cut back at a time when they would like very much to hire. Under these circumstances, with many people coming up for election in 1972, not only the President but Members of Congress, Governors, State legislators and others, isn't there likely to be a willingness to get that money in the spending stream?

Mr. HYMANS. I don't think it is a matter of State and local governments cutting back in the absolute sense.

Chairman PROXMIRE. After, all, our country is bigger and our responsibilities are bigger. State and local needs are greater than ever, by far.

Mr. HYMANS. I don't believe it is true that State and local spending over the past year has risen significantly less than it did the year before or 2 years before that. There still is a need, a desire, for more rapid rates of spending on the State and local levels, and I think that the grant proposals as in the official budget would lead to that. I am saying it will lead to it very slowly and you are not going to get very much more stimulus in the short run than if you just phase those grants in a slower fashion.

Chairman PROXMIRE. You are concentrating your response on grants and that is only one phase.

Mr. HYMANS. But that is a very big part of the acceleration foreseen in the budget.

Chairman PROXMIRE. We have a big acceleration in some aspects of defense spending, for example, and that is wholly within the control of the administration.

Mr. HYMANS. And that part of it I have left in.

Representative BROWN. How do you have it in?

Mr. HYMANS. If you look at table 1 attached to my statement, you will see my estimate for national defense spending for fiscal 1972. The figure I have in there differs very little from the official figure. It is practically the same figure. There is also practically the same figure on nondefense purchases for fiscal 1972. The major difference comes in the grant program.

Chairman PROXMIRE. Mr. Okun, I would like to get to the composition of spending. The administration wants to step up defense spending, as indicated. From the Economic Review, is that a desirable way to create jobs? There may be a strong case, but it should be the prevailing way.

What I am getting at is the argument that once you move it is very, very hard to turn it off. You have started with a program, whether it is the B–1 bomber, an aircraft carrier, and it gets bigger and bigger and becomes almost uncontrollable at a geometrically increasing rate.

Mr. WALLICH. There is a question on the content. On the timing, I think that tax changes are preferable to expenditure changes because they can be enacted faster. I would prefer in that case, however, not an income tax action but an excise tax action, something like the investment tax credit, because that causes people to bunch their spending during the period in which the tax cut takes place, whereas an income tax change if it is known to be temporary may be treated as a windfall and may not lead to much additional spending.

As for the content of spending, we have to make a choice between the private sector and the public sector. I see with considerable alarm the way in which the budget increases relative to GNP, but it is fair to say it increases in some highly desirable areas; for instance, social security, medicare. Those are areas in which one likes to see an increase. When one looks at the broad sweep of the budget I think one should temper one's alarm over the expansion of the public sector by a realization that we are improving the structure of our Government expenditures.

Chairman PROXMIRE. Mr. Okun, in the past you have warned us about the importance of trying to emphasize expenditures which are relatively flexible, that could be reduced when the time comes. You have been concerned about the inflationary impact and the tremendous priority demands we have. How do you react to this budget which seems to be setting forth a spending program in the future for defense that will expand?

Mr. OKUN. I think this is an important element in reducing the flexibility that we will have in 1973 and 1974. Because obligational authority outpaces expenditures, it certainly builds extra expenditures into the future budget. That makes it more difficult to provide for other programs, avoid tax increases, and still attain the kind of responsible budget that we ought to have, which ought to begin to shift toward less stimulus and ultimately toward restraint.

We should be looking forward to taking our foot off the gas and gradually applying the brakes as the economy picks up speed. It is precisely for that reason that we do need flexibility. Devices like the automatic triggers on unemployment extended benefits and the public service jobs program are highly desirable, while the advance commitment to rapidly rising procurement in the defense area can create fiscal problems for the future.

Chairman PROXMIRE. I take it, however, that you disagree, based on what you said in the past, with the recommendations of the CED before this committee and before the country yesterday when they indicated that we had an overstimulus, that we ought to be more concerned about inflation. That was a kind of unusual warning from that group because it has been a very liberal, progressive business group. In the past they have been rather progressive. Does this give you any cause? It was a careful analysis by competent economists.

Mr. OKUN. I haven't seen the entire statement. I find it a little hard to understand how people can be so concerned about stimulus in the near term at the same time that they are predicting an enormous amount of remaining slack in the economy with respect to both manpower and industrial capacity over the next 18 months. The budget position is only one indicator of where the economy is going. A deficit is inflationary only to the extent that it means an overheated economy. No one seems to forecast an overheated economy, yet some are becoming very concerned about the onset of inflation at a time when the unemployment rate is 5.5 to 6 percent, and when we have the added protection of a control system.

It seems to me perhaps that they are fighting the last war. The anxieties about inflation have become so great that we tend to forget the needs and the possibilities for expansion in this economy. Everybody's forecast for this year points to a slower expansion than we had in the good years following previous postwar recessions. Why would this trigger off extra inflationary pressures, that it represents overheating and overstimulus, when the past recoveries didn't trigger off inflation?

We are puzzled about our price behavior in recent years. It has been less favorable than expected. But I don't think that gives us a basis for predicting that the trigger point at which inflation would be renewed is that much more unfavorable than it used to be. Indeed, I think one could make an argument to the contrary, because the extra protection against inflation from a wage-price control system. Productivity could and would be better, if we had a good strong expansion, and that would give extra protection against inflation. The inflation problem will become a very real and very serious threat as we succeed. But we have just begun to make some progress toward catching up with the potential of this economy.

Chairman Proxmire. I will refer to the analogy that you gave at the outset of your statement, about the college bull session. The boys are talking about an inflationary impact, whether to retire after you make the first or second million and so far you have made nothing.

Representative Brown. I would like to make one observation and go to specific questions. With reference to defense spending as a means of stimulating the economy and the inflexibility that might apply there, it seems to me that same application could be made to almost any kind of Federal spending if the nature of the spending is long term and if in the expansion you make a commitment for an 8-year program, the purchase of weapons systems or something like that. Then indeed I would suggest you are tying yourself into a commitment that may not be wise if you want to damp down later.

On the other hand, I would think this same thing applies to grant programs and local community facilities. If you are going to build a dam with the money, then you have an 8- or 10-year program. If you are going to build a Federal building you may have a 2-year program. Or if you are going to do something else in terms of replacement of plant or research and development programs that last a relatively short time, that hires people to do that job, it seems to me it is vastly different than going into the construction of an aircraft carrier or some such thing as that.

Would you accept that codicil to the concern about the defense spending and the desirability of grants?

I find some problem why personal tax credits in a time of high savings and at a time when our deficit results as much from the reduction of tax revenues as from the increase in spending programs, why more personal tax credits at such a time is a desirable means of dealing with the problem of an understimulated economy.

Mr. OKUN. I made that proposal without much hope that it would be taken very seriously at this time, given the congressional legislative agenda. But I think we would be better off with it for a number of reasons. One, I feel that we gave too much emphasis to investment incentives in the design of last year's tax package. If I could redesign that, I would shift somewhat more relief in the direction to the consumer. There is basically an issue here that affects the longer run sustainability of this expansion. At the moment I am prepared to bet that the disappointments in consumer spending in December and January are temporary. But if they should not turn out to be temporary, and if we do have the kind of expansion in investment that seems to be now programed by American industry, we would have an imbalance. In that event, which again I stress as a possibility rather than a probability, the possibility that investment would be cut back in 1973 and that the expansion would, as a result, be aborted is a risk that one has to bear in mind.

One way of getting insurance against that risk would be to underwrite greater strength in the consumer sector. At least, I would hope that this proposal could be taken seriously as a call for contingency planning. If subsequent reports on consumer spending continue disappointing, we should be prepared to act to put more purchasing power in the hands of the consumers.

Representative BROWN. Mr. Hymans.

Mr. HYMANS. I agree with the concern for the rate of growth of consumer spending. I can't help but believe, however, that something like a tax credit is giving the money to the wrong consumers or the wrong potential consumers. There are too many people who don't have any taxes against which to give them a credit. These are the people who are unemployed, who basically are not paying taxes, and a tax credit is not going to help these people at all. A tax credit will help those consumers already contributing to an 8 percent saving rate. I would be the last to say that the full $100 will get socked away in the bank. Some will be spent. But I think doing it on an aggregate basis like that is not taking care of the distribution problem, the allocation problem, that is really the difficulty here. I would rather see some way that it gets to those who would really spend the money and who don't have the income against which the tax would be a credit.

Mr. WALLICH. In the past we have talked about things as extreme as a temporary suspension of income tax withholding as a possible shot in the arm, and we have come away from that, I think, mostly with the realization that this type of money would have a very low expenditure coefficient. People would tend to sock it away. It would be a very expensive way of getting the economy going. If we went the tax cut route, which in principle I like, and I liked the original design of the investment tax credit for first 10 and after 1 year 5 percent better than the 7 percent forever, we should aim at a tax that is an expenditure tax.

In other words, something like the value-added tax, for instance. That would make a good anticyclical measure. Reducing it temporarily would be an opportunity to intensify purchases. It would be the opposite of the effect of a tax credit which might be partly squirreled away.

As for the timing, any of these devices clearly are faster than most expenditure devices. The best I can say for expenditures, such as a step-up of a long-term program, such as defense construction, is that something happens to the orders of business long before the money is spent by Government. It shows up then in a faster rising inventory and employment even though the Government doesn't get the money out yet.

Representative BROWN. I appreciate that exchange. I must say I tend to concur with Mr. Hymans' analysis of the problem specifically at this particular time. It may have application at other times.

Would you each speak in the same vein with reference to the minimum wage, a sharp increase in the minimum wage at this time with reference to the distribution of funds in the economy, and to the employment of the segment of the economy which is currently the most greviously underemployed? Mr. Wallich.

Mr. WALLICH. I would regard an increase in minimum wage as very unfortunate. First, because of the effect on teenage unemployment, to which I think it has contributed. Second, because of a somewhat more remote effect on the general movement of wages, which we are trying to slow rather than intensify. Third, because of its effect on international competition where we have the problem of competitive prices. One has to recognize minimum wage has really very little to do with the wages of the skilled labor force. It is more in the nature of something that limits the expansion capabilities of the unorganized, the low-income workers. Some have called it a tariff against the industrial products of the South imposed by the North.

Representative BROWN. There is the ripple effect that goes on to raise the wages of the most expensive employees in a shop.

Mr. WALLICH. To some extent it ripples; yes. I would think this is the last moment at which one should stress a measure like that.

Representative BROWN. Mr. Okun.

Mr. OKUN. I would agree that there is evidence of an unfavorable ripple effect on the employment of teenagers. I would think that this is not the time to move the minimum wage up, certainly not up significantly.

Representative BROWN. What would you call significant?

Mr. OKUN. Figures like $2 sound pretty significant to me. I think the minimum wage has some use in the long run as a standard and as a basic floor. It has a certain desirable effect in creating a known minimum in areas where employers have strong bargaining power against workers, in smaller towns, in less organized labor markets. I think over the long run moving it up about in step with the average wage rate is probably desirable social policy. I think a number of priorities one the legislative agenda for 1972, could help labor and the country by creating the basis for noninflationary prosperity. This would be a good year not to act on the minimum wage.

Representative BROWN. Mr. Hymans.

Mr. HYMANS. I am not sure about the long range effects, but I feel very strongly that increases in the minimum wage should not be enacted at this time.

Representative BROWN. I am concerned about what we do with these underskilled, underemployed young people. Obviously, the question about the minimum wage infers that concern. This is with reference to a situation in the economy where you don't have jobs developing in those low skill areas. We have to do something, but what do you do to help them out at the moment? Do you send them to a summer camp and simply entertain them and pump money in the economy by paying them to do that? Do you provide a make-work project of some social significance, cleaning up the environment, which leaves them with no lasting skill? Do you train them to a skill which may or may not be needed at the time they are finished and available for employment, and pay them while you are doing it? Just what specifically can be done? How do we know what to train these people for, or is that what you are suggesting, to train them specifically for something? Do you just want to get them off the streets and into some wholesome activity and pump money out in the process of doing that?

There is a reverse point about women in the labor force. That is that young people are simply not going to be employed very much in the future because of the nature of their education and the needs of our work force. Can I have each one of you comment on that, and then I will subside?

Mr. HYMANS. I think the way you raise the question makes perfectly clear all of the difficulties that are involved in this thing. But what I would add is that you have to continue to view this, or view it more strongly, as a long run problem, and realize that the nature of the difficulty is not something that is cyclical. This is a difficulty whether we are at 4-percent unemployment or 6-percent unemployment; that it stems much more from unequal educational opportunities, from discriminatory housing and job patterns.

That is the only way we are going to be able to avoid having to talk about this same problem 10 or 20 years from now. What we have to do right now is of a shortrun nature. If we can identify social projects, or projects of social value, like cleaning up the environment, I wouldn't consider that a make-work project. I would say, sure, let's put them to work. But, while we are taking care of these people, putting them to work, through guaranteed annual income, negative income taxes, or whatever, we have to recognize that we have to get out of this bind 10 or 20 years from now and that requires not manpower training programs of the kind we are talking about for people currently in difficulty; rather, that involves problems of discrimination in housing, in jobs, in educational opportunities, in attitudes, and everything else. That is the only way you get out of this in the long run.

Mr. OKUN. Let me say I think your concern is entirely appropriate, and that the problem you are focusing on is one that requires very special solutions. Much as I favor a more prosperous and fully employed economy, aggregate demand is not going to solve the teenage unemployment problem.

It is rather interesting how the recession pattern of unemployment has emerged. Some of the more detailed calculations like the ones I presented show that 7 percent of all the unemployment in the Nation at full employment was accounted for by black teenagers. Only 2.5 percent of the increase in unemployment in the past 2 years can be attributed to an increase among black teenagers.

To turn that around, we are not going to solve that problem by stepping on the fiscal and monetary gas. Of the various unsatisfactory short-term alternatives you outlined, the route of make work combined with an effort to make some efficiency along with the work looks most promising to me. You pointed out correctly that, even in the process of making work, one can design that work to achieve something productive in the society.

The question of whether you create a lasting skill or not is a hard one to answer. Sometimes the real issue is that of creating the kind of job experience and subtle kind of on-the-job training that may profit people a great deal in their lives. They would learn how to handle a work situation much better if they have a congenial work environment for the first time in their lives.

I think training as well as education is very important in the long run. I would emphasize a concern that Mr. Reuss expressed earlier for a massive training effort in a weak labor market. We have 78,000 vacancies in the 18 million job sector of manufacturing today. Under these circumstances, a mass training effort would create unrealizable expectations and would be doomed to failure.

The training route is complementary with prosperity in the economy. Although prosperity won't solve the problem of the black or white teenager, it will make it possible to use training to an increasing extent to channel them into the places where vacancies begin to emerge as we form a firmer labor market.

Mr. WALLICH. We are talking about a group of young people of well over 1 million. I agree with the proposition that aggregate demand is not the answer. It is a structural problem. I like the idea of a massive training program. I must confess that I have thought of that not just in terms of learning some very specific skill, but something that may be at the same time also giving them remedial education, because many of these young people are deficient on things like reading skills. Anything that can be done to upgrade them in those areas will certainly serve them all their lives. It will improve their performance and competitiveness throughout.

To do this without incurring tremendous costs is going to be very difficult. I would argue in terms of not putting everybody in a given place, in other words removing them from their normal places of residence and then incurring all the difficulties of housing, feeding them, and so forth. I would rely as much as possible on existing arrangements, that they mostly live with their families and would spend their days, then, instead of having to stand on a street corner, in some aspect of this training program.

I am aware that this probably does not take care of more than a part of these people, that it is going to be impossible to capture them all. Some subsidization of employers to hire them may be a way of reducing the residual. It is so large a problem and so different from all the rest that it deserves very detailed study.

Representative BROWN. I would like to conclude with this observation: The Council of Economic Advisers expressed an awareness and concern about this problem without any real specific recommendation for a solution. I think it is one of the more critical problems because I think it is evidence of a change in our whole employment picture which cannot be overlooked. There was a day when we were a rural society, an agricultural society. We went into a craft society and our labor organizations reflect that. You had to move from that into the industrial society which at first did not employ women and they went into that field. I think we will change from an industrial society into a technological society in which the strong backs and dexterous hands of young people will not be enough, where they have to be trained in a more sophisticated way. We have to recognize this problem and consider whether or not in fact they will be employed at all, whether we educate them better and longer or whether, as with the wives of a century ago they just don't work at all. Maybe they are just around the house and being otherwise engaged in reflective activity or something but not considered part of the employment market.

I don't have the answer, but I do think we have to come to an answer in our society shortly or we will have problems. With the birth rate as it is, maybe in another 15 years we won't have any young people to worry about as a problem. Thank you.

Chairman PROXMIRE. I think Congressman Brown's questions have been very good and I want to follow up on some of them.

Mr. Wallich, you made an excellent proposal in recognizing the realities that Congress is just not going to give to the President the discretionary authority to change tax rates. Congress feels as if we don't have much left anyway and regardless of what the economists can say about this, and you can say a lot, that we shouldn't lose any more.

You suggested that we trigger, instead, the tax reduction to unemployment. While that might be a happy long-range kind of thing to think about, it seems to me right now our problem is not taxes that are too high, and then getting them lower, but it is something else. We have so much to do in our society. We are so far behind in so many ways, in health, in counteracting pollution, in rebuilding our cities. The needs are just overwhelming, much greater than our resources would permit, it seems to me.

Mr. Hymans gave an impression which I think he has somewhat softened about make-work jobs. There was a lot of satire and a lot of criticism of WPA in the thirties but it was a marvelous program. Even if it had done very little for the country, but it did a lot. It did build a lot of very useful projects, but it did far more for the human beings who otherwise would be unemployed. It seems that while we don't have the enormous kinds of unemployment we had in the depression of the 1930's, we do have far greater needs that we know about, that we are willing to do something about.

Therefore, I would like to suggest to you that we consider revising the Wallich approach and saying that whenever we get unemployment above 5 percent we have an automatic government program to put people to work in useable things. Heaven knows there are many. We could clean up Lake Erie. We could prevent Lake Michigan from dying. That alone would take billions of dollars. We could begin to rebuild our cities. We could have a mass transit program that would mean something. We could improve our health services, train far more people in paramedical work There is a desperate need for more assistants, nurses and doctors.

It seems to me we are not using our imagination in this kind of an area.

I have been one of those who have been critical of wasteful spending, but I think the biggest waste of all is the waste of human resources. Once that is gone, it is gone forever. If a man is unemployed for a day or a year, you can never get it back. It is a fundamental shame, it seems to me, an outrage, with all we have learned over the years, with the Full Employment Act on the books, which this committee is responsible to help carry out, that we are willing to tolerate this kind of thing under these circumstances.

Mr. Okun, what would you think of readjusting the Wallich proposal to try and trigger a job program whenever unemployment gets above 5 percent?

Mr. OKUN. I would be strongly in favor of that as a permanent feature in our legislative arrangements. I would want to design it so it can move fast, both upward and downward.

Chairman PROXMIRE. I think that is so important, because the trouble with the tax thing is we know there is a lag. By the time people start spending the tax cut, you may not have the same kind of a problem. Of course, here you have a lag, too.

But I would think that there are so many things that we are doing that we could at least design a program to put people to work fairly rapidly when we have these needs.

Mr. HYMANS. There is only one aspect of what you said that I would disagree with and that is considering it to be solely a stabilization policy.

I can agree with virtually every need that you cited. I think that is something that the Federal Government ought to be involved in, but not as a stabilization device. It ought to be involved in these things. We need to clean up Lake Michigan. We need to build hospitals and so on. We ought to do it.

Chairman PROXMIRE. We are not going to do it. We should do them, that is true. But look at the budget. Look at the defense proposals. We are going to get enormous resistance to these other programs. It is hard to buck an established defense program.

You have built-in labor unions, contractors, areas, regions, and so forth, which have nothing to do with defense but will keep it alive.

I think we will have to be a little imaginative and recognize we are going to have to interrupt some of these high-priority programs, unfortunately. In other words, it seems to me better to have a period of a year or so of vigorous activity in counteracting pollution, solid waste, water pollution, and so forth, than to not do it at all. Maybe it is an inefficient way to do it, but at least you are doing something during this period.

It certainly is not the best way to stabilize the economy but absent that you are not going to be able to get a stabilization policy with respect to your defense spending. Obviously, we should have it. That is an area where you shouldn't spend a nickel more than you need. You can't turn it off like a faucet. With taxes, of course, there is the lag. There are many of these programs that lend themselves to this even though it doesn't fit into a neat economic framework.

Mr. HYMANS. If you are going to use a period of high unemployment to initiate something of social value, I don't consider that a make-work idea.

Chairman PROXMIRE. We did it in the 1930's. We built roads and we had reconstruction for the soil and many other things. We stopped doing them when World War II began. But we did it because we wanted to put people to work.

Mr. HYMANS. At that point in time there was, of course, a lot of room to get a lot of good benefits even if you wasted a lot. You don't have that much room now. I don't think we are ever going to have that much room again. We are not going to be worrying about 25-percent unemployment rates that existed in 1933.

I agree with everything you say except that I would do less on the cyclical factors except that you can use the slack in the employment sector to move strongly on these things.

Chairman PROXMIRE. We are going to solve this problem one way or another. As people get better informed, either we are going to solve it that way or we are going to solve it by reducing the supply of labor. Nobody discusses that. Economists throw up their hands in horror when you mention that. But I can tell you there is nothing more popular in my State than earlier retirement on social security.

They say, "This will open up jobs. We want to retire at 60. Why shouldn't we? Also popular is reducing the workweek, cutting it down from a theoretical 40 hours to 30 or 35. This means we would have to settle for a lower standard of living than we otherwise would have if we had everybody working.

But it is a solution and it is a solution which might catch on if we don't solve this nagging unemployment problem which seems to be so far from solution.

Mr. Okun, have you any comment on Mr. Wallich's statement that the overall unemployment rate no longer serves the purpose of measuring the labor capacity, that we ought to move to married men?

Mr. OKUN. I keep being impressed with how accurately the overall unemployment rate continues to measure waste in the economy. Drawing a potential GNP path on the basis of long-term trends, its relationship to the overall unemployment rate continues to be quite accurate. There are times when the unemployment rate lags behind as we saw in 1969. I would reiterate that if I could know only one number about the economy, I would choose the overall unemployment rate as the one most revealing on the state of the economy.

I suspect that the overall rate is also subject to less erratic fluctuation from quarter or month to month than that of married males, partly because it is based on a bigger sample involved. There is a reasonably close relationship between the married male rate and the overall unemployment rate, even though it has changed some over time. If you tell me the married male rate, I will give you a fairly good estimate of the global unemployment rate.

Chairman PROXMIRE. Instead of using married men, how about making it head of household. After all, a female head of household is no less important when unemployed than the male. It is just as tragic and the responsibilities are just as great.

Mr. OKUN. I am not sure whether one turns to the married male rate because one thinks it is of greater social significance or a better indicator of waste and unused labor capacity. On the latter, I think one might well find that the rates for demographic groups would give you a pretty good estimate without specifying family status. George Perry has experimented with weighting the different demographic groups to reflect how much labor each carries, measured in terms of hours and wages, and how much is being withheld when they don't have a job.

In that way, you need not judge that some sectors count and others do not count at all. Instead you are given a spectrum of weights, which has the effect of reducing the weight on teenagers, because they work less and at lower wages.

Chairman PROXMIRE. Mr. Wallich and Mr. Okun, both of you stressed the need for Congress to consider new measures for improving the fiscal instruments. A possibility given widespread discussion is the value-added tax or other form of consumption tax.

What would be your evaluation, Mr. Wallich, of a value-added tax?

Mr. WALLICH. A value-added tax lends itself well to use as a cyclical stabilizer because it has the right kind of bunching effect. If at a given time stimulation is desired, the tax is lowered. It will pay people to spend as much as they can in the temporary period in order to get more benefit than they would if they continued spending at a steady rate. This is just the opposite of what is likely to happen with a temporary income tax cut, where people knowing it is temporary, will tend not to adjust their purchases but to save a substantial part of the windfall.

There is a countervailing difficulty. It has to do with the way the tax gets collected up and down the stages of production, as it were, so that there may be a problem about a product having been taxed before the tax cut went into effect. Then the cut does go into effect and the product is not taxed when the retailer sells it.

But that is a technical problem that ought to be capable of adjustment.

Chairman PROXMIRE. Don't you also get an aggravation of inflation? Is the tax likely to be increased at exactly the time when there are pressures for prices to rise, so you get inflation which is more severe?

Mr. WALLICH. If you regard the tax as part of the price, then it would raise prices at a time when the need is to restrain prices. I think one should look for a way of avoiding that, if it can be done within the structure of the tax.

Chairman PROXMIRE. How can you possibly avoid it?

Mr. WALLICH. Well, we know what the percentage is, and we could adjust the price index accordingly.

Chairman PROXMIRE. But its purpose, as I understand, was to discourage spending at times when the pressure on resources is great. The only way you can possibly do that is to let the prices go up and aggravate your inflation.

Mr. WALLICH. You would pay more, but whether you show this in the price index or not, that is what I was trying to say, is a matter where we have a choice.

Chairman PROXMIRE. Mr. Okun.

Mr. OKUN. I am not sure I quite follow Henry Wallich. It is part of the cost of living and people will know it is. The evidence abroad is that it has had a cost-push influence on wages. In a column on the editorial page of the Washington Post today, Philip Trezise focuses on the international implications of the tax, but the mentions the evidence in Belgium that it got passed on with a markup. In working through the system, it tended to cascade. There is some evidence of a cascade in other countries as well.

Whether it is easy or hard to deal with cyclical fluctuations with a value-added tax seems less important than what the value-added tax and its imposition would do to the tradeoff between unemployment and inflation. This tax is bound to make the task of accomplishing high employment without inflation all the more difficult. It adds to the inflationary force within the system. No tax gets passed forward with the reliability and the likelihood of escalation of a value-added tax.

Chairman PROXMIRE. Mr. Hymans.

Mr. HYMANS. I would agree that the inflationary effect of a value-added tax is of far more significance in terms of the problems it creates than is its potential as a cyclical stabilizer.

I think equally important, however, is the equity problem connected with the use of a value-added tax. It seems to me that a value-added tax violates all the basic principles of equity in taxation that we know about.

It seems to me that is equally as important as the inflationary problem.

Chairman PROXMIRE. We are going to have extensive hearings on the value-added tax before this committee in about a month.

Gentlemen, I want to thank you very much. As I said to begin with, you are a superb panel. You have been most responsive and helpful.

The committee will stand in recess until Tuesday morning, when Congressman Reuss will preside.

(Whereupon, at 12:45 p.m., the committee recessed, to reconvene at 10 a.m., Tuesday, February 22, 1972.)

THE 1972 ECONOMIC REPORT OF THE PRESIDENT

TUESDAY, FEBRUARY 22, 1972

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

The committee met, pursuant to recess, at 10 a.m., in room 1202, New Senate Office Building, Hon. Henry S. Reuss (member of the committee) presiding.

Present: Senators Javits and Percy; and Representatives Boggs and Reuss.

Also present: John R. Stark, executive director; Loughlin F. McHugh, senior economist; John R. Karlik and Courtenay M. Slater, economists; George D. Krumbhaar, Jr., and Walter B. Laessig, minority counsels.

OPENING STATEMENT OF REPRESENTATIVE REUSS

Representative REUSS. Good morning. The Joint Economic Committee will be in session for a further review of the Economic Report.

Today our attention turns to international economic problems. Last August the administration, apprehending that the U.S. economic position was untenable, announced a set of new economic policies. Although as with all policies there have been criticisms of them on a number of grounds, they have surely succeeded in achieving one major objective, the general realinement of exchange rates among the great industrial countries.

But no one claims that we have solved all our international economic problems. There is no new mechanism to assure prompt exchange adjustments, and the activity of the International Monetary Fund are still trammeled by the consequences of our August 15 action.

Unless we move quickly to consolidate the gains in our relative competitive position produced by the December exchange rate changes, our position could gradually erode. In a few years our policymakers will again be confronted with much the same set of problems.

We have with us today three heroes of the international monetary wars who have in the past graced this committee.

Our first witness today is Mr. Peter Peterson, who was confirmed yesterday by the Senate as Secretary of Commerce. He is particularly qualified to assume his new responsibilities.

As Assistant to the President for International Economic Affairs, Mr. Peterson played a vital role in shaping the direction of our foreign economic policy throughout 1971. His briefings have been of great assistance to both the executive and legislative branches in our attempt to understand the dimensions of international economics.

I know that Secretary-designate Peterson will bring the same dedication and intelligence to the Department of Commerce.

After Secretary-designate Peterson we shall hear from Mr. Edward M. Bernstein and Robert Triffin. Mr. Bernstein is a former Treasury adviser and is former Director of Research for the IMF.

Professor Triffin teaches at Yale. He is known for his critical role in helping to plan the restoration of currency convertibility in Europe following World War II.

Both of these gentlemen have long warned of difficulties that were likely to arise if the United States ignored the need for fundamental monetary reform.

Last August events proved the worth of their foresight. We are particularly happy to have them here today.

I will now turn to my distinguished colleague, the Senator from Illinois, Senator Percy, to say a personal word about Mr. Peterson.

Senator PERCY. Representative Reuss, I would simply like to welcome Mr. Peterson. In his new role he will be appearing, I am sure, many times before this committee as the Secretary of Commerce. But I would like to note that perhaps no man confirmed by the Senate has been so unanimously supported by both labor and business. The Secretary of Commerce has put on the record his feelings, beliefs and ideas. I would have thought that anyone who has produced a volume such as the one on the changing United States economy, a copy of which has been sent to all Members of Congress and to all leaders in the country, would have created a controversy. It does not lay out a placid role for Government or the business and labor communities in the future in reestablishing or reasserting our leadership role in the world.

The very fact that Mr. Peterson was confirmed unanimously by the Senate yesterday indicates there is a growing awareness in the country that we need real leadership for American business because of our need to create enough jobs for the future and to maintain our position in the world.

The fact is that this job of Secretary of Commerce is one of two where a President has been denied his nominee—President Eisenhower was denied his nominee. There have been only two turned down in a century. I think it takes an unusual man to fill this position and I am pleased that it is Mr. Peterson.

I think at this time, a very challenging time in America's history, we are very fortunate to have a man such as Mr. Peterson to take over the leadership in this challenging area.

It gives me great personal pride and privilege to welcome him and to have a chance to question him for the last time before he then outranks me, his former colleague, and takes a protocol position ahead of a U.S. Senator.

We are very happy to have such a distinguished man here.

Representative REUSS. Knowing the Secretary-designate, I am confident that success will not turn his head, and you will not find him overbearing.

Senator PERCY. I find the modesty with which he opens his statement is not only becoming but well advised.

STATEMENT OF PETER G. PETERSON, SECRETARY OF COMMERCE DESIGNATE, ACCOMPANIED BY HAROLD PASSER, ASSISTANT SECRETARY FOR ECONOMIC AFFAIRS

Mr. PETERSON. I must say, Senator, as is your gracious habit, you put the most charitable interpretation on things. I think it is possible that my nomination meets with no opposition for the simple reason that none of my opponents read my report which, of course, would not have been unusual, if that is the case.

With regard of any of this going to my head, I told a group in Chicago the other day that I have become accustomed to being known as "Mr. Whatshisname who followed Mr. Percy" and I have no reason to believe that is going to change in the future.

This is my first appearance, of course, before this distinguished committee, and I must confess to a certain trepidation in being here; partly because I am taking a plunge out of the warm but protective environment of executive privilege into these substantially colder and most certainly less protective waters; partly because I have been preceded by more distinguished, and certainly more informed and senior colleagues on the subject of our domestic economy; and partly because I try, if all too rarely, to practice what I preach.

Since I have been preaching in my recent White House undertaking the virtues of the principle of comparative advantage in world trade and investment, I have struggled to define whether I have any comparative advantage in these hearings—an area of expertise that might conceivably be of interest to you. It hasn't been easy to define such an area of comparative advantage—which, incidentally, I find easier to admit this morning than yesterday, prior to your confirmation vote.

I take it that a central focus of these hearings is jobs and unemployment. I have read with interest the dialog, if I can correctly call it that, between yourselves and the administration's previous spokesmen on whether the unemployment rate by year end will in fact be in the neighborhood of 5 percent, how large an area that neighborhood is, and in any event, whether there aren't better and alternative ways to get the unemployment rate lower, sooner, and at less cost.

Let me try today to make a contribution by putting this employment issue in a somewhat longer term framework—the 1970's and even the 1980's.

A special study prepared for the recent White House Conference on the Industrial World Ahead in 1990, concluded that we must have 28 million more jobs by 1990—three-fifths of which must be created in the present decade. Just to provide these jobs will require a gross national product in 1990 of at least 2.4 trillion of today's dollars.

Already today we are seeing that unemployment rates among our young people are higher than any of us would like to see—partly because this age group is a larger percentage of the workforce now (22 percent) than in 1960 (17 percent) and partly because we are now seeing, and will continue to see for much of this decade the substantial increase in young job entrants conceived and born in the postwar era of the fifties.

For example, there were somewhat more than 4 million births per year in the latter half of the 1950's compared with only 2½ million annually in the 1930's.

I am making the obvious point that the challenge of providing an increasing number of jobs is not simply a challenge for 1971 or 1972—it is a longer range challenge of the 1970's.

Thus, while some of our young people have focused much of their clearly apparent energy and sense of purpose on new challenges—such as improving the quality of our lives and our environment—it may also be true, if ironic, that some of our more pressing challenges of the 1970's may also in retrospect turn out to be the old bread-and-butter ones such as providing jobs.

Permit me against that longer range challenge to emphasize that our trading and monetary systems can have an important impact on that job challenge.

There were those who said after August 15 that the President's actions were blunt, restrictionist, and perhaps worst of all, unnecessary. It was argued that since exports amounted for only about 4 percent of our GNP, we should look elsewhere to provide jobs—suggesting that the job effects of our balance-of-payments imbalance were trivial.

I should like to explore that. We have seen our trade balance, as now measured, going from a surplus of over $7 billion in the mid-sixties to a deficit of about $2 billion in 1971, or a swing of about $9 billion. Various experts have estimated that in each billion dollars of exports as against imports, there are provided about 60,000 to 80,000 jobs.

Thus, since the mid-sixties when we were in rough balance of payments equilibrium one could estimate that we have about one-half million (or more) fewer jobs as a result of the shrinkage in our trade account.

Let me hasten to add that the employment figures in the most recent Labor Department studies on the job impact of trade showed that total employment would be reduced if we stopped trade both ways, where there were alternatives to trade. Also, these studies indicated that jobs in our export industries tend to be higher paying jobs.

Thus, to those who would respond to the deterioration of our balance of payments and trade accounts by, in effect, closing off America, I would say even in the specific context of U.S. jobs, this is likely to be self-defeating, let alone the profound impact such moves would have on our competitiveness and productivity. Indeed, let alone the impact they would have on the kind of world we would be living in and the kind of country we would become.

It was to return the United States to a balance-of-payments equilibrium that the President took the decisive actions of August 15 to suspend gold convertibility and impose the surcharge.

You have seen the first results of those moves in the fact of a major realinement of exchange rates, briliantly negotiated in my view by Secretary Connally, and the trade concessions recently announced by Secretary Connally and Ambassador Eberle, as first steps.

If, as we hope and expect, these moves will bring the U.S. balance-of-payments situation into rough equilibrium over the next couple of years, this improvement of a half million or more jobs, all other things being equal, will reduce our unemployment rate by about 0.6 percent—which I would consider anything but trivial, given the demonstrated difficulties of reducing the rate of unemployment, in spite of large budget deficits.

Over the longer term, it is of prime importance to this country that we operate within a new monetary and trading system that prevents these serious balance of payments imbalances from developing in the future—and, in the context of our discussion today, aggravating the domestic job effects of trade.

Thus, the Smithsonian agreement and the results of the trade negotiations marked the end of our international phase I. Phase II, aimed at initiating major negotiations toward a more open and equitable trading system and achieving significant monetary reform, is taking shape. Achieving equity and responsiveness in the systems are absolutely necessary—but not enough. There must be a phase III.

I might say one of the wits around the White House, having heard of all these phases, suggested that the President's next television address should be called "Phase the Nation."

In short, we cannot assume monetary and trade reform will be cure-alls.

The basic long-term solution really rests with what we do at home, not what the rest of the world does. In the immortal words of Pogo, "We have met the enemy, and he is us."

Even in 1971, when profits went up slightly, they were still below any other year since the end of World War II, when expressed as a percent of GNP. To me, at least, it is no accident that during the same period, several other things happened.

1. OUR DECLINING PRODUCTIVITY GAINS

Our productivity performance has been unsatisfactory. Productivity in manufacturing increased 23 percent between 1960 and 1965. From 1965–70, however, it increased only 10 percent for the entire period.

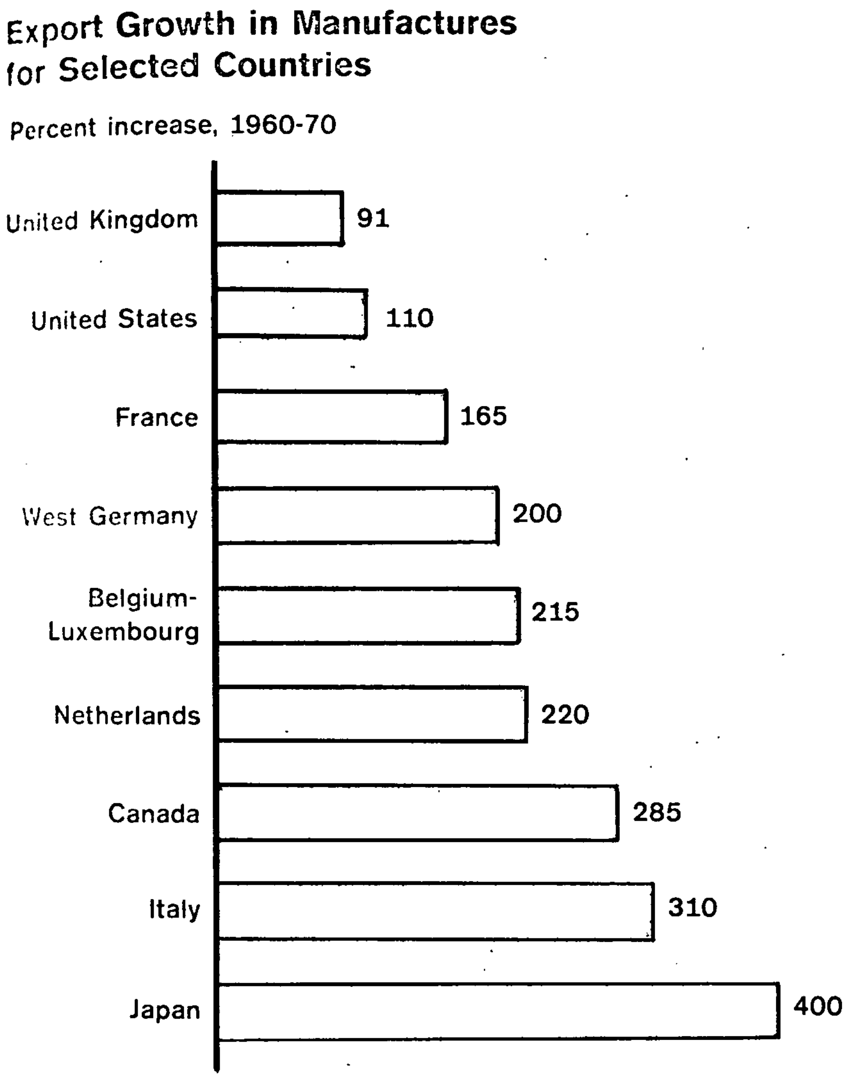
For comparison during this same period, productivity in manufacturing increased 91 percent in Japan, 49 percent in the Netherlands, 43 percent in Sweden, and 37 percent in France.

I believe that this sluggish productivity has been a major factor accounting for our decline in competitiveness and, in many cases, profitability.

2. OUR UNSATISFACTORY POSITION IN EXPORT COMPETITIVENESS

I have attached a chart to my statement. What it shows is that during the decade of the 1960's, when Japan's exports were increasing 400 percent, Italy's 210, Canada, 285, all the way down to the United Kingdom and the United States; the United States at 110, clearly our export competitive position was not moving in a satisfactory direction during the 1960's.

(The chart referred to above follows:)



3. TECHNOLOGICAL POSITION

Mr. PETERSON. To give in the limited time I have but one small example of the growing technological strength of our international competitors, foreign applications to the U.S. Patent Office have moved up from below 20 to around 40 percent of total applications since 1961.

But, in some ways, even more fundamental to our problem, is the question of our own attitudes. There is little question in my mind that too many of us in this country suffered from a "perceptual lag"—a belief that because we once dominated the world's international markets, we always would.

I don't even remember in my previous business incarnation ever waking up, driving to work, and thinking how glad I was to have competitors. Deep down I suspect few of us really enjoy competition. It was easy to like foreign competitors even less, but we certainly learn, if too slowly and reluctantly, to respect the enormous importance of competition in spurring us to improve products and lower costs in ways we would not otherwise do,

We tended even as recently as 10 years ago to see foreign manufacturers as being almost inherently of lower quality—certainly less technologically advanced, "Chinese copiers," if I may mix my metaphors. Foreign competition then just wasn't a dominant fact of life.

As my good friend and former business associate Chuck Percy can attest, even in the amateur photographic market 10 years ago, as I recall, only about 10 percent of the market was held by foreign imports. But, and I say this with a slight wince, we were forced to become rapidly "oriented" to overseas competition during the decade.

Thus, at the end of a decade when costs went up and prices rose all too easily in the attempt to cover them, I think too many managements slipped into the habit of being more concerned with the short-term earnings statement than with the long-term improvement of productivity. And yet in a competitive world, long-term earnings were seriously affected by sagging productivity.

The point is that increased productivity is a key to our future competitiveness. The emphasis on productivity must come from the top. I believe the inflation psychology, or I should say the inflation virus, affected the management of some, perhaps many, of our companies.

Must we not reinstill in our businesses both the rationale and indeed the passion for productivity? Productivity must become a way of life.

And in an era when our business and labor people see each other all too often as adversaries, with the consumer as an innocent victim, is not added productivity the bridge that links their interests—for higher wages, higher profits, and stable and competitive prices?

The President has set up a Productivity Commission consisting of outstanding labor, management and public representatives. As you know, Congress has authorized $10 million for this effort. And the President has asked me to chair it. This effort will focus on specific issues such as productivity bargaining, how we communicate both the overall importance and the specific techniques of productivity improvement, and how to approach the particular problems of particular industries, such as construction on the one hand and local, State and Federal Government on the other.

But we must also focus on some of these longer range issues, even if we don't come up with all the answers by 1972 or 1973.

For example, by 1980, full employment will require jobs for something close to 100 million Americans, about 20 million more than at the beginning of the decade.

The problem of finding jobs for this labor force will require both an economy growing at its full potential (which, in turn, means exploiting to the fullest our international opportunities) and, among other things, a much improved system of fitting manpower skills to job requirements.

The United States today is over-supplied with technical manpower for its defense and space requirements. Yet, there are shortages of laboratory specialists, medical assistants, computer technicians, and maintenance personnel for other complex equipment. I am told that less than half of the available jobs have been filled in these specialists.

The mismatch of technical skills to opportunities, and what might be the current and perhaps continuing excess supply of college graduates, is compounded by an apparent shortage of appropriate vocational training in high schools and post high school education and training.

Some estimate that 8 of 10 in high schools should be receiving occupational skill training, yet, less than 1 in 4 are receiving it and much of this training is not directed to anticipated needs in the labor force.

Yet, our high schools and colleges (with nearly 40 percent of college age young people now in colleges) are turning out many graduates in much the same way as always, on the presumption that society will need their skills.

If indeed it doesn't, we can logically look forward to future generations of angry men and women. And, of course, unemployment will be significantly higher than it need be.

Let me share with you a personal experience that may dramatize the training problem and, indeed, opportunity for you. About 5 years ago, my predecessor company looked at the obvious fact that our economy was growing increasingly sophisticated, requiring in turn more and more people in the services, but more and more people who had specific skills.

Yet, as we looked at the rigidities of the public school system, we decided there were real opportunities to fill this training vacuum—and the company went into the business of training electronic and computer technicians.

In 1968, I recall vividly the decision to build about nine residential schools across the country. To particularize this, I recall the case of Phoenix, Ariz., in which we courageously, I thought at the time, decided to plan a school that could handle 500 students, even though it might have seemed more prudent to build a technical school for 300 students.

I had occasion recently to be in Phoenix and I was told that the school had to be expanded several times and was now handling about 1,500 students, or perhaps even more by now.

What was even more shocking was that over 40 percent of the students came from California which, as you know, has low cost junior colleges in the vocational field. And if the experience continues to be what it has been in the past, many of these Phoenix students will be getting several job offers at the same time their friends without such training will be getting no job offers.

It is experiences like these that suggest that an important part of our unemployment problem may be increasingly structural. It also helps explain why the 1973 budget includes some $50 million to explore various ways career education can be given a new, and more relevant thrust, in bridging the gap between school and work.

Let us take another area as an example of longer range approaches to our employment problems. As we explore how dependent our experts have been in technological contents, as we refresh ourselves on the importance of research and development in increasing productivity, it is clear that our longer range success in meeting our employment goals may also depend heavily on how well we manage and stimulate America's R. & D. effort. We must do a good deal better.

For example, many people have tended to confuse Government R. & D. with our overall private industrial R. & D. capability. That is a dangerous error.

While one can think of individual examples showing the advance of Government R. & D. into the private economy, in the forms of better products or entirely new products, I feel this is an area of serious shortcoming.

I question that we have had much real or broad success in getting highly successful product and marketing firms involved with Government-financed R. & D.—and in translating technological improvement into increased industrial productivity and enhanced competitiveness.

The most prudent premise is that we don't now have the proper arrangements to increase the industrial pay-out from Government R. & D. This is the reason the President has, in his new technologies program, provided money for some major experiments on how this industrial fallout can be increased

I think many companies reason that they are going to commit their best people only to projects in which the company will enjoy a rich share of the rewards, if the project is successful.

One thrust that must be explored is how we can get such companies to commit some of their own funds and some of their best technological people to projects that may not have immediate payout.

This also suggests a look at our patent policies to fashion means in which we can provide participation incentives to such "partnership" companies, while at the same time protecting the public's investment through some arrangement such as royalties, or perhaps even some concept of profit sharing.

In the time I have taken today you can see I have tried to stay away from that very important ground of our economic performance and program for the years 1972 and 1973, ground already cultivated so well by Secretaries Connally and Hodgson and Messrs. Shultz, Burns, and Stein. It is, of course, imperative that you deal seriously with these urgent questions.

Rather, I have tried to focus more in other longer range areas that I believe are also worthy of your distinguished committee's time and energy—the issue of what we should be doing now in such areas as longer range trade and monetary reform, in longer range productivity improvements—to help assure that the rest of the seventies and eighties are an era of full employment, an era of price stability, and an era of competitiveness in what is an increasingly economic world and an increasingly competitive world.

Thank you, Mr. Chairman.

Representative Reuss. You end up asking that we concentrate our attention on, as you put it, the issue of what we should be doing now in such areas as longer range trade and monetary reform. I thoroughly agree with you.

In your excellent report, which Senator Percy referred to, you have given your ideas on long-range trade policy ideas. It seems to be generally agreed that 1973 is going to be the year of the big tariff and nontariff negotiations with the Common Market, Japan, Canada, and everybody else.

If it is to be, of course, it requires major new legislation. Yet, I hear it said that the administration is not going to have any such legislation this year, that this is an election year and it would be better to wait until next year. If that is so, I am disappointed.

It seems to me that if the administration doesn't do anything about it this year, the election is likely to produce a worse rather than congressional environment next year.

Secondly, I don't see how, with a new administration or a reelected administration, as the case may be, and a new Congress, if a trade bill is not sent up until next year, in 1973, how it is going to be enacted in time for there to be any real start to negotiations in 1973.

Therefore, why not send up a bill this year, so that the trade legislation-writing committees can have some hearings and take a look at it? It would not necessarily be enacted this year, but it would certainly be a good idea to get it in the domain of public dialog and have congressional hearings, if not completed, at least substantially underway.

If eventually, why not now?

Mr. PETERSON. Representative Reuss, I believe you indicated that this was what you heard. To my knowledge, and I think I would know, there has not been a decision not to propose trade legislation. As a matter of fact, under the Council of International Economic Policy, a major amount of effort is going on into planning the elements of what I think will be one of the most comprehensive trade packages the country has ever seen.

There is some reason beyond the fact that it is going to take a few more months, I think, to get the total package prepared, why timing, I think, is important. In the first place, there is the critical matter of priorities in the legislative arena.

The Ways and Means Committee, as you know, has on its plate a rather full legislative menu at the moment—revenue sharing, health care, a number of other items.

Representative REUSS. Revenue sharing has had hearings and they are starting executive sessions today. When you get a Mills bill that the administration agrees to, that doesn't present many problems. I think that will be out of the way soon. I don't know about all this over full employment on the Ways and Means Committee.

Mr. PETERSON. I am a nonexpert on many subjects, but I have been told it is quite a menu.

Secondly, there are some very important discussions going on now in the so-called OECD trade group. In fact, meetings were held last week most of the week. One of the principal purposes of this trade group is to try to define the parameters of multilateral trade negotiations.

The Williams Commission and others, the others being in Congress, have strongly counseled us to be sure that in asking for trade liberalizing authority in the future we consult very closely with the rest of the world and with them.

By about May of this year, perhaps early June but we are hopeful in May, the OECD trade group will hopefully have articulated a variety of areas where it will be possible to engage in trade negotiations.

We have felt it very important to know what those areas are, as have a variety of Senators and Congressmen, on the grounds that if we are going to ask for liberalizing authority we get the very clear message from the Congress that it will be very desirable to know what the quids are and what the quos are.

We are very much, therefore, in the process of planning that operation.

A third factor, to be quite candid about it, is to allow a few months to pass which in turn will permit the effects of certain other policies to show their impact. We are hopeful that a little later in the year some of the effects of the exchange rate, after the initial perverse effects demonstrate themselves, will begin to operate and the country will see how enormously important these exchange rate alinements are in regressing our trade balance.

Finally, I think it is also candid for me to say that the right environment probably includes an unemployment situation in this country that is improving.

We are confident that later in the year it will improve, and for that reason as well, we think a better timing might be a little later in the year. But as far as I know, certainly no decision has been made not to introduce trade legislation, and a great deal of work is now going on that will put us in a position to submit it a little later in the year, if that is what the President decides.

Representative REUSS. I am very encouraged by your answer. It is news to me. I gather it is your own personal view that there should be sent up to the Congress this year in time for at least consideration, if not passage, comprehensive trade legislation.

Mr. PETERSON. It is my view that if the climate is right, Congressman, and that climate includes not only having the work program done, which is going to take a few months, but real progress in the OECD so that we can be much more definitive than we can at the moment.

That climate, I think, does include improvement in our domestic situation, which I think is desirable in order to submit that kind of legislation.

Representative REUSS. I do, too, but I am a little put down by the suggestion that unless the climate is right, by which you mean unemployment decisively down, no trade legislation.

Has it occurred to people in the administration that if the Ways and Means Committee isn't busy considering new forward-looking trade legislation it may be busy considering Burke-Hartke?

Mr. PETERSON. I am sure that there are a lot of things that haven't occurred to us but that is one thing that has occurred to us. I am clearly on record, as is Secretary Connally and a variety of other important spokesmen, feeling that the Burke-Hartke bill would be a very undesirable bill from the standpoint of the long-term interests of this country.

We feel there are far better alternatives to that, including negotiation. Also, in the event that possibility were to become real, that might have quite an effect on the timing of any trade legislation.

More important, it would be sending an alternative that would be far more responsive than that.

Representative REUSS. Let me turn now to the statement you made in your oral statement on profits, where you said that: "Even in 1971, when profits went up slightly, they were still below any other year since the end of World War II, when expressed as a perecnt of GNP."

It is your view that profits should always increase, or at least stay the same, as a percentage of GNP, no matter how much improvement there is in GNP?

Mr. PETERSON. In the late 1940's, it was in the 8 to 9 percent range and now it is in the 4 to 4.5 percent range, so it is half of what it was as a percentage.

I am not an expert on precisely what the level should be, except I do know this: that in the Productivity Commission, under Mr. Passer's chairmanship, there has been a lot of work done on capital formation requirements in the 1970's, if we are going to provide these new jobs, substantially more jobs, incidentally, than we have had to provide in previous decades.

I think there is every evidence that the capital requirements will go up substantially. In our system, one important source of capital, obviously, is profits. So I guess in a rather circular answer to your question, I see nothing to suggest that corporate profits could be much smaller than they would have been in previous months.

Perhaps you would want to say something, Mr. Passer. You are much more expert on this than I am.

Mr. PASSER. Thank you, Mr. Peterson.

Mr. Reuss, I would just like to add to that, as Mr. Peterson has made the point, that in the 1970's we will need a considerable amount of capital in order to continue to have the investment needed to move this economy ahead.

I might add to that that it is pretty clear that profits are an incentive for job creation, and that the very low level of profits relative to national income has certainly been an inhibiting factor.

So when we talk about this need for the very large number of jobs to be created in the 1970's, the kind of environment in which this can in fact occur would be a environment in which there would be an improvement in profits from these very depressed levels.

Mr. PETERSON. I think, Mr. Reuss, the number I recall—and you can check me on this, Harold—is that as we more into not only many more new jobs, but jobs with an increasing skill content, the evidence that I have seen suggests that the capital required per job, if anything, is likely to go up rather than down.

The latest estimate I have seen is at least $20,000 per job. So I think we are in an era when we will need more capital, rather than less, whatever the source might be.

Representative REUSS. What about the Henry Ford approach, smaller profits and make it up on volume? Wouldn't corporations be better off with full employment, full production, with somewhat of a shift of national income toward the 25 million Americans defined as poor?

Wouldn't a smaller profit percentage, on a larger GNP, be actually better for the corporations than keeping income shares where they are now and having a static percentage of GNP, but a relatively stagnant GNP, which is what we have had recently?

Mr. PETERSON. Mr. Reuss, I won't say it has been intentional, but I think I would argue that if profits are half of the previous share of GNP there has already been a rather substantial reallocation somewhere. Certainly, business profits have not had the share they had before.

Representative REUSS. Corporate profits this year are going to be the highest in the history of the Republic, are they not? Isn't that what you are predicting?

Mr. PETERSON. Let's look at the dollars. They did go up in 1971 to about $47 billion.

Representative REUSS. What do you predict for 1972?

Mr. PETERSON. I have seen estimates all the way from 10 to 20 percent up as the kind of range I have seen.

Representative REUSS. $56 billion or $57 billion?

Mr. PETERSON. Ten percent would be about $52 billion, and 20 percent would be $56 billion.

Representative REUSS. Which is considerably higher than ever before in the history of our country, isn't it?

Mr. PETERSON. Well, let's look at the record.

Representative REUSS. Wasn't the highest after taxes in 1966, $49 billion?

Mr. PETERSON. In 1966, they were $49.9 billion. I think you, among others, have reminded us of the inflationary rates that have taken place since 1966. If the capital requirements are what I think they are, it is perfectly obvious that capital is costing a great deal more dollars today than in 1966.

Harold, what has been the aggregate rate of inflation since 1966?

Mr. PASSER. Approximately 25 percent. We will supply additional information for the record relative to this.

(The information to be furnished follows:)

The January 1972 issue of *Business Conditions Digest*, a Commerce Department publication, carried for the first time a chart of corporate profits in real terms. This chart, on page 30 of the January issue, shows that real corporate profits in 1971 were more than 20 percent below 1966. Thus even a 10 to 20 percent rise in 1972 from the 1971 level would still leave real corporate profits well below the 1966 level.

Mr. PETERSON. Then in 1966 dollars it is perfectly clear, I think, that 1972 profits would still be substantially below 1966 profits.

Representative REUSS. I guess my point is that with your expecting this year the highest profits since 1789, it can't exactly be said that we are destroying the profit system in this country.

Mr. PETERSON. I haven't said we are destroying the profit system. I am saying that given the capital requirements that we all want, the requirement will be more for profits. I haven't suggested we have destroyed the system. I am saying that I see little evidence that we can get along with lesser capital requirements, given this requirement.

Representative REUSS. Perhaps Mr. Passer can furnish the data in response to this final question.

Why shouldn't corporations rely on the capital market for a substantial part of the capital funds that they will need? Why should

Government in its tax policy try to accommodate all the capital needs by allowing the earnings to stay in the corporations in the first place? Do you get my question?

Mr. PASSER. Yes.

Representative REUSS. My time is up, so perhaps you could add at this point in the record your answer.

(The information to be furnished follows:)

The need for business investment promises to be substantial during the 1970's. New and more efficient plant and equipment are required to help increase productivity, to provide jobs for a growing labor force, to abate pollution, and to improve job safety. These and other needs taken together will generate a large demand for capital funds.

There have been several studies of the capital needs for the next 10 years or more. The results of these studies are mixed, with no universal agreement about whether there will or will not be a capital shortage. There is general agreement, however, that the demand will be large. My own view is that with even-handed economic policies to assure relative price stability once full employment is reached and moderate interest rates, the supply of funds in the aggregate will be adequate during the 1970's, but serious allocation problems are possible. This is particularly true for the business sector. which will need more funds than it is able to generate internally. Indeed, the financial outlook for business may be one of the most crucial situations facing the economy during the 1970's.

The business sector has always relied upon the capital markets, to some extent, for financing purposes. Even in 1948 when corporate profits after taxes were almost 9 percent of the GNP, the internally generated funds of nonfinancial corporate businesses were insufficient to meet their capital needs. Consequently, about one-fourth of all their funds were obtained from external sources.

There have been some important changes in the sources of business funds during recent years. In 1950, for example, about 75 percent of business funds were generated internally through undistributed profits and capital consumption allowances (see table). The remaining funds were obtained through the capital markets. Corporate profits (after taxes) as a percent of the Gross National Product (GNP) were almost 9 percent in 1950.

The relative shares accounted for by internal and external funds were essentially the same in 1955 and 1960 as they had been in 1950, even though the ratio of corporate profits after taxes to the GNP was reduced considerably. Moreover, the relative distribution between internal and external funds was unchanged during the entire first half of the 1960's. Thus, from 1961 to 1965, internally generated funds accounted for slightly more than 75 percent of total nonfinancial corporate business funds.

Within the internal funds category, however, the relative proportion accounted for by undistributed profits declined substantially. In 1950, for example, undistributed profits were about 62 percent of internal funds; in the period 1961 to 1965 they accounted for only 31 percent or half as much.

During the 1966 to 1970 period. there was a significant shift in the fiancing structure of the business sector. Internally generated funds accounted for only about 65 percent of all funds while external funds increased to almost 35 percent of the total. Not surprisingly, the ratio of corporate profits to GNP declined sharply during this period and in fact by 1970 it was less than half the postwar high in 1948.

Most of the increase in external sources of business funds during the 1961–1970 period was accounted for by debt and equity financing and non-bank loans. Corporate bonds increased from an annual average of $4.5 billion during the period 1961–1965 to $14 billion during 1966–1970. Equity financing increased from about $1 billion a year in the 1961–1965 period to almost $3 billion a year in the 1966–1970 period. Non-bank loans increased from $.5 billion a year in 1961–1965 to almost $4 billion a year in the next five-year period.

Although internal funds were insufficient to finance capital outlays during the period 1961–1965, the shortfall was greater during the next five years. The unimpressive behavior of corporate profits accounted for a substantial part of this development, although admittedly not all. Higher depreciation allowances reduce corporate profits, for example, but do not reduce internally generated funds. Also, the last half of the 1960's was a period of rising interest rates. Since there was considerably larger external debt financing by business, interest costs rose substantially and thus helped to reduce corporate profits after taxes. Temporary suspension and later elimination of the investment tax credit in 1969 also helped to weaken the corporate profits picture.

The likelihood of large capital needs during the 1970's emphasizes the importance of corporate profits and the need for internal funds. As indicated, the ratio of corporate profits after taxes to the GNP declined sharply from its postwar high in 1948 to the low point in 1970. There was some improvement in 1971, but the ratio was still only about one-half the 1948 rate.

There is no fixed ratio that one can say is correct or proper. It is reasonable to maintain, however, that the ratio should not be substantially more or substantially less than the historical average.

Even if the ratio of corporate profits to the GNP returns to its postwar high, corporations in all likelihood will have to rely to some extent on the capital markets for some financing, as they have had to do in the past. The problem is that if corporate profits, or other measures of successful business performance, are not sufficiently attractive, business would find it difficult to obtain equity funds or find it burdensome to pay the interest charges on borrowed funds. In order to attract equity funds, of course, corporations must demonstrate that it is profitable for investors to supply such funds. In part, business may be caught in a circular problem.

Business could continue to rely more heavily upon debt financing as they have had to do during the last half of the 1960's and the first few years of the 1970's. However, business debt has been growing faster than business activity and debt-equity ratios have been rising. Interest costs of business also have been rising very rapidly, reflecting the shift upward in interest rates during the past several years. Thus, many business firms have developed a disinclination or an inability to obtain additional funds through the issuance of debt.

In summary, business requirements for capital funds during the next 5–10 years appear to be large. Corporate profits, an important source of internal funds, have not kept pace with the total economy, forcing business to rely more heavily on external financing and particularly in recent years, on debt financing. Although business has always had to rely upon external financing to some extent, even when the relative share of corporate profits was much more favorable than now, it has had to rely more heavily on the capital markets in recent years. Moreover, presently high debt-equity ratios could create a financing problem for business, if they are forced to seek substantial amounts of equity capital. Investors seek the most profitable uses for their funds and low profit margins are not conducive to the attracting of such equity funds. Thus, it is difficult to avoid the conclusion that increased business profitability is required if business is to obtain the necessary funds in the years ahead, either from internal or external sources.

SOURCES OF NONFINANCIAL CORPORATE BUSINESS FUNDS

[Percentage distribution]

	1950	1955	1961–65	1966–70	1961–70
Internal	75.2	73.9	75.7	65.7	69.5
Undistributed profits	46.3	31.8	23.6	17.4	19.8
Capital consumption allowances	28.9	42.2	52.1	48.3	49.7
External	24.8	26.1	24.3	34.3	30.5
Stocks	4.7	4.7	1.4	3.0	2.3
Bonds	5.4	6.9	7.6	14.8	12.0
Mortgages	3.0	4.5	7.1	5.2	5.9
Loans	11.4	9.9	7.5	7.4	7.4
Other	.3	(1)	.8	3.9	2.7
Rate of capital requirements to internal funds	107.5	105.7	108.1	126.8	119.0

1 Less than 0.1 percent.

Source: Board of Governors, Federal Reserve System.

Note: Details may not add to totals because of rounding.

Representative REUSS. Senator Javits.

Senator JAVITS. Thank you, Congressman Reuss. I would like to profile you a partial answer. This is in order to raise capital in the market, you have to show profits. It doubles back on itself. If you don't have profits, nobody is going to lend you money and you will pay a lot more for money than you otherwise should.

Incidentally, Mr. Peterson, at the risk of belaboring the issue, I would like to join Congressman Reuss in the urgency at the moment in the trade field. We are in terrible trouble in this country in terms of protectionism and isolationism. Let's stop kidding. Unless the administration moves in to take a strong and solid position against it, you may have "no nothingism" sweeping the American economy.

The result will be a world depression and catastrophic unemployment in this country if legislation such as the Hartke-Burke bill becomes law. The moment is now. I would like to state that to you, as the new Secretary of Commerce, unequivocally. I am deeply convinced of it. We are in dreadful troubles since the proponents of this disastrous legislation have been working very hard.

All this pussyfooting around about whether to send up a trade bill tomorrow, the next day or next year, when the moment is right for this now may cause you to miss the boat by a mile. I think the Burke-Hartke bill has a big head of steam. That will be difficult to stop be it this year or the next. I think the fact that the internationals and the labor movement have gone thoroughly protectionist against the best interests, against the interests of their workers, is an unbelievable sociological development in this country

Unless the Government, representing all the people and the interest of our total economy, stands up to it in a manly way, you are going to run right into a difficult legislative situation that could contribute to trade wars and world depression. We are right on the brink of it.

I don't think you fellows know the attitude in the Congress if you think you can, wait until the moment is propitious, when unemployment is down from 6 to 5.4 or 5.5 percent to launch a positive counteroffensive based on a positive legislative approach. By then the whole thing may be gone.

I wish to sound advisedly a note of the gravest emergency on growing protectionism, coupled with the fact, because it directly is coupled, that productivity is down, disastrously down. There is also a deep erosion of motivation by the American worker and because the administration doesn't face up to what a business administration should.

You put your finger on it, on profits. The chair argued with you. It is a strange anomaly that Congressman Reuss, who is a very able man, should have a blind spot on profits. The question isn't the profits, the question is what do you do with them. For example, there is a disastrous situation in American pension and welfare plans which are supposed to provide for the security of the worker, for the future, 30 million workers. Why? Because not enough money is going out of profits into the pension and welfare fund.

There is nothing that is going to fatten the pockets of people in Palm Beach, if you use profits to provide for better pensions, or if you use it to create jobs, or to get abreast of modern technology, which you are not doing.

Congressman Reuss has given you an excellent lead in the trade area. He represents the party that controls the Congress. I hope you will bring the message home to the White House. All the questions I can ask are meaningless if the administration doesn't realize that.

All this parochialism that we are seeing—well, I look to you as a businessman, the successor to a man I esteem so highly, as I do Senator Percy, I look to you to be the evangelist in this Government or the matters of fighting protectionism and improving productivity. You haven't a job; you have a mission.

I am serious about it, You have enough friends around here to back you up, but you have to do something. You have to come forward with concrete, positive proposals. If the administration is going to play election year politics with this, which I hope and pray they won't do—the President certainly hasn't done it in going to China—you ought to do the same thing in the economic field in terms of legislation. You have to act and be bold, or you are going to be in a lot of trouble. The other side has come forward with a bold proposal—it is disastrous and backward looking but it is bold.

Mr. PETERSON. That is an inspiring message and I trust I will be properly inspired, Senator.

Senator JAVITS. I have had this very much on my chest and I thank Representative Reuss for indulging me.

Representative REUSS. I enjoyed a good part of your statement.

Senator JAVITS. On the productivity business, I think you point out very properly our decline in the productivity level. I would like to ask you this: What is the administration's view, if they have one, on the incentive to productivity which comes out of imports? Let's remember the analogy that the United Kingdom is joining the Common Market in order to put the pressure on itself; or, in other words, so that it is subject to competitive pressures of the Common Market.

How do you relate imports to the issue of productivity in this country?

Mr. PETERSON. Senator, in the part of my statement before you came I made the point that there are very few businessmen that I know that if they were honest would say they enjoyed competition or liked it.

I think it is possible, as I indicated, to like foreign competitors even less. But I think in those more sober moments when we reflect on the truth of the situation, any businessman that I know worth his salt will acknowledge that without the spur of competition we are far less likely to take those steps to innovate in the area of new products or to lower costs.

To me, one of the most disastrous effects imaginable of permanent restrictions of products into this country is that it would have two tendencies: It would tend, first of all, to remove one of the principal spurs to increased productivity.

Second, it would have a tendency to freeze our economy into a certain distribution of our resources, whereas, the rest of the world, over the period of the next 10 to 20 years would be shifting its resources into things in which it had higher productivity.

So I feel that the effects of permanent restrictions of the type you refer to are disastrous both on the short-term, in terms of productivity, but also on the entire structure of the American economy over the next 10 to 20 years.

Senator JAVITS. In the productivity field, we gave you $10 million only because the administration didn't back it. If you hadn't had Chuck Percy and myself in the Senate, nothing would have been done

What recommendations are you going to make to the administration or could you make any to us on what you really need to put on a major productivity drive in this country?

Mr. PETERSON. Senator, I am going to hide under the honest cloak of lack of full knowledge. I will only take over the chairmanship of the Productivity Commission when the President signs my commission next week. So it is really too early for me to lay out a program.

I can only tell you that he has talked to me about productivity. If you read his speech to the World Conference on 1990, I hope you were encouraged. I will be happy to send it to you if you haven't read it.

Senator JAVITS. I have read it.

Mr. PETERSON. I think compared at least to a year or two ago, there is much more recognition today than there was a year ago that the world is not ever going to be the same again. We are in a competitive ball game that is truly at the Olympic level, and increased productivity is absolutely the central part of that program. It must be.

Senator JAVITS. My time is up, Mr. Peterson, but may I just add one point?

The public relations problem that our chairman put his finger on is to translate that into goods, not goods in a finite thing but good things, peace, stability, as well as stabilization of the economy for the American worker in a normal America.

The idea is all too prevalent that all of these things you talk about are good for the fellow who is the manager of industry, the fellow in the front office, and don't reach down to the humble American who is working very hard for under $10,000 a year.

I strongly urge you to be sure that that relationship is constantly not asserted—that is nonsense—but planned for and demonstrated.

Thank you, Congressman Reuss.

Mr. PETERSON. Thank you, Senator.

Representative REUSS. Senator Percy.

Senator PERCY. I would like to reiterate what Senator Javits has said, Mr. Peterson. I know that many times the Congress is looked on by downtown as the enemy. But in this regard, I would say categorically that in the past, in my short experience in the Senate, many times we would have had highly restrictive and dangerous trade legislation if Senator Javits and I had not agreed at all times we would be on the floor. We had an arrangement with Senator Mansfield not to allow anything to be decided on the floor if the two of us were not there.

So we do need strong support now in the administration and, I think, some muscle. Restrictive trade legislation could come soon, and the gold adjustment bill could be the vehicle on which restrictive bills will be hung.

We also need a lot of support in the productivity area.

I think we should add that we have not only unanimity here in the two parties, but when a former chief economist for Eastman Kodak sits alongside the former chief executive for Bell & Howell, we really have unanimity.

Mr. PETERSON. I want you to know that the antitrust implications of this do not exist.

Senator PERCY. Mr. Peterson, I would like to ask you about China. I realize some of the questions you may have to exercise executive privilege on. I will understand it if you do.

First, can you tell us whether trade is on the agenda of the President for Peking? Is it possible, do you think, that trade can be one of the things that the President refers to as opportunities for the future? He has made it clear that he wishes unilaterally to remove a lot of these restrictions that we have clung to in the past, in the cold war, and that period should be over.

What is the potential for trade with China? What can you say about a State like Illinois? What is our potential for exports to China and, therefore, creation of jobs in this country? What do they have that we can buy in return?

Mr. PETERSON. First, Senator, as you indicated, the President has taken some unilateral initiatives of his own, both last summer and last week. I think this is the case, and I am far from a China expert or China watcher, where in the Chinese view appropriate political and perhaps security relationships will probably precede any major expansion in trade.

But that is obviously a conjecture on my part; since we have been forthcoming in the reduction of barriers in trade to China.

Second, I think while the long-term outlook for trade with China is indeed a very promising one, given 800 million people and given the enormity of their economy potential over a long period, I wonder if I could refresh your memory, if it needs refreshing, on the amount of exports that China accounts for in the world today.

In 1970, for example, our estimates are that China accounted for only 0.9 percent of the world's exports, whereas Japan, for example, a country with one-eighth of the people, accounted for about 6 percent of the world exports.

So we have the interesting phenomenon of a country with one-eighth the people doing about six or seven times as much trade.

My own candid view on this is that trade is not likely to develop into very large numbers for some time, due not only to the political climate that I mentioned earlier, but due to the fact that at the present time, Senator, China is not a major exporting or importing nation.

Senator PERCY. In the CIEP task force report on adjustment assistance, the recommendation is made that programs of adjustment assistance to communities be limited in scope. Why is this so? What sort of limitation should be placed on the adjustment assistance programs?

Mr. PETERSON. Would you repeat that again, Senator?

Senator PERCY. The task force report made recommendations that adjustment assistance programs to communities be limited in scope. In other words, limitations should be placed on assistance to a community or an industry affected adversely by imports.

What are your views on how far the Federal Government should go in assisting and helping industries adversely affected by imports?

Mr. PETERSON. There is no question, Senator, if I can take your last question first, that one of the things that has happened in the trade field is that competitive impact, as you well know, is coming harder and faster than it did in the past and, therefore, one of the programs that has received enormous energy in the Government is a much more comprehensive adjustment assistance program to industries that have been impacted.

As far as communities are concerned, I think what that report intended to say was that there is a wide variety of, as you know, regional and community economic support activities that take place now, and that the impact of imports tends to be on particular companies or particular industries.

I think the view was that we should probably rely less on some of these communitywide activities and put more of the adjustment assistance effort at the industry level and at the worker level. Incidentally, I personally feel that a good deal of adjustment assistance should be at the worker level, because that is where the impact is the most serious.

Senator PERCY. In your report to the President recently, "The United States and the Changing World," you pointed out that Japan has thought of certain industries as what are termed "throwaway" industries, and others as "early state industrialization activities" which do not deserve all-out Government assistance to keep them alive. Nevertheless, the task force report on adjustment assistance make no such distinction in its description of what the ideal adjustment assistance program should be.

Would you care to comment on the adaptability of the Japanese approach to our own adjustment assistance program?

Mr. PETERSON. I think, Senator, as you well know, any formulation that decides in advance that a particular industry or a particular company cannot adjust, strikes me as the kind of prescription that mortals in Washington are really ill equipped to make.

We have too many cases of companies and impacted industries who are doing extraordinarily well because they have been very imaginative. You will recall our own experience previously where the response to some of this competition led the company to do things that prior to that people thought could not have been done. Therefore, I would personally not be inclined to make any kind of absolute judgment that certain companies or certain industries in advance cannot compete.

I would be inclined to look at ways of making them more productive through productivity incentives, through technological incentives, through R. & D. efforts of all kinds. Then if it is in fact demonstrated that a particular industry or company cannot compete, then I think is the time to really look into adjustment efforts.

But I would be reluctant to be making that kind of prognosis from Washington in advance.

Senator PERCY. You mentioned productivity as the answer to many of our economic problems. I would like to give you the same opportunity we have given every other witness, including Secretary Connally recently, to put on the record your own support of legislative initiatives undertaken. First, the amendment by Senator Javits to provide $10 million to fund productivity councils and to beef up the Productivity Commission. We were aghast to find this prestigious Commission with only an Executive Director and a secretary, and he was to mobilize all of America, its industry and labor, to increase productivity.

Do you feel this will be a major part of your work as Secretary of Commerce, to see that we create productivity councils across the country, plant by plant, industry by industry, department by department, if necessary, within companies?

Mr. PETERSON. In my discussions, Senator, with the President about my new role, I was very encouraged that he put primary emphasis on the future competitiveness of this economy.

I think he very wisely pointed out that while we need a better monetary system and we need it badly, and while we need better trading systems and need them badly, ultimately, whether we survive effectively in this world depends on whether we can compete.

He considers, and I consider, increased productivity as the single most important thing this country has to do in that regard. So I welcome your support of this activity.

Senator PERCY. There is one other aspect to productivity. You believe deeply in incentives and you can't exhort workers to produce more without saying why they should. Self-interest is a perfectly natural thing so we put an amendment in that I worked out with Senator Javits. He was the principal cosponsor of it and Senator Proxmire was a principal cosponsor of it, to totally exempt from the Wage Board any pay increases related to productivity increases. We need guidelines. I established a legislative history on the floor as to what I had in mind and, therefore, what the Congress had in mind in adopting this. But we need guidelines laid down by the Pay Board.

I have written a followup letter to the Pay Board. It has been several months now and we haven't had guidelines yet. Could you use your influence to blast those out of the Pay Board so that we can get underway? We have literally thousands of companies waiting to see what they can accomplish and do in this area, and they need guidelines.

Mr. PETERSON. I will be happy to use my influence, Senator, and happy to confirm my own support of what I think your view is.

One of the reasons that I believe increased productivity is so central is it is the only way I have been able to imagine, conceptually, that you can meet the requirement for higher wages and price stability and the profits that are necessary to support this capital formation. Any other formulation leaves somebody in that triangle inadequately compensated. I will be delighted to look at what guidelines can be implemented, because I think the sharing of increased rewards is one of the incentives that is needed to get labor, in particular, to be more productive.

Quite frankly, in some of the preliminary discussions I have had with some very able labor people, the attitude still persist about productivity, as you well know, that perhaps what we mean by productivity is people working harder and working faster but not sharing in the rewards. I don't know how many of you have seen the Charlie Chaplain movie of "Modern Times," but I commend it to anyone interested in this particular subject.

I think the sharing of a larger pie is an absolutely essential part of getting the motivation required in getting more productivity in our system.

Senator PERCY. I thank you for that. No Secretary of Labor could better try to dispel the fears. Specifically, on the floor, I said we are not talking about piecework, the dole system, or speedups. We are talking about overall plans developed by labor and management on the same side of the table just as Japan has been doing for 25 years, to our discomfort.

It is about time labor and management realized they had a lot in common. They have to work hard. The enemy is not each other, but it is the markets we are losing all over the world and in this country because we have not been working together.

Thank you very much.

Representative REUSS. Senator Javits.

Senator JAVITS. Thank you, Congressman Reuss.

I have a letter from the Department of Commerce relating to adjustment assistance which indicates that the amount requested in the budget is inadequate if you are going to do a job.

I would like unanimous consent to include that in the record. It is signed by the Assistant Secretary for Domestic International Business.

I would ask you, if you would, to comment on that.

Representative REUSS. Without objection, it will be received.

(The information to be furnished follows:)

THE ASSISTANT SECRETARY OF COMMERCE,
Washington, D.C., August 3, 1971.

Hon. JACOB K. JAVITS,
U.S. Senate,
Washington, D.C.

DEAR SENATOR JAVITS: During the recent hearings of the Senate Joint Economic Committee, Subcommittee on Foreign Economic Policy, you requested Mr. George Hildebrand, Deputy Under Secretary of the Labor Department, to obtain a statement from the Department of Commerce concerning the current and proposed expenditure of funds for the program of adjustment assistance to firms authorized under the Trade Expansion Act of 1962.

The statement attached shows the actual expenditures for assistance to firms during the fiscal year ending June 30, 1971, and the projection for fiscal 1972.

In response to the request for a statement concerning the amount of money needed to deal with "the worst effects upon both business and labor of undue concentration within a short period of time of increased imports" it is our belief that the amount proposed to be available, $65 million, for the fiscal year 1972 will not be sufficient to cope with the full impact of such developments. The request for funds for the fiscal year 1972 submitted by the Department of Commerce was predicated upon the qualifying conditions of the Trade Expansion Act of 1962, which specify that injury must be related to increased imports resulting from tariff concessions granted by the United States under trade agreements.

There are other areas in which imports have or may increase which cannot be readily identified in such a causative relation but which nevertheless have or could have had deleterious impact on domestic production and sales. The entire problem might be encompassed under the trade legislation proposed by the Administration to the last Congress which would have eliminated the requirement to relate injury from increased imports as directly resulting from tariff concessions.

While it is not possible at this time to determine the total cost of such a program, it is our estimate that a minimum of $100 million a year would be required to meet the needs for industry assistance predicated upon the liberalized criteria recommended by the President.

Sincerely,

ROBERT MCLELLAN,
Assistant Secretary for Domestic and International Business.

Enclosure.

DEPARTMENT OF COMMERCE

AMOUNTS OBLIGATED FOR TRADE ADJUSTMENT ASSISTANCE

	Fiscal year 1971	Fiscal year 1972
Bureau of Domestic Commerce loans and loan guarantees	(1)	[2] $65,000,000
Economic Development Administration technical assistance	$200,000	[2] 500,000
Total	200,000	65,500,000

[1] Funded by the Small Business Administration ($6,400,000 in outlays).
[2] Current request.

U.S. DEPARTMENT OF COMMERCE,
OFFICE OF THE SECRETARY,
Washington, D.C., March 27, 1972.

Hon. JACOB K. JAVITS,
U.S. Senate,
Washington, D.C.

DEAR JACK: This is in response to your letter of February 24, 1972, concerning the trade adjustment assistance program. I understand a similar letter has been sent to the Secretary of Labor and that he is communicating with you directly regarding the adjustment assistance program as it relates to workers. In it you asked several specific questions, and I have tried to answer each of them in this letter.

Your first question pertains to possible inadequacies in the current provisions of the Trade Expansion Act (TEA) that apply to trade adjustment assistance. In my view this question gets at the heart of problems that have been encountered with this program. As you point out, the entire program is under review both on an interagency and intradepartmental basis. Before this review is complete I hesitate to make piecemeal recomendations on possible changes in the statute. However, it is my personal feeling that there are some major deficiencies in the law. For example:

(a) Injury criteria are too stringent, especially the criterion limiting the availability of assistance to those cases in which injury has already occurred and in which the injury is a result "in major part" of prior trade concessions.

(b) The TEA does not provide for methods of response to import problems that would constitute a genuine adjustment assistance program for an industry as a whole apart from escape-clause relief.

In addition, as I pointed out in my report "The United States in a Changing World Economy," the adjustment process takes time even when accelerated by a good program of assistance. Recently some economic changes associated with increased imports have occurred very fast. When increasing imports have the potential to bring change faster than the adjustment system can cope with it—and thus to bring hardship—some have suggested that temporary orderly marketing mechanisms should be available. I believe we should explore the possibility of developing criteria for invoking such mechanisms, and see how these criteria can be internationalized so that such temporary protection could be available in all countries on an equitable basis.

You also asked whether the TEA provision requiring a Commerce certification of eligibility after the Tariff Commission or the President has already made such a determination is "an anachronism that serves no useful purpose." There are two situations in the certification process that relate to your question.

First, there is no finding of injury or threat of injury to any particular firm in cases where the Tariff Commission finds injury with respect to an industry and the President authorizes firms within the industry to request certification of eligibility to apply for adjustment assistance. Accordingly, the Department of Commerce must make a thorough investigation of the facts pertinent to each applicant firm, before determining whether the firm is eligible to apply for adjustment assistance.

A second situation is one in which the certification of eligibility to apply follows a Tariff Commission determination of injury upon petition of a particular firm. It can be argued with some justification in this situation that the Department's certification of eligibility to apply is largely pro forma. We have recognized this. On February 18, we published in the Federal Register proposed new regulations for the adjustment assistance program, a copy of which is enclosed. Section 500.23 of these proposed regulations is specifically designed to facilitate prompt certification of eligibility for individual firms that have already been the subject of an affirmative injury finding by the Tariff Commission. You will note that the extent of our review in such cases is limited to obtaining adequate assurances that no material facts were omitted from the firm's presentation before the Tariff Commission and that there has been no significant change in economic circumstances affecting the firm since that time. Of course, the statutory requirement of the TEA must be satisfied before we are justified in spending government monies on adjustment assistance. Again, my personal view is that a strong case can be made for changing the concept and approach to adjustment assistance from one of adjudication to one of program management by an Executive Department. Under the program management approach, the particular agency involved would administer adjustment assistance from beginning to end. This would permit us to get a much faster jump on the problems.

Your second question relates to the time taken to process cases. As I pointed out, the time lapse between application by a firm for eligibility to apply for adjustment assistance and the certification of such eligibility depends on whether the case stems from an injury determination with respect to the particular firm or with respect to the whole industry. In an individual firm case, an application to this Department for certification of eligibility to apply will be processed promptly, generally within 20 days. We have had one case, however, where certification was delayed until allegations of impropriety with respect to the Tariff Commission proceedings could be reviewed by the Department of Justice.

In cases where the Tariff Commission has made an injury finding as to the whole industry, the time involved is much longer. In these cases, apart from the fact that recourse to adjustment assistance is contingent upon an intervening decision by the President that such form of relief shall be available, the findings of the Commission with respect to the industry are not necessarily illustrative of the situation with respect to a particular firm. We must, therefore, determine whether the firm has been injured by the imports which the Tariff Commission found were injuring the industry. The length of time required for such an investigation depends on many factors, including the size of the firm, the diversity of its product line, the adequacy of its record keeping and the adequacy of the data submitted by the firm to the Department. One such investigation took as long as ten months, while another was completed within two months. Most cases more closely approximate the latter than the former in the amount of time spent on the investigation. As you know, although the trade adjustment assistance program was established in 1962, our experience with processing adjustment assistance cases only began in 1970, following the first affirmative finding by the Tariff Commission. We are now at the point where each case no longer involves entirely new policy considerations and I expect the time lapse between receipt of an application for certification of eligibility to apply and the granting of assistance to be even further reduced as we gain more experience.

With respect to your request for information on the total number of firms certified as eligible to apply for adjustment assistance, 20 firms have applied to date for certification of eligibility. Of these 20 firms, 18 have been certified eligible; one has been denied certification and one application is currently pending.

As to the data requested concerning recipients of adjustable assistance to date, please see the attached table. The time period between certification of eligibility to apply and certification of the firm's adjustment assistance proposal is set forth on this table as well.

You have requested information on the nature, scale and level of adjustment assistance over the past five fiscal years. For the reason explained above, no adjustment assistance was provided until Fiscal Year 1971, when two proposals were certified and financial assistance provided through the Small Business Administration. In Fiscal Year 1972, to date, we have committed $4,672,000 in financial assistance from our own appropriation. With respect to technical assistance, we committed $195,611 in Fiscal Year 1971 and $138,000 so far in Fiscal Year 1972. Total tax assistance certified to date (all in Fiscal Year 1972) amounted to $390,000.

Finally, you asked about the study undertaken by an inter-agency task force on adjustment assistance. As you know, this task force was established by the Council on International Economic Policy to develop recommendations for a more comprehensive and effective adjustment assistance program. It is still in draft form and has not yet been submitted to the Council. Accordingly, I cannot specifically respond to your inquiry as to the content and timing of possible legislative recommendations until the Council has had an opportunity to consider the findings and conclusions of the task force. The decision whether to make this report available to the Congress will presumably be made by the Council after it has completed its review.

I hope I have answered your questions. In closing, let me say that I believe there is much we can do to broaden both the concept and delivery of trade adjustment assistance. For example, we are now moving ahead in the Commerce Department to give close and expedited attention to the following possibilities:

(*a*) An early action mechanism designed to spot potential import-impact problems and to help industries and firms take prompt and responsive steps before a critical point of economic detriment is reached.

(*b*) Techniques and forms of assistance that could be made available on an industry-wide basis (e.g., funding for R&D projects of general application to the industry). This approach, in my view, would provide a broader-gauged response to adjustment assistance problems than that of dealing primarily with individual firm cases, as has been the approach to date under the TEA.

(*c*) Some form of adjustment assistance to communities economically dependent upon firms that are heavily impacted by import competition.

I appreciate your interest in the trade adjustment assistance program and intend to give it considerable attention in the coming months. Should you or your staff have further questions or useful information about adjustment assistance, please get in touch with me. I hope to continue to strengthen the program, and look forward to working with you toward that end.

Sincerely,

PETER G. PETERSON,
Secretary of Commerce.

Enclosures.

Company	Industry	Amount of assistance	Certification of eligibility	Proposal submitted	Proposal certified	Assistance provided
Emil J. Paidar Co., Chicago, Ill	Barber chairs	$2,500,000	July 20, 1971	July 29, 1970	Aug. 20, 1970	Sept. 20, 1970.
Benson Shoe Co., Lynn, Mass	Nonrubber footwear	1,700,000	July 21, 1970	Oct. 7, 1970	Nov. 19, 1970	Jan. 7, 1971.
Louis Shoe Co., Amesbury, Mass	do	747,000	May 4, 1971	Sept. 8, 1971	Oct. 19, 1971	2d disbursement, Jan. 20, 1972.
ASG Industries, Kingsport, Tenn	Sheet glass	4,000,000	Sept. 22, 1970	June 4, 1971	Dec. 7, 1971	
Arista Co., Winston-Salem, N.C	Textiles/data processing	160,000	Dec. 28, 1971	Feb. 2, 1971	Jan. 11, 1972	
H. H. Scott, Inc., Maynard, Mass	Consumer electronics	230,000	Mar. 18, 1971	Sept. 21, 1971	Dec. 23, 1971	
Estey Piano Corp., Union, N.J	Piano	[1] 100,000	June 5, 1970	February 1971	Mar. 4, 1971	
Bel-Tronics Corp., Addison, Ill	Electronic components	712,000	June 17, 1971	Oct. 25, 1971	Mar. 3, 1972	

[1] Approximate amount of technical assistance provided to date. Final amount of other assistance not yet determined.

Representative REUSS. We want to thank you very much, Mr. Peterson and Mr. Passer. We are glad that you are where you are and we wish you very well.

Mr. PETERSON. Thank you.

Representative REUSS. We will now ask Professor Bernstein and Professor Triffin to step up.

STATEMENT OF ROBERT TRIFFIN, PROFESSOR, DEPARTMENT OF ECONOMICS, YALE UNIVERSITY

Mr. TRIFFIN. Congressman Reuss, I recall, in the opening section of my statement, the untiring efforts of our committee, over a period of more than 12 years, to prod four successive administrations to negotiate fundamental reforms of an international monetary system whose obvious defects and unviability have been the source of multiplying and mounting crises, culminating in its total downfall on August 15 of last year.

Hopes for a prompt negotiation of such reforms were fanned by the Smithsonian agreement of December 18, hailed by President Nixon as "the most significant monetary agreement in the history of the world."

I have racked my brains ever since to discover what might justify such an extravagant appraisal, and I think I have succeeded. It is not, of course, the first time, nor—alas—the last time in the history of the world that exchange rates have been changed, or—to use the new terminology—realined. But it is the first time that responsible officials have candidly proclaimed that the international monetary system lay in utter shambles, could no longer be patched up or reconstructed on the previous basis, but would have to be totally and drastically reformed by concerted, multilateral, agreement. This is indeed without precedent in world history.

I shall resist the temptation of simplifying my job today by merely reading back to you my testimony before this very same committee, more than 12 years ago, on October 28, 1959. I raised at that time the two problems which still confront us now, that is, our persistent balance-of-payments deficits and their relation to an anachronistic and unviable international monetary system. I foresaw the recurrent and mounting gold and dollar crises that would confront us if we failed to solve these problems, and outlined the solutions that might ward off such crises.

I concluded: "I fervently hope that we shall be able to act in time, and to refute the disabused comment and dire prediction of a former colleague of mine in the administration: Triffin, you are very probably right, but, in this matter as in that of EPU, your proposals come several years too soon, and this time I don't honestly think you'll get anywhere until people are shaken into action by a real crisis. Then, maybe!"

Later events have unfortunately confirmed my friend's judgment. And even the growing crises, culminating in the August 15 suspension of dollar convertibility and the subsequent depreciation of the dollar, have not yet moved us to negotiate and implement the long overdue reforms of the international monetary system which died on August 15, after a long agony.

Congress—and particularly your committee—cannot be blamed for such procrastination. Twelve years ago, your committee was sufficiently impressed by my representation to take, by *unanimous* consent of both its Democratic and Republican members (and I quote from Senator Douglas' letter of transmittal) "the somewhat unusual course of transmitting to you for your consideration and, we hope, your comments, a copy to Mr. Triffin's statement and the transcript of the day's hearing" to the President of the United States, the Secretary of the Treasury, the Chairman of the Board of Governors of the Federal Reserve System, the Managing Director of the International Monetary Fund, and the chairmen of six congressional committees.

Responses to this "unusual" step of your committee were, alas, far from "unusual": the papers and suggestions were gratefully received and would be "read" or "carefully studied" by the agencies concerned. The only substantive comments were those of the Managing Director of the International Monetary Fund and of the Secretary of the Treasury. Neither of them could detect any real problem "under any foreseeable conditions" (Per Jacobsson) or "in the foreseeable future" (Secretary Anderson).

This failed to reassure your committee, as demonstrated by your later debates, and particularly by your decision to create a special Subcommittee on International Exchange and Payments. This subcommittee, under the farsighted and dynamic leadership of its Chairman, Henry S. Reuss, has issued since then about 25 volumes of hearings and reports, and a series of recommendations, some of which—but not all—have belatedly been adopted by successive administrations.

Let me mention particularly the support given by your committee to the establishment of the Special Drawing Rights system, but its warning, as early as September 1968 (in a report entitled "Next Steps in International Monetary Reform") that the mere creation of SDR's would not solve the problem if supplementary—or rather complementary—measures were not taken to deal with the residue of the previous system, that is, gold and dollars.

And when this oversight predictably triggered again new gold and dollar crises, your committee recommended, on August 6 of last year, a series of drastic measures, some—but again not all—of which were adopted by the administration, under the pressure of events, less than a week later, on August 15.

"THE MOST SIGNIFICANT AGREEMENT IN THE HISTORY OF THE WORLD"

The August 15 bombshell finally brought a refreshing degree of urgency and realism in the international negotiations dealing with the mounting crisis in the world trade and payments system.

The agreement painfully hammered out on December 18 of last year was hailed by President Nixon as "the most significant monetary agreement in the history of the world". This seems rather extravagant praise for an agreement whose main achievement was merely another readjustment—or, in the new terminology, "realinement"—of exchange rates. Exchange rates have often been "realined" in the past, and will undoubtedly be "realined" again many times in the future.

Yet, President Nixon may have been right, for the following reasons:

1. Firstly, because the December 18 realinement was the first one in the history of the world in which all the major exchange rates, including the dollar rate, were readjusted realistically and simultaneously by international negotiation.

2. Secondly, because the surplus countries accepted, for the first time in the history of the world, to share the burden of correcting an international disequilibrium in the network of world payments, rather than leave it entirely to the deficit countries.

3. Thirdly and mostly, however, because the participants in the December 18 agreement recognized that they were leaving the international monetary system in utter shambles, and officially proclaimed that it could no longer be reconstructed on the previous basis, but would have to be totally reformed by concerted, multilateral, agreement. Such a proclamation is certainly without precedent in world history.

Two months have gone by, however, since the December 18 call for "prompt discussion" on what might be called phase II of the international monetary negotiations, and a climate of complacency seems to have replaced the sense of urgency that was then felt by all. There is no indication as yet as to when the "prompt" discussion might even begin. This seems to me to invite disaster. The full impact of the exchange-rate realinement on our merchandise account will be felt only slowly, and our trade deficit is expected to be even larger this year than last year. On the other hand, the expected repatriation of the previous outflows of speculative capital has, for various reasons, failed to materialize so far. Thus, we might be faced again, in the forthcoming months, with huge overflows of U.S. dollars in the exchange markets of the world.

The December 18 communique has established a theoretical floor for the dollar at 2.25 percent below its new "central rates." But who will defend those rates? Who will repurchase the excess dollars that might push its market rate below the announced floor? The communique states that "it was agreed that attention should be directed to the appropriate monetary means and division of responsibilities for defending stable exchange rates and for insuring a proper degree of convertibility of the system," but no agreement is yet in sight on how these "responsibilities" should be shared. Indeed, we are, for the time being, disclaiming any share of responsibility whatsoever, since the dollar remains inconvertible not only into gold, but into any other international assets as well.

Is it realistic to expect other countries to assume for long the full burden of defending the exchange rate of an inconvertible paper dollar? This would be tantamount to renouncing all control over their money supply, and to putting their own money-printing press at the disposal of U.S. policies or policy failures. Further procrastination in reaching agreement is a sure road to new crises—like that of May 5, when the Bundesbank suspended its purchases of dollars after swallowing about $1 billion in 40 minutes of trading—and to a gradual poisoning of political, as well as financial, relations between the United States and other countries.

The "most significant monetary agreement in the history of the world" might then be followed by a rude awakening and a relapse into the nationalistic, "beggar-my-neighbor" policies that followed the suspension of convertibility by Britain, 40 years ago.

PHASE II OF THE INTERNATIONAL MONETARY NEGOTIATIONS

This dangerous procrastination about phase II of the international monetary reforms is all the more understandable as an extraordinary consensus emerged, at the last annual meeting of the IMF, and in previous debates of this very committee, on the reforms needed to restore a viable international monetary system, fair and acceptable to all concerned.

It was agreed that the cornerstone of future convertibility should be neither gold, nor any national currency—such as gold-convertible or, a fortiori, an inconvertible paper dollar—but reserve accounts with the International Monetary Fund similar to the SDR's; that is, convertible not into gold but into any currency needed for international settlements. It was also agreed that the future role of the reserve assets inherited from the past; that is, gold and reserve currencies—primarily dollars and pounds sterling—should be clearly defined and integrated into the new system.

As far as gold is concerned, very little need be changed, at least in the short run, to the system now in operation. Official purchases and sales of gold by the national monetary authorities should be channeled through the IMF, and central banks should be free to hold on to their present gold holdings unless forced to draw on them in order to procure currencies needed to settle their deficits. In the longer run, after confidence has been gained in the new system, one might expect central banks to prefer exchange-guaranteed and interest-earning reserve accounts with the IMF to sterile and costly gold hoards, and to offer voluntarily more and more gold to the Fund for conversion into such reserve accounts.

Ultimately, member countries might direct the Fund to dispose on the market, at a substantial profit, of its surplus gold stocks no longer needed for monetary settlements. There is no reason, however, to hurry up a process that is likely to develop naturally in the course of time, but that would be strongly resisted until full confidence has been established in the alternative system of IMF reserve accounts.

The role of reserve currencies calls for a very different solution, for two reasons. First of all, they must retain a role in the system as long as reserve accounts with the IMF are not made accessible to commercial banks and to private traders and investors as well as to central banks. The latter will retain a need for so-called reserve currencies for their stabilization interventions in the private market in defense of the agreed floor or ceiling on permissible—even though enlarged—exchange-rate fluctuations.

Secondly, however, the accumulation of any national currencies as international reserves should be strictly limited to the so-called working balances needed for such day-to-day interventions in the market. Any currencies acquired from the market and exceeding some agreed ceiling—for example 15 percent of global reserves—should be turned over to the IMF, credited to the depositor's reserve account, and debited from the account of the issuing country.

Conversely, any currencies needed to replenish depleted working balances should be bought from the IMF, debited from the buying country's reserve account, and credited to the account of the country whose currency is bought.

In brief, reserve accounts with the IMF would be used by central banks for international settlements in exactly the same way as the man in the street uses, for domestic payments, its checking account with a commercial bank.

And working balances in national reserve currencies would be used by central banks as dollar bills are used by the man in the street. Excess working balances would be deposited in the country's reserve account just as dollar bills in excess of daily requirements are deposited by Tom, Dick, or Harry in his checking account. And central banks would draw on their IMF account to reconstitute needed working balances, just as private individuals draw on their checking account to procure the dollar bills needed for their daily cash transactions.

Such a system should be accepted as eminently fair by our trading partners, and restore what your committee recommended (on page 2 of its September 1968 report): a "symmetrical adjustment mechanism (under which) all nations experience the same type of pressure from reserve losses when running deficits."

Transitional provisions, however, would be needed to deal with the huge overhang of dollar—and sterling—balances inherited from half a century of functioning of the defunct gold-exchange standard.

Outstanding dollar—and sterling—balances in excess of agreed "working balances" should be turned over to the Fund and credited to the depositors' accounts, as suggested above. But they could not, and should not, be deducted overnight from our—or Britain's—IMF reserve account. They should be held by the Fund as long-term investments, with appropriate interest earnings and exchange guarantees, but subject only to gradual amortization over a period of, let us say, 50 years. Such amortization could be financed—or even overfinanced—from the interest differential between guaranteed and unguaranteed dollar obligations. Better still, and far more logical, the "overhang" of dollars and sterling should be held by the Fund as "consols," with no specific maturity date, and repayable only either at our own discretion, or at the request of the IMF as and when our gross reserves rise above a level considered as ample for the financing of temporary deficits in our balance of payments.

These suggestions are very similar indeed to those summarized in your September 1968 report on "Next Steps in International Monetary Reform." They are far simpler and more negotiable, I think, than those of Mr. Bernstein for a "reserve settlement account." The main difference between Mr. Bernstein's proposal and mine is that he tries to merge into a single formula the use of gold and reserve currencies in future settlements. This, however, leads to a somewhat ambiguous definition of the title retained by each country to the assets "earmarked" with the Fund and, most of all, to complex calculations making this earmarking dependent on the varying porportions of gold and foreign exchange assets in the reserves of the countries called upon to settle deficits with the creditors. The end result of the two plans, however, is broadly similar, and I am sure that Mr. Bernstein, just as I, would be happy to leave the choice between them to be determined—as it inevitably would be—by the course of the negotiation rather than by ourselves.

I shall touch only very briefly on two other issues on which I feel in full agreement with your committee's report of last August. The first is that the expanded lending potential derived by the IMF from the reforms proposed above should be used in support of internationally agreed objectives, such as, among others, "to increase the flow of financial assistance to developing countries" (p. 17 of your report). The other is that "the Treasury and the Federal Reserve System should continue their participation in current international discussions to develop cooperative policy tools for managing Eurodollar flows, and should share fully in their implementation" (page 9 of your report). The events of last year have amply demonstrated the incapacity of national monetary authorities to deal effectively, in the absence of such cooperative instruments, with the enormous flows of speculative capital that can wreck all prospects for domestic, as well as international monetary stability.

As far as exchange rate flexibility is concerned, I am somewhat less sanguine than most of my academic colleagues about the actual use that national authorities would be likely to make of merely permissive crawling pegs or of the enlargement of permissive exchange-rate fluctuations around parity. Experience has amply demonstrated the resistance opposed by trading interests to any upward currency revaluation by persistent surplus countries.

I have long proposed myself that more symmetrical pressures for adjustment be imposed by international agreement upon persistent surplus countries, as they are already imposed, by the facts of life, upon persistent deficit countries. I have suggested a "fork"—to distinguish it from the "band" proposal—not around par values, but around "normal" reserve levels.

If persistent surpluses or deficits drive a country's global reserves well beyond, or below, normal levels, this should automatically trigger consultations with the IMF on the readjustments of either domestic policies, or exchange rates, or both, deemed most appropriate to restore equilibrium in the country's balance of payments. If these consultations fail to produce agreement, the IMF should be empowered to enjoin the countries concerned from further market interventions pushing their reserves further away from "normal," in defense of a clearly undervalued, or overvalued rate of exchange.

At this point, the floating of exchange rates, or at least their crawling, toward a more realistic level could thus be made compulsory by the fund.

Finally, I would like to stress our own interest in an acceleration of the immensely difficult program for monetary union on which the countries of the European Economic Community are now engaged.

Progress along this road should greatly facilitate the forthcoming negotiations and their effective implementation. Agreement among the six countries of the present community, and with their prospective new members, is obviously a prerequisite to broader agreements in the IMF, and even in the Group of Ten.

The program outlined above calls for vastly expanded efforts to harmonize vital policy decisions between major countries and groups of countries. This calls for a restructuration of international organizations, decentralizing the excessive responsibilities of the IMF for the efficient functioning of the international monetary system, and making fuller use of the regional groupings for monetary cooperation that are emerging in various parts of the world, and particularly in Europe, in Central and Latin America, in Asia, and in the Comecon. Looking further ahead, such decentralizing would also help pave the way toward the eventual reintegration of the communist countries into the international economic and monetary community.

Let me summarize what I have said today.

The Smithsonian agreement of December 18 reflected the sense of urgency rightly felt by all countries, following the August 15 collapse of the long ailing international monetary system anchored on the gold-convertible dollar.

This sense of urgency has unfortunately been succeeded, on both sides of the Atlantic, by complacency and procrastination about phase II of the negotiations on international monetary reform. This is a sure road to new crises and upheavals in the forthcoming months, since a totally inconvertible paper dollar is unlikely to be acceptable for long as the universal means of intervention used by central banks to defend the new rates of exchange established on December 18.

Joint action is urgently needed to restore some form of international convertibility of the dollar as well as of other currencies. The new convertibility mechanism should be anchored on reserve deposits with IMF, rather than on gold or so-called reserve currencies, and be essentially similar to the checking deposits with a commercial bank used by private firms and individuals for internal payments within each country's borders.

The participation of the former reserve currency countries—and particularly the United States—in such a system should require international agreement on two major issues:

1. The consolidation of the dollar—and sterling—balances overhang inherited from more than half-century of functioning of the defunct gold-exchange standard;

2. Symmetrical pressures on surplus, as well as deficit, countries to readjust more promptly domestic policies and/or exchange rates leading to persistent disequilibria in world payments.

The Joint Economic Committee of Congress should resume vigorously its efforts to prod the administration to negotiate such reforms, repeatedly advocated by the Committee over a long period of years.

I have tried to be brief, at the risk of being obscure or too elliptic. The points I summarized for your committee today are developed in greater detail in the articles and tables which I will submit for the record.

Thank you.

(The articles and tables referred to above follow:)

HOW TO ARREST A THREATENING RELAPSE INTO THE 1930's ?

by

Robert TRIFFIN

Published in French and in Dutch in the Bulletin of the National Bank of Belgium, 46th year, vol. II, Nr. 5, November, 1971.

THE PRESENT CRISIS IN INTERNATIONAL PAYMENTS

Diagnosis and prospects

In his article « How to arrest a threatening relapse into the 1930's », Professor Triffin discusses three main themes. The present international payments situation is untenable and is in danger of degenerating in monetary and trade guerilla warfare, reminiscent of the 1930's. A return to the past, and particularly to the role of the dollar as dominant currency is unthinkable for political as well as economic reasons on both sides of the Atlantic. It is therefore essential to negotiate with all urgency the reorganisation of the international monetary system, taking account of the existing balance of power, and particularly of the existence of the European Economic Community, which will soon include other members. Only the rapid establishment of a European Fund for the administration of foreign exchange and reserves can give the new European Community the instrument of a consistent and effective policy, both within the Community and in relation to the rest of the world, especially the dollar area.

The present international payments situation is, in Professor Triffin's view, untenable owing to the protectionist responses which it will arouse, by way of chain reaction, in the various countries affected by foreign exchange uncertainties and trade restrictions. If the danger of systematic deflation policies and competitive devaluations is less than on the morrow of the suspension of the convertibility of sterling in September, 1931, recourse to compensatory policies of reviving the internal economy is not certain of success, especially in small countries highly dependent on the external market. The dangers of the situation are made worse by the total disappearance of any generally usable and acceptable instrument of international settlements since the suspension of the convertibility of the dollar on 15th August. In this state of affairs the different countries are induced to try to « square the circle » by endeavouring simultaneously to avoid unacceptable exchange fluctuations and an accumulation of inconvertible dollars.

The return to the past, which Professor Triffin regards as unthinkable, could be effected by a return to gold or to the dollar as dominant currency. Agreement is practically general on the impossibility and undesirability of reviving a straightforward gold standard, which has never existed, except in the imagination of the theorists. The hazards of gold production could not support a rational expansion of world reserves; furthermore, it is impossible to choose another price for gold which would make it possible, without repeated modifications, and without sharp inflationary pressures, to supply the world appropriately with international reserves. The return to a system centred on the dollar as dominant currency would re-create the difficulties inherent in such a system : so long as the dominant currency remains convertible, balance-of-payments discipline can still be exercised, but only by means of crises of convertibility which profoundly shake the economy of all countries and threaten the system with collapse, as happened with the sterling standard in 1931. When it becomes inconvertible, in law or in fact, the dominant currency is an uncontrollable instrument of world inflation, since it compels other countries to finance without limit the external deficit of the dominant currency country. Finally, there is no guarantee that such a system can adjust the world stock of reserves to potential world production and trade, since the increase in the stock of the dominant currency is left to the requirements of the policy of a single country. It is, moreover, hard to conceive the systematic and concerted re-creation of a system which originated in circumstances of fact, just like the sterling system which we knew up to 1931.

The general lines of the new international monetary order, as Professor Triffin conceives it, are to be found both at world level and at Community level. At world level, the reform should relate principally to the composition of reserves and the adjustment mechanisms for national balances of payments. In the matter of reserves, the special drawing rights accorded by the International Monetary Fund should play a predominant role in future, because only the concerted creation of liquidities by agreement among participating countries can, at world level, adjust the world stock of reserves to needs, thus avoiding generalised situations either of inflation or of deflation. The name of special drawing rights and other unconditional rights in the Fund should, however, be changed and they should simply be called reserve deposits with the Fund in order to avoid the quibbles in which even the experts lose their way. The new reserve instruments should, moreover, be placed at the service of jointly accepted objectives, instead of being allocated, as at present, on an arbitrary scale of distribution, namely quotas in the Fund. Finally, the voting rules in the International Monetary Fund must be amended so that they reflect more accurately the intervention of the different countries as lenders and not merely as potential borrowers, as is the case at present, since voting rights depend on quotas. The substitution of special drawing rights for gold as the pivot of the system would mean the definition of parities in relation to special drawing rights and the effective convertibility of those rights into national currencies.

The success of this solution would nevertheless be compromised if the traditional reserve instruments, gold and foreign currencies, were not the subject of an agreement. Professor Triffin therefore proposes that the central banks should be able to retain, as an instrument of intervention on the market, working balances which might, for example, be estimated at 15 p.c. of the reserves of each country; any surplus of foreign currency above this ceiling would be paid to the International Monetary Fund and credited to a deposit account with the Fund. Similarly, any country whose working balances were exhausted by stabilisation interventions on the foreign exchange market could reconstitute them up to the ceiling of 15 p.c. of its total reserves by drawing on its deposit account with the International Monetary Fund. Foreign currencies accumulated in the past would be retained as a long term investment by the International Monetary Fund, taking the form of perpetual annuities or « Consols » guaranteed by their denomination in special drawing rights and earning interest. The International Monetary Fund should have the right to require the debtor country to amortize part of its consolidated debt by drawing on its deposit account, if its total reserves increased appreciably above a normal level, which would obviate for a long time any risk of a dollar shortage. Precautions should be taken to prevent any evasion of the agreed ceiling by excessive transfers of foreign currency by a central bank to its commercial banks. Under this system, the central banks would remain free to hold in reserve the gold which they hold today or to exchange it for deposits with the International Monetary Fund, whose gold assets would necessarily increase for two reasons. Some countries would have to draw on their gold reserves to settle their deficits. And secondly, though no doubt in the longer term, the central banks would certainly give preference over the sterile holding of metal to an increase in their deposit assets which would benefit both from an exchange guarantee and from an appropriate rate of interest.

With regard to balance-of-payments adjustments, it would have to be accepted that margins of fluctuation could become wider by allowing currencies to appreciate or depreciate within agreed limits in response to pressures on the balance of payments. In order to prevent a country from postponing the readjustment of its parity, Professor Triffin proposes the rule of a « bracket » around the level of reserves which can be regarded as normal for each country. Any variation in reserves of more than 25 p.c. in relation to this level would be the subject of compulsory consultation with the International Monetary Fund to determine the internal measures or adjustments of parity to be taken. If the consultations broke down, or if the variation reached 33 p.c., the International Monetary Fund would be entitled to limit to a specified amount, or even to prohibit altogether, any intervention by the country in question on the foreign exchange market, so as to compel an adjustment of the exchange rate. In order to prevent the principle of the reform being frustrated by short term capital movements, agreements could be concluded between international capital markets and concerted controls could be introduced over international capital operations by banks and big multinational companies.

At the level of the European Economic Community shortly to be enlarged, Professor Triffin recommends a concrete plan of action relating partly to exchange rates and partly to the creation of a European Fund for the administration of reserves. What matters most for the Community, in Professor Triffin's view, is to establish with all urgency a range of fixed exchange rates between members, since it is intra-Community trade which is by far the most important for the partner countries. During a transitional period the rates would be provisional pivot rates which could still be remedied to correct possible future disequilibria. The fluctuation between Community currencies would be limited to one and a half or even one per cent, interventions being effected in Community currencies and balances being converted into special drawing rights or any other instrument of settlement accepted by the central banks of member countries. The European Fund which, in Professor Triffin's view, should be created without delay, would have the task of multilateralising the credit and settlement procedures. It would keep accounts in European units of account of the claims and debts between European central banks resulting from interventions on the foreign exchange markets and would enter them to the debit or credit of members. Special agreements could also be made, which would allow deposits with the European Fund arising

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out of credit operations between member countries. The Fund would intervene on the dollar market of the Community by purchases and sales so as to maintain the « brackets » of exchange rates against the dollar decided among the Community countries and, if possible. the United States.

Professor Triffin believes that these various Community solutions are essential, as a matter of urgency and in any event, since the world-wide reform of the monetary payments system may take a long time, and regional agreements make it possible to halt, in a given zone, the ravages of protectionism and competitive devaluation. Furthermore, the working of the international payments system will be more effective if it is based on regional entities, the International Monetary Fund being charged solely with responsibilities which cannot be exercised within the Community, within the group of countries under the influence of the dollar or any other similar group.

HOW TO ARREST A THREATENING RELAPSE INTO THE 1930's ?

by Robert TRIFFIN

Introduction.

When we look at the course of events, the content of national decisions and the succession of fruitless conferences, we may well ask ourselves today whether the decision-makers and their counsellors have forgotten the principle that the smooth working of payments mechanisms is an essential element in economic development. The crisis triggered off in mid-August has gravely disordered the international organisation of money, which Adam Smith long ago called the « great wheel » of the economic system.

The bloodstream has become clogged — and it is no coincidence — at the very moment when many signs of weakness already betrayed a feeble state of health.

There is nothing new in the recognition that under-employment in the United States and the United Kingdom coincides with a slowdown in internal expansion in Japan and in many European countries, and, it goes without saying, with a contraction of real income in the producer countries of raw materials, the prices of which have already fallen sharply.

Neither is there anything new in the recognition that the efforts made by the different countries, in dispersed order, to restore the level of internal employment may be inspired by short-sighted concerns and that there will be a constantly growing temptation to resort to dangerously self-centred proceedings.

It is all the easier to cherish the idea of applying remedies which injure one's neighbour since yesterday's relative international monetary order has yielded place to anarchy and the monetary pretext of external national equilibrium is a convenient screen for other objectives.

The action to be taken with all urgency is clearly apparent if the three following fundamental propositions are accepted :

1. The present situation is *untenable* and becomes more and more likely each day to degenerate into disastrous and contagious monetary and trade guerilla warfare, reminiscent of the 1930's.

2. A simple return to the past is equally *unthinkable,* for political as much as economic reasons, *on both sides of the Atlantic.*

3. It is therefore *essential* to negotiate with all urgency the establishment of the basic elements of a viable international monetary order which will take account of the realities and of the existing balance of power. This new order should, in particular, be inspired by the radical differences which characterise the present and prospective evolution of the different economic regions, and, very specially, of the European Community, enlarged by the accession of new members, including the United Kingdom. Only the rapid establishment of a European Fund for the administration of foreign exchange and reserves — or, in the words of the Werner Plan, for monetary cooperation, — can give the new European Community the essential instrument of a consistent and effective policy, both within the Community and in relation to the rest of the world, especially the dollar area (1).

I. The present situation is untenable.

The situation which we are at present experiencing is untenable on two grounds. First and foremost, because it is intolerable as it stands, but even more because it is in danger of rapidly deteriorating as a result of the protectionist responses it cannot fail to arouse, by a chain reaction, in the various countries affected by the foreign exchange uncertainties and trade restrictions originating from the measures taken by the United States on 15th August and their repercussions on the economies and policies of other countries.

It would be tempting and easy to draw a parallel between the probable aftermath of 15th August, 1971 and that — unfortunately too well known ! — of 21st September, 1931 : the formation of monetary blocs pursuing totally different and contradictory policies — deflation in the gold bloc countries from 1931 to 1935 and after, internal revival in the sterling bloc countries, draconian controls in the Central European countries —, competitive devaluations in a number of countries and everywhere restrictions on trade and foreign exchange and the collapse of the international capital market.

(1) The reader who is in a hurry or already well informed of the general aspects of the subject is invited to concentrate his attention on section III, B (pages 25 to 32) of this study, which I regard as the most crucial for the purposes of action.

These dangers are only too real, but certain essential differences between 1931 and 1971 leap to the mind. Some of them are reassuring. Others cannot fail to deepen the anxieties of responsible men who contrive to retain their lucidity in the midst of the surrounding chaos.

It is evident that there is virtually no danger of *deliberate and systematic* policies of deflation and that the danger of competitive devaluations is not immediate. but this is only meagre comfort, since « policies » are in grave danger of being everywhere frustrated and overtaken by events beyond the control of national authorities acting separately in dispersed order.

The signs of economic slowdown, and even of recession, were already manifest before 15th August and have multiplied since then. Recourse to compensatory policies for reviving the internal economy is far from being easy and certain of success, especially in small countries highly dependent on the external market. This recourse is likely to manifest itself partly in a surge of protectionism and restrictions on trade and imports. designed as much to reserve the internal market to national producers as to mitigate the repercussions of internal revival on the balance of payments and reserves. These measures are contagious and inevitably call for measures of defence and reprisal which accentuate the difficulties all round.

Even more agonising for the monetary authorities is the total disappearance of any generally usable and acceptable instrument of international settlements. Until yesterday, the dollar enjoyed a virtually absolute monopoly in this respect, going far beyond the role of the pound sterling on the eve of September. 1931. The dollar has suddenly become a paper currency, inconvertible not only into gold, but into any other currency, special drawing rights or any other generally acceptable instrument. Can the central banks reconcile themselves to the further piling up of the mountains of paper dollars offloaded on to them ? If they refuse them, what will they accept in settlement of their future surpluses. not only against the United States but against other countries ? By refusing to intervene on the foreign exchange market, will they allow their currency to appreciate. in relation not only to the dollar but also to other currencies which decline to accept such appreciation ?

The Secretary of the Treasury. Mr. Connally, has expressed himself in favour of « clean floating », leaving it to market forces to determine exchange fluctuations, without intervention by the monetary authorities, and, *a fortiori,* without exchange control, double market techniques and the like. It is doubtful whether such a recommendation will be universally followed. It might in practice involve exchange fluctuations which undervalued. or above all, overvalued, the currency of various countries at commercial level. To cite only one example, would the producers and trade unions allow the monetary authorities of their country to let the rate of their currency appreciate considerably, where such appreciation resulted not from excessively competitive costs and wages. but from a flood of speculative capital or capital driven out of its own country by a policy of artificially low interest rates? Would public opinion and the interested parties accept recession and unemployment resulting from a « laisser faire » attitude towards exchange rates in a world where these rates are vitally affected by manifold political interventions and decisions which no government is willing or able to renounce?

These considerations explain the tightrope-walking policies followed in the principal countries since 15th August. These countries have endeavoured to avoid exchange fluctuations deemed unacceptable, while at the same time trying to limit their accumulation of inconvertible paper dollars. This attempt to « square the circle » can only further accentuate the chain recourse to restrictions and controls of foreign exchange and the capital market.

This disastrous spiral can be broken only by combined efforts to concert the national policies of the principal countries to restore a commonly accepted framework for international transactions and settlements.

II. A return to the past is unthinkable.

A. RETURN TO GOLD?

There is virtually general agreement that it is impossible and undesirable to revive a straightforward gold standard, which in any event never existed, except in the imagination of the theorists. There is no need to dwell on this self-evident truth, unanimously recognised today, by academic circles as well as by responsible officials.

Whatever the level at which the official gold price might be fixed tomorrow, the hazards of current gold production, diminished by the private purchases of industry, the arts, dentists, hoarders and speculators, could not serve as a criterion for the growth of the monetary reserves necessary to sustain the possible, but not inflationary, expansion of world trade and production. This is obvious at the present price of $ 35 per ounce, the world stock of monetary gold having increased by only $ 6 billion over the last twenty years ($ 0.3 billion a year), $ 1 billion over the last ten years ($ 0.1 billion a year) and having in fact *fallen* by $ 2 billion over the last five years.

It would be not only difficult, but even impossible to choose another price (double? treble? fourfold?) which would, without repeated changes of price. ensure an appropriate future supply of international reserves. And what can be said about the inflationary forces which would immediately be unleashed by such a policy and about the waste of resources which might be better employed than by digging holes in the ground in the gold producing countries and other holes in the ground to re-inter it at Fort Knox and elsewhere?

When Mr. Rueff himself has renounced his old dream who would think of reviving it ?

B. RETURN TO A DOMINANT CURRENCY ?

Before seeking to install deliberately, and almost at discretion, an international payments system based on a national currency, which would be elected the dominant currency, we must ask how the two systems of this type which the world has known — the sterling system and the dollar system — originated and developed, and why they collapsed.

1. The origin of the system.

The choice of the monetary system has never resulted, in the past, from the concerted decisions of governments. Numerous conferences failed in their efforts to negotiate an international agreement confirming either bimetallism or the gold standard. In the absence of such agreement, gold largely prevailed in practice, but only as an *ultimate* means of settlement and accumulation of statutory reserves. The spontaneous evolution of international payments imposed as a general means of settlement, as a unit for the denomination of contracts and as an international reserve asset, the currencies of the countries which exercised a predominant influence on world trade and which possessed sufficiently organised money and capital markets to act as bankers for the rest of the world.

The use of such currencies, known as « key currencies », in private contracts and settlements increasingly imposed them on the central banks themselves as a means of intervention on the foreign exchange market with a view to preventing excessive and undesirable fluctuations in the exchange rates. It was through the channel of one or more dominant currencies, generally, or regionally, accepted in exchange for their national currency that the central banks for more than half a century conducted their stabilisation operations on the foreign exchange market.

This technique of intervention itself is the origin of one of the considerable extensions of the use of dominant currencies no longer only as *working balances* for these interventions, but also as *reserve assets,* together with gold, far in excess of the normal level of the necessary working balances. In the 1920's the pound sterling became the principal dominant currency for these functions of intervention and reserves. The dollar succeeded it after 1931, and above all, after the Second World War, and in fact acquired a virtual monopoly as *dominant currency,* although the pound also continued to play an important role in this respect in the countries of the sterling area.

2. **The development and inevitable deterioration of the system.**

The observations which follow reveal a striking parallel in the historic development of the sterling standard after the First World War and of the dollar standard after the Second World War. This evolution can be described as a drama in three acts.

The *first act* is marked by the euphoria and growing financial irresponsibility inevitably aroused by the « exorbitant privilege » — in the words of President de Gaulle — conferred on the dominant currency, that is to say, the facility it enjoys of in fact being able to settle a substantial proportion of its growing deficits, first, by the accumulation of its national currency as working balances by private individuals, enterprises and the world's commercial banks and, secondly, by the banknote printing press of foreign central banks.

In the *second act*, the price for this facility already begins to be paid in the emergence of economic, social and political problems. Foreign financing impels the overvaluation of the dominant currency : the return to the 1913 gold parity by Great Britain in 1925, the maintenance of the gold parity of the dollar in spite of growing deficits and the devaluation of several currencies in relation to the dollar, the anchor-currency of the system since the Second World War. Important sectors of the reserve currency economy lose their markets, and the workers lose their jobs, as a result of the shift of demand, both on the home market and on foreign markets, to the benefit of competitors whose currency is undervalued in relation to the dominant currency, or — if it is preferred — who benefit from the overvaluation of that currency. Business firms and trade unions do not care whether the balance of payments is settled by losses of gold or by the accumulation of the country's currency by foreign central banks. They are irritated by the « unfair » competition of the countries with undervalued currencies, the fall in their sales and profits and the growing unemployment.

The recession tends to bring down interest rates and a systematic policy of reducing rates is indicated in order to revive the economy of the dominant currency country. But it will still further aggravate the deficit on its balance of payments. Great Britain, in the face of alarming unemployment on the eve of 1931, maintained high interest rates longer than the United States, less vulnerable, economically and financially to external pressure than Great Britain. After the Second World War, the monopoly of the dollar had become more absolute than that of the pound in the old days. The political influence of the United States was — and still is — much greater. And the example of 1931 discouraged those responsible abroad from claiming gold conversions which the United States would have been unable to honour.

If foreign central banks had reacted to the dollar problem as they did to the sterling problem in 1931, it would have been in 1960 or shortly after that the convertibility of the dollar would have had to be suspended. The dollar survived another ten years as dominant currency only thanks to the growing acceptance of its *de facto* inconvertibility, which everyone thought it their interest not to force the United States to proclaim *de jure*.

In the *third act* of the dollar drama, as in the sterling drama, considerations of internal policy prevail over the politically weaker imperatives of the balance of payments and external policy. The revival of the economy is sought by recourse to measures of protectionism and cuts in interest rates. The deficit skyrockets with the exodus of capital in search of higher interest. Foreign central banks had to face, in 1970 and 1971, a veritable flood of surplus dollars and had to start their own printing presses rolling to redeem them on the market and to preserve against hell and high water the parity of the dollar against their own currencies pursuant to Article IV, section 4 (b) of the Articles of Agreement of the International Monetary Fund.

In contrast with what happened in Great Britain in 1931, American professors and officials proclaimed to the four winds of heaven, in the penultimate scene of their drama, their conviction that it was necessary to readjust exchange rates, thus eliminating the disequilibria caused by the undervaluing of strong currencies in relation to the dollar. Such propaganda could only hasten the « dénouement » by precipitating vast speculative movements of funds towards these currencies and especially towards the German mark.

The gold commitments of the United States to foreign central banks thus increased by nearly $ 20 billion between 1st January and 15th August, 1971, at which date they had reached about $ 43 billion, that is to say, more than four times the total gold stock of the United States.

The *fall of the curtain,* foreseeable and foreseen for many years, could hardly be deferred. It had at least the merit of forcing other countries, as well as the United States, to look the situation square in the face and to recognize the bankruptcy of a system which has to be reformed in its very foundations and not simply patched up.

3. The inherent defects of the « dominant currency standard ».

Such a patching up would be hard to negotiate in view of the disenchantment of the United States as well as of other countries as a result of the disastrous experience through which they have just passed. The United States rejects as an « unacceptable responsibility » and harmful to its internal economy a mechanism denounced by the other countries as an « exorbitant privilege ».

Officials as well as academics are today agreed on the inherent and fatal defects of the « dominant currency standard ».

a) So long as the dominant currency remains convertible into gold. in fact and not only in law, balance-of-payments discipline remains in the background but can come into the limelight only at the cost of repeated and increasingly grave crises to the system.

b) If, on the other hand, these dangers of crisis are palliated by the inconvertibility, in law or in fact, of the dominant currency, that currency is transformed into an uncontrollable instrument of world-wide inflation. The dominant currency country finds itself withdrawn from any international adjustment mechanism. The richest and most highly capitalised country in the world finds its deficits financed in one continuous stream by the banking system of foreign countries at a rate which attained for the United States about one billion dollars a year during the 1950's, \$ 2.5 billion a year during the 1960's, and \$ 8.2 billion (\$ 1.4 billion *a month*) in the first six months of 1971. or a total of more than \$ 45 billion from the end of 1949 to the end of June. 1971 (1).

Table I.

Gross and net reserves of the United States, 1949 to June, 1971

(billions of dollars)

Source : *International Financial Statistics.*

	End of year				June, 1971	Changes end 1949 to June, 1971
	1949	1959	1969	1970		
I. **Gross reserves**	**26.0**	**21.5**	**17.0**	**14.5**	**13.5**	**−12.5**
of which : gold	24.6	19.5	11.9	11.1	10.5	−14.1
II. **External commitments (−) to :**	**− 5.0**	**−15.3**	**−40.7**	**−42.4**	**−50.6**	**−45.6**
— Monetary authorities (including allocations of S.D.R.)	− 3.2	−10.6	−17.1	−25.3	−36.2	−33.0
— Commercial banks	− 1.8	− 4.7	−23.6	−17.1	−14.4	−12.6
III. **Net reserves :**						
— Monetary authorities only	**+22.8**	**+10.9**	**− 0.1**	**−10.8**	**−22.7**	**−45.5**
— Including liquid commitments to commercial banks	**+21.0**	**+ 6.2**	**−23.7**	**−27.9**	**−37.1**	**−58.1**

The dangers of such a system for the internal economy of the United States have been described above. For the other countries, that system raises a fundamental problem, political as well as economic. Can they condemn themselves to

(1) See, by difference, row I of Table I.

finance blindly. by the printing press of their central bank and the expansion of credits by their commercial banks, the policy of the dominant currency country, whatever objections they may have to that policy? The rejection of such an abdication of national sovereignty in favour of a foreign country is perfectly well understood in the United States which conquered its independence to the cry of « No taxation without representation! ».

This does not mean that national monetary sovereignties can continue to be effectively exercised in ways which are incompatible with each other in an increasingly interdependent world. But the limitations or fusions of sovereignty which are patently demanded by political realism can be conceived only through the medium of procedures which enable each country to make its voice heard, and not by the outright absorption of all national sovereignties by the *super-sovereignty* of a dominant currency country.

c) Finally, both under a system of convertible dominant currency and under a system of inconvertible dominant currency, the creation — or destruction — of world reserves is quite obviously incapable of serving its fundamental objective, that is to say, of adjusting the world stock of reserves to the expansion potential of world production and trade. The growth of the stock of dominant currencies in world reserves is left to the hazard of fluctuations even more disordered than

Table II.

Composition of world monetary reserves, 1949 to June, 1971

(billions of dollars)

Source : *International Financial Statistics.*

	End of year				June, 1971	Changes end 1949 to June, 1971
	1949	1959	1969	1970		
1. *Gold*	33.5	37.9	39.1	37.2	36.5	+ 3.0
2. *Special drawing rights*	—	—	—	3.1	5.9	+ 5.9
3. *I.M.F. reserves*	1.7	3.3	6.7	7.7	6.9	+ 5.2
4. **Foreign currencies :**	**10.4**	**16.4**	**32.3**	**44.4**	**55.5**	**+45.1**
Dollars	3.2	10.1	16.0	23.9	34.3	+31.1
Sterling	6.9	7.0	9.0	6.6	6.8	– 0.1
Eurodollars, etc.	0.3	–0.8	7.4	13.9	14.4	+14.1
Total ...	45.5	57.5	78.2	92.4	104.8	+59.3
United States	26.0	21.5	17.0	14.5	13.5	–12.5
Other countries	19.5	36.0	61.2	77.9	91.2	+71.7

those of the stock of monetary gold. The world's foreign exchange reserves — mainly dollars and sterling — have varied over the last few years from *minus* $ 350 million in 1965 to *plus* $ 3.6 billion in 1967, *plus* $ 12.1 billion ($ 1 billion a month) in 1970 and *plus* $ 20 billion in the first eight months of this year [1].

Everyone agrees today in recognizing that a system which permits such absurdities is finally and irrevocably intolerable.

But what is to be done ? What is to take its place ?

III. Innovatory reforms are essential.

Reform is impossible unless it starts from a generally accepted conception of the ultimate goal.

The following pages are devoted to tracing the outline of this ultimate goal.

But let us not be under any illusion ! The creation of a new world monetary system will call for protracted efforts and will therefore take time : the negotiation of the concrete agreements essential to sweeping reform and their ratification by the national parliaments will take many months, perhaps even years. Furthermore, the success of this negotiation is still far from certain.

But, as we have said, events are in danger of taking such a course that the deterioration of economic relations between nations may outpace the talks on the monetary system and may jeopardise the result of the efforts made.

We are therefore convinced that, in a first stage, which should be achieved without delay, we must be less ambitious and must set ourselves immediate objectives, more limited but for that very reason, more realistic.

The success of this first stage is fundamental, since it will restore to international relations a stability which is essential for the pursuit of further negotiations with a view to achieving the more distant goal. We shall, moreover, show that the mechanism of partial, or more accurately, of three-pronged, organisation which we contemplate as probable in the immediate future will be perfectly compatible with the subsequent functioning of a vaster agreement on a world-wide scale.

We shall therefore devote the end of our study, with the intention of highlighting them in this way, to the actions which must be taken with all urgency by the principal countries and groups of countries to speed up the current negotiations and to minimise the damage which may result, in the meantime, from the disunion of these countries in the face of the immediate and agonising problems summed up in the first section of the present study.

(1) See row 4 of Table II.

A. A WORLD MONETARY ORDER.

The official discussions which have been going on without interruption for more than eight years on the essential reconstruction of the international monetary order have finally disclosed a surprising degree of agreement on the general lines of such a reform at world level ([1]).

The world aspects of the reforms to be introduced relate principally to :

1. The future composition of world reserves :

a) reserves with the International Monetary Fund;
b) national currencies;
c) gold.

2. The balance-of-payments adjustment mechanism :

a) internal adjustments of national demand and costs policies;
b) external adjustments by the adaptation of exchange rates.

1. Reserves with the International Monetary Fund.

The principal speeches made in the discussions at the International Monetary Fund, last September, left no doubt as to the predominant and decisive role which reserves with the International Monetary Fund should play in the international monetary system of the future. Only the concerted creation of world monetary reserves, by agreement among the participating countries, can render possible, at world-wide level, the non-inflationary adjustment of the world stock of reserves to the expansion potential of the world economy and trade. Everyone is today agreed on this self-evident truth.

The agreement on special drawing rights has opened the door to the introduction of such a system, but needs to be completed and improved on several points if it is to yield the expected results. I will cite four, in *ascending* order of importance and urgency.

a) First of all, the appelation « *special* drawing rights » would be absurd to designate the normal and general instrument of international settlements and accumulation of reserves. It would be desirable and possible radically to simplify a maze of legal quibbles in which the experts themselves get lost. Special drawing rights, gold tranches, super-gold tranches and even formal lines of credit resulting from what are called « stand-by arrangements », all contribute to the same result, namely to ensure the holder country of the unconditional

([1]) See, in particular, the statements by Mr. Schweitzer, Mr. Barber and Mr. Giscard d'Estaing at the last annual assembly of the International Monetary Fund.

disposal of means of international settlement, which would be quite simply described by the term « reserve deposits » with the International Monetary Fund, exactly comparable to the deposits which the man in the street holds in his current account with a commercial bank or with the Post Office.

b) Secondly, the new reserve instrument created by international agreement should be placed at the service of *objectives jointly accepted* by its creators. The aim is, in fact, to review the ways and means of issuing these instruments, since the way in which the aggregate amount, the creation of which has been accepted, is distributed determines who shall benefit from this new currency. These instruments are today allocated to all the members of the Fund, according to a totally arbitrary scale of distribution — their quotas — under which the lion's share goes to the richest and the crumbs fall to the poor. The United States alone receives a share practically equal to that divided among the 80 or 90 countries of the Third World described as « the developing countries ».

This distribution system results in financing the possible deficits of any country, whatever the national policy from which those deficits originate, whether they are unbalancing and odious to the countries called upon to finance them, or whether they tend to restore the balance and are acceptable to all the partners. This is an absurdity which will certainly have to be corrected one day or another. The international community which decides on the creation of international fiduciary reserves should also decide on their most appropriate use for jointly accepted objectives.

Attention has so far been mainly concentrated on one of these objectives only, namely financial aid to the development of the Third World. This concern is perfectly legitimate and certainly merits inclusion among the possible and desirable uses of the system. The International Monetary Fund could, for this purpose, use part of the creation of special drawing rights to buy International Bank for Reconstruction and Development, International Development Association, etc. bonds, thus enabling these institutions to step up their aid to developing countries.

There are, however, other conceivable uses of special drawing rights which should not be ruled out. We may cite by way of example :

1) support of policies for monetary stabilisation and the restoration of balance-of-payments equilibrium, which remains central to the responsibilities of the International Monetary Fund;

2) the equalisation, or « re-circulation », of reversible, but unbalancing, movements of private capital between the main money and capital markets, a function which inspired the system known as the « General Arrangements to Borrow » of the International Monetary Fund;

3) in the longer term, no doubt, when people's minds have had time to become familiar with such an iconoclastic proposal, the financing of other

operations by international organisations, such as the United Nations. the World Health Organization, etc. which merit priority, but which are short of funds, such as the international war on pollution and the like.

It may be noted that long term uses — and even outright grants — are in no way ruled out as soon as it is accepted that *world* reserves cannot fail to increase and that the International Monetary Fund will therefore not be faced with the problem of liquidity which arises for the commercial banks and even for the central banks. This principle is, moreover, already sanctioned in the present system of drawing rights, 75 per cent of which need not be « reconstituted ».

c) Thirdly, the acceptability of such a system and the choices imposed by this vast range of possible uses, raise, it must be recognized, two major political problems : the dominant role of the United States in the voting system of the International Monetary Fund and the legal link created — no doubt by inadvertence — between special drawing rights and the gold parity of the United States dollar.

The voting rights of the International Monetary Fund are determined almost exclusively by the relative proportion of each national quota in the capital of the institution. But the quota in fact measures two totally different elements; the country's borrowing right and its obligation to lend. The industrial countries of Continental Europe have been, for many years past, the main investors in the International Monetary Fund (75 per cent of the total in

Table III.

Net creditor or debtor (–) positions, and voting rights in I.M.F., August, 1971

Source : *International Financial Statistics.*

	Millions of dollars	Percentages of total	Percentages of voting rights
1. United States [1]	30	*1*	*22*
2. United Kingdom [1]	– 523	*– 12*	*9*
3. Industrial Europe	3,315	*76*	*22*
4. Canada	291	*7*	*4*
5. Japan	490	*11*	*4*
6. Other developed countries	460	*11*	*9*
7. Developing countries	310	*7*	*31*
Total ...	4,373	*100*	*100*
Offset by :			
1. Assets of I.M.F. in gold and S.D.R.	5,159		
2. *Less* : undistributed profits	– 786		

[1] Allowing for the investments and the gold deposits of the I.M.F. in the United Kingdom and the United States.

August last) but they hold only 22 per cent of the votes, compared with 22 per cent for the United States, whose proportion of loans has fallen to less than 1 per cent, and 9 per cent for Great Britain, the principal *debtor* country of the Fund [1].

The accession of Great Britain and other countries to the European Community — and, who knows, the accession of the People's Republic of China to the International Monetary Fund — will no doubt lessen the importance of this problem. but it would certainly be desirable that the voting rules of the Fund should in future be amended to take greater account — though not, of course, exclusively — of the relative real contributions of countries to the financing of the institution.

A second political problem arises out of the gold definition of special drawing rights and of a dollar which has become inconvertible, not only against gold, but against drawing rights or any other international instrument of payment. So long as the United States can maintain the legal fiction of a *gold parity* ($ 35 per ounce) at which it *no longer sells* gold, special drawing rights remain equivalent to the dollar and diminish in value in relation to currencies which appreciate against the dollar.

The substitution of special drawing rights for gold as the keystone of the system means that all currencies must define their parity and convertibility in relation to special drawing rights. as the international « unit of account », instead of in relation to gold, and that this convertibility must be effective rather than mythical, as is the case today with gold convertibility. The whole concept of parity should be identified with the rate at which each currency is *in fact* convertible into drawing rights, and vice versa. If a country finds itself obliged to modify its effective rate of convertibility with other currencies. upward or downward. it could do so only by modifying at the same time its « parity » with the S.D.R. unit.

The restoration — which, it is to be hoped, may be speedy — of the convertibility of the dollar and other currencies which are today fluctuating, should involve a devaluation — no doubt modest, say 5 per cent — of the dollar and of the currencies tied to it. as well as a rise in certain other currencies in terms of S.D.R. This participation of the dollar in the realignment of the exchange system is indispensable, not only for the reasons of political morality given prominence by the « Nine », but also in order clearly to manifest the dissociation of the S.D.R. unit from the dollar and to demonstrate that the S.D.R. is not identified with currencies capable of depreciating in relation to others. It is on this condition only that the S.D.R. can win the acceptance which is essential if it is to serve as the normal instrument for the accumulation of reserves by the monetary authorities of each member country of the I.M.F.

(1) See Table III.

d) Finally, and *above all*, the creation of the S.D.R. system can bear fruit only if the future role of the traditional reserve instruments — gold and foreign currencies — in the future international monetary system is also made clear. This has been quite obvious ever since the morrow of the Rio de Janeiro agreement on S.D.R. Massive conversions into gold resulted in an alarming drain on world monetary reserves in 1967 and 1968. And in 1970 and 1971 the world dollar reserves were inundated by a veritable tidal wave. Both of these movements, especially the second, frustrated the whole basis of the essential object of adopting the S.D.R., that is to say, the adaptation of the world stock of reserves to the recognized needs of the international economy and its dissociation from the hazards governing both the production of and private demand for gold and the world supply of reserve currencies through the deficit of issuing countries, especially the United States.

2. The role of reserve currencies.

It is, however, hardly possible — or indeed necessary — entirely to eliminate national currencies from the international reserve system. Particularly since business firms, private individuals and the commercial banks will everywhere continue to hold assets from transactions in national currencies, and, by shifting their liquid assets, will force the central banks to intervene in those national currencies. The central banks must have at their disposal an instrument of intervention on the market with which they buy in — in the event of a balance-of-payments deficit — or sell — in the event of a surplus — their own national currency.

The use of national currencies, largely dealt in on the market by the commercial banks and their customers, remains indispensable for this purpose and it is infinitely probable that the dollar will continue to play an important — though not exclusive (1) — role in these transactions.

In order to eliminate the defects indicated above (2) in the so-called gold standard or dominant currency standard, these holdings of *national* currencies as an *international* reserve instrument should be rapidly reduced to this role alone, that is to say, to the level of the « working balances » essential to finance the stabilisation interventions of the central banks on the foreign exchange market.

For the sake of simplifying the following reasoning, the need for working balances is estimated at 15 per cent of the total reserves of each country (approximately equal to 5 per cent of their annual exports, on average). This figure more or less corresponds to the proportion of foreign currencies traditionally held

(1) See below, page 30.
(2) See pages 9 to 12.

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in reserve by the countries least inclined to accept the dominant currency standard, namely, Belgium, the Netherlands and Switzerland.

Table IV.

Illustrative ceilings of working balances in foreign currency

(billions of dollars)

Source : *International Financial Statistics.*

	5 p.c. of 1970 exports	15 p.c. of reserves at end of 1970	Actual foreign currency reserves, end 1970
1. United States	2.2	2.2	0.6
2. United Kingdom	1.0	0.4	1.2
3. Industrial Europe	5.5	5.8	18.0
4. Canada	0.8	0.7	3.0
5. Japan	1.0	0.7	3.2
6. Other developed countries	0.9	1.3	5.0
7. Developing countries	2.7	2.7	13.4
Total ...	14.0	13.9	44.4

I would therefore propose that the monetary authorities of each country should *remain free* to hold in foreign national currencies up to 15 per cent only of their total reserves. Any foreign currency in excess of this ceiling would be immediately paid to the International Monetary Fund and credited to the country's reserve deposit account with the Fund (1). Conversely, a country whose working balances in foreign currency fell excessively as a result of its external payments and the stabilisation interventions of the monetary authorities on the foreign exchange market, could reconstitute them in whatever currency or currencies it liked, up to the approved ceiling of 15 per cent of its total reserves by drawing on its deposit account with the International Monetary Fund.

All national currencies paid into the Fund under this system would normally be debited, in future, to the deposit account of the issuing country. This would, however, prove impracticable, unjust and absurd for the vast amounts of foreign currency accumulated in the past during more than half a century's operation of the gold exchange standard. The foreign currency derived from this *past* accumulation would be retained as a long term investment by the International Monetary Fund. Ideally and logically, these investments should take the form of perpetual annuities or Consols guaranteed against any exchange fluctuation by being denominated in I.M.F. units of account and paying an interest to be agreed. The debtor country could nevertheless amortize part of its consolidated debt by drawing on its deposit account, or could be required by the

(1) But see below, pages 30 and 31.

I.M.F. to do so in the event of its total reserves growing appreciably above the normal level ([1]). This would obviate for a long time any recurrence of a shortage of dollars or sterling within the meaning of Article VII of the Articles of Agreement of the Fund.

If the negotiators were unable to agree on the technique of perpetual annuities, the proposed consolidation could, as an alternative be effected in the form of long term bonds (between 25 and 50 years ?) which would, however, remain subject to the extraordinary amortization procedure suggested above. It should be possible to finance — or more than finance — the compulsory amortizations involved in such a solution from the difference in the interest rate on existing bonds in non-guaranteed foreign currencies and on bonds with an exchange guarantee under contract with the International Monetary Fund.

The obligation to convert into a deposit account with the Fund any foreign currency in excess of the agreed ceiling (15 per cent of total reserves ?) would meet with obvious objections if the interest rate paid on these deposits remained as low as that at present applicable to S.D.R. The rate should be at least doubled (3 per cent) while remaining lower than the rate earned today on the mass of foreign currencies held in central banks and not generally benefiting from an exchange guarantee.

Finally, precautions should be taken to prevent any evasion of the agreed ceiling by excessive transfers of foreign currency by a central bank to its commercial banks. As a start, a provision could be adopted similar to that introduced for the same purpose into the Agreement for the establishment of a European Payments Union ([2]) subject to progressively working out more precise criteria of application in the light of experience.

3. The role of gold.

As for the other traditional reserve instrument, namely gold, its role will be destined to diminish progressively in future until the day when complete confidence in the new international system makes it possible and desirable to eliminate it as a reserve instrument.

This day is, however, still distant and provisional arrangements must be made which will take account of existing realities and the negotiating positions of the various countries in this respect.

([1]) See below, pages 22 and 24.

([2]) Part I, Article 4 (f) : « Each Contracting Party shall use its best endeavours to ensure that abnormal balances in the currencies of other Contracting Parties are not held by banks other than central banks or otherwise placed so that they are excluded from the calculation of bilateral surpluses or deficits ».

Each central bank could remain perfectly free to keep in reserve the gold which it holds today, or to exchange it — in whole, or in part, at its own convenience — against an increase in its deposit account with the I.M.F. All purchases and sales of gold by the monetary authorities would, however, in future be channelled through the I.M.F., as is already very largely the case today.

The gold assets of the I.M.F., which already amount today to $ 4.7 billion, would inevitably increase, no doubt considerably, in the coming years as a result of the three following types of transaction :

a) purchases of gold on the market or from the producer countries by the I.M.F. in the event of the market price falling below the official gold price fixed by the Fund;

b) free payments of gold to the I.M.F. by central banks which prefer, instead of the sterile holding of gold, an increase in their deposit account, benefiting both from exchange guarantees and an appropriate rate of interest;

c) sales of gold by debtor countries, obliged to sell in order to reconstitute their working balances or their deposit account, owing to deficits incurred in their balance of payments.

It could also be contemplated empowering the I.M.F. to make any loans — the use of « credit tranches » with the Fund — to deficit countries subject to the obligation to procure at least a part of the foreign currencies requested from the Fund against payments of gold, in the event of the country in question holding a proportion of gold in its total reserves *in excess* of the average proportion of member countries of the Fund (about one third in June, 1971).

This progressive increase in the gold assets of the I.M.F. would enable it, if it thought fit :

a) to offer countries with the lowest proportion of gold in their total reserves the repayment in gold, should they so desire, of part of their deposit account;

b) to sell — at a profit — part of its gold on the market when the price is well above the official price.

In the longer term, the ultimate success of the new system of deposit accounts would facilitate the progressive liquidation on the private market of the gold assets inherited from the past and which became less attractive for the central banks than the holding of reserve deposits with the International Monetary Fund.

4. Balance-of-payments adjustments.

a) *Internal adjustments.*

Balance-of-payments equilibrium will certainly continue to depend mainly on the success of national demand and costs policies. Fiscal and monetary policy should be aimed to adjust aggregate expenditure — private and public, consumption and capital investment — to the country's production capacity, *less* the exports of capital or *plus* the imports of capital justified by the country's relative level of development in relation to the rest of the world. As for price and incomes policies, they should aim at preserving the competitive equilibrium of business firms on the international market.

Daily adjustment is obviously out of reach in this respect. for many reasons. The increase or diminution in international reserves are precisely designed to palliate the temporary, normal and inevitable fluctuations in the overall balance of payments without having to resort to measures which upset the internal equilibrium of the economy or are exaggeratedly harsh or harmful for partner countries.

Occasional setbacks are. however, inevitable in carrying out such internal adjustment policies. The pessimism reflected at this moment by the writings of most economists is no doubt excessive — judged in the light of the past — and derives mainly from the defects, listed above, of the dominant currency standard in its declining and dying phase.

It remains none the less true that institutions should facilitate and accelerate, more than they did yesterday, the external adjustments which are finally enforced in the event of the persistent failure of internal adjustment policies, and, in particular, in the event of evident disparities between national levels of costs and prices.

b) *External adjustments.*

Even assuming the total success of present efforts to readjust exchange rates and to establish a more realistic range, new disequilibria will inevitably arise in future and will have to be corrected more rapidly than in the past.

Current negotiations point in this respect to a certain degree of *permissive* relaxation of the old system of parities. The margins of fluctuation will be slightly widened — up to 1.5 of even 3 per cent either side of parity — *permitting* currencies to rise or fall within these limits in response to pressures exerted on the balance of payments. Some people even advocate what are called « crawling pegs » *permitting* a slow and progressive adjustment of the parities declared to the International Monetary Fund.

Whatever system is finally agreed in this respect, simple *permission* will not suffice. To cite only two examples among many others, Germany and France no doubt unduly delayed until the end of the summer and the beginning of the autumn of 1969, the readjustments which would have been not only permitted, but were in fact implored. to remedy evident disequilibria. The case of the pound sterling from 1964 to November, 1967, would be another example of the reluctance of the authorities to resign themselves to the exchange adaptations rendered indispensable by the persistent failure of internal adjustment policies.

Some economists — very few, it is true — see a panacea in the compulsory and daily readjustment of exchange rates by the total abstention of the central banks from intervention on the market. The market itself would determine the daily level of freely fluctuating exchange rates, at the whim of supply and demand, influenced by speculators assumed to be wiser than the country's monetary authorities.

Such a suggestion — and for excellent reasons, as it seems to me — has no chance of being adopted. It would sanction any inflationary error in national monetary policies by the depreciation of the currency and a correlative rise in prices, the cost of living and wages. But the subsequent correction of such errors, or even the acceptance of deflationary policies, would be incapable, in the world as it is today, of bringing wages *down*. The sanction would be, not a fall in wages, but recession and unemployment.

Is it conceivable, moreover, that the sectors directly influenced by foreign competition — particularly the export industries — would allow the monetary authorities to force them into losing markets — and force their workers into unemployment — if the appreciation of the currency resulted from the massive inflow of capital due to speculation or the adoption of an artificially low interest rate by another country ?

The application of a dogmatic « laisser faire » to the foreign exchange system is unthinkable in a world in which no government would agree to leave it to market forces alone to determine interest rates or to renounce other and multiple forms of intervention in the country's finances and economy.

This does not mean that nothing should be tried to induce the monetary authorities to correct a « fundamental disequilibrium » gravely affecting the balance of payments and the economy of their partner countries. I would propose in this connection the rule of the « bracket » on either side of normal monetary reserves as a complement to or substitute for the « range » proposed around agreed parities.

In brief, each country would be invited to define what it regards as a « normal » level of its monetary reserves. Its definition would be automatically accepted by the Monetary Fund if it corresponded to a proportion of total world reserves equal to the country's relative importance in world trade. It is remarkable to note in this connection that these two proportions are in fact very close to each other for all major groups of countries and differ only moderately even for several countries taken individually (see Table V, col. 3). Certain adjustments would, however, be admitted, to take account, in particular, of the vulnerability of the principal capital markets to sudden shifts of capital.

Table V. **Calculations illustrating the bracket**

Source : *International Financial Statistics.*

	Imports 1970		Reserves, end 1970				Bracket in relation to normal level	
	(billions of dollars)	*(as p.c. of world total)*	*(as p.c. of imports)*	« Normal »	Actual	Difference	1/4	1/3
				(billions of dollars)			*(billions of dollars)*	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
I. **World Total**	**292.3**	**100.0**	**31.6**	**92.4**	**92.4**			
A. *Industrial countries*	*211.4*	*72.3*	*31.1*	*66.8*	*65.7*	*— 1.1*	*16.7*	*22.3*
1. Europe	135.6	*46.4*	*30.8*	42.9	41.7	— 1.2	10.7	14.3
2. Others	75.9	*26.0*	*31.6*	24.0	24.0	—	6.0	8.0
B. *Other developed countries*	*26.9*	*9.2*	*31.6*	*8.5*	*8.5*	—	*2.1*	*2.8*
1. Europe	16.6	*5.7*	*34.3*	5.3	5.7	+ 0.4	1.3	1.8
2. Others	10.3	*3.5*	*27.2*	3.2	2.8	— 0.4	0.8	1.1
C. *Third World*	*54.0*	*18.5*	*33.7*	*17.1*	*18.2*	*+ 1.1*	*4.3*	*5.7*
1. Latin America	16.9	*5.8*	*33.7*	5.4	5.7	+ 0.3	1.4	1.8
2. Middle East	7.9	*2.7*	*39.2*	2.5	3.1	+ 0.6	0.6	0.8
3. Other Asian countries	19.0	*6.5*	*26.8*	6.0	5.1	— 0.9	1.5	2.0
4. Other African countries	10.0	*3.4*	*41.0*	3.1	4.1	+ 1.0	0.8	1.0
II. **Group of Ten**	**199.78**	**68.2**	**31.3**	**63.1**	**62.6**	**— 0.5**	**15.8**	**21.0**
United States	42.46	*14.3*	*34.1*	13.2	14.5	+ 0.7	3.3	4.3
United Kingdom	21.73	*7.4*	*12.9*	6.8	2.8	— 4.0	1.7	2.3
Japan	18.90	*6.5*	*25.4*	6.0	4.8	— 1.2	1.5	2.0
Canada	14.52	*5.0*	*32.4*	4.6	4.7	+ 0.1	1.2	1.5
Germany	29.81	*10.2*	*45.6*	9.4	13.6	+ 4.2	2.4	3.1
France	19.11	*6.5*	*26.3*	6.0	5.0	— 1.0	1.5	2.0
Italy	14.94	*5.1*	*35.6*	4.7	5.3	+ 0.6	1.2	1.6
Netherlands	13.39	*4.5*	*24.6*	4.2	3.2	— 1.0	1.1	1.4
B.L.E.U.	11.36	*3.8*	*23.9*	3.5	2.8	— 0.7	0.9	1.2
Sweden	7.01	*2.4*	*11.4*	2.2	0.8	— 1.4	0.6	0.7
Switzerland	6.55	*2.2*	*77.2*	2.0	5.1	+ 3.1	0.5	0.7

Brief explanation of calculations :

Column (3) = column (5) : column (1).
Column (4) = total 92.4 × column (2) = column (1) × total 31.6 p.c. to column (3).
Column (6) = column (5) – column (4).
Column (7) = column (4) × 1/4.
Column (8) = column (4) × 1/3.

Once the « normal » share of each country in the world's monetary reserves was defined by common agreement, each central bank would be allowed complete freedom to intervene on the foreign exchange market to keep its exchange rates within the margins agreed — and possibly enlarged, as I have noted above. But if the persistent surpluses or deficits of a country pushed its reserves more than 25 per cent above or below the agreed « normal » reserves, the country would have to enter into consultation with the Monetary Fund on the adjustments of internal policy or of parity deemed necessary to restore its equilibrium (1).

In the event of these consultations being unsuccessful and of the variation from « normal » reaching 33 per cent, the Monetary Fund would be entitled, *if it thought necessary,* in the light of other complementary criteria to be taken into account, to prohibit the country from any market intervention which had the effect of increasing beyond 33 per cent the variation of its reserves from the agreed normal level. It could also, instead of totally prohibiting such interventions, limit them to a specified amount, or to the amounts necessary to ensure that the exchange rate itself « crawled » within the permitted limits rather than « jumping » in disorderly fashion.

In short, the « bracket » technique would *compel* recourse to the exchange rate adaptations advocated by many economists, but only to prevent the persistent and excessive export to other countries of national inflation or deflation. The central banks would remain free, on the contrary, to intervene on the market according to their own criteria, so long as the fluctuations in their reserves served the purpose assigned to them, namely to offset temporary and moderate fluctuations in their balances of payments.

Finally, it may be noted that the system would restore a desirable symmetry between creditor and debtor countries by imposing on the former a discipline from which — unlike the latter (2) — they can at present escape almost indefinitely by selling their own currency on the market.

5. Short term capital movements.

The history of the past few years has demonstrated the magnitude which may be assumed by short term capital movements originated by speculation on exchange rates or by the distortion in interest rates between the world's leading money markets.

(1) See also page 19 and note (2).

(2) The latter are obliged to stop their interventions on the market by selling foreign currency to redeem their own currency when their monetary reserves are excessively whittled down to the point of being wholly swallowed up by their defence of an overvalued exchange rate.

The gravity of the problem was, however, due to the disequilibrium, accumulated over many years, in the balance of payments of the two dominant currency countries — the United States and the United Kingdom — which no longer allowed for the reform of the international reserves system suggested above.

The International Monetary Fund would, moreover, be better armed than in the past (see above, paragraph 3, page 14) to offset by its own investment operations the influence of such reversible capital movements on the reserves of its member countries.

The fact nevertheless remains that certain efforts are imperative to direct and canalise the excessive mobility of capital connected with the spectacular development of the Eurocurrency market and the great multinational firms. Efforts could be made to conclude international agreements on this subject between the leading capital markets, defining certain rules to be applied both to the import and to the export of capital under the combined supervision of the countries concerned.

The foreign credit operations — both credit and debit — of the banking system could be subjected to certain ceilings, compulsory deposits with the central bank, rates of taxation, etc. Similarly, one could try to limit, by common agreement, any massive transfer of capital by the big companies wholly unrelated with the nature of their industrial, commercial or financial operations.

The suggestions recently put forward by Professor Robert A. Mundell in *Note Economiche* (« World Inflation and the Eurodollar ») certainly merit thorough study. So do the suggestions often repeated by Mundell and other economists, both official and academic, advocating greater flexibility in budget and fiscal policies as an instrument for the *internal* equilibrium of economies, so as to avoid excessive and unbalancing distortions of the rates of interest between the main capital and money markets.

B. URGENT ACTIONS AT REGIONAL LEVEL.

1. Why ?

The world reforms outlined under section A above do not exhaust the list of actions to be taken, both to carry through the reforms and to parry the imminent catastrophes which threaten all countries. There are four main reasons in this connection which dictate the imperative need to speed up the efforts at closer monetary cooperation, and even integration, which seem politically possible at regional level, especially in an enlarged European Community.

a) The first and most evident of these reasons for immediate action lies in the fact that reforms of such magnitude will take many months to negotiate and to be ratified by more than a hundred national parliaments. The present situation, described as *untenable* in the first section of this study, threatens to degenerate rapidly into a series of nationalist « every man for himself » actions, reminiscent of the worst years following 21st September, 1931.

This rot can be stopped, or even checked, only by agreements concluded with all urgency among the countries which are prepared to do so, to avoid such contagion. Such agreements would be even more indispensable if the current negotiations were to break down at world level and deliver each country to the ravages and temptations of competitive devaluations, exchange and trade restrictions, and chain reprisals, which would be fatal for everybody.

b) The negotiations to be opened can be not only facilitated and speeded up, but better balanced and more effective, in so far as group agreements can be concluded among countries already engaged in a process of regional integration, notably in Europe and Latin America. Such agreements will help to pave the way for the indispensable world agreements and to ensure the more generally acceptable discharge of the enormous responsibilities which they will inevitably place on the International Monetary Fund.

c) In the longer term a decentralisation or restructuration of these responsibilities seems indispensable to the whole effectiveness of the operations of the Fund. Why should questions have to be discussed and negotiated among more than a hundred countries which affect only some of them and which they are prepared to settle at regional level ?

Recourse to the world forum should be reserved for questions which cannot be settled at regional level. Balance-of-payments difficulties between the countries of the European Community can be settled among themselves, while the Monetary Fund would be relieved of superfluous responsibilities, which would leave it free to devote itself to the tasks which it alone can solve, that is to say, the problems which arise between the European Community *taken as a whole* and the other countries or regional groups in a world every part of which is interdependent.

The same would apply to other groups of countries, such as those of Central America, the Andes Group, etc. and those of Comecon. It is not, indeed, entirely out of the question that such a restructuration and decentralisation of the Monetary Fund could one day facilitate the reintegration of these latter countries in an international monetary community less characterised than in the past by the role of one or two dominant currencies.

d) Finally, this decentralisation will be imposed by the progress made during the next few months and years towards monetary union by the countries which have proclaimed their political determination to achieve such a union.

The progressive application of the decisions of the Summit Conference of The Hague will be of capital importance in this respect, in view of the weight of the present Community, and still more of an enlarged Community, in the international economy, trade and payments.

2. **The immediate future : The probable emergence of a three-pronged system.**

The American decisions of 15th August laid in ruins the institutional structure which served as a framework for the economic and monetary policies of the hundred and more countries which share the world. Their forced adaptation and their reactions — of cooperation and defence — to these decisions will not await the finalisation of the world negotiations outlined above. They will also differ considerably from country to country.

It is infinitely probable that many developing countries, particularly in Latin America and in Asia, will gravitate around the dollar, forming an area recalling the sterling bloc which, some forty years ago, followed the suspension of convertibility by the United Kingdom. These countries will continue to anchor — even if they do not succeed in stabilising — their currency to the dollar and to use the dollar as the main currency for external settlements, market intervention and the accumulation of reserves. It is very possible that many of them will prefer, even in the long term, to preserve, and even to institutionalise, their membership of the dollar area, rather than adopt the agreements suggested above (see section III, A) arranging for the replacement of reserves in a dominant currency by deposits with the International Monetary Fund.

It is also probable that other countries in Europe, Africa and Oceania, and even some Asian countries, will similarly turn to a monetary association, in fact or in law, with the enlarged European Community of tomorrow.

Finally, Japan will constitute a third monetary force on its own. It is improbable that it will tie itself formally to either of the others, and it is not out of the question that it may attract into its orbit certain Asian countries.

During the many months which will still elapse before the finalisation of world reforms and the restoration of lasting parities in the I.M.F., the best chance of avoiding chaos and monetary guerilla warfare which would be disastrous for everybody will undoubtedly lie in close political concert between these three monetary poles. Our hope is that the United States, Japan and Europe will, within the shortest possible time, arrive at an approximate, presumptive and factual stabilisation of exchange rates among themselves. This stabilisation will, no doubt, not rule out a certain flexibility, within jointly accepted margins, or even fresh readjustments, subject to prior consultation, in the light of circumstances and the evolution of the balance of payments.

But, in contrast with the dollar area and the yen, there is not yet any European currency, or even a genuine currency zone or European monetary community. This is the last problem I have to tackle and the one which seems to me the most crucial, the most urgent and the one which can most possibly be solved without waiting for the final result of the negotiations opened on the world-wide scale or even for an agreement among the Europeans themselves on the last stages of the Werner Plan.

3. Outline of a concrete plan for immediate action by the European Community.

a) *A range of intra-European pivot rates.*

The first decision to be taken, which will condition all the rest, is an urgent agreement on a range of exchange rates among Community countries.

Such an agreement must not and cannot in any way be subordinate to an agreement on European exchange rates in relation to the American dollar or to any other currency outside the enlarged Community which is now in sight. The United Kingdom should certainly be associated with it as soon as possible.

It is essential at the outset to recognize clearly that the foreign exchange relations which are most important for each of the Community currencies are those with the other Community currencies and not with the dollar.

The United States absorbs only an average of 7.5 per cent of the exports of the present Community countries and the whole Western Hemisphere 11.5 per cent, while exports to the other Community countries amount to 49 per cent and to a presumptive European zone between *70 and 75 per cent* (see row I of Table VI).

What is therefore of paramount importance to the Community countries is to establish a stable range of exchange rates between the Community currencies themselves and not with the dollar.

It must, however, be recognized that this stability cannot be prematurely declared irrevocable. It will certainly remain subject to revision in the light of present uncertainties, both outside and inside the Community. It can only be a question at this stage of establishing — in the language of the recent monetary agreement between the Benelux countries — provisional « pivot rates » rather than final parities. But these « rates » should be modified only by common agreement, or by the application of commonly recognized objective criteria, such as, for example, losses or gains of reserves or the application of agreements for short term monetary support or medium term financial assistance for amounts deemed manifestly excessive either by the creditor countries or by the debtors.

Table VI.

Percentages of total exports of the European countries in 1970 to various prospective monetary areas

From \ Exports to	Existing Community	Enlarged Community	O.E.C.D. Europe	O.E.C.D. Europe and Africa	United States	American continent	Japan	Sino-Soviet zone	Rest of the world
I. **Existing Community**	**48.8**	**55.8**	**69.7**	**74.5**	**7.5**	**11.5**	**1.1**	**3.8**	**9.0**
Germany	40.1	47.8	67.6	**70.3**	9.1	**14.0**	1.6	4.3	9.8
France	48.3	54.1	65.7	**77.1**	5.3	**9.1**	0.9	4.1	8.9
Italy	42.8	48.3	61.3	**66.4**	10.3	**15.4**	1.0	5.8	11.4
Netherlands	62.0	71.7	79.8	**82.5**	4.3	**6.9**	0.7	2.0	7.9
B.L.E.U.	68.6	74.3	81.5	**84.3**	6.0	**8.1**	0.7	1.7	5.3
II. **Enlarged Community**	**42.8**	**51.7**	**66.1**	**71.0**	**8.2**	**12.6**	**1.2**	**3.8**	**11.4**
III. **O.E.C.D. Europe**	**41.1**	**51.7**	**66.1**	**70.9**	**8.1**	**12.7**	**1.2**	**4.4**	**10.8**

b) *Intra-Community payments.*

The total margin of fluctuations permitted between Community currencies would be limited, as already agreed in principle, to a maximum of 1.5 per cent or even 1 per cent. Interventions designed to maintain these margins would be effected, in principle, only in the Community currencies themselves. Functionally, the main responsibility for such intervention should be placed on the country whose currency tends to go above the agreed ceiling, since that country can always prevent this ceiling from being exceeded by selling *its own currency* in exchange for the currency which is tending to fall below the « floor » rate.

The debtor country's obligation to repay would be denominated in the Community unit of account, which could only be modified by decision — by qualified vote — of the Council of the Community, following the procedure already accepted on the initiative of the old Agreement for the establishment of a European Payments Union.

This repayment could be made, either at the request of the creditor, or on the initiative of the debtor, in any form acceptable to both. One can conceive, for example, repayment in gold, dollars or any other mutually agreed currency, at the prevailing market rate, in the absence of *effective* parities of gold or of the relevant currency. Ideally, however, repayment should be made by the use of normal or special drawing rights on the International Monetary Fund. *It is therefore particularly important in this connection, to define with all urgency, the conditions for the practical use of this procedure, at present partly paralysed in consequence of the American decisions of 15th August.*

It is, moreover, unnecessary to add that the creditor country may prefer to postpone settlement and to retain its claim in units of account, and that the debtor could rely on existing support or assistance agreements.

Finally, there would be great advantage in multilateralising these credit and settlement procedures by the immediate institution of a European Fund, proposed at The Hague by Chancellor Brandt under the name European Reserve Fund, rechristened European Monetary Cooperation Fund in the Werner Plan and agency for the concerted management of reserves by President Pompidou at his Press Conference of 23rd September last.

c) *European Reserve Fund.*

All claims or debts between central banks resulting from the operations described in b) above would be entered, in units of account, to the credit or debit of a reserve deposit account kept by each country with a joint Fund or agency.

These accounts could also be fed by deposits in national currencies of member countries giving concrete form to the lines of credit mutually opened pursuant to agreements of monetary support or financial assistance.

One could also contemplate deposits in gold or third country currencies, either on the initiative of the depositor country, or even — which would be highly desirable — for an agreed proportion (20 or 25 per cent to start with ?) of the gold and foreign currency reserves of member countries. In contrast with deposits in Community currencies, these deposits could not be entered in the unit of account, in the absence of prior negotiations of exchange guarantees in that unit by the country issuing the currency deposited.

Finally, the Fund could accept deposits from non-member countries, on their own request, particularly from countries desiring to be associated in law or in fact with the prospective European monetary area.

d) *Interventions on the dollar market.*

Such a Fund could then serve as a common agency for intervention on the dollar market at rates, or up to total amounts decided by a Board of Management.

Such a Board would, in any event, be essential to coordinate the direct interventions of the central banks on the dollar market and to ensure that the dollar fluctuated only in parallel with all the Community currencies.

The rates and amounts of intervention would merely be the obverse and the reverse of the same medal. It is conceivable that the Board of Management might fix presumptive intervention rates subject to certain ceillings as to the maximum amount of dollars it would be necessary to buy — or to sell — to maintain these rates. It goes without saying that these decisions should, so far as possible, be concerted with the principal interested party, the United States, so as to ensure the participation of that country itself in the stabilisation of its own currency and to avoid a return to the virtually unlimited financing of dollar deficits by the banknote printing press of other countries (see section II, B, above).

Some countries have referred to the danger of seeing their currencies involved in an excessive appreciation of the dollar as a result of such Community management decisions.

It should be pointed out in the first place that these decisions would be *Community* decisions, in which all the members of tomorrow's enlarged Community would take part. No currency is in danger of being forced up by the unilateral decision of the country with the strongest currency.

Finally, we would recall the considerations set out on page 28 and in Table VI; the « weighted » exchange rate of each country with the rest of the world depends much more on the intra-Community exchange rates than the dollar rate. And the intra-Community range of exchange rates should be capable of modification, where appropriate, at the request of a country whose balance of payments deteriorated excessively.

Conclusion.

A great deal still remains to be said to throw light on the manifold aspects of such a complicated problem. But time does not permit. We must act or perish. The agreements which may be arrived at tomorrow will certainly be imperfect and will, in any event, have to be revised in future, in the light of the progress or setbacks encountered by world-wide negotiations, which are essential, but doomed to spread over many months.

Addressing myself today principally to the authorities of the Community countries, I can only utter a cry of anguish in the face of the procrastinations and quarrels which have paralysed the European Community since 15th August. In the eyes of your peoples, who will suffer the consequence, you will tomorrow bear the terrifying responsibility for a continued paralysis under the menacing danger of a relapse into the « every man for himself » protectionism of the 1930's.

Some of you blame the United States for not putting forward clear proposals for a viable monetary order which it can accept. The Americans likewise complain of the absence of any initiative on the part of the Community countries, and even more, of the impossibility in which they find themselves of negotiating effectively with a divided Community.

And yet that which unites you is infinitely greater than anything which can still divide you. You have expressed your agreement on the essential lines of the Werner Plan. The crisis triggered off since 15th August merely compels you to speed up the first stages.

Everyone will no doubt find that the agreements which I have had the temerity to put forward in the last section of this long, but still too short, survey, and all those which could usefully be substituted for them, are lame in one respect or another. Never mind if the Community you have created limps, if need be, during the long months of world negotiations but at least let it move — or even simply survive !

Brussels, 3rd November, 1971.

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THE INTERNATIONAL MONETARY POSITION OF THE UNITED STATES

(Statement of Robert Triffin before the Joint Economic Committee, Oct. 28, 1959, hearings on Employment, Growth, and Price Levels)

I

Let me first apologize for being unable to offer you today more than a very narrow contribution to the broad and fundamental policy issues debated by your committee. The time at my disposal was extremely short, and my only field of competence—if any—lies in the area of our international monetary policy, rather than in the field of domestic economic policies which is the main concern of this inquiry.

I am very much afraid, however, that the evoution of the last 10 years has now brought us to a point where these issues have become inextricably intertwined, and where we can no longer afford to ignore the impact of our domestic policies upon our balance of payments and reserve position. I must admit that this way of looking at things is still very unfamiliar to most of my colleagues in the academic world, although it has recently begun to force itself upon the attention of economists in business and Government circles.

For many years after the war, our only problem in this field was to reduce to more manageable proportions our enormous surpluses with the rest of the world, and to find adequate means to finance them. The so-called "dollar shortage" theory dominated economic thinking and inspired economic policy, both here and abroad. The authors of these theories, however, and policymakers themselves were extraordinarily slow in realizing the full extent of their own success in dealing with the problem. Only our large gold losses of last year finally woke us all to the fact that our balance of payments had shown persistent deficits on overall account ever since 1949, and that our net international reserve position had been declining continuously at a rate of about $1¼ billion over the 8 years, 1950-57. This latter figure rose abruptly to $3.3 billion in 1958, and is likely to exceed $4 billion this year. While our gold losses have been dammed up somewhat this year by sharp increases in interest rates, they have nevertheless continued, and been accompanied by a further upward spiraling of our short-term indebtedness abroad. Finally, and for the first time in many years, this country—the richest in the world, by far—is now experiencing large and growing deficits even in its current account, i.e., its purchases of goods and services abroad far exceed its sales to foreign countries, even though a substantial portion of these sales are financed and supported by extraordinary aid programs, particularly in relation with the disposal of our agricultural surpluses. More and more is being heard about our producers "having priced themselves out of the world markets."

The situation clearly calls for an "agonizing reappraisal" of our foreign economic policies, but we are in great danger of misinterpreting the evidence and of taking refuge in the kind of policies which, although extremely plausible on the surface, are not likely to be as effective as one might think in redressing our own position and are most likely, on the other hand, to trigger off a disastrous reversal in the postwar trend toward freer and expanding world trade.

My main attention has been directed at the international aspects of this problem. I beg your permission to introduce in evidence a paper on "The Gold Shortage, the Dollar Glut and the Future of Convertibility" which discusses it from that angle and which I submitted last month to the annual meeting of the International Economic Association. I shall try to summarize today the main conclusion and policy suggestions of that paper, but in doing so I'll attempt to relate them more explicity to the problems of the United States, and more particularly, to the issues raised by your committee.

II

Two major questions emerge from any objective examination of our current balance of payments and reserve position. Does the evolution of our balance of payments on current account suggest that we may be in danger of pricing ourselves out of the world markets? Does the evolution of our international reserve position suggest that we might have difficulties in maintaining the free convertibility of the dollar at its present value in terms of gold and foreign exchange?

I do not pretend to be able to give you a definite answer to the first of these two questions, but I might point out some reasons for serious concern in this respect.

As the richest country in the world, with far-flung economic, political, and military responsibilities, we should be able to finance a large and steady capital outflow toward the underdeveloped countries, to help sustain their economy and their defense establishment. With far less resources than we have, the British estimate that they should aim for such purposes, at a current account surplus averaging more than $1 billion a year. On a comparable basis, an average surplus of, let us say, $4 billion a year in our own balance of payments would not seem excessive. This is indeed just about the level around which our capital exports—public and private—have fluctuated, rather narrowly, over the last 9 or 10 years. Our current account surplus, however, has long been insufficient to cover such exports. It averaged slightly more than $2 billion over the years 1952–57, fell to $1.5 billion in 1958, and turned into an annual deficit rate of more than $1 billion in the first half of this year.

Even more disturbing as an indication of our relative competitiveness in world trade is the evolution of our current account with Western Europe. This is the area which is most directly in competition with us in the field of manufactures, while our balance with the rest of the world is more responsive to cyclical conditions and to the level of foreign aid and capital made available to these countries. Discounting some highly abnormal movements connected with the peak of the European boom and the Suez crisis, in 1956–57, our current account with Western Europe has shown a pronounced and markedly unfavorable trend ever since 1951. Our surpluses of the immediate postwar years had thinned out rapidly even before then, falling from $5 billion a year in 1947 to $1.8 billion in 1951. They averaged less than $100 million a year in 1952–57, and have now shifted to an annual deficit rate of $800 million in 1958 and more than $2 billion in the first half of this year.

The combination of a relatively stable level of capital exports—about $4 billion a year—with much smaller and fast declining surpluses on current account, turning into an actual deficit in 1959, has left us with a persistent and growing deficit on overall account, running today at the rate of about $5 billion a year. A small portion of this, however, is covered by long-term foreign capital exports to the United States and by other untraceable transactions appearing as "errors and omissions" in our balance of payments estimates. The remainder has given rise to annual gold losses and increases in our short-term indebtedness abroad totaling, on the average, more than $1 billion a year in 1952–57, $3.4 billion in 1958 and, at an annual rate, $3.7 billion in the first half of this year.

A continuation of this trend would clearly be untenable in the long run. It is not to be anticipated in any case. The incipient, but strong, recovery of economic activity in Europe and the end of the steel strike should produce some improvement over the forthcoming months. Yet, this is most unlikely to redress the situation fully and to bring about a reasonable and tenable equilibrium in our overall balance of payments account, at satisfactory levels of trade and of net capital exports by the United States to the rest of the world.

Among the policy measures which suggest themselves, two are particularly plausible and yet likely to prove both ineffective and unwise. The first, and most obvious one, would be a sharp curtailment of our foreign-aid programs. The trouble with this is that such curtailment would be offset, in very large part, by corresponding cuts in our exports. Of a total capital flow of $5.4 billion in 1958, less than $800 million went to Western Europe, and more than $4.6 billion to the rest of the world, i.e., mostly to the underdeveloped countries. A comparison of our capital exports to this area with our current account surplus with it shows a high degree of correlation, as the ability of these countries to run deficits with us on current account depends primarily on the financing made available to them by our own capital exports and foreign aid. A lesser flow of capital to them is thus likely to be matched, in very large part, by declining purchases of U.S. exports by them, and to bring relatively little improvement in our overall balance of payments.

We must also note that most of our aid programs and official capital exports are closely linked to political objectives which we would hardly abandon on mere balance of payments grounds.

This may yet leave some room for so-called tied loans, ensuring that the recipients of aid use it to buy in this market rather than to add to their reserves or to spend the dollars in other areas. This would be a palliative at best, the practical results of which are likely to prove disappointing as a great deal of our aid—such as the financing of our exports by agricultural surpluses—is already tied in this manner, or is, in any case, used in fact for purchases in the United States.

A second, and even more disastrous, line of action would be to reverse the liberal trading policies pursued by us for more than 20 years, and which have helped so spectacularly in the recovery and liberalization of world trade in general. This could hardly fail to trigger off similar reactions abroad, to arrest and reverse the current trend toward liberalization by foreign countries and to stifle further our own export trade.

The remedies, I feel, should be sought in a different direction. First of all, the current relaxation of world tensions may possibly enable us to reduce the terrifying and disproportionate defense burdens—internal and external—which probably accounts, more than any other single factor, for the revolutionary shift in the international dollar balance from prewar to postwar days. This is, however, only a hope yet, and one about which I feel totally incompetent to hazard any guess or suggestion.

We should, secondly, continue to press vigorously for the elimination of remaining discrimination on dollar goods and the further reduction of other obstacles to trade and payments by foreign countries, particularly in Europe. A more determined support for GATT and its efforts to outlaw unjustified discrimination and liberalize other damaging restrictions on world trade should also serve as a basis for greater efforts on the part of our own producers to prospect foreign markets and expand the level of our exports.

We should, in the third place, do everything we can to encourage European countries to assume a larger share of the burden of development financing, and to allow the recipients to spend the proceeds of such financing in the United States as well as in Europe itself. (This is another reason, by the way, for us to be chary of "tying" our own lending operations any more than they already are.) Success along these lines should probably involve some redirection of our own programs away from bilateral assistance, and toward multilateral assistance, such as is implicit in the present IDA project.

Fuller European participation in the financing of developmental needs seems to me particularly crucial at the present juncture, since I am not confident that the various measures mentioned above will be sufficient to bring about a sufficiently rapid and drastic improvement in our overall balance of payments position. Time will be needed to restore, in a politically desirable and feasible manner, full competitiveness in our external trading position. Creeping inflation here must be arrested, while our rates of growth and productivity are stepped up at the same time by appropriate investments in research and technology. We should also be aided by the inevitable adjustment of foreign wage and consumption levels to the steep increases in production and the large balance of payments surpluses achieved by foreign countries over recent years. In the meantime, we shall probably be forced to keep our interest rates high enough to retain and attract foreign funds to this market, and to slow down somewhat our own capital exports. While unavoidable in the short run, this policy would be difficult to reconcile with our longer run policy objectives, internally as well as externally. The last part of my statement will come back to this point and make concrete suggestions to help us out of this dilemma.

III

The second major question which I raised above relates to the evolution of our international reserve position and the threat which it may raise for the future stability of the dollar.

I have already mentioned the fact that the largest portion of our persistent balance of payments deficits on overall account has been financed, year after year, for nearly a decade, by a growing deterioration in our net reserve position. At the end of 1949, our gold stock exceeded the liquid dollar claims of foreign countries by more than $18 billion. This exceedingly comfortable cushion was already down last June to less than $3 billion. At the rate of loss experienced in 1958 and eary 1959, these $3 billions would be wiped out within a year, and our short-term indebtedness abroad would begin to outstrip our total gold stock.

The financial press, here and abroad, has sometimes exaggerated the significance of these figures. First of all, we are not in any danger of becoming insolvent as a Nation. Our gold losses and the increase in our short-term liabilities abroad are matched—and far more than matched—by the enormous growth of our foreign investments since the war. Most of these investments, however, are long-term investments on private account and could not be mobilized quickly to meet any demand for foreigners for conversion of their liquid dollar holdings into gold.

Secondly, however, there is nothing unusual or necessarily alarming, for a country like ours, in this rough equivalence between our gold assets and the dollar balances held abroad. Sterling was made convertible last December, and has shown considerable strength ever since—as reflected in its persistent premium over the dollar on the exchange market—in the face of a level of foreign sterling balances three to four times larger than the total gold and convertible currency reserves of the United Kingdom.

The strength, and the weaknesses, of our international position cannot be gaged from any simple formula or calculation of this sort. Account should also be taken of our short-term, and even long-term, assets abroad, but also of other assets held here by foreigners and which might, under certain circumstances, be liquidated by them for reinvestment elsewhere or for repatriation to the owners' countries. Continued mismanagement of our own affairs might even prompt a flight from the dollar by our own citizens and find us unwilling or unprepared to take effective measures against it. The future of the dollar is far less dependent on transitory fluctuations in our balance of payments than on the maintenance of people's confidence in our determination to preserve its basic and still formidable strength, in our own interest as well as in the interest of the world at large. Our capital is very high in this respect, and there is no reason to think that it is in serious danger of being jeopardized by excessive complacency, or dissipated by sheer irresponsibility, on the part of the monetary and political authorities of this country.

IV

Even the most successful readjustment of our overall balance of payments, however, will leave in its wake two major problems. The first is the impact which such a readjustment will entail for the maintenance of an adequate degree of international liquidity in an expanding world economy. The second is the need to protect our own economy and the freedom of our internal economic policies against the dangers inevitably associated with the existence of such a huge backlog of foreign short-term funds in our financial and exchange markets. The concrete, but somewhat revolutionary suggestions presented below aim at solving rationally both of these problems together. First, however, it is necessary to state them more precisely and to replace them in their historical perspective.

The present international monetary system of the world can be sketchily described as follows. A number of countries—particularly the old industrial countries of Western Europe—are both anxious and able to maintain relatively high levels of monetary reserves and to increase them more or less pari passu with increases in production, money supply and international trade turnover. Other countries—particularly in the underdeveloped areas of the world—are content with much lower levels of reserves and a more continuous recourse to foreign aid and short-term capital, currency devaluation or trade and exchange restrictions as alternative techniques of balance of payments adjustment. Current increases in the world monetary gold stock meet only a fraction (about one-third) of the combined demand for monetary reserves defined above. Most—although not all—countries, however, have shown themselves willing to accumulate a substantial portion of their monetary reserves in the form of foreign exchange rather than gold. In choosing a particular foreign currency for this purpose, they naturally tend to select the currency that appears safest, i.e., that of a major creditor country: primarily the United Kingdom in former days, and primarily the United States today. This accumulation of a key currency as international reserves by the rest of the world necessarily entails a large amount of "unrequited" capital imports by the key currency country. Coal is brought to Newcastle, from which it should be exported instead. The international liquidity shortage, moreover, is not thereby relieved, unless the key currency country allows its resulting short-term indebtedness to grow continually and persistently at a faster pace than its own gold assets. (It may otherwise disguise the basic gold shortage into a scarcity of the key currency itself.)

This is an exact description of what has happened in fact since the war, and a major explanation of the growing threat to our own liquity position. We have been lending long—and even given funds away—while borrowing short and losing gold. Foreign countries' gold reserves and dollar holdings have risen by $20 billion (from $15 billion to $35 billion) between the end of 1949 and the middle of this year, but only one-fourth ($5 billion) of this increase has come from new gold production—including Russian gold sales in Western markets. The remaining three fourths ($15 billion) were derived from our own gold losses and increasing short-term liabilities to foreigners.

The restoration of overall balance in the U.S. international transactions would put an end to this process and deprive the rest of the world of the major source, by far, from which the international liquidity requirements of an expanding world economy are being met currently in the face of a totally inadequate supply of monetary gold. This might trigger off tomorrow—as it did under very similar circumstances in the early 1930's—a new cycle of international deflation, currency devaluations, and trade exchange restrictions.

The other problem that would be left unsolved by the readjustment of our current balance of payments is that of the huge legacy of short-term foreign indebatedness inherited from the past, and the huge handicap that might be placed thereby on sound policies for economic growth and stability of our own economy. Such funds are extremely volatile and may, at any time, move out of our market in response to interest rate differentials or to foreign conditions over which we have no control.

The experience of the United Kingdom, in the late 1920's and early 1930's, is particularly eloquent in this respect. The pound had been stabilized in 1925 at an overvalued level with the help of large amounts of speculative foreign funds and refugee capital, particularly from the continent, during the period of currency depreciation that followed World War I. The dangers of this situation were well perceived and led to various exchanges of views between Montague Norman of the Bank of England and Benjamin Strong of the Federal Reserve Bank in New York. Both men agreed, in general terms, that interest rates should be kept higher in London than in New York, in order to prevent an outflow of short-term funds from the first to the latter. This soon entered into conflict with domestic policy criteria in both countries. A rise of interest rates in the United States seemed highly desirable at times to slow down excessive lending here, particularly in connection with the boom in Wall Street. Even greater pressure arose in England to ease credit conditions in order to fight the economic stagnation and mass unemployment which plagued the British economy in the late 1920's.

The enormous repatriation of French refugee capital after the Poincare stabilization of the French franc heralded the beginning of the end. The pound still held out for a few years, but had to be bolstered in various ways, including urgent pleas to the Bank of France and other central banks to refrain from converting, at an unpropitious time, the huge amounts of sterling absorbed by them from private traders and speculators. Some reluctant cooperation was given to the British in answer to these pleas, and substantial exchange losses were incurred as a result by several central banks when the pound finally devalued in September 1931.

A disquieting parallel could be drawn between those events and our own situation today. The extent of foreign currency devaluation since the war may have given a competitive edge to those countries after their production potential had recovered from the early postwar low. Some foreign currencies may now be undervalued in relation to the dollar, as they were in relation to the pound in the late 1920's. Refugee capital flew here in large amounts after the Second World War, as it had flown to London after the First World War. Some of it may again return home, as currency conditions become definitely stabilized in Europe. Our huge gold losses of last year were due in part to such a movement. They have been slowed down this year by an extremely sharp rise in interest rates, prompted by our domestic concern with creeping inflation in this country. In this case, external and internal interest rate policy criteria happily coincided. but they may diverge tomorrow. If any when we feel reassured about our internal price and cost trends. we are likely to turn increasingly our attention to our laggard rates of economic growth as compared not only with Russia, but also with most countries in Western Europe. We may wish to ease credit and lower interest rates to spur new investments and technological progress. At this point, however, interest rates abroad might again become more attractive to financial investors, and the gold dammed up this year by our high interest rates might flow out at a rate comparable to that of 1958, or even worse.

I cannot resist quoting here an incisive remark of Suntyana, which the dynamic Managing Director of the International Monetary Fund, Per Jacobsson, has used most aptly in some of his recent speeches: "Those who do not remember the past will be condemned to repeat it." John Steinbeck wrote in the same vein: "The study of history, while it does not endow with prophecy, may indicate lines of probability."

My final remarks will attempt to sketch, in very succinct form, the most logical policy answer to the two problems which I have just discussed. Those of you whom this summary might leave both interested and unconvinced may find a somewhat more detailed presentation of these suggestions in my paper on "The Gold Shortage, the Dollar Glut and the Future of Convertibility" and a fuller and more technical treatment in another publication of mine on "Tomorrow's Convertibility: Aims and Means of International Monetary Policy." [1]

The keystone of my proposals lies in the true "internationalization" of the foreign exchange component of the world's monetary reserves. The use of national currencies as international reserves constitutes indeed a totally irrational "built-in destabilizer" in the present world monetary system. It is bound to weaken dangerously in time the key currencies—primarily sterling and the dollar—used as reserves by other countries under this system. These difficulties are then bound, in turn, to endanger the stability of the whole international monetary superstructure erected upon these key currencies.

The logical solution of the problem is obvious enough, and would have been adopted long ago if it were not for the enormous difficulties involved in overcoming the forces of inertia and reaching agreement among several scores of countries on the multiple facets of a rational system of international money and credit creation. This is, of course, the only explanaiton for the survival of gold itself as the ultimate means of international monetary settlements. Nobody could ever have conceived of a more absurd waste of human resources than to dig gold in distant corners of the earth for the sole purpose of transporting it and reburying it immediately afterward in other deep holes, especially excavated to receive it and heavily guarded to protect it. The history of human institutions, however, has a logic of its own. Gold as a commodity enjoyed undoubted advantages over other commodities that could alternatively be used as money. The substituiton of debt or paper money for commodity money within each country's national borders was a slow, gradual, and still recent phenomenon in world affairs. Its extension to the inernational sphere is even more recent and has also developed haphazardly under the pressure of circumstances rather than as a rational act of creation on the part of any national or international authority. This explains the present, and totally irrational, use of national currencies as international reserves. Yet, the proliferation of regional, international, and supranational agencies since the war is slowly laying the groundwork for further, and long overdue, adaptations in the international monetary system, and particularly for the internationalization of the fiduciary portion—foreign exchange—of countries' monetary reserves. This portion should be made up of international deposits rather than of national currencies.

The United States and the United Kingdom should bar the use of sterling and dollars as monetary reserves by other countries. All countries should simultaneously renounce the use of these, or other, national currencies as international reserve holdings. They would be offered instead the opportunity of keeping in the form of deposits with the International Monetary Fund any portion of their reserves which they do not wish to hold in the form of gold. Deposits with the Fund would be constituted initially by transferring to the Fund the national currencies—primarily dollars and sterling now held as reserves by the central banks of member countries, plus any amount of gold which they might also wish to exchange for such deposits.

Reserve deposits at the Fund would be as fully usable as gold itself in all international settlements. They could be drawn upon by their holders to procure any currency needed in such settlements or for stabilization interventions of central banks in the exchange market. The amounts wihdrawn would

[1] Published (in English) in the June 1959 issue of the Banca Nazionale del Lavoro Quarterly Review. This and another article on the international liquidity problem form part of a forthcoming volume, to be published by the Yale University Press early next year.

be merely debited from the withdrawer's deposit account and credited to the account of the country whose currency has been bought from the Fund.

Fund deposits would carry exchange rates and convertibility guarantees which would make them a far safer medium for reserve investment than any national currency holdings, always exposed to devaluation, inconvertibility, blocking, or even default by the debtor country. They would, moreover, earn interest at a rate to be determined, and varied from time to time, in the light of the Fund's earnings on its own loans and investments.

These various features, combining the earning incentive of foreign exchange holdings with the safety incentive of gold holdings, should insure in time a large and continuing demand for Fund deposits by central banks, once they become sufficiently familiar with the system and confident in its management. In order to take account of initial diffidence and inertia, however, and to guarantee the system against the vagaries of sudden and unpredictable shifts between gold holdings and Fund deposits, all members should undertake to hold in the form of Fund deposits a uniform and agreed proportion of their gross monetary reserves. They would be entitled, but not compelled, to convert into gold at the Fund any deposits accruing to their account in excess of this minimum requirement.

A minimum deposit ratio of 20 percent would probably be ample to initiate the new system, and would substiute for the present, exceedingly complex and rigid, system of IMF quotas. This ratio might have to be increased in time, however, in order to provide adequate lending power to the Fund and to insure beyond any shadow of doubt the full liquidity and convertibility of Fund deposits necessary to make them as unquestionably acceptable by all countries as gold itself in all international settlements. On the other hand, prudent management of the system would, in all likelihood, make it unnecessary to resort to compulsion for that purpose, as member countries' own interests would lead them to maintain with the Fund, rather than in gold, a much larger proportion of their total reserves than the minimum percentages imposed by the Fund.

The major objection to this proposed reform in the Fund's operations would be the same as that raised against the Keynes plan for an International Clearing Union. Such a system would endow the Fund with a lending capacity which, if improperly used, might impart a strong inflationary bias to the world economy. This is no reason, however, to fall back upon a system whose deflationary bias can only be combatted through an ever-increasing dependence upon the haphazard constituion of reserves in the form of national currencies, and an increasing vulnerability to unfavorable developments in one or a few key countries. The threat of inflationary abuses can be guarded against far more simply and directly by limiting the Fund's annual lending authority to the amount necessary to preserve an adequate level of international liquidity.

Various alternative criteria could be retained for this purpose. The simplest one might be to limit the Fund's net lending, over any 12 months period, to a total amount which would, together with current increases in the world stock of monetary gold, increase total world reserves by, let us say, 3 to 5 percent a year. The exact figure could not, of course, be determined scientifically and would, in any case, depend in practice upon the compromise between divergent national viewpoints which would emerge from the negotiation of the new Fund agreement. A reasonably conservative solution would be to retain a 3 percent figure as definitely noninflationary, and to require qualified votes (two thirds, three fourths, and ultimately four fifths of the total voting power, or even unanimity) to authorize lending in excess of 3, 4, or 5 percent a year.

Assuming, for instance, that monetary gold stocks continue to increase by $700 million or $800 million a year, the Fund's annual lending quota based on a 3 percent rate could be roughly estimated today at about $800 million to $900 million. A 4 percent rate would raise this to about $1.4 billion, and 5 percent to about $2 billion a year. These estimates would rise gradually, but slowly, with further increases in world reserves. They could decrease as well as increase, on the other hand, with future fluctuations in the current additions to the world monetary gold stock.

The Fund's lending oprations, moreover, should be no more automatic than they are at present, and this discretion should enable it to exercise a considerable influence upon members to restrain internal inflationary abuses. The experience acquired in the 12 years of operation of the Fund is extremely valuable in this respect. Fund advances should continue to require full agreement between the

Fund and the member with relation not only to the maturity of the loan, but also to the broad economic and financial policies followed by the member to insure long run equilibrium in its international transactions without excessive recourse to trade and exchange controls. The recent standby techniques of lending might, in addition, be supplemented by overdraft agreements, to be renewed at frequent intervals, and guaranteeing all members in good standing rapid and automatic Fund assistance in case of need, but for modest amounts and with short-term repayment provisions. These overdraft agreements would be primarily designed to give time for full consideration of a request for normal, medium-term, loans or standby agreements, and would be guaranteed by the country's minimum deposit obligation.

A second broad category of Fund lending would take the form of investments in the financial markets of member countries. These operations would be decided at the initiative of the Fund itself, but always of course in agreement with the monetary authorities of the countries concerned. Such agreement would be necessary in any case to attach to these investments the same guarantees against exchange and inconvertibility risks as those which protect the Fund's own deposit liabilities.

The first investments of this character would be imposed upon the Fund by its absorption of the outstanding national currency reserves transferred to it by members in exchange for Fund deposits. The bulk of these reserves would be in the form of bank deposits, acceptances and Treasury bills previously held by the central banks themselves in New York and London. The Fund would have no immediate need to modify the pattern of these investments, but should be impowered to do so, in a smooth and progressive manner, insofar as useful for the conduct of its own operations. This purpose would be served by giving the Fund an option—which it would not necessarily wish to use every year—of liquidating such investments at a maximum pace of, let us say, 5 percent annually. The resources derived from such liquidation would normally be reemployed in other markets whose need for international capital is greater than in the United States and the United Kingdom. A portion of such investments might even be channeled into relatively long-term investments for economic development through purchases of IBRD bonds or other securities of a similar character.

The acceptance of the basic reforms proposed above should eliminate all existing balance of payments grounds for permissible discrimination under the GATT. This should constitute a powerful incentive for U.S. support of these proposals, as the United States has long been the main target of such discrimination by other countries.

The gradual liberalization of remaining trade, exchange, and tariff restrictions could also be given a new impetus by these reforms if they were allied to a continuous and worldwide negotiation of *reciprocal* liberalization commitments, similar to that successfully undertaken regionally by the OEEC on the basis of the EPU agreement. Prospective credit assistance by the Fund to countries in difficulty should help spur the acceptance and implementation of such commitments by members. Yet the OEEC experience also suggests that members will insist on retaining the right to invoke escape clauses whenever such assistance is either insufficient or inappropriate to meet their deficits. As in OEEC, a joint examination of the overall policies followed by the member should be undertaken in such cases and lead to agreed proposals for monetary rehabilitation and stabilization and for the restoration of the liberalization measures reciprocally accepted by all Fund members. Ideally, the Fund should be given the right to disallow, after 1 year, for instance, continued recourse to such escape clauses if it deems them to be no longer justified. Such a decision might entail automatically the right for the country in question to allow fluctuations in its exchange rate as long as its gross reserves remain inferior to, let us say, 30 percent of annual imports.

Finally, some fundamental reforms in the cumbersome administrative machinery of the Fund have long been overdue. Greater efforts should be made to preserve effective contacts at all levels between the Fund and the national administrations of its members. Periodic meetings of high-level representatives currently entrusted with monetary policy in their own country should determine the broad lines of the Fund's policy and the limits within which decisions can be delegated to permanent representatives or to the Fund's management itself. The OEEC and EPU experience should serve as an invaluable guide in shaping up such reforms in more concrete terms.

These and other questions cannot be fruitfully explored here. Actual possibilities for agreement can only be discovered through the process of international negotiations itself. A number of compromises and adaptations in the broad and bold aims and techniques suggested here could undoubtedly prove necessary to reach such an agreement. A number of these adaptations should probably be directed at decentralizing the heavy responsibilities placed here upon the IMF, by transferring to some existing or prospective regional groups—such as the European Economic Community, the sterling area, or the European Economic Association—the handling of all international settlements and financial assistance involving only the use of their own members' currencies.

VI

May I close with a few words about the advantages and disadvantages which such a reform would entail for the United States itself.

Its major advantage emerges clearly, I hope, from our previous discussion. The United States would no longer have to bear the burden and court the danger, inseparable from the use of the dollar as a reserve currency by other countries. This would, it is true, deprive us of unrequited capital imports which have, in the past 10 years, allowed us to carry a heavier burden of foreign lending and aid programs than we could have financed otherwise. We would now have to share these responsibilities—and the political influence that might accompany them—with other countries, through processes of multilateral decision making which would, at times, be irritating and frustrating. We would, on the other hand, have consolidated in the hands of the Fund a large portion of highly volatile foreign funds, whose sudden and unpredictable outflow might otherwise unleash, at any time, an unbearable drain on our gold reserves. Most of all, we would have shed thereby the straitjacket which the need to prevent such an outflow would impose upon monetary management and interest rates in this country, whenever the success of our price stablization efforts allows us to give primary consideration once more to the furtherance of maximum feasible rates of employment and economic growth.

A second and closely related consideration is that these reforms would put an end to an absurd situation under which we have been in practice—with only minor exceptions—the sole net lender in the IMF, in spite of our persistent deficits and of the equally persistent and huge surpluses accumulated over the last 10 years by other IMF members. We would, moreover, be able for the first time to obtain ourselves assistance from the IMF—through the more flexible procedure of IMF investments rather than loans—without triggering off the dangerous psychological reactions which would now accompany a U.S. request for assistance. The IMF itself would need to look for safe investment outlets for its expanded resources, particularly during the initial years of the new system, and this would fit in particularly well with our own need to buy the time necessary for effecting, in as smooth a manner as possible—in the interest of other countries as well as in our own—the readjustment of our current overall balance of payments deficits.

These I think, are the essential considerations that should guide us. I should mention, however, two other points of a more technical character, but which may still be of interest to this committee.

Our minimum deposit obligation in this new IMF can be calculated approximately, on the basis of our current position, as in the neighborhood of $4.3 billion, which is just about equal to our present Fund quota. About half of this obligation would be discharged by counting as part of our required deposit the $2.1 billion of net claims on the Fund accumulated by us as a result of our gold contribution to the Fund's capital and of the Fund's use of our local currency subscription in its lending operations. The other half, however, would have to be paid in gold, but the IMF would also cancel about $2 billion of demand deposits and Treasury certificates which it now holds against us, and which represent the still unused portion of our local currency capital subscription.

It should also be noted that our deposits with the Fund should be properly regarded in a very different light from our present subscription to the Fund capital. This subscription is not considered, and should not be considered, as a fully liquid and bankable asset. It is therefore excluded from the calculation of our monetary reserves. Our deposits with the Fund, on the other hand, would be as fully liquid as gold itself and as fully usable in all international payments. It should therefore properly be counted—in our case as in the case of other countries—as fully equivalent to gold for the calculation of monetary reserves and of gold cover requirements. Our monetary reserves, after the cancellation of our present quota subscription and its replacement by a 20-percent deposit with the Fund, would actually have risen from its present level of $19.5 billion to about $21.6 billion. Most of all, our short-term liabilities to foreign countries would have declined by approximately $9 billion through the transfer to the Fund, and consolidation by it, of the liquid dollar holdings now held by these countries as monetary reserves.

These, I firmly and deeply believe, are extremely powerful arguments for a serious study of these proposals by the administrations and by Congress. I fervently hope that we shall be able to act in time, and to refute the disabused comment and dire prediction of a former colleague of mine in the administration: "Triffin, you are very probably right, but in this matter as in that of EPU your proposals come several years too soon, and this time I don't honestly think you'll get anywhere until people are shaken into action by a real crisis. Then, maybe."

This, I must admit, is probably the most widely held view on this subject at present.

The Role of a Developing European Monetary Union in a Reformed World Monetary System

(By Robert Triffin, Yale University, a background paper prepared for the Conference on Europe and the Evolution of the International Monetary System, Geneva, Jan. 13–15, 1972)

I. INTRODUCTION

The agreement painfully hatched on December 18th by the Group of Ten was hailed by President Nixon as "the most significant monetary agreement in the history of the world." I would hardly go that far in describing an agreement that merely sets up a new—and undoubtedly more realistic—pattern of exchange rates, but that leaves unsolved all the basic questions arising from utter collapse—on August 15th—the international monetary system, after ten years of mounting crises and patchwork operations.

The official communique itself candidly enumerates the awesome list of issues that remain to be negotiated in Phase II of the marthon discussions envisaged for the "reform of the international monetary system":

1. "the appropriate means and divisions of responsibilities for defending stable exchange rates and for insuring a proper degree of convertibility of the system;"
2. "the proper role of gold, of reserve currencies, and of special drawing rights in the operation of the system;"
3. "the appropriate volume of liquidity;"
4. "the re-examination of the permissible margins of fluctuation around established exchange rates and other means of establishing a suitable degree of flexibility;"
5. "other measures dealing with movements of liquid capital."

As you know, I have spent the last fifteen years developing and disseminating my own answers to all these questions, and others, beginning with my book on *Europe and the Money Muddle,* and ending—provisionally—with my most recent article on "How to Arrest a Threatening Relapse into the 1930's?" (in the November 1971 *Bulletin of the National Bank of Belgium*). This is not the place to rehash these previous contributions, especially as you will have benefited from far better advice at our morning session of today. Yet, they cannot fail to crop up in my discussion of "The Role of a Developing European Monetary Union in a Reformed World Monetary System", since this role will obviously depend on how a world system now in utter shambles will actually be put together again.

I shall proceed in two steps: discussing first what the European Community can and should do until world reforms are agreed upon, and secondly how a developing European Monetary Union should fit into such a new worldwide monetary system.

II. IMMEDIATE STEPS, PENDING WORLDWIDE AGREEMENT

The immediate steps to be taken by the European Community, in cooperation with its prospective new members and other European countries, consist essentially in implementaing as rapidly as possible the program outlined in the Werner plan, and in accelerating the time-table initially envisaged for such implementation.

The need for such acceleration derives essentially from two new factors inserted into the data of the problem by the decisions of August 15 and of December 18 of last year.

The first is the temporary inconvertibility of the dollar, not only into gold, but in any other international assets or currencies as well. This creates a gaping void in an international monetary system which, since the end of the last war, used nearly exclusively a convertible U.S. dollar not only for settlements with the United States, but also as the major intervention currency for setlements between third countries and as the major component of reserve building by all countries experiencing surpluses in their balance-of-payments. The temporary inconvertibility of the dollar clearly affects deeply its acceptability in all these respects, but what is there to take its place?

The second factor is the equally temporary—but possibly due to become permanent—enlargement of the intervention margins for exchange rates from 1%—actually 0.75% under the European Monetary Agreement—to 2.25% on either side of the newly realigned exchange rates agreed upon. A total swing of 4.5% in European currencies vis-a-vis the traditional intervention currency—i.e. the U.S. dollar—would mean a possible swing of 9% between the European currencies themselves. The European Community has reiterated, time and time again, its determination to preserve much smaller margins of fluctuations between its member currencies, and, indeed, to eliminate gradually such margins in preparation for full Monetary Union within the Community. New methods of stabilization interventions by Central Banks in the exchange market will clearly be needed to fulfill this objective.

Both of these factors should lead to a much earlier implementation of the European Reserve Fund initially proposed at The Hague by Chancellor Brandt, and rechristened European Fund for Monetary Cooperation in the Werner Plan and "Organisme pour une gestion concertee des reserves" by Président Pompidou.

The December 18 decisions have not only increased the need and urgency of such an organization. They have also lifted one of the major obstacles to getting it off the ground. The first prerequisite, indeed, for any resumption of progress toward any European monetary organization was the definition of an agreed constellation of intra-European exchange rates. Community action had been blocked, ever since May 5th, by continued wrangling between the French and the German Ministers of Finance about the appropriate exchange rate between the mark and the franc, on the one hand, and their relationship to the U.S. dollar, on the other. The appropriate exchange rate of the lira toward other Community currencies was also in doubt. The December 18 decisions have overcome these obstacles and established presumptive rates among all European currencies—including these of future members and of non-members—and between them and the dollar.

Progress can now be resumed toward the second objective of the Werner plan, i.e. the maintenance of a modest—and declining—range of permissible fluctuations among the member currencies of the present—and of an enlarged—European Community. Moreover, the enlargement of permissible fluctuations in the dollar rate now makes it clearer than ever that the fulfillment of this objective entails the direct use of European currencies themselves—rather than the use of the dollar as an intermediary—for stabilization interventions by Central Banks in the exchange market. To take a simple case, if the German mark tended to exceed its agreed ceiling in relation to the French franc, on the exchange market, the preservation of the agreed margin would require—tomorrow as yesterday—sales of German marks and redemptions of French francs on the market by either or both of the two Central Banks concerned. But this should no longer be done indirectly through daily sales of dollars by the Bank of France and purchase of dollars by the Bundesbank. The Bundesbank would sell marks against French francs and accumulate a claim on the Bank of France rather than against the U.S. Federal Reserve system. This claim would of course:

(1) carry an exchange-rate guarantee, either in terms of the creditor's currency—the mark, in this case—or, preferably, in terms of a Community unit of account, or of SDR's;

(2) earn appropriate interest, at a rate related to market rates, but taking into account the existence of such an exchange guarantee;

(3) be repayable in a form of assets mutually acceptable to both the creditor and the debtor.

These repayments could always be effected in the creditor's currency—procured from the I.M.F., if need be, through the use of SDR's or through normal drawings on the Fund—in any other currency—including, but not exclusively in, U.S. dollars—or in gold, at any price mutually acceptable or at which such currencies or gold can be transferred into convertible claims on the I.M.F.

As noted already in the Werner and Ansiaux reports, these operations could be greatly streamlined and facilitated by the establishment of a European Fund. "Each country would have an account with the Fund (in lieu of bilateral accounts between each pair of Central Banks), and its assets or liabilities on this account would be denominated in units of account. The account would be settled from time to time by the transfer of reserves from the debtor countries to the surplus countries." The size and frequency of these eventual settlements would be greatly reduced by multilateral compensations of bilateral claims and debts, such as were made familiar to all by the highly successful operation of the European Payments Union, from 1950 through 1958.

The third problem to be faced by the Community relates to the settlement of its transactions with non-member countries, and particularly to the rates of exchange between each member currency and the U.S. dollar. It is now agreed that the dollar fluctuate up and down in terms of European currencies within a total range of 4.5 percent. To prevent such fluctuations from introducing a similar—and unacceptable—degree of instability between the member currencies themselves, these will have to fluctuate *jointly* in terms of the dollar. The simplest way to reach this objective would be for all member Central Banks to avoid any intervention whatsoever on the dollar market until the dollar rises to the ceiling or falls to the floor of this 4.5 percent range. Market arbitrage among the member currencies themselves, together with the Central Bank interventions already discussed above, would then ensure a parallel flotation of the dollar vis-a-vis all member currencies.

Problems of joint decisions about the dollar rate would arise, however, in two cases:

(1) If member countries decided that they prefer to buy or purchase dollars, rather than let its rate go down or up by the full amount of the permissible margin;

(2) Unavoidably, if the dollar rate threatened to rise, or to fall, beyond the 4.5 percent margin of permissible fluctuations. The December 18 communique makes it clear that the United States is not ready yet to shoulder full responsibility for keeping market fluctuations within the agreed 4.5 percent margin by selling, or buying, itself other reserve assets against dollars in such a case: "appropriate monetary means and *division of responsibilities* for defending stable exchange rates and for insuring *a proper degree of convertibility* of the system" (italics mine) are still listed among the unresolved issues to be tackled in Phase II of the negotiations.

A persistent weakness of the dollar on the exchange market would thus face once more the European countries with the same problem that has long confronted them and that culminated in the May 5th and August 15 crises: what amounts of inconvertible dollars would their Central Banks be ready to purchase in order to avoid—or limit—an unwanted appreciation of their currency vis-a-vis the dollar? Europeans firms and trade unions would once more exercise enormous pressure on their monetary and political authorities to prevent currency appreciations reducing their competitiveness at home and in world markets, especially if the weakness of the dollar arose from vast capital movements unrelated to the evolution of comparative prices and costs, and prompted instead by pure exchange-rate speculation, or even by differential movements of interest rates at home and abroad. *Joint* decisions would have to be as hard to harmonize as they were since May 5th and August 15th. The reaching of such decisions and their concrete implementation would at least be facilitated by the creation of the proposed European Fund.

Fortunately, the evolution of the U.S. balance of payments is likely to provide a substantial breathing space before such a problem has to be met in practice. Interest rate developments and exchange-rate speculation have moved billions of dollars into the coffers of reluctant Central Banks in 1970 and 1971. The December 18 realignment of exchange rates can be expected to trigger enormous flows of such funds back to the United States. The dollar will probably be very strong on the markets over the forthcoming months and Central Banks should not be faced, in the short run, with the need to accumulate further amounts of dollars. They should instead be able to get rid of some of the huge amounts of unwanted dollars reluctantly piled up by them over the last two years.

In the longer run, however, the balance of payments of the United States—like that of every other country—should be expected to experience again temporary deficits alternating with temporary surpluses, and the problem of more lasting and fundamental disequilibria may well emerge again. The Phase II negotiations on long-term reforms of the international monetary system should be predicated on the realistic assumption that neither the United States nor other countries will be permanently wise and lucky in the running of their own affairs, and that temporary, and even enduring, disequilibria are the rule, rather than the exception, in the worldwide pattern of international settlements.

Phase II should therefore be tackled with a feeling of real urgency, if we do not wish to expose the world again to the recurrence of the crises that plagued, and finally broke, the ill-fated gold-exchange standard of yesteryears. If acceptable and viable solutions were deferred too long, the countries of the Community—and others—would be sorely pressed to seek in various forms of exchange control an escape from the dilemma of unwanted dollar accumulation on the one hand, or unwanted—possibly unwarranted—exchange-rate appreciation vis-a-vis the dollar on the other. If this were to happen, and particularly if the problem arose again from large movements of funds among major money and financial markets, the monetary authorities should be ready to meet them through controls jointly agreed and jointly implemented both by the countries suffering from undesirable capital outflows and those suffering from undesirable capital outflows. Temporary recourse to double-tier exchange systems—a la Swiss or a la Belgium—separating the exchange rate on trade transactions from the exchange rate on financial transactions might be a lesser evil in this respect than rigid systems of quantitative controls, Yet, the two rates could not be allowed to diverge too much without inviting widespread evasions, extremely difficult to control.

If agreement can be reached on the temporary nature of such disturbing capital movements, they should preferably be met by compensatory official financing, preferably through the I.M.F.—as aimed for in the General Arrangements to Borrow—or through a broad network of multilateralized swap agreements. Enduring, but undesirable, capital movements, on the other hand, could not be handled in this manner, but would be unlikely to persist in the absence of other disequilibrating factors calling for reconsideration of national policies and/or exchange rates.

In brief, the European Community should turn urgently toward concrete implementation of the Werner plan, with an accelerated time-table for the measures then contemplated, and particularly for the establishment of a European Fund, capable of dealing effectively with the problem of exchange rates and settlements both among its members and with non-member countries. Joint agreements within the Community itself are a prerequisite not only for its own survival, but also for successful negotiations and agreements with other countries, including the United States. They should help both to solve the immediate problems ahead and to accelerate agreement on the worldwide issues of monetary reform enumerated in the December 18 communique of the Group of Ten.

III. LONGER TERM ISSUES

First and foremost among the longer-term issues facing the Community is that of reaching agreement on the worldwide reform of the international monetary system. I shall not repeat here the suggestions developed at length in my former writings, and most recently in my article, already referred to above, in the November 1971 *Bulletin of the National Bank of Belgium.*

1. Reserve Composition

The keystone of such a reform should, as largely agreed already, be the use of a new type of reserve asset on the I.M.F.—building on the SDR system as the major form of international reserves, and the gradual phasing out of gold and reserve currencies from the system. The huge gold and foreign currency reserves inherited from the past should be converted into this new reserve asset, and holdings of foreign currencies as monetary reserves should be confined in the future to the modest "working balances" needed for stabilization interventions in the exchange market. Any foreign currencies bought from the market in the course of such interventions, but exceeding agreed ceilings (15% of global reserves?)

should be promptly deposited with the I.M.F., credited to the depositing country's reserve account and debited from the reserve account of the country whose currency has been deposited with the Fund. Conversely, any country should be able to withdraw from its reserve account any currencies needed to replenish working balances depleted by stabilization interventions in the exchange market.

2. The "Overhang"

The vast amounts of foreign currency reserves—primarily dollars—inherited from more than half a century of functioning of the gold-exchange standard could not, however, and should not, be debited overnight from the debtor countries' reserve account. As indicated above, a substantial portion of the $45 to $50 billion of US dollars now held by foreign central banks is likely to be absorbed by the probable repatriation of the speculative outbursts of the last two years, and another $10 billion or thereabouts to be retained as working balances. The remainder should be exchanged by the Fund for the new I.M.F. reserve asset, but held by it as long-term investment—or even, preferably, consols—rather than debited overnight from the U.S. reserve account.

3. Financing and/or Adjustment of Disequilibria

Temporary disequilibria should be financed for all countries—including now the former reserve-currency countries—through fluctuations in reserve assets and/or drawings on the I.M.F. The United States and the United Kingdon should no longer enjoy the "exorbitant privilege" of financing their deficits through unlimited, but precarious, accumulation of their national currency as international reserves by foreign central banks. This could avoid the main source of the international monetary crises that plagued, and finally killed, the ill-fated gold exchange standard.

Persistent disequilibria call, not for financing, but for appropriate readjustments of either domestic policies or foreign exchange rates. The need for such readjustments should be recognized as a matter of common concern and be imposed upon persistent surplus countries as well as upon persistent deficit countries. I have suggested that any persistent surpluses or deficits bringing a country's reserves, let us say 25% beyond or below "normal" should trigger automatically consultations between the country and the I.M.F. regarding appropriate changes in domestic policies and/or exchange rates, and that if agreement cannot be reached, the Fund may be empowered to prohibit, or limit, any further interventions on the exchange market having the effect of bringing reserves let us say 33% above, or below, their normal level.

Such a suggestion might help solve the problems that may still confront the countries of an enlarged European Community during the 10 year transition period now envisaged for the completion of their Economic and Monetary Union. Exchange rates among the currencies of the European Community countries would normally be fixed within very narrow, and declining eventually to zero, margins of fluctuations. But such rates cannot be realistically considered as irrevocable until much greater progress has been achieved toward harmonization of national policies, and substantial transfers of jurisdiction and authority from national to Community institutions. Persistent failures of harmonization policies should trigger a reconsideration of existing pattern of intra-Community exchange rates. Consultations on such readjustments could be called for by any country whose reserve increases or reserve losses (including claims or debts arising from mutual support or assistance operations) exceed an agreed percentage of the country's normal reserves, and these Community consultations should precede the consultations with the I.M.F. envisaged above. Since most of the Community countries' foreign trade is with one another, they would be the parties primarily affected by such exchange rate readjustments, and any proposals for parity changes should be agreed among them before being submitted to the I.M.F.

Changes in official reserves should not, of course, be regarded as the only criterion determining the appropriateness of a readjustment of exchange rates. Other factors would have to be taken into account, such as the evolution of external debts and claims of the country's commercial banks, of other items—particularly merchandise exports and imports—in the country's balance of payments, comparative movements in prices and wage rates, etc. These factors should confirm, or weaken, the presumption that large and persistent reserve gains or losses should justify and require a readustment in the country's basic exchange rate or par value.

4. From the European Reserve Fund to a European Reserve System

The European Reserve Fund suggested in the first section of this paper should centralize, from the very beginning, the credit lines already agreed for short-term monetary support and any further credits granted for medium-term financial assistance. Interventions in member currencies needed to keep intra-Community exchange rates within the permissible margin of fluctuations should be credited and debited in each country's account with the Fund.

Each member country should, in addition, deposit with the Fund an agreed proportion of its global gold and, particularly, foreign currency reserves. Future market interventions in dollars and/or other foreign currencies should conform to the directives of the Fund and should be credited or debited also in the country's account with the Fund. This account would therefore reflect the total evolution of each country's reserves and provide daily the information relevant to the consultations suggested under (3) above.

In the course of time, the proportion of each country's monetary reserves to be held with the Fund should be gradually increased until all reserves are held with the Fund and jointly managed by it, in preparation for the ultimate merging of their national currencies into a single European currency.

Until, and even after, that ultimate step is taken, the European Reserve system—just as the U.S. Federal Reserve system—could retain a considerable degree of autonomy for the participating national central banks. Each of these could continue to manage its own monetary and credit operations within agreed statutory limits, under the general supervision of a joint Board, or European Monetary Authority, grouping the Governors of national Central Banks, or their deputies, and—for certain important decisions—the Ministers of Finance of the Participating countries.

The statutory rules to be adopted would probably include the setting up of national credit ceilings, to be exceeded only with the approval of the European Monetary Authority, of minimum reserve ratios, and other regulatory techniques inspired from present central banking legislations in the Community and abroad, and from the experience acquired by the European Reserve Fund in the first stages of the developing Monetary Union.

An equitable distribution of the burden associated with the maintenance of adequate external reserves by the Community as a whole would probably require that each member Central Bank observe some minimum prescriptions with regard to such reserve holdings. These prescriptions might have to be met at times by the negotiation of interest-bearing, stabilization loans, at long or medium term, by the low reserve countries, either abroad or with the high reserve countries. Such loans could also be used to amortize, or rather to consolidate, the debts incurred under the provisions for mutual monetary support and financial assistance among member countries. Denominated in the Community's unit of account, they could be placed initially with the Central Banks of the countries with the highest levels of external reserves, but under arrangements—especially as to interest rates—facilitating their negotiation with the public, and enabling such Central Banks to mop up excess liquidities in their market. They could be jointly guaranteed by all member Central Banks and serve as a primer for the development of open-market operations throughout the territory of the Community.

The Community's unit of account would also be likely to be used more and more, in lieu of the Euro-dollar, in private lending and borrowing operations. Travelers' checks denominated in the unit of account should also become more acceptable than travelers' checks denominated in dollars, since they would be subject to much smaller margins of exchange-rate fluctuations.

Finally, the European Reserve Fund itself could issue a new money market asset, denominated in the unit of account, carrying a rate of interest making it an attractive instrument for short-term investment, and usable as an intervention currency in the exchange market, in lieu of dollars or other national currencies. This suggestion is by no means an academic dream, having been made in fact by Rinaldo Ossola, the imaginative Chairman of the respectable Group of Ten deputies.

The Community's unit of account could thus gradually take the place now played by the Euro-dollar in the monetary and financial markets, preparing the public for its ultimate substitution for the national currencies themselves in the final stage of the European Monetary Union.

5. Relations with the IMF

At some stage in the development of the system—and, indeed, as early as possible—the operations of member countries with the I.M.F. should be merged, and a single membership substituted for the separate membership of each participating country.

Until this can be accomplished, member countries should, in accordance with previous decisions of the Council of Ministers, harmonize their own policies in the I.M.F. and consult in advance on all their borrowing and lending transactions with it and with non-member countries. Such lending and borrowing transactions should, ideally, be undertaken only to help in the settlement of global surpluses, or deficits, of the Community as a whole with the rest of the world. As long as national transactions with the Fund cannot be merged into single Community transactions, the European Monetary Authority should apportion among its members, in the light of their individual reserve positions, all proposals for Fund lending or borrowing, and all Community countries' representatives in the Fund should support such proposals in the debates of the Fund's Executive Directors.

IV. SUMMARY AND CONCLUSIONS

The agreements reached on December 13 have removed the main obstacle to the resumption of progress along the Werner Plan for European monetary unification, i.e. the difficulty to reach agreement on a constellation of stable—although not irrevocably stable, yet—exchange rates among the countries of the Community.

They have, moreover, vastly increased the need and urgency for such progress. The continued inconvertibility of the dollar and the enlargement of permissible margins of fluctuations in the dollar rate combine to make the dollar less and less usable as an intervention currency for the maintenance of the lower and declining margins of fluctuations which the Community countries wish to preserve between their own national currencies, preparatory to their merging of these separate currencies into a single Community currency.

Movement toward the Monetary Union affirmed at the summit meeting of The Hague would be greatly eased and accelerated by the early establishment of a European Reserve Fund, already agreed to in principles—under varying vocables—by all member countries.

Internally, such a Reserve Fund would provide the most appropriate instrument for the use of member currencies—rather than of a non-member currency—in the stabilization interventions needed to prevent fluctuations of intra-Community exchange rates beyond the agreed margins. It should also be the most appropriate instrument for the gradual development of a European Reserve system, capable of reaching and implementing the multiple policy decisions needed for the completion of full monetary union among the member countries.

Externally, the European Reserve Fund should concentrate gradually into a single depository institution the holdings and management of member countries' external reserves, and facilitate joint decisions—and their implementation about interventions in the foreign exchange market for non-member currencies, particularly the dollar. It should also prepare and facilitate agreement with the United States and other foreign monetary authorities and the I.M.F. concerning the amounts of such interventions, the rates at which they should take place, and the joint elaboration and implementation of measures designed to control and/or to offset volatile movements of capital between the major money markets.

The operations of the Community countries with the I.M.F. should be reserved to financing of global disequilibria between the Community as a whole and the outside world, while disequilibria among member countries themselves should be handled by the European Reserve Fund, thus relieving the I.M.F. from responsibilities that can best be discharged on a regional rather than on a worldwide basis.

Ultimately, the relations of the Community countries with the I.M.F. should be merged into a single membership, reflecting the realities of the Monetary Union of its participating countries.

[From the New York Times, Jan. 23, 1972]

Point of View—Toward a Viable Monetary System—Reserves With IMF Should Dominate

(By Robert Triffin)

The Dec. 18 agreement among the Group of 10 was hailed extravagantly by President Nixon as "the most significant monetary agreement in the history of the world." It is in the sense that it left the international monetary system in utter shambles, but recognized that multilateral negotiations were urgently needed to reconstruct a system totally different from the one that died, after a long agony, on Aug. 15, 1971.

These negotiations should restore a viable system of currency convertibility, the main features of which are now intellectually—but not politically—obvious to all concerned.

1. The Special Drawing Rights system, ratified by practically all International Monetary Fund members in 1969, was intended to adjust the future creation of world reserves to the requirements of noninflationary growth of the world economy. It predictably failed to do so because it merely added S.D.R.'s to the traditional reserve assets—gold and reserve currencies—without limiting the ability of the latter to drain, or flood, the world reserve pool. Thus it is that dollar deficits could—and did—increase world reserves by nearly $30-billion in the 21 months from January, 1970, through September, 1971, that is, by more than the total increase over the previous 20 years.

2. Gold should be gradually phased out of the international reserve system and returned entirely—like silver before it—to the private market. Sterile and costly gold holdings should, in due time, be voluntarily and spontaneously exchanged by central banks for an alternative and truly international reserve asset—similar to S.D.R.'s—carrying appropriate interest earnings and exchange-rate guarantees.

Meantime, all official gold transactions should be channeled through the I.M.F., as they have largely been since March, 1968.

3. Reserve currencies—overwhelmingly the United States dollar—pose a more difficult problem, indeed the crucial problem, for the reform of the system. It is generally agreed that reserve currency holdings should be limited to their proper role, that of "working balances" needed by central banks for their stabilization interventions in the exchange market.

Holdings of foreign national currencies by central banks should be strictly limited to an agreed ceiling (5 per cent of annual imports, or 15 per cent of global reserves) and any currency balances acquired from the market and exceeding this ceiling should be immediately exchanged into the I.M.F. reserve accounts outlined below.

4. Reserve accounts with the I.M.F. should become the basic instrument for all international settlements and reserve accumulation. Their total amount should be adjusted periodically and systematically to the requirements of feasible growth in world trade and production through corresponding increases in I.M.F. loans and investments. These reserve accounts would carry agreed interest and exchange rate guarantees.

Any deficit country would draw on its account to procure any currency needed for settlements, and the I.M.F. would credit correspondingly the account of the countries whose currency is being purchased.

Conversely, any surplus country would deposit in its reserve account any currencies received in settlement from other countries, or purchased from the market, and the fund would debit correspondingly the account of the countries whose currencies have been deposited with it.

Such a system would be perfectly understandable to the man in the street, as it would use for international settlements a procedure similar to that used by him in making, or receiving, payments through his checking account with a commercial bank. It would demystify the obscure and barbarous I.M.F. jargon of ordinary drawing rights, special drawing rights, credit-tranches, gold-tranches, super-gold tranches, etc.

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5. The "overhang" of dollar and sterling reserves accumulated abroad over half a century of functioning of the previous system could not, however, be deducted overnight from the reserve account of the United States and the United Kingdom with the I.M.F. They should be retained by the fund as long-term investments, or preferably "consols," with appropriate interest earnings and exchange guarantees, and be subject only to gradual amortization as future surpluses of the United States and the United Kingdom increase their reserves beyond "normal" levels.

A. This limitation of reserve currency balances to agreed "working balances" ceilings would, by itself, remove the major impediment to the balance-of-payments adjustment process. The former reserve-currency countries would no longer enjoy the "exorbitant privilege" of financing persistent deficits through the accumulation of their i.o.u.'s—sterling or dollar balances—by foreign central banks, suffer the domestic consequences of a growing overvaluation of their currency, undercompetitiveness of their firms at home and abroad, and expose their own currency and the world monetary system to mounting crises and eventual collapse (as brought the end of the sterling standard on Sept. 21, 1931, and of the dollar standard on Aug. 15, 1971).

B. Prompter adjustment of future disequilibrium would also be facilitated by some acceptable degree of exchange-rate flexibility, such as "wider bands" as "crawling pegs." It would not be assured, however, as long as such flexibility remains purely "permissive." Surplus countries, particularly, would still be prone to resist, through market interventions, an upward revaluation of their currency, depriving their firms from the advantages of an undervalued, overcompetitive exchange rate.

The simplest suggestion to meet this problem would be to require any country whose reserves rise or fall by more than say, 25 per cent beyond their "normal" level to accept consultations with the I.M.F. on the policy readjustments most appropriate to correct such persistent surpluses or deficits. If these consultations failed to produce agreement, the fund should be empowered, as a last resort, to prohibit—or limit—any further stabilization interventions by the monetary authorities in the exchange market pushing the country's reserves beyond, say, 33 per cent above or below their agreed "normal" level. Exchange rates would thus be forced, by the market itself, to float, or crawl, to the extent needed to restore adjustment in the country's external transactions.

C. Finally, the lending—or "giving-away"—power derived by the I.M.F. from the continued expansion of reserve deposits should no longer be distributed, like manna from heaven, to all I.M.F. members, irrespective of the policies thereby financed. It should be earmarked for the support of internationally agreed policies and objectives only. I would list among such objectives the traditional support given by I.M.F. to programs of monetary stabilization, the restoration of balance-of-payments equilibrium and the recycling or offsetting of destabilizing capital movements. I would add the indirect financing of development programs through the purchase of I.B.R.D., I.D.A., obligations, etc., and even of other agreed international objectives claiming the highest priority for scarce funds in the United Nations, the World Health Organization, etc.

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BALANCE OF PAYMENTS OF THE UNITED STATES: 1960 TO SEPTEMBER 1971

[In billions of U.S. dollars]

	Years, or yearly rates, seasonally adjusted							Actual January–September 1971
						1971		
	1960–64	1965–67	1968	1969	1970	January–June	July–September	
I. Goods, services and remittances	5.2	4.8	1.3	0.7	2.2	1.0	−1.6	0.1
A. Investment income	3.9	5.5	6.2	6.0	6.2	7.9	6.7	5.6
B. Other	1.3	−.7	−4.9	−5.2	−4.1	−6.9	−8.3	−5.5
1. Merchandise	5.4	4.2	.6	.7	2.1	−1.5	−2.1	−1.3
2. Military	−2.4	−2.7	−3.1	−3.3	−3.4	−2.7	−2.9	−2.1
3. Other services	−1.0	−1.1	−1.2	−1.3	−1.4	−1.3	−1.7	−1.1
4. Remittances	−.7	−1.1	−1.2	−1.3	−1.4	−1.4	−1.6	−1.1
II. Exports of U.S. capital	8.6	8.9	9.9	11.9	11.4	19.7	38.6	19.5
A. Official	3.1	3.7	4.0	3.8	3.3	4.2	3.5	2.9
1. Loans	1.3	1.9	2.3	2.2	1.6	2.4	1.4	1.5
2. Grants	1.8	1.8	1.7	1.6	1.7	1.8	2.1	1.4
B. Private and errors and omissions	5.5	5.2	5.9	8.0	8.0	15.5	35.1	16.5
1. Direct investments	1.8	3.4	3.2	3.3	4.4	5.5	5.6	4.2
2. Securities	.8	.8	1.2	1.5	.9	1.5	.9	1.0
3. U.S. banks	1.4		−.3	.6	1.0	.9	6.4	2.1
4. Other, recorded	.5	.3	1.2	.1	.5	.9	1.4	.8
5. Errors and omissions	1.0	.6	.5	2.6	1.1	6.7	20.8	8.6
III. Imports (—) of foreign nonbank capital	−.9	−1.3	−6.8	−4.7	−5.0	−1.8	.6	−.7
A. Direct investments	−.1	−.1	−.3	−.8	−1.0	−.2	1.3	.2
B. Stocks	−.2	−.5	−2.1	−1.6	−.7	−.2	−.9	−.3
C. Bonds			−2.3	−1.5	−1.5	−1.4	−1.3	−1.0
D. Other nonliquid	−.3	−.7	−1.7	−1.2	−1.6	.7	.7	.5
E. Liquid	−.3		−.4	.5	−.3	−.8	.9	−.2
IV. Settlements balance (I–II–III)	−2.6	−2.9	−1.7	−6.5	−4.2	−16.9	−40.8	−18.7
A. Liquid liabilities (—) to foreign commercial banks	−.4	−1.4	−3.4	−9.2	6.5	6.3	8.4	5.2
B. Net U.S. reserves	−2.2	−1.5	1.6	2.7	−10.7	−23.2	−49.2	−23.9
1. SDR allocation					−.9	−.7	−.7	−0.5
2. Liabilities (—) to	−1.2	−.9	.8	1.5	−7.3	−19.8	−43.7	−20.9
(a) I.M.F	−.1	−.1			.5			
(b) Foreign official agencies	−1.1	−.8	.8	1.5	−7.8	−19.9	−43.7	−20.9
Nonliquid	−.1	−.7	−2.3	1.0	.3	.8	.7	.5
Liquid	−1.1	−.1	3.1	.5	−8.1	−20.6	−44.5	−21.4
3. Assets	−1.0	−.6	.9	1.2	−2.5	−2.7	−4.8	−2.5
(a) Foreign exchange	.1	.6	1.2	−.8	−2.2	−1.1	−1.2	−.9
(b) IMF positions	−.2	−.1	.9	1.0	−.4	.1	.1	.1
(c) SDR's					.9	−.6	−.3	−.4
(d) Gold	−.8	−1.1	−1.2	1.0	−.8	−1.0	−3.4	−1.4

See "Source, Notes, and Brief Comments," p. 606.

Source, Notes, and Brief Comments

(Source: Survey of Current Business, September 1971 and former issues)

NOTES

1. For consistency sake—and easier reconsiliation with stock estimates of the U.S. international investment position—reserve gains and capital exports are shown throughout without sign, and reserve losses and capital imports with a *minus* sign.

2. Errors and omissions, whose sharp increases in 1969 and 1971 are ascribed by the *Survey* to unrecorded outflows of U.S. funds, have been included throughout with private exports of U.S. capital.

3. The settlements balance on line IV measures official and bank settlements. It is very close to the new net liquidity balance (line 33 of Table 1 of the *Survey*), except for the exclusion of liquid claims (line 35 of same Table) and of liquid liabilities to non-banks (lines 40 and 41 of same Table) and for the inclusion of liabilities arising from SDR allocations (line 31 of same Table).

BRIEF COMMENTS

1. The most remarkable feature of this Table is the extraordinary stability (or rather stable growth) of U.S. capital exports (line II) until 1971, and their dramatic increase in 1971 under the influence of interest-rate differentials and exchange-rate speculation. If we take as a benchmark the annual averages of the years 1960–1967, the annual rate of U.S. capital exports increased in the third quarter of 1971 by nearly $30 billion, while the reversal of foreign funds (line III) accounts only for a deterioration of less than $2 billion.

2. The persistent deficit of the settlements balance (line IV) and its dramatic increase in 1971 (to an annual rate of more than $40 billion in the third quarter) is due to the persistent and growing excess of those net capital exports (lines II and III) over and above the vanishing surplus on current account. This deficit:

   (*a*) was temporarily reduced in 1968–1970 by large imports of foreign non-bank capital (line III);

   (*b*) was overfinanced in 1969 by unprecedented borrowings ($9.2 billion) from foreign commercial banks (line IV A);

   (*c*) had to be financed primarily by the I.M.F. and foreign monetary authorities (line IV B2) when capital imports from non-banks declined, and borrowings from commercial banks were repaid, in 1970 and 1971.

3. Exports of U.S. capital were not excessive until 1971, being in most years about 1 percent of GNP, i.e. close to an internationally proclaimed objective in this respect. The current account surplus, however, should recover to approximately that level, but has become negative in spite of huge and growing receipts of net income from investments (line I A).

The merchandise balance, particularly, has declined from a surplus of nearly $7 billion in 1964 to a yearly deficit rate of about $2 billion, in spite of stagnant economic activity and high unemployment. The exchange rate realignment of December 18, 1971, should help to restore needed surpluses, but its impact will not be fully felt for many months to come. In the meantime, a tenable situation will depend mostly on the expected flow back of the huge outflows of funds of last year, but this is in turn dependent on a recovery of confidence in the dollar, the success of the U.S. anti-inflationary program, and particularly a better adjustment of comparative rates of interest in the United States and the major financial markets abroad.

The enlargement of the "band" of permissible fluctuations to 4.5 percent may well postpone—rather than accelerate—such capital repatriation, until the dollar rate moves closer to the agreed "floor".

U.S. DEFICITS AND WORLD MONETARY RESERVES, 1969–71

[In billions of U.S. dollars]

I. U.S. NET RESERVES AND OFFICIAL SETTLEMENTS DEFICITS

	December 1949	December 1969	December 1971	Deficits: 20 years, 1950–69	Deficits: 2 years, 1970–71
A. Reserve assets	26.0	17.0	12.2	−9.1	−4.8
1. Gold	24.6	11.9	10.2	−12.7	−1.6
2. Other	1.5	5.1	2.0	+3.6	−3.1
B. Liabilities (−) to	−3.2	−17.0	−54.1	−13.8	−37.1
1. IMF and SDR allocations		−1.0	−2.1	−1.0	−1.1
2. Foreign central banks	−3.2	−16.0	−52.0	−12.8	−36.0
C. Net reserves (A+B)	+22.8	−.1	−41.9	−22.9	−41.9

II. WORLD MONETARY RESERVES

	December 1949	December 1969	September 1971	Increases: 20 years, 1950–69	Increases: 21 months, 1970 to September 1971
A. Gold	33.5	39.1	36.2	+5.7	−2.9
B. SDR's			5.9		+5.9
C. IMF reserve positions	1.7	6.7	6.3	+5.1	−.4
D. Reserve currencies	10.4	32.3	68.9	+22.0	+36.6
1. Sterling	6.9	8.9	7.1	+2.0	1.8
2. Dollars	3.2	16.0	45.7	+12.8	+29.6
3. Euro-dollars and residual	.3	7.4	16.2	+7.1	+8.8
Total	45.5	78.2	117.3	+32.7	+39.1

BRIEF COMMENTS

1. Our deficits on official settlements (shown in the last 2 columns of the last line of Table I) totalled nearly $42 billion in the last two years, i.e. nearly twice the total deficits accumulated over the previous 20 years.

For 1971 alone, the deficit is estimated at about $31 billion, i.e. nearly 3 times the 1970 deficit ($10.7 billion) and 30 times the average annual deficit of the years 1950–69.

2. Only 10% (8.4 billion, shown in last column of line A of Table I) of the last two years deficits were covered by our own reserve losses, while 90% (37.1 billion, shown in last column of line B) were financed by our increasing liabilities to foreign and international monetary institutions.

3. The amounts of dollars absorbed by foreign central banks are shown both on line B2 of Table I and on line D2 of Table II. They account in the last 21 months for an increase in world reserves nearly equal to their total increase, from all sources, over the previous 20 years (penultimate column of last line of Table II).

4. Errors in provisional estimates for the last quarter of Table I estimates are unlikely to exceed a few hundred million dollars.

Representative Reuss. Thank you very much, Mr. Triffin.

We will next hear from Mr. Edward M. Bernstein of EMB, Limited.

STATEMENT OF EDWARD M. BERNSTEIN, EMB, LTD.

Mr. Bernstein. The Smithsonian Agreement of December 18, 1971, is a notable achievement. It provided, first, for a realinement of the central exchange rates of the currencies of the Group of Ten relative to the U.S. dollar; and, second, for discussions to be undertaken promptly on reform of the international monetary system. The difficulty, as Professor Triffin has pointed out, is that nothing has been done about these discussions.

It was also noted in the statement of the Ministers and Central Bank Governors that urgent negotiations were underway on trade questions and that pending longer-term monetary reforms, the permissible margin of exchange rate fluctuation above and below the central exchange rates would be increased to 2.25 percent.

The sole purpose of the realinement of the central exchange rates was to restore the U.S. balance of payments. The ability of the United States to compete in world trade was destroyed by the inflation of the past 7 years. This resulted in a deterioration of the U.S. trade balance from a surplus of $6.8 billion in 1964 to a deficit of $2.9 billion in 1971. The balance on other goods and services, however, has improved somewhat despite the large increase in military expenditures. To put it plainly, the major factor in the critical deterioration of the U.S. balance of payments since 1964 is the enormous increase of imports relative to exports. That was mainly due to the inability of U.S. producers to compete with imports of manufactured goods in our domestic market and with exports of other countries in world markets.

In my statement to this committee on September 1, 1971, I expressed the view that the realinement of exchange rates should average between 12 and 15 percent in terms of the currencies of the Group of Ten, excluding Canada. In fact, the appreciation of these currencies relative to the dollar has ranged from 7.48 percent for the Italian lira to 16.88 percent for the Japanese yen. Weighted by the bilateral trade of the United States with these nine countries in 1971, the average appreciation relative to the dollar is 12.7 percent. Weighted by their export trade to all other countries in 1971, the average appreciation is about 13 percent. These averages show the approximate price effect of the realinement of currencies in improving the price-competitive position of the United States with respect to the Group of Ten, excluding Canada, in U.S. direct trade with them and in U.S. export trade in third markets.

It is not possible to say with assurance whether any given depreciation of a currency will be adequate. That is particularly true at a time when inflation is almost worldwide and when the country whose currency is depreciated is the United States.

We can be sure that other countries will compete strenuously to maintain their position in the U.S. market and wherever necessary and possible they will hold the rise in the dollar prices of their export goods to less than the appreciation of their currencies.

Moreover, the depreciation of the dollar shows only the immediate effect on the price-competitive position of the United States. What the ultimate effect will be depends on how well the United States succeeds hereafter in holding down its prices and costs relative to those in other industrial countries.

According to the Economic Report of the President, unit labor costs rose less in the United States than in most other industrial countries in 1971, and prices of exports of manufactured goods rose about as much as in these countries. There may be some question as to whether the target of the Price Commission will be achieved for consumer prices, but there is no doubt that in 1972 unit labor costs in manufacturing and wholesale prices of manufactured goods will rise less in the United States than in nearly all other industrial countries, although this may not be fully reflected in relative export prices. I conclude, therefore, that the realinement of exchange rates provides a satisfactory basis for restoring the U.S. balance of payments, provided the United States succeeds in halting the inflation of prices and costs.

Since the Smithsonian agreement, the exchange rate for the dollar in most of the major currencies has moved to the lower end of the permissible range of exchange rates. Of itself, this is not an adverse development for the U.S. balance of payments.

The extra margin of depreciation below the central exchange rates will be of some help in strengthening the U.S. balance of payments. After all, that is one reason why the margins of exchange rate fluctuation above and below parity were widened to 2.25 percent.

The difficulty is that this was not expected and it has been interpreted, probably correctly, as a lack of confidence in the dollar.

Why do we find a lack of confidence in the dollar? In my opinion, this attitude is not justified. Nevertheless, it is understandable, because the Group of Ten have not as yet taken the necessary measures to assure the maintenance of the new central exchange rates and the equivalence of the dollar to other major currencies.

There are several reasons for the change in market opinion in the past 2 months. First, the U.S. payments deficit in 1971 was nearly $30 billion on an official reserve basis and over $22 billion on a net liquidity basis. As about $20 billion of the deficit was due to the outflow of short-term funds, much of which will be reversed sooner or later, the magnitude of the payments problem is considerably less than is shown by the deficit.

Moreover, there is always an attitude of skepticism regarding every devaluation. I have seen this in the devaluations of the European currencies in 1949, the devaluation of sterling in 1967, and the devaluation of the French franc in 1958 and 1969. The fact is that devaluations of major currencies have been effective; and I know of no good reason for doubting that this will be true of the dollar.

Of course, it takes time for changes in exchange rates to act on the balance of payments. In practice, the time necessary to restore the balance of payments depends on conditions in the devaluing country and in the world economy. Where a country still has excessive demand, the restoration of the balance of payments after devaluation takes more time. That is because it is necessary to divert resources from producing for the home market to producing export goods and import-substituting goods.

The time required for restoring the balance of payments also depends on the economic situation in the rest of the world. Obviously, if world trade is expanding rapidly, the change in exchange rates will operate more quickly to increase exports than if world trade is stagnant or growing slowly.

The Economic Report of the President projects a deterioration in the balance on goods and services in 1972. Apart from the usual lag in adjustment after a depreciation, the Council's projection assumes a rapid expansion of output in the United States while other countries have a slowdown or recession. It is estimated that the recession in the United States in 1970 served to improve the U.S. balance on goods and services by about $2.5 billion.

Thus, if the United States has a rapid expansion and other industrial countries have a slowdown this year, the effect will be to keep the U.S. balance on goods and services about $2.5 billion below what it would be if the cyclical conjuncture were in the same phase in the United States and abroad—that is, if all countries had normal levels of high employment.

In my opinion, the surplus on goods and services will be over $2 billion in 1972. I believe that the Council has overestimated the expansion in the United States and underestimated the expansion in Europe, Japan, and Canada. Real output will probably increase less in this country than the 6.2 percent projected by the Council. Output in other industrial countries will increase more than the Council assumes. While there is a slowdown at present in Europe and Japan, a recovery should begin by midyear and output in these countries may be growing at about the same rate as in the United States by the end of the year. The adjustment made by the Council in the projected balance on goods and services because of cyclical conditions is excessive.

In addition, I believe that the U.S. trade deficit in 1971 was exaggerated. Our exports increased by 1.8 percent in a year in which world trade expanded by over 10 percent. Our imports increased by14.5 percent in a year in which the GNP increased by 2.7 percent in constant dollars and industrial production declined slightly. This marked difference in the behavior of exports and imports was not due to a further deterioration in the price-competitive position of the United States last year. To some extent it was undoubtedly due to a disruption of shipments by dock strikes that had a much greater effect on exports than on imports. To a large extent it was probably also due to acceleration of imports and retardation of exports.

The specific reason usually cited for the recent weakness of the dollar is the failure of the large outflow of capital to return to the United States immediately after the realinement of exchange rates. The recorded and unrecorded outflow of short-term funds from the United States in 1971 was on the order of $20 billion. In addition, U.S. corporations transferred about $2.5 billion to their foreign affiliates in excess of their direct investment quotas. About $6 billion of the outflow of short-term funds was a reduction in liabilities of U.S. banks to foreign commercial banks—nearly all the repayment of Eurodollar borrowing. These funds will never come back.

Of the rest, perhaps about $9 billion is accounted for by the leads and lags in trade payments and credits and about $5 billion or more to purely speculative transfers to acquire assets denominated in foreign currencies.

The excess transfers of U.S. corporations to their foreign affiliates will be reversed before the end of this month, and this is necessary to get within their direct investment quotas. The leads and lags in trade payments and credits will be gradually reversed over the next 3 or 4 months. The backflow of speculative funds may be spread over a longer period. The interest cost of carrying a speculative position is relatively low, whether the funds are borrowed in this country or in the Eurodollar markets. On the other hand, the holding of U.S. dollar assets, including common stocks, may offer better prospect of profit than to wait for still lower exchange rates for the dollar. The speculative outflow of funds will return, although it will apparently be delayed.

Rightly or wrongly, confidence in the dollar is being undermined by our easy monetary policy and our very large budget deficit. The accepted opinion is that a country that depreciates its currency should have very tight monetary and fiscal policies.

This is based on the classical case where the devaluation is caused by excessive domestic demand. It does not apply to the United States under present conditions. This country has a considerable amount of unemployed labor and unused capacity in manufacturing to expand output for export and as a substitute for imports.

Monetary policy is relatively easy, but not too easy for our cyclical position. Coming after 2 years of a very tight policy, I would regard monetary policy at present as reasonably conservative. Although monetary policy is now accommodating, it will become gradually tighter as the recovery takes hold. I see no need to tighten our monetary policy merely to induce an immediate return of the funds that went abroad. These funds will come back and it is not of basic importance in the restoration of the U.S. balance of payments whether they return in 1 month or in 1 year.

I feel differently about our budget policy. There is something basically wrong with a budget that shows a deficit of nearly $39 billion while unemployment remains at 6 percent. There is some truth in the statement that a balanced full-employment budget is a self-fulfilling prophecy, but only if the budget is designed to facilitate an expansion of output.

As it is, too much of the budget deficit has gone into private savings and too little has gone into expanding consumption and investment. Moreover, much of the deficit that went into spending was dissipated in excessive imports that stimulated output abroad but not in this country, although this will be remedied by the depreciation of the dollar. Nevertheless, I believe that we have reduced taxes too much and that the reduction has been excessively biased in favor of the high-income taxpayers.

I have stated the various economic reasons why confidence in the dollar has not been restored by the realinement of exchange rates. These reasons are not enough to explain the present situation. The continuing doubts about the dollar and the present pattern of exchange rates are a result of the failure of the Group of Ten to take positive action to show that the United States and other countries are determined to maintain the new pattern of exchange rates.

These countries are not carrying out the tasks that they undertook in the communique issued at the close of the Smithsonian meeting. Paragraph 7 of the communique states:

> The Ministers and Governors agreed that discussions should be promptly undertaken, particularly in the framework of the IMF, to consider reform of the international monetary system over the longer term. It was agreed that attention should be directed to the appropriate monetary means and division of responsibilities for defending stable exchange rates and for insuring a proper degree of convertibility of the system; to the proper role of gold, of reserve currencies, and of Special Drawing Rights in the operation of the system; to

the appropriate volume of liquidity; to reexamination of the permissible margins of fluctuation around established exchange rates and other means of establishing a suitable degree of flexibility; and to other measures dealing with movements of liquid capital. It is recognized that decisions in each of these areas are closely linked.

It has been obvious to everybody for the past 5 years, and evident to students of the international monetary system for the past 15 years, that far-reaching changes are necessary in the methods of providing for the growth and use of reserves and in responsibilities for maintaining stable exchange rates and convertibility of currencies.

The reform of the international monetary system involves complex technical questions, and their solution will require extended consideration. Provided there is a clear understanding on how the international monetary system is to function in the meantime, discussions on the longrun reform of the international monetary system can proceed with the deliberation necessary for reaching agreement on basic changes in the Bretton Woods system.

The one question on which there can be no delay, without undermining confidence in the international monetary system, is "the appropriate monetary means and division of responsibilities for defending stable exchange rates and for insuring a proper degree of convertibility of the system."

With fluctuating exchange rates, there need be no problem regarding convertibility of currencies. They can be convertible in the exchange market at prevailing rates of exchange. With stable exchange rates, it is essential to have convertibility in some other form in order to avoid an appreciation or depreciation of currencies above and below the accepted margins from parity. Under favorable conditions, the pattern of exchange rates may remain stable even without convertibility. But there can be no assurance that it will, and it is this doubt that undermines confidence in the new central exchange rates.

The purpose of the International Monetary Fund is to establish a multilateral system of payments based on stable exchange rates. That means that a country that earns dollars, sterling, or other currencies can use its earnings to make payments to other countries. It also means that a country that holds reserves of dollars, sterling, or other foreign exchange can use its reserves to settle a payments deficit with any other country.

On the other hand, without convertibility, countries might be compelled to control their exchange transactions to assure continuous balance in their international payments, and, in extreme cases, bilateral balance with every other country. It should be noted that under the Fund agreement, a country cannot require the conversion of dollars merely in order to change the composition of its reserves.

The present international monetary system cannot operate without convertibility of the dollar. There are now about $75 billion of reserves in the forms of currencies, of which about $50 billion are in U.S. dollars. For most of the other foreign exchange reserves—for example, sterling—convertibility means conversion in dollars. Moreover, as the greater part of international payments is made in dollars, actual day-to-day convertibility for almost every currency is maintained by official support of the exchange rate through intervention in the exchange market to buy or sell dollars.

To put it as plainly as possible, convertibility in the international monetary system is based almost entirely on convertibility of the dollar.

It is difficult if not impossible for the International Monetary Fund to operate unless the dollar is convertible. While countries can draw on the IMF either in dollars or other currencies, they have no assurance that they will be able to meet their repayment obligations unless they can directly or indirectly use dollars for this purpose.

The United Kingdom now owes the Fund a billion dollars, but it has no way of paying. That is impossible while the dollar is inconvertible.

Representative REUSS. May I interrupt you at that point, since you have mentioned it? Do you agree with the criticism voiced by Mr. Emminger of Germany that the United States ought to cooperate in the restoration of what is called miniconvertibility by permitting the depletion of our reserves by $300 billion to $400 billion in order to help the United Kingdom and other debtors repay their IMF loan?

Mr. BERNSTEIN. I would prefer, Congressman, to set out my proposal for restoring convertibility without risking a depletion of U.S. reserves and then see how that fits into it. May I?

Representative REUSS. Surely.

Mr. BERNSTEIN. Furthermore, the system of special drawing rights may be undermined by continued inconvertibility of the dollar. What is the use of providing SDR's for the trend growth of reserves if the dollar is to be inconvertible? In one form or another, convertibility of the dollar must be restored if the international monetary system is to function.

The United States terminated the convertibility of the dollar into gold on August 15, 1971, and it will never resume such convertibility. Every country knows the difficulties the United States would experience if it undertook to make the dollar convertible into reserve assets without safeguards.

Under present circumstances, with a continuing deficit in its payments, with $50 billion held by foreign monetary authorities, with the strong preference for gold, SDR's, and other foreign exchange, the limited reserves of the United States could be quickly exhausted.

In fact, even if the United States had a payments surplus. it could find that its reserves are being depleted through the ordinary operations of international settlements. The deficit countries would settle their deficits with the United States in dollars, while the surplus countries would present the dollars they acquire for conversion into reserve assets.

These are real difficulties in undertaking convertibility of the dollar into reserve assets. The proper way of dealing with these difficulties is not to keep the dollar inconvertible, but to devise a method of convertibility that will safeguard the position of the United States while giving assurance to the countries that hold dollar reserves.

As things stand now, no country can know for certain whether it will be able 1 year from now to use its dollar reserves to make payments to Europe or, if so, at what approximate rate of exchange.

If the U.S. balance of payments recovers quickly, the European countries may not object to a moderate increase of their dollar holdings, even if the dollar is not convertible in any form.

On the other hand, if there is a sharp increase of their dollar holdings, some of them may decide not to accept more dollars, even if this means abandoning their dollar exchange rates. Or if they continue to accept dollars, it may be only in connection with trade, while other payments go through a free market at fluctuating exchange rates.

Is it any wonder that some countries with nearly all of their reserves in dollars feel that they must diversify their reserves, not to escape from the dollar as such, but to escape from an inconvertible dollar?

The United States must consider carefully what degree of convertibility of the dollar is essential for the functioning of the international monetary system and how it can provide such convertibility without risk to its own reserves.

First, countries that earn dollars now must know with certainty that they can use their newly acquired dollars to make payments to any other country.

Second, countries that hold dollar reserves must know with certainty that they can use their dollars to settle a balance of payments deficit with any other country. With safeguards, the United States can afford to convert the increment of dollars resulting from its own balance of payments deficit. It cannot afford to convert present holdings of dollars merely to enable countries to change the composition of their reserves.

I have proposed that the United States agree with the leading reserve-holding countries on interim arrangements for maintaining convertibility of the dollar in international settlements.

Under the interim arrangements, the other participating countries would agree not to diminish their holdings of dollar reserves except as required to meet their own balance of payments deficits.

In addition, they would agree to accept dollar reserves presented by other countries in settlement of payments deficits with them. The United States, in turn, would agree to convert any net increase in the dollar reserves of other countries up to the amount of the U.S. payments deficit in the interim period.

Convertibility of the net increase in dollar reserves held by the other participating countries would be in one of the following forms:

1. If the United States had an increase in reserves during the interim period, other than through the allocation of SDR's, it would convert the increment of dollars pro rata in these reserve assets.

2. If the increase in the dollar holdings of the other participating countries is more than the increase in U.S. reserves, the United States would convert the excess, at its option, either—

(*a*) In reserve assets or in the currencies of any of the participating countries; or

(*b*) In intermediate-term or long-term securities of the United States denominated in SDR's or dollars having the same exchange guarantee.

Nonparticipating countries would have the same rights of conversion as the participating countries for any increase in their dollar holdings. When the international monetary system is reformed, the dollar would become fully convertible by whatever method is provided for under the new system.

I believe that such interim arrangements for convertibility would be acceptable to other countries. From the point of view of the United States, it would be far superior to compelling the world to add another uncertain amount of dollars to their present large holdings when neither we nor they know what rights attach to these dollars.

These interim arrangements would provide assurance that the exchange rate for the dollar in all the leading currencies would be stable within the new range above and below parity. The interim arrangements would provide a fair and reasonable division of responsibilities between the United States and other countries.

As it is now, the United States is in effect saying that it has no responsibility whatever for defending the present central exchange rate for the dollar or for insuring a proper degree of convertibility of the system.

The United States cannot walk away from the $50 billion of reserves that other countries hold. It cannot adopt the attitude that whether and how these dollars can be used as reserves is not our problem.

It is our responsibility to see that they can be used as reserves. We have a right to expect that the use of dollar reserves will not weaken the reserve position of the United States or undermine the working of the international monetary system.

Other countries have a right to expect that their dollar reserves will be freely usable in all international settlements, but not for the purpose of changing the composition of their reserves.

It is time for the United States and other countries to discuss the arrangements that will respect their rights and protect our rights in the holding and use of the $50 billion of reserves that they now have and in any additional dollar reserves they may acquire in the future. An agreement on this question cannot wait until the international monetary system is reformed.

Representative Reuss, I would like to enter into the record, if you will permit, a paper I wrote on this problem of cyclical monetary policy when there are balance of payments problems.

Thank you.

Representative REUSS. Without objection, it is received.

(The paper referred to above follows:)

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INTERNATIONAL CAPITAL FLOWS

DOMESTIC AND INTERNATIONAL OBJECTIVES OF UNITED STATES MONETARY POLICY*

EDWARD BERNSTEIN†

IT IS WIDELY AGREED that the objectives of monetary policy include the maintenance of a high level of production and employment, stability in the wholesale prices of domestically produced industrial goods, and a strong balance of payments under a system of fixed exchange rates. Ordinarily, there is no conflict between the domestic and the international objectives of monetary policy. The monetary measures that are necessary to avoid excessive fluctuations in economic activity and prices are, at the same time, conducive to maintaining an appropriate balance of payments.

When excessive aggregate demand, for example, is causing a boom and putting upward pressure on prices, there will tend to be a deficit in the balance of payments. Monetary measures to restrain demand will also reduce imports and perhaps induce an inflow of funds from abroad. On the other hand, when inadequate demand is causing a recession and putting downward pressure on prices, there will tend to be a balance-of-payments surplus. Monetary measures to expand demand will also increase imports and perhaps induce an outflow of funds abroad. In fact, a balance-of-payments surplus or deficit will act directly to ease or tighten credit unless the monetary authorities intervene to offset its effects on the money supply.

CONFLICTS BETWEEN OBJECTIVES

The conflict between the domestic and international objectives of monetary policy arises when there is a persistent tendency toward surplus or deficit in the balance of payments. That is to say, there may be a large and prolonged payments surplus in a country with a very high level of economic activity. This has been the situation in a number of Continental European countries in recent years. Or

* This paper and the following papers by Milton Gilbert and Poul Høst-Madsen, with discussions by Roy Reierson, Hal B. Lary, and Philip Bell, were presented at a meeting of the American Finance Association in Pittsburgh, Pa., on December 28, 1962. The program was under the chairmanship of Henry C. Murphy.

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there may be a large and prolonged payments deficit in a country with a low level of economic activity. This has been the situation in the United States since 1958. Under such conditions, measures taken in a surplus country to restrain excessive demand will encourage an even larger balance-of-payments surplus. And measures taken in a deficit country to restore the balance of payments will tend to cause a further decline in economic activity. This is the conflict between domestic and international objectives of monetary policy that must somehow be resolved, not only by the United States but by some European countries.

This conflict existed under the traditional gold standard, although it was not always recognized because the maintenance of the gold value of the currency was regarded as the paramount objective of monetary policy. The classical means of defending the exchange rate in a period of balance-of-payments difficulty was to raise interest rates. This principle was clearly stated by Bagehot ninety years ago:

> The Bank of England must keep a reserve . . . to be used for foreign payments. And foreign payments are sometimes very large and often very sudden. In order to find such great sums, the Bank of England requires the steady use of an effectual instrument. . . . That instrument is the elevation of the rate of interest. If the interest of money be raised, it is proved by experience that money does come to Lombard Street. . . . Continental banks and others instantly send great sums here, as soon as the rate of interest shows that it can be done profitably.[1]

The use of high interest rates to attract funds in a period of balance-of-payments difficulty has never been popular with the business community. The greatest criticism of the British monetary system in the nineteenth century was that it tolerated, if it did not generate, such severe monetary pressure as to induce periodic depression and occasional panic. To a surprising extent, this was accepted as inevitable under the gold standard. The rise of London as a financial center increased the risk of monetary difficulties in England and the tendency to transmit such difficulties to other countries. As some critics pointed out, the need to rely on severe credit restriction could be obviated by holding larger reserves. On this, we may quote Bagehot again:

> Now that London is the clearing house to foreign countries, London has a new liability to foreign countries. . . . A large deposit of foreign money is now

1. Walter Bagehot, *Lombard Street* (New York, 1873), pp. 45–56.

necessary for the business of the world. . . . And we may reasonably assume that in proportion as we augment the deposits of cash by foreigners in London, we augment both the chances and the disasters of a run upon England. . . . And if that run should happen, the bullion to meet it must be taken from the Bank [of England]. . . . A great City opinion—a great national opinion, I may say, for the nation has learnt much from many panics—requires the directors [of the Bank of England] to keep a large reserve.[2]

The change in the attitude of monetary authorities toward monetary policy came gradually, notably after the first World War, with a recognition of the importance of maintaining a satisfactory monetary environment for the domestic economy. On this, the Federal Reserve, if not the champion of the new policy, was its practical advocate. While the Federal Reserve in the 1920's opposed congressional efforts to include the stabilization of prices as one of the objectives of the Federal Reserve Act, it did abandon the view that the supply of money in the United States must fluctuate with the stock of monetary gold. "The theory on which the Federal Reserve Board is supposed to govern its discount policy, by reference to the influx and efflux of gold and the proportion of gold to liabilities, is as dead as mutton," Keynes wrote in 1924. "It perished justly, as soon as the Federal Reserve Board began to ignore its ratio and to accept gold without allowing it to exercise its full influence, merely because an expansion of credit and prices seemed at that moment undesirable."[3]

While some central bankers still say that the primary objective of monetary policy is to regulate the balance of payments, their principal concern, at least when there is a balance-of-payments surplus, is to avoid the inflationary effects of accumulation of reserves on a prosperous domestic economy. Despite their large payments surplus in 1959 and 1960, the central banks of some countries of Continental Europe made special efforts to hold down the expansion of credit. Admittedly, when the balance of payments was under pressure in 1956 and 1957, most European central banks did tighten credit and raise interest rates; but this was also a period of inflated home demand. The monetary authorities have never lost sight of the importance of the balance of payments in the formulation of monetary policy, but quite properly they have not been able or willing to ignore the domestic objectives of monetary policy.

2. *Ibid.*, pp. 33–37.

3. J. M. Keynes, *A Tract on Monetary Reform* (New York, 1924), p. 198.

Monetary Policy and the United States Balance of Payments

The United States has had a large balance-of-payments deficit since 1958. An important element in this payments deficit has been the outflow of United States private capital. Nevertheless, the United States has had a relatively easy-money policy since mid-1960, as indicated by the large amount of free reserves of member banks of the Federal Reserve System, averaging over $400 million, and the yield on three-month Treasury bills, ranging from $2\frac{1}{4}$ to $2\frac{7}{8}$ per cent a year. Obviously, the United States private-capital outflow could have been diminished through a tighter credit policy. The question is how much this would have improved the balance of payments and what the consequences would have been for the economy of the United States and of other countries.

Nearly two-thirds of United States private long-term investment in recent years has been in the form of direct investment. Such investment is determined by the profitability of production and trade abroad and it is not much affected by interest rates. The level of direct investment was unusually large in some years from 1956 to 1959 because of the deficiency of direct investment in the early 1950's. Direct investment has already passed its peak and declined considerably in the last two years, even with lower interest rates. We may expect the amount of new funds going into direct investment to flatten out during the next few years. Provided the inducement for United States direct investment is based solely on profitability of production and trade abroad, there is no reason to attempt to restrict such investment through a rise in interest rates in this country.

New issues of foreign securities in the United States have increased considerably in the last six years. These securities are issued in the United States because of the easy access of borrowers to the United States market, the restrictions on foreign issues in other markets, the low issuing costs in the United States, and lower long-term interest rates. A considerable part of the new issues of foreign securities is purchased by investors in foreign countries. A rise in long-term interest rates in the United States might induce a reduction of new issues of foreign securities and would, in other cases, encourage a postponement of the issues, perhaps to a time when there is less pressure on the balance of payments.

Foreign securities are a very small part of the new issues of bonds in the United States market. In 1961, new issues amounted to $8,345 million of state and local government bonds and $9,425 million of corporate bonds. In contrast, new issues of foreign securities involved an outflow of $510 million in 1961. Excluding United States government securities, foreign securities were 2.8 per cent of total new issues in 1961. It would be a serious burden to the United States economy to raise long-term interest rates sharply in order to reduce by $100 million, or so, new issues of foreign securities in the United States. This problem can be handled much better by co-operation of the United States with other countries.

The outflow of United States private short-term funds has put enormous pressure on the balance of payments. In 1960 and 1961, the recorded outflow of United States short-term funds averaged about $1.4 billion a year, and net payments on unrecorded transactions averaged $600 million a year, much of which was undoubtedly an outflow of United States funds. A considerable part of the outflow of United States short-term funds in the last two or three years has been for the purpose of financing the large expansion of United States exports. Much more has been lent abroad to take advantage of opportunities that had been neglected in the past. In my opinion, the large outflow of United States private short-term funds, particularly that of banks, represents an extraordinary effort to adjust the holding of liquid assets more suitably between this country and abroad. The outflow of United States private short-term funds has been much less in 1962, and it is very unlikely to be resumed on the scale of 1960–61.

This is not to deny that interest-rate differentials between the United States and other financial centers provide a great incentive to transfer funds abroad. While it is impossible to estimate the precise magnitude of the outflow of funds in response to differences in interest rates, it may have been within the range of $300 million to $500 million a year in 1961. The statistical studies of Philip W. Bell and Peter Kenen place the outflow induced by interest-rate differentials at less than this. Allowance should also be made for the possibility that a much higher level of short-term interest rates in the United States might actually have drawn foreign funds from other financial centers.

When interest rates are considerably lower in the United States than in other countries, there is an inducement to transfer funds abroad. Where the movement of funds is covered by a forward exchange contract, to eliminate the exchange risk, the differential return is quickly eliminated, as the premium for forward exchange relative to spot exchange tends to rise to offset the higher interest rates in other centers. Thus the movement of funds for covered interest arbitrage is self-limiting. In fact, by operating in the forward exchange market, the United States monetary authorities have facilitated the adjustment of the relation of the forward to the spot rate of exchange and thus have held down the outflow of funds.

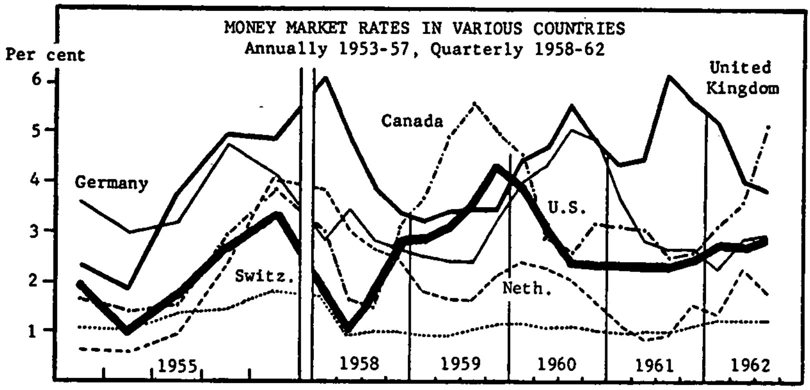
Uncovered interest arbitrage, however, can continue so long as there are differences in interest rates in the United States and abroad. Under conditions where the United States balance of payments is weak and that of other countries is strong, considerable sums will move abroad without covering the exchange risk. This was the situation in 1960 and 1961, when the enormous outflow of United States private funds took place. Except in the Netherlands and Switzerland, interest rates were higher in all other important financial centers than in the United States. With their strong balance of payments and the convertibility of their currencies, the higher interest rates in other countries offered a better return and sufficient security against exchange risks to attract a large amount of United States funds.

With the rise in United States rates and the fall in European rates, interest-rate differentials, as measured by money-market rates in the principal financial centers, have become much narrower in 1962. At present, the yield on three-month Treasury bills in the United States is higher than the comparable return in other financial centers except the United Kingdom and Canada, which have payments and reserve problems, and France, whose economy is still booming. In Germany and Belgium, as well as the Netherlands and Switzerland, short-term money market rates are now lower than in the United States. The lending rates of banks to their customers, however, are still higher in some of these countries than in the United States, and this undoubtedly has some effect on trade credit and the movement of funds (see Chart 1).

Effect of High Interest Rates on United States and World Economy

The monetary policy of the United States should take account and does take account of the effect of relative interest rates on the balance of payments. It cannot, however, be indifferent to the effect of monetary policy on the United States economy. The United States has had a high rate of unemployment and a low rate of economic growth since 1957. Even at the peak of cyclical expansion in 1960, the unemployment rate was 4.9 per cent of the civilian labor force, and in the present expansion it is unlikely to go below 5.3 per cent. The gross national product in constant dollars increased by 7.6 per cent from the cyclical peak of 1957 to the peak of 1960 and may increase about the same to the peak of the present expansion. Industrial production increased from 102.3 in August, 1957, to 111.7 in January, 1960, and may increase to about 121 by the end of the present expansion.

CHART 1



The recent weakness in the United States economy is to a large extent due to the exhaustion of the backlog of the extraordinary postwar demand for durable goods, residential construction, and plant and equipment. While this extraordinary demand was being met from 1946 to 1955, the rate of economic growth was exceptionally high. There has been very little increase in output in these sensitive sectors of the economy in the past few years, and for this reason there has been a slowdown in economic growth. This is a typical postwar-trend cycle, the low phase of which may come to an end in two or three years. In the meantime, every effort must be made to maintain and stimulate aggregate demand until the normal replacement of durable goods and the normal growth in the stock of such goods once more raise production and employment to a satisfactory level. This will require a wide range of measures—the reduction of taxes, encouragement of investment, retraining of labor, aid to depressed areas, etc. A sharp rise in interest rates at this time would make it more difficult to stimulate the expansionary forces that are now lacking in the United States economy.

In the present state of the United States economy, it is not practical to attempt to eliminate the balance-of-payments deficit through high interest rates. A tighter credit policy would, no doubt, reduce to some extent the outflow of short-term funds. It would, however, hamper the longer-range measures necessary to strengthen the basic balance of payments. For the United States, an increase in investment, particularly for cost-reduction purposes, is essential not only to stimulate the domestic economy but also to improve its competitive position in world trade. While other measures that have already been taken, such as the tax credit and revised depreciation schedules, are helpful to investment, it would be undesirable to diminish their favorable effects through high interest rates. A reduction of taxes would, of course, make it possible to maintain and increase aggregate demand even with a rise in interest rates. Even so, interest rates would have to be kept at a moderate, rather than a high, level until there is fuller use of United States productive resources.

The United States must also take account of the effect of its economic policies on other countries. The United States is a prime mover in the world economy. Its industries consume a large part of the raw materials produced in all parts of the world. A slowdown in the United States economy, particularly of investment, would put further pressure on the prices of raw materials and lead to a deterioration in the economic situation of the low-income countries dependent on such exports. Furthermore, some large trading countries, notably the United Kingdom and Canada, have recently had payments difficulties while their own economy has been lagging. A sharp rise in United States interest rates would necessitate an even sharper rise in their interest rates. The competitive rise in interest rates would probably have a negligible effect in changing the capital outflow; but it would have a seriously detrimental effect on the economy of all three countries. The United States balance of payments must be corrected through a variety of measures acting on international trade and foreign investment that spread the impact equably among many other countries. This cannot be done by relying on high interest rates as the principal instrument for eliminating the balance-of-payments deficit.

While it is important for monetary policy to take account of the balance of payments, it is not possible or desirable for the United States to abandon the use of monetary policy as an instrument for influencing the domestic economy. Virtually all other measures that can be used to act on the domestic economy are subject to congressional approval. At best, new policies in these fields can be established only after considerable delay, and they can be applied only within narrow and clearly defined limits. Monetary policy remains the one instrument that can be used quickly and flexibly within the discretion of the United States Administration. It is essential for the monetary authorities to continue to have and to use the power to tighten credit in a period of excessive expansion and to ease credit in a period of cyclical recession. Obviously, their use of monetary policy must be tempered by the state of the balance of payments.

There is no reason why the use of monetary policy as an instrument for guiding the United States economy cannot be combined with its use as one of the means of alleviating the balance-of-payments difficulties. Both the domestic and the international objectives of monetary policy can be attained, provided that the monetary authorities are careful to avoid extremes that may have a seriously adverse effect on either the level of economic activity or the balance of payments. The limitation on the use of monetary policy in the form of very low or very high interest rates does mean, however, that greater use must be made of other measures to act on the balance of payments and on the domestic economy. Most important, it means that international co-operation is necessary on a much broader range of questions in order to assure that policies of other countries do not hamper the United States in dealing with its domestic economic problems or its balance-of-payments difficulties.

International Cooperation on Monetary Policy

The sensitivity of governments to domestic economic conditions now is far greater than it has ever been in the past. No government can neglect the primary objective of economic policy, which must be the maintenance of a high level of production and employment. This must be achieved within a framework of monetary stability and an appropriate balance of payments. No economic policy, and particularly no monetary policy, is without some influence on the balance of payments. The great industrial countries must find the means of reconciling the domestic and the international objectives of monetary policy.

The basis for the reconciliation of domestic and international objectives of monetary policy is to create an environment in which a serious conflict can be avoided. This means that all the great industrial countries must take prompt action to put their balance of payments in order when there are indications of a deterioration in their payments position. If large and prolonged balance-of-payments deficits can be avoided, it will not be necessary to take extreme measures that will inevitably have an undesirable effect on the domestic economy and the world economy. One of the objectives of the International Monetary Fund (Art. I, sec. v) is to enable member countries "to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity."

Not only must countries act more promptly, but they should make wider use of other measures, in addition to monetary policy, as a means of regulating aggregate demand, domestic prices and costs, and consequential effects on imports and exports. Too much reliance on a single instrument of policy, whether it is monetary policy, fiscal policy, or direct restriction of imports, may place too great a burden on a single sector of the domestic economy, or it may concentrate the impact of the adjustment on the balance of payments of one or a few countries. More moderate action in a wider range of policies will facilitate the adaptation of the domestic economy to the restraints imposed by the balance of payments and will spread the impact of such measures over the trade and payments of many countries, each absorbing to a small extent the effects of reduced imports and reduced capital outflow. Nothing is gained by shifting the balance-of-payments problem from one country to another with a weak payments position, and it may induce competitive restrictions that can only undermine the world economy.

In specific terms, there must be greater co-operation among the financial centers on monetary policy generally and on short-term interest rates particularly.[4] This does not mean that these countries must have the same interest rates regardless of the state of their economy or their balance of payments. If short-term interest rates are the same in all of the financial centers, they may not be appropriate in any. Instead, countries must use a flexible monetary policy

4. The Federal Reserve and the Bank of England worked closely together on monetary policy throughout the 1920's, when sterling was under severe pressure. The adjustment necessary for sterling, Governor Strong of the Federal Reserve Bank of New York wrote to Secretary of the Treasury Mellon in 1924, "can be facilitated by cooperation between the Bank of England and the Federal Reserve System in the maintaining of lower interest rates in this country and higher interest rates in England so that we will become the world's borrowing market to a greater exent, and London to a less extent. The burden of this readjustment must fall more largely upon us than upon them. It will be difficult politically and socially for the British Government and the Bank of England to force a price liquidation in England beyond what they have already experienced in face of the fact that their trade is poor and they have over a million unemployed people receiving government aid" (Lester V. Chandler, *Benjamin Strong, Central Banker* [Washington, 1958], pp. 283–84).

without the extremes of credit ease or credit restriction that were so common only a few years ago. Fluctuations in interest rates should be within a narrower range than in the past. The United States cannot again expect to have a 1 per cent bill rate, as it did in the recessions of 1954 and 1958. Nor can the United Kingdom have a bank rate of 7 per cent as it did in 1957 and again in 1961. The old saying in the City that "7 per cent will bring gold from the moon" may some day be true.[5] At present, it is more pertinent that 7 per cent will bring a large drain of gold from New York.

There is an exaggerated notion of what is gained, either for domestic or international objectives, through extremely high or low short-term interest rates. When interest rates are reduced during a recession and raised during an expansion, one objective is to let the economy know that interest rates will be higher after the recession and lower after the expansion. This can be done just as well with Treasury bill rates of about 2 to $3\frac{1}{2}$ per cent instead of 1 per cent to $4\frac{5}{8}$ per cent, the range in the cycle of 1958–60. Similarly, when a country has a payments deficit which necessitates an immediate influx of foreign funds, it can be achieved in a reasonable way with a bank rate of 4 or $4\frac{1}{2}$ per cent. A much higher bank rate than this creates a crisis atmosphere and may necessitate an offsetting rise in interest rates in other financial centers. If a country will deal with its balance-of-payments problem in its early stage, a moderate rise in interest rates will give as much support through capital inflow as other countries can be reasonably expected to finance without necessitating protective measures through a rise in their own interest rates.

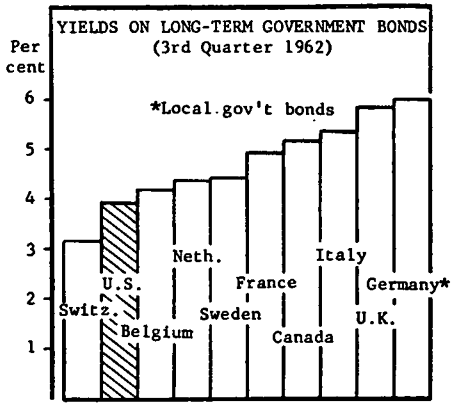
The United States is by far the largest source of capital through the issue of new foreign securities. It is anomalous for a deficit country to provide so much capital in this form. Some of the countries of Continental Europe are natural capital exporters, with large reserves, a balance-of-payments surplus, and an excess of savings for their own investment needs. With the exception of Switzerland, long-term interest rates in these countries are higher, in some instances considerably higher, than in the United States. Their long-term interest rates should be better related to those of the United States. Because of the high unemployment in this country, the narrowing of his gap will have to come through a decline in European rates rather than a rise in United States interest rates. Dr. Holtrop, the president of the Netherlands Bank, has called for greater co-

5. Walter Leaf, *Banking* (London, 1935), p. 38.

operation on long-term interest rates and capital markets. There is no reason why governments and international institutions which are borrowers of long-term funds in the United States should not raise more of the capital they need in other countries. Consultation among the financial centers could very well direct more of such borrowing to the surplus countries of Europe (see Chart 2).

The use of a flexible, but more moderate, monetary policy would reduce the outflow of short-term funds in response to interest-rate differentials without stopping it. In fact, it would not be desirable to eliminate such capital movements. With a better-balanced pattern

CHART 2



of international payments, short-term capital movements can be helpful in financing temporary balance-of-payments deficits. Nevertheless, even with smaller interest-rate differentials, there will be periods when large capital outflows occur either in response to such differentials or for speculative reasons. At such times, it may not be possible for a country to raise interest rates sufficiently to stem the outflow of capital. Instead, it would be desirable to have access to special resources to finance the outflow of funds and restraint by the recipient countries in converting into gold the funds they acquire.

Fortunately, measures for these purposes have recently been taken. Just a year ago, ten large countries agreed with the International Monetary Fund to make available $6 billion to be used primarily to finance short-term capital movements.[6] It would be highly desirable to extend these arrangements among the same group of

6. The countries are United States, United Kingdom, France, Germany, Italy, Netherlands, Belgium, Sweden, Canada, and Japan.

countries, and Switzerland, to minimize the pressure on gold reserves by a greater holding of foreign exchange as reserves. The Secretary of the Treasury has already stated that this will be the policy of the United States when the balance of payments is once more in surplus. The Federal Reserve has entered into arrangements for currency swaps with other central banks and the Bank for International Settlements. What is necessary now is to place these arrangements in a systematic framework that will strengthen the capacity of the great financial centers to deal with the reserve and payments problems peculiar to them, particularly the recurrence of large movements of liquid funds and the massive conversion of currency balances into gold.

Never before has there been so clear an understanding among the great industrial countries of the need for common action to enable the world economy to function effectively under a system of fixed exchange rates supported by adequate reserves. The fields of international financial co-operation are being gradually broadened. Such co-operation is indispensable to the effectiveness of national economic and monetary policies. With co-operation among the leading financial centers, there is no reason why monetary policy cannot continue to be an important, although not the only, instrument for achieving both its domestic and its international objectives.

Representative REUSS. Thank you very much, Mr. Bernstein.

I will ask each of your this question? How do you think your proposal for dealing with the questions of greater ease in determing the exchange rates of the United States, with respect to the $50-billion overhang, and convertibility of the dollar, how do you think your views on those questions differ from those of the Treasury?

Mr. BERNSTEIN. I don't always know for certain what the views are of the Treasury, particularly on reading the first statements.

Representative REUSS. The publicly stated views.

Mr. BERNSTEIN. The Secretary of the Treasury has said there will be no convertibility of the dollar in 1972. I think how that fits with what I said depends on two things: First, if he means gold convertibility there will be none. If he means convertibility in other reserve assets without question, it is possible but risky. But if he means no form of convertibility within a multilateral payment system, then I think we differ very seriously, because I believe it is in our interest to do this, to have a form of convertibility that safeguards our reserves but gives other countries assurance on the use of their dollar reserves.

I don't think it is reasonable, I don't thing it is possible, to expect other countries to take an uncertain amount of dollars in the future, to accept the sole responsibility for defending the dollar rate of exchange, when they don't know what rights, if any, attach to those dollars.

Representative REUSS. Mr. Triffin.

Mr. TRIFFIN. I share the view of Mr. Berstein on this. I would go maybe a little further and say that if the expectation is that other countries will automatically absorb any amount of dollar overflows that come to the market, that means, in effect, that there would be no exchange rate readjustment of the dollar, even if such readjustment were to be needed.

It means we could have any amount of deficits and we would be prevented, in fact, from readjusting the value of the dollar because other countries would buy it to prevent it from being readjusted.

Second, however, I would say that I deeply share the views of Mr. Bernstein that such expectation would soon be proved wrong if our balance of payments remains in substantial deficit. Other countries might then either let their currency appreciate, but more likely they would use all kinds of exchange restrictions, exchange controls to stem the flood of dollars.

They might resort to a two-tier exchange market, as Mr. Berstein suggested, to let the dollar depreciate on financial transactions while preventing devaluation of the dollar as far as current transactions are concerned.

Obviously, foreign firms would prevent the central banks from letting their own currency appreciate indefinitely, thus undermining their own competitiveness in world trade.

Representative REUSS. In the light of the beliefs of you gentlemen that you have just expressed, would you agree that there should be taking place now meetings of finance ministers, central bankers, deputies, of at least the same number and intensity as was the case between August 15 and December 18, when the object was an interim realinement agreement?

Mr. TRIFFIN. Absolutely. I think that is the main burden of my own statement. What I deplore is the complacency, the procrastination, which is bound to lead to new crises blowing in our faces, and to disorderly reactions on the part of foreign countries.

I think that is the same message that was given by Mr. Bernstein.

Mr. BERNSTEIN. Congressman, I don't mind the Treasury waiting and studying the problem of reform of the international monetary system. I am positive that a reform will come.

What I am afraid of is that waiting isn't the proper policy for the functioning of the international monetary system in the meantime. We do have to know how dollars can be used. If we don't let them know how dollars can be used, there will be a quiet escape from the dollar.

As I mentioned, some central banks are, in fact, selling moderate amounts of dollars, which are their only reserves, in order to have another reserve asset on which they could count in the future.

Incidentally, I think this view that the backflow of funds to the United States isn't taking place is greatly exaggerated. It is coming in but not as rapidly as we had expected It is financing a good part of our deficit today, our continuing deficit on goods, services and long-term capital It would come back much more quickly if the world had confidence that we and other countries intend to defend the present parities and also to reestablish convertibility.

Representative REUSS. Gentlemen, thank you very much for your very significant contributions to our thinking. Unfortunately, Senator Javits, Mr. Boggs and others, have been called to the floor.

Thank you very much.

The committee will now stand in recess until 10 o'clock tomorrow morning, when we will reconvene in this room.

(Whereupon, at 12:10 p.m., the committee recessed, to reconvene at 10 a.m., Wednesday, February 23, 1972.)

THE 1972 ECONOMIC REPORT OF THE PRESIDENT

WEDNESDAY, FEBRUARY 23, 1972

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

The committee met, pursuant to recess, at 10 a.m., in room 1202, New Senate Office Building, Hon. William Proxmire (chairman of the committee) presiding.

Present: Senators Proxmire and Pearson; and Representative Conable.

Also present: John R. Stark, executive director; Loughlin F. McHugh, senior economist; Courtenay M. Slater, economist; Lucy A. Falcone and Jerry J. Jasinowski, research economists; and Walter B. Laessig, minority counsel.

OPENING STATEMENT OF CHAIRMAN PROXMIRE

Chairman PROXMIRE. The committee will come to order.

We are going to proceed in the absence of Mrs. Kreps because I understand she is on her way, and Mr. Brimmer, unfortunately, has to leave early. We would like to accommodate him.

Of the many problems which confront economic policymakers at the present time, the most urgent is to begin reducing unemployment. A difficult question which has come up again and again during these hearings is the extent to which unemployment can be reduced through the use of fiscal and monetary policy and the extent to which we must turn to manpower programs and other efforts to improve the structure of the labor market.

Indeed, this question of aggregate versus specific policies may have received more attention than is really required at this particular moment. We need both. There may be no conflict between them, between fiscal and monetary policy on the one hand and efforts to improve the structure of the market on the other. Unemployment has been high for a long time and it seems obvious that stimulative and monetary policies to shake this problem out of the doldrums are required.

The unemployment rate for teenagers will be well above 10 percent. The unemployment rate for blacks will be twice that for whites. The unemployment rate for female heads of household will be substantially above that for males.

When we know these facts, we know that structural improvement of the labor market must go hand in hand with fiscal and monetary stimulus.

We should have better manpower training, better job placement services and elimination of discriminatory practices. We are happy that yesterday the Senate passed a strong antidiscrimination bill that should help a great deal.

The difficult question is to determine how we achieve these improvements, what specific steps are to be taken to improve manpower services, and how we go about providing the same job opportunities for a woman who supports a family as we do for a man who supports a family; how do we eliminate discrimination against blacks or Mexican-Americans. These are questions which must be answered if our commitment to a full employment economy is meaningful.

Our distinguished panel this morning has been asked to address themselves to these difficult questions of providing employment opportunities to the various groups which make up the labor force.

Our first witness is Andrew F. Brimmer, member of the Board of Governors of the Federal Reserve System. Governor Brimmer was Assistant Secretary of Commerce for Economic Affairs. Prior to that he taught at the Wharton School at the University of Pennsylvania. Thus, he brings not only a deep personal interest but a background of both scholarship and policymaking experience to our subject this morning.

Following Governor Brimmer, if Mrs. Kreps comes in time, we will hear from Mrs. Kreps, who is dean of the Woman's College at Duke University. Mrs. Kreps is professor of economics at Duke as well as dean.

She has authored a number of scholarly publications, many in the manpower field. One of the most recent in a study of the work experience of women entitled "Sex in the Marketplace."

The third member is Vincente Ximenes, vice president of the National Urban Coalition. Mr. Ximenes was formerly a member of the Equal Employment Opportunity Commission and head of President Johnson's Cabinet Committee on Mexican-American Affairs.

I would like to request that all panel members hold their statements to 15 minutes or less. Because Mr. Brimmer is in a hurry, we are going to question him first and then excuse him.

STATEMENT OF HON. ANDREW F. BRIMMER, MEMBER, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. Brimmer. Thank you, Mr. Chairman.

The invitation to me to appear at these hearings asked that I discuss the difficulties of minority groups, particularly blacks, in their attempt to surmount discriminatory barriers to equal employment opportunities.

It is in that context that I appear to present my personal views.

Mr. Chairman, you will recal that, on February 9, the Chairman of the Federal Reserve Board appeared before your committee on behalf of the Board as part of the annual hearings on the President's Economic Report. Consequently, I will not travel over that ground again.

Moreover, the general assessment of the outlook for the national economy in 1972 has been presented by the Council of Economic

Advisers (CEA), and I am in broad agreement with the Council's conclusions.

Therefore, I will not attempt to present a separate estimate or projection of gross national product (GNP) and its components. Instead, within the framework developed by the CEA, I will (1) review recent economic trends in the black community, and (2) attempt a rough assessment of the prospects for blacks in the short-run.

In approaching this subject, I worked against the background of the research I have been doing, dealing with employment, unemployment, income and the interrelations among the black community and the total economy.

The prepared statement, itself, is focused primarily on the recent experience of blacks in the economic arena, but to provide some perspective I have also looked at the progress blacks have made in terms of employment and occupational upgrading in the last decade. That accounts for the first section of the prepared statement.

The net result of the analysis is as follows: Over the 1960's, blacks made a substantial number of gains in terms of the range and level of jobs acquired. The statistics in table 1 of the prepared statement demonstrate that fact. However, if one looks at the distribution of black employment in terms of the principal occupations, it is clear that the blacks are still heavily concentrated in the occupational categories which require little skill. In particular, the deficit in white collar occupations remain fairly large.

Chairman PROXMIRE. Are you referring to a particular table?

Mr. BRIMMER. The tables are attached to the prepared statement. It may be helpful to pull them apart from the prepared statement.

I was saying, Mr. Chairman, that the progress over the decade was substantial, but, nevertheless, compared with their overall participation in the economy, which is about 11 percent for blacks, the occupational deficit in white collar employment averages about 40 percent and remains quite large.

It was against the progress of the 1960's that I took a particularly hard look to see what had happened in 1971. As I said at the outset, part of my comments will be focused on developments during the cyclical experience, 1969–71. If one compares in table 1 of the prepared statement the situation in 1971 with the situation the year before, several things stand out. First, blacks in 1971 had a mixed employment experience. Total employment rose moderately while the number of black jobs declined somewhat. The losses were concentrated among blue collar workers because the number of blacks in white collar jobs continued to expand.

Within the blue collar group the attrition was most noticeable in the case of operatives. The chairman will remember that these are primarily manufacturing workers. I want to stress that.

This situation was mainly a reflection of the continued sluggishness of activity in the manufacturing sector in which a sizeable proportion of blacks are employed.

In general, blacks made sizeable gains in the 1960's, but these gains came to a halt in 1971, as far as employment in concerned.

Moreover, it was the first time in the decade that the year-to-year change in the number of jobs held by blacks declined. There was a decline of some forty-odd thousand jobs as far as blacks were concerned, whereas total employment continued to expand at a fairly good rate in 1971.

I also looked a the growth of the labor force.

Chairman PROXMIRE. What was that period of decline?

Mr. BRIMMER. Some forty odd thousand, 1970 to 1971. In my prepared statement I spell that our a little more fully.

In 1971, there were some 8.4 million blacks who were holding jobs, representing 10.6 percent of the labor force. However, the number of employed blacks in 1971 was about 43,000 below that for the year earlier, while total civilian employment was 490,000 higher.

In contrast, in 1970, black employment rose by 62,000. Let me repeat: In 1970, there was an increase of 62,000, and in 1971, there was a decrease of 43,000.

Again, in both years the total number of jobs continued to expand. As I said earlier, this represents mainly the adverse effects of the recession on blacks.

During the downphase of the recession, blacks were not hit quite so hard as whites, mainly because the down side of the recession was characterized to some extent by the cutback in employment in the aerospace industries and blacks were not so heavily represented there.

I have been particularly concerned, in working up the material in the preparation of this prepared statement, with the outlook for blacks in manufacturing. To get a feeling for the outlook, I went in some detail into the distribution and growth of black employment in private industry. The highlights of that inquiry are presented in my prepared statement.

Let me pause a moment to say that for the first time we were able to get a fairly comprehensive view of the proportion of jobs held by blacks in the major industries. This was possible because of my access to two sources of data. The first one is a summary of statistics prepared by the Equal Employment Opportunity Commission based on the report it gets from those companies, mainly large companies, covered by title 7 of the Civil Rights Act of 1964.

I summarize those data for 1970 in table 2 of my prepared statement. Although the sets of information are somewhat incomplete because of the differing degrees of coverage in particular industries, the key points arising from these data are roughly as follows: The data show that for the companies reporting, 28.9 million jobs were reported.

Roughly 14.5 million were in manufacturing. For blacks, about 3 million jobs were covered, and about 1.4 million were in manufacturing. That comes close to 50 percent in each case.

As I said earlier, that series is incomplete and it would be much better to have a more comprehensive series. For this purpose, the Bureau of Labor Statistics (BLS), at my request, permitted me to use the ratios of employment by color in each industry, calculated from the data which the Census Bureau collects for them in the household survey. The BLS publishes the gross figures. They do not (and still do not) publish the detailed figures.

However, BLS did permit me to use the ratios and I summarize these, Mr. Chairman, in table 4 of my prepared statement.

I call the committee's attention particularly to tables 3 and 4 of my prepared statement. First table 4. You will notice that in the right-hand column, the last column, I show in 1971 Negroes and others as a percentage of total employment. About 92 percent of all the coverage in that series are blacks. The rest are mainly orientals and American Indians.

I want to stress that in this series Mexican-Americans are treated as white and not as blacks. So there may be a difference in the coverage of the series presented here today.

You will notice that of the total jobs reported, blacks held about 11 percent. But they held about 9 percent in manufacturing.

Chairman PROXMIRE. What is that table?

Mr. BRIMMER. That is table 4 of my prepared statement.

In other words, it would be helpful if the committee thought of 10 percent as a rough benchmark from which to measure the situation in each case.

However, when the data are turned around, and we look at the places where blacks worked—in other words, ask the question, Where have blacks found jobs? The results are shown in table 3 of my prepared statement.

Here again we take the roughly 8.5 million employed blacks in 1971 and we distribute them according to the places in which the blacks had jobs. Here we are looking at the situation from the point of view of the black households and then tracing through the distribution of black employment by industry. These data show, for example, that about 4 percent of all employed blacks were in agriculture, 0.2 percent in mining, about 5.5 percent in construction, 23 percent in manufacturing.

That is one of the points I wanted to make. If we look at the 23 percent of blacks in manufacturing, it is not essentially different from the 25 percent of the total in manufacturing.

But when you look at other major industries, except services, in most cases—not all, but in most cases—the blacks have found proportionately fewer opportunities. That is the key point I wanted to make. For this reason, the behavior of the manufacturing sector is important.

Second, the behavior of the services sector, trade and so on, are also important, because these are the growing sectors. The behavior of the Government sector is important because blacks are represented to a much greater extent on Government payrolls than they are in the private economy as a whole.

We have very good data for the Federal Government. There blacks make up some 15 percent of the Federal payroll as opposed to, say, roughly 10 percent of all the jobs in the economy.

These industry data are also important because when they are analyzed, they shown that blacks lost substantially—as I said, 43,000 jobs—in 1971. And that reflected mainly the losses in manufacturing—and not in services, trade, and Government where there was continued growth.

One other point I wanted to make about the industry data concerns the outlook for blacks in Government employment. As I said earlier, blacks are much more heavily represented in Government service than they are in the economy generally. However, blacks remain heavily concentrated in the lower grades of the Federal service. With the holddown and, in fact, 5 percent cutback projected in Federal employment for fiscal 1972, I wanted to know whether there was a likelihood that blacks would end up bearing a disproportionate share of the cutback. I tried to formulate the question in terms of the turnover rate of blacks compared with expected attrition rates.

I asked the Civil Service Commission for some data to assess this possibility, but the Commission did not have the information. They assured me that they had no indication that the cutback in Government employment would affect blacks adversely. However, the data show that from May 1970 to May 1971, there was a decline, a net decline, in the number of blacks in the Federal public service.

However, as I said earlier, where the cutbacks did occur in Government service, and blacks did see some reduction, it was in the lower grade of the Postal Service, where in the white-collar jobs there was an increase.

There is an interesting aspect of the behavior of black employment in Government: The turnover rate tends to be very high; that is the quit rates are very high. I suspected that, but in order to get a better feeling, since the Civil Service Commission did not have the statistics, I asked the Federal Reserve banks to do a survey in their institutions to see what the situation was.

These data show what all of us expected and what should have been expected, that the turnover rate among blacks in the lower grades, grades 1 through 5, is particularly high. These grades are not appreciably different from the same kind of grades in the Federal service, although they do differ to some extent, because the Federal Reserve banks are not carbon copies of the Federal Government.

The information shows in broad outline that the turnover rate is particularly high among blacks. As a matter of fact, it is about 1½ times as high for blacks as for all employees. These data suggest that one would have to be particularly careful to make certain that the high turnover rates among blacks in fact are not translated into high attrition rates, and thus, into a decline in the percentage of blacks employed in the Federal Government.

Mr. Chairman, in conclusion, these different employment patterns and trends suggest a fairly clear but far from comfortable picture.

The depressed conditions in manufacturing industries, only partially offset by growth in other sectors, have had a seriously adverse effect on black employment in the last 2 years. The net result has been a halt to the vigorous growth of black employment registered during the last half of the 1960's.

The situation with respect to black unemployment is not surprising. Most times when figures on unemployment among blacks are compared with total unemployment, focus is put on the unemployment rate. But I wanted to get a feeling for the composition of unemployment.

I will not go into the details, but the broad outlines are clear. Blacks tend to have unemployment rates about twice those of whites, except in very few years when the unemployment rates for whites were rising.

I also show here that the cutback in manufacturing jobs in the last couple of years has had adverse effects on the level of unemployment among blacks.

The statement also contains an analysis comparing the 1960–61 recession with the 1970–71 recession and its effect on blacks. Essentially, the pattern was roughly the same, but there are a few differences. I will not take the committee's time to go through them now.

The next thing I looked at in assessing the situation of blacks was their income position. Here, again, the broad outlines are familiar to the committee. Black income still remains some three-fifths that of white income. The black share of total income, however, has been rising since the year 1960. It was rising from the neighborhood of just over 6 percent to about 6.5 percent.

However, in 1970, it hit about 6.5. Though I have not worked out the details, given the employment situation, it is my impression that black income as a proportion of the total did not grow in 1971. If it grew, it grew very little.

There is one other thing that the committee might notice. That is while the black median income in relation to that for whites has been rising a bit, the absolute gap between black and white income has been getting larger. The gap rose steadily through the 1960's.

So black families, in terms of income, still lag substantially behind white families.

I also looked at what had been happening to the distribution of income within the black community. The net conclusion is that this distribution, which had been tending toward more equality during the 1960's, apparently in the last 2 years began to show somewhat less equality than had been true before.

Finally, before summarizing and turning to the outlook, I would call the attention of the committee to a piece of analysis which I undertook for the first time.

I find it interesting but also of some significance. This deals with the share of taxes paid by blacks. I think it provides some insight into the situation of the blacks in the economy as a whole. The Census Bureau was very helpful and prepared some special tabulations on household income, which we could then use to estimate Federal income taxes paid by blacks.

The method adopted was that developed by Mr. Miller of the Census Bureau. I summarize the results. Essentially, what these data show is the following: I estimate that in 1969, Negroes and other races paid about $4.7 billion in Federal income taxes, while their income amounted to about $41 billion. The white families received about $562 billion of income and paid Federal income taxes of approximately $82 billion.

Thus, while blacks and other races constitute about 13 percent of the population, they received about 6.8 percent of the adjusted gross income, filed 11.5 percent of the tax returns and paid roughly 5.5 percent of the Federal income taxes.

When you take account of the social security taxes and State and local taxes and others, the discrepancy between income and taxes paid by blacks is somewhat narrowed. But, in general, these data also show the extent to which blacks in fact are sharing only roughly half as much in the economy as the population as a whole.

Finally, Mr. Chairman, I tried to look ahead to what might be expected in broad outline for blacks in 1972. Again I took the framework prepared by the Council of Economic Advisers as a guideline and I looked at the prospects for manufacturing, services, and several other industries.

In general, I get the impression that the environment in business today is much more hospitable to the hiring and upgrading of blacks than it was even a few years ago. At the same time, I also get the feeling that, although many of the leaders in industry are very conscious of the need to promote equal employment opportunity by increasing their percentage of black employment, in many cases the rehiring of workers—because of trade union agreements—would have to be done on a seniority basis, which would generally not favor blacks and other minority groups that are still relatively newcomers to certain sections of industry.

In some industries in which blacks are heavily concentrated, in fact, there were declines in 1971. I spell these out in some detail.

I also wanted to get a feeling for the way in which industry was looking toward rehiring. This is very tenative, but in general I concluded that the growth of jobs in manufacturing—I cannot estimate how large that might be in 1972—will be helpful to blacks.

Also, the expansion in jobs in services, government, and trade, will be helpful. But I came away with the net conclusion that the continued sluggisness in manufacturing, in which blacks are heavily concentrated, would dampen to some extent the overall prospects for black employment in 1972.

There will be some progress—but this will fall short of the strides made in the late 1960's. Moreover, since the Council of Economic Advisers has estimated that even at the end of the year the total unemployment rate would not be below 5 percent, I concluded, as blacks have traditionally had a 2-to-1 ratio, that there appeared to be no basis for expecting blacks to improve their relative unemployment position in the course of this year.

In my judgment, the single most important contribution that can be made this year to enable blacks to make further economic progress is at least to insure the sizable expansion projected by the CEA, in the national economy in 1972, while at the same time pressing onward with the campaign to check inflation.

Thank you.

(The prepared statement of Mr. Brimmer follows:)

Prepared Statement of Hon. Andrew F. Brimmer

Economic Situation of Blacks in the United States

INTRODUCTION

Mr. Chairman and Members of the Committee, I am pleased to appear before this Committee to discuss recent economic developments in the black community. The invitation requested that I ". . . discuss . . . the situation of minority groups, particularly blacks, in their attempt to surmount discriminatory barriers to equal employment opportunities. . . ." It is in that context that I appear to present my personal views.

On February 9, the Chairman of the Federal Reserve Board appeared before your Committee on behalf of the Board as part of the annual hearings on the President's Economic Report. Consequently, I will not travel over that ground again. Moreover, the general assessment of the outlook for the national economy in 1972 has been presented by the Council of Economic Advisers (CEA), and I am in broad agreement with the Council's conclusions.

Therefore, I will not attempt to present a separate estimate or projection of gross national product (GNP) and its components. Instead, within the framework developed by the CEA, I will (1) review recent economic trends in the black community and (2) attempt a rough assessment of the prospects for blacks in the short-run.

LONGRUN TRENDS IN EMPLOYMENT

Most of this statement is focused on economic trends in the black community during the last few years. /To put this recent experience in perspective, it might be helpful to summarize briefly the overall economic progress among blacks in the last decade. This progress can be traced in the trends of the labor force, employment and occupational advancement. In 1970, there were 9.2 million Negroes and other races [1] in the labor force—meaning that they were holding jobs or seeking work. This was a rise of about one-fifth since 1960, a rate of increase somewhat faster than for whites and for the total labor force. However, employment of blacks rose more rapidly than it did for all employees (by 22 per cent to 8.4 million for the former compared with 19½ per cent to 78.6 million for the latter). Expressed differently, while blacks represented about 11 per cent of the total civilian labor force in both 1960 and 1970, their share of the gains in employment during the decade was somewhat larger; they accounted for nearly 12 per cent of the employment growth, although they held just over 10 per cent of the jobs at the beginning of the period. (See Table 1, attached.)

Advancement in the range of jobs held by Negroes in the last decade was also noticeable. This was particularly true of the improvements in the highest paying occupations. Between 1960 and 1970, the number of blacks in professional and technical positions increased by 131 per cent (to 766 thousand) while the increase in the total was only 49 per cent (to 11.1 million). Blacks had progressed to the point where they accounted for 6.9 per cent of the total employment in these top categories in the occupational structure in 1970, compared with 4.4 per cent in 1960. They got just over 9 per cent of the net increase in such jobs over the decade. During this same period, the number of Negro managers, officials and proprietors (the second highest paying category) rose two-thirds (to 297 thousand) compared to an expansion of 17 per cent (to 8.3 million) for all employees in this category.

In the 1960's, black workers left low-paying jobs in agriculture and household service at a rate two to three times faster than did white workers. The number of black farmers and farm workers dropped by 63 per cent (to 328 thousand) in contrast to a decline of about 40 per cent (to 3.1 million) for all persons in the same category. Therefore, in 1970, blacks accounted for about 11 per cent of employment in agriculture, less than their share in 1960 when the proportion was 16 per cent. The exit of blacks from private household employment was even more striking. During the last decade, the number of Negroes so employed fell by about 34 per cent (to 652 thousand); the corresponding drop for all workers was only 21 per cent (to 1.6 million). Although roughly half of all household workers were black in 1960, the ratio had declined to just over two-fifths by 1970. The number of black nonfarm laborers declined (by 9 per cent to 866 thousand) over the last decade, but the total number of laborers rose somewhat.

Nevertheless, as already indicated, the accelerated movement of blacks out of the positions at the bottom of the occupational pyramid did not flow evenly through the entire occupational structure. For example, Negroes in 1970 still held about 1.5 million of the service jobs outside private households—most of which require only modest skills. This represented almost one-fifth of the total—about the same as the proportion in 1960. Moreover, the number of blacks holding semi-skilled operative jobs (mainly in factories) rose by 42 per cent (to about 2.0 million) during the decade, compared with an expansion of only 16½ per cent (13.9 million) for all workers. The result was that blacks' share of the total climbed from 12 per cent to over 14 per cent. Taken together, these two categories of lower-skilled jobs (chiefly in factories or in nonhousehold services) accounted for a somewhat larger share (42 per cent) of total black employment in 1970 than they did in 1960—when their share was about 38 per cent. In con-

[1] Negroes constitute about 92 per cent of all persons in this group. Other races included are American Indians and Orientals. Thus, this statistical series can be taken as an approximate measure of economic trends among blacks.

trast, among all employees the proportion was virtually unchanged—27 per cent at the beginning of the decade and 28 per cent at its close.

While Negroes made substantial progress during the 1960's in obtaining clerical and sales jobs—and also registered noticeable gains as craftsmen—their occupational center of gravity remained anchored in those positions requiring little skill and offering few opportunities for further advancement. At the same time, it is also clear from the above analysis that blacks who are well-prepared to compete for the higher-paying positions in the upper reaches of the occupation structure have made measurable gains. Nevertheless, compared with their overall participation in the economy (11 per cent of total employment), the occupational deficit in white collar employment—averaging 40 per cent—remains large.

Data on occupational distribution of total employment by color in 1971 are also shown in Table 1. In general, these figures show the mixed job experience of blacks in the last year. While total employment rose moderately, the number of black jobholders declined slightly. However, the losses were concentrated among blue collar workers, as the number of Negroes employed in white collar jobs continued to expand. Within the blue collar group, the attrition was most noticeable in the case of operatives. This situation was mainly a reflection of continued sluggishness of activity in the manufacturing sector in which a sizeable proportion of blacks is employed. Recent trends in this sector are examined more closely below.

RECENT GROWTH OF THE BLACK LABOR FORCE

But before taking up that task, we might look briefly at the impact of the recent recession on the black labor force. In 1971, there were 9.3 million Negroes and other races in the civilian labor force. In the same year, the total civilian labor force amounted to 84.1 million, so blacks represented 11.1 per cent of the total—the average for the last decade. For 1971 as a whole, the black labor force rose by 124,000, compared with a rise of 1.4 million in the total civilian labor force. Thus, the increase in the black component amounted to 8.9 per cent; in the previous year, blacks had accounted for 12.2 per cent of labor force growth.

To a considerable extent, the slower expansion in the number of blacks in the work force reflected the impact of the recession. The latter's adverse effect on the black community is evident in the increasing tendency for discouraged blacks not even to look for jobs. One can make a rough judgment of a group's willingness to engage in economic activity by tracing its labor force participation rate.[2] For blacks as a group, the participation rate has been declining for a number of years, while it has been rising for whites. For example, the rate for blacks fell from 64.5 per cent in 1960 to 60.9 per cent in 1971; in the same period, the rate for whites rose from 58.8 per cent to 60.1 per cent. These divergent trends were accelerated during the 1970–71 recession. Particularly in the last half of 1971, the participation rate for blacks showed consistent declines at a time that the white participation rate was rising—most probably in response to the sizable growth in white employment. Discouragement over employment prospects evidently has led more blacks to stay out of the labor force during the recovery period than can be explained by longer term trends in the age-sex composition of the black labor force. Consequently, the behavior of labor participation rates suggests that the economic situation among blacks deteriorated more in 1971 compared to whites than might be evident on the surface.

SLUGGISH EXPANSION IN JOBS

For the first time in a decade, the number of blacks with jobs in 1971 was below that for the previous year. This was not the case with whites. The year-to-year decrease in black employment (white quite modest) was a direct result of the recession and slow recovery in national economic activity in 1970–71. In fact, the employment experience of blacks during the last two years has shown some similarity to that recorded during the 1960–61 business cycle. In general, blacks did *relatively* better than whites in the 1969–70 recession phase of the business cycle and *relatively* worse in the 1970–71 recovery stage.

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[2] The participation rate is defined as the percentage of the civilian noninstitutionalized population age 16 and over that is in the civilian labor force.

In 1971, an average of 8,403 thousand blacks were holding jobs, representing 10.6 percent of total civilian employment (which amounted to 79,119 thousand). However, the number of employed blacks in 1971 was about 43 thousand below that for the year earlier—while total civilian employment was 490 thousand higher. In contrast, in 1970, black employment rose by 62 thousand, accounting for 8.5 percent of the gain of 727 thousand in total civilian jobs.

Several developments in the national economy help to explain the recent adverse black experience on the jobs front. At the beginning of the economic slowdown in 1969, employment cutbacks were most severe in professional jobs related to the defense and aerospace industries. Blacks comprise only a minute proportion of the labor force in this sector and thus were not affected significantly. Sectors such as services and government (which employ a higher fraction of blacks) continued to expand through 1969. Thus, in the initial stages of the recent business cycle, blacks were less affected than were whites—both by general cyclical forces and by the special situation in the defense and aerospace industries.

In 1970, employment cutbacks in the economy as a whole were more widespread as overall economic activity declined and as business attempted to control costs. Proportionately, employment grew slightly less for blacks than for whites in 1970. A smaller rise in employment for adult black women than for adult white women—and an actual decline for black teenagers—more than offset a somewhat faster rise in employment for adult black men than for adult white males. However, as mentioned above, the participation rate for blacks continued its long-run decline in 1970 while the white participation rate showed a slight increase. As a consequence, the unemployment rate for blacks did not rise proportionately as much as the rate for whites.

Overall employment increased very little in the first half of 1971—although economic activity showed a mild recovery. Continuing to be concerned about inflation and low profit levels, businessmen attempted to limit hiring in order to hold down labor costs. In the second half of 1971, total employment rose substantially. However, all of the gains were made by whites. By year-end, white employment was 1,636 thousand above the level in December, 1970; black employment registered a small decline of 67,000 over the year.

Again, the composition of the recovery in national economic activity had a direct bearing on the less favorable job experience of black workers. The manufacturing sector of the economy (which employs a significant proportion of blacks in blue collar jobs) remained weak throughout 1971. In addition, government employment (a sector where blacks are well represented) grew more slowly than it had in recent years prior to 1971. An examination of the recent trends in those industries in which blacks are heavily represented provides some little-noted insights into the situation of blacks in the national economy.

PRIVATE INDUSTRY PERFORMANCE AND BLACK EMPLOYMENT

As indicated above, blacks are heavily dependent on the manufacturing sector for employment. This is especially true of black men. It is hard to obtain detailed statistics to trace the pattern of black employment. The main source of employment data by industry is the series of reports collected from private establishments by the Bureau of Labor Statistics (BLS). This series does not include a racial breakdown of the number of workers. In addition, BLS publishes employment data collected by the Bureau of the Census in its household survey. This series as published does include estimates of employment by demographic characteristics—such as age, sex, and race. However, while an industry distribution of employment can be calculated by BLS on the basis of the data collected, such calculations are not published. Finally, the Equal Employment Opportunity Commission (EEOC) collects employment data once each year from the larger companies under the Civil Rights Act of 1964. At my request, BLS has given me permission to use the ratios calculated from the household data showing blacks as a percentage of total employment in each industry. Using the same data, I have calculated the percentage distribution, by broad industry grouping, of total and black employment. Data from these three sources are presented in Tables 2, 3, and 4.

The heavy dependence of blacks on factory jobs is clearly suggested in the EEOC data shown in Table 2. In 1970 (the most recent year for which statistics are available), about 3.0 million blacks were on the payrolls of private employers (mainly large companies) reporting under EEOC requirements.[3] This number represented 10.3 per cent of the 28.9 million workers reported by these companies. About 1.4 million (48.7 per cent) of the 3.0 million black jobholders reported were employed in manufacturing. This proportion was not appreciably different from that for all EEOC-reported jobholders (50.3 percent). However, since the EEOC reports are more complete for manufacturing than for other sectors, these ratios tend to overstate the actual degree of reliance on manufacturing as a source of jobs.

A somewhat more balanced picture of the industry distribution of black employment is provided by the BLS household data. As shown in Table 3, when the more comprehensive statistics are analyzed, about 23.0 per cent of black jobholders in 1971 were employed in manufacturing. The corresponding proportion for total employment was 24.7 per cent. The extent to which blacks—compared to all workers—have found jobs in other industries is also shown in Table 3. For example, the proportion of the black work force employed in transportation and public utilities is roughly the same as that for all workers—6.6 per cent and 6.7 per cent, respectively. However, a sizable divergence is evident in the trade field, in which 14.2 per cent of blacks—in contrast to 20.1 per cent of the total—had found jobs. A smaller (but still noticeable) divergence can be seen in the case of finance, insurance and real estate—which accounted for 5.2 per cent of total employment compared with 3.6 per cent of black employment. On the other hand, blacks were overly represented in services (29.1 per cent of employed blacks vs. 20.1 per cent of the total).

Within manufacturing, blacks were found employed particularly in heavy industry. They found especially in industries producing transportation equipment (mainly automobiles); in primary metals (particularly steel); in electrical equipment; in food and related products, and in textile mill products. While blacks held about 9.9 per cent of the total jobs in manufacturing as a whole, in several industries, their share of the jobs was considerably higher. For example, as shown in Table 4, in 1971, their shares were: tobacco, 32.5 per cent; lumber and wood products, 20 per cent; primary metals, 14.4 per cent; apparel, 13.2 per cent; food processing, 12.4 per cent; stone, clay and glass, 11.9 per cent; transportation equipment, 11.6 per cent and furniture, 11.5 per cent.

In weighing these figures on black employment in manufacturing, however, one should not conclude that blacks have found an equal chance for advancement in the nation's factories. This is far from the case. To a considerable extent, the industries with large numbers of black employees are those in which numerous jobs are unpleasant and routine or which require much physical strength or long endurance. Moreover, blacks are typically found in the lower paid blue collar occupations requiring only limited skills.

Given this exceptional dependence of blacks on factory jobs, the sluggishness in manufacturing during the last two years was bound to have a serious impact on the black community. In 1970, while total employment rose by 727 thousand (or by 0.9 per cent), factory jobs declined by 768 thousand (or by 3.8 per cent). Last year, total employment registered another modest gain of 491 thousand (0.6 per cent), but the number of factory workers dropped further—by 761 thousand (or by 3.9 per cent). Over this two-year period, total factory employment declined by 1.5 million, a decrease of 7.7 per cent.

The industries in which blacks have significant representation experienced even large setbacks: transportation equipment recorded a two-year decline of 15 per cent; nonelectrical machinery 12 per cent; electrical machinery 11½ per cent, and primary metals 10 per cent.

In contrast, several sectors which provide a smaller proportion of all black jobs continued to expand total jobs during the recent recession. For example, total employment in wholesale and retail trade rose by nearly 4 per cent during the two years 1970 and 1971. The gain in finance, insurance and real estate amounted

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[3] These data are reported annually to the U.S. Equal Employment Opportunity Commission under Title VII of the Civil Rights Act of 1964. The statistics do not cover all employment; they have only limited coverage of small firms, and no reports for governments and educational institutions are included. However, the EEOC reports do cover a substantial proportion of total employment in some industries. About three-quarters of total employment in manufacturing, transportation, communication, and electric and gas utilities are reported, and well over one-half of the total in mining, and in finance, insurance and real estate is covered. On the other hand, the reports cover only about one-third of total employment in wholesale and retail trade, and in services. Just under one-fifth of contract construction employment is covered. Coverage and other characteristics of the EEOC data are discussed further in the notes to Table 2.

to 7 per cent. Employment in services expanded by 6 per cent in the same period. However, in each of these industry groups (except services), blacks generally have a smaller share of the total jobs than they have in the economy as a whole.

On balance, the continued growth of total employment in the trade and service sectors cushioned the impact of the 1970–71 recession in the economy as a whole. But blacks did not share proportionately in these gains because they are generally underrepresented in the highly-paid expanding sectors and over-represented in low-paid service activities or in those manufacturing industries which were stagnant or declining.

BLACKS IN GOVERNMENT JOBS

In the case of public sector employment, blacks have had a mixed experience over the last two years. As mentioned above, blacks constitute an above-average proportion of the persons employed in government service. For example, in May, 1971, there were 389 thousand blacks employed in civilian jobs in the Federal Government. This represented 15 per cent of the 2.6 million civilians on the Federal payroll at that time. In contrast, blacks accounted for 10.6 per cent of all civilian employees in the country in the same month. Moreover, while Federal employment provided 3.3 per cent of the total civilian jobs, about 4.6 per cent of the blacks holding civilian jobs were on the Federal payroll. In the case of State and local governments (many of which have substantial numbers of blacks in their jurisdiction) the percentage of blacks among all public employees may be even higher than it is in the Federal Government.

Given this situation, the downtrend in employment in the Federal Government in the last two years seems to have had a mixed effect on blacks. In the two calendar years 1970 and 1971, total civilian employment in the Federal Government dropped by 93 thousand, a decline of 3.3 per cent. Here, of course, the cutback in employment reflected a conscious effort to pare the level and scope of Government activities—and was not a by-product of the recession. Exactly how these reductions have affected blacks cannot be determined because of a lack of data for 1971 as a whole. Between May, 1970 and May, 1971, total Federal employment declined 15,000, and Negro employment declined 798. This net decline among blacks reflected a drop in black employment in blue collar jobs and in lower grade levels of the Postal Field Service. Blacks made further gains in both the higher grades of the postal service and in civil service white collar jobs.

Yet, we know that blacks are still heavily concentrated in the lower grades of the Federal service where turnover is typically high. Thus, in the light of the decision to reduce Federal Government employment by 5 per cent during the current fiscal year, one might ask whether blacks are likely to be exposed to a much higher rate of attrition than that faced by the average white employee. An informal request to the Civil Service Commission for data to assess this possibility did not yield the necessary statistical information—although the Commission has no indication that the cutback in Government employment is affecting blacks adversely.

Simultaneously, the Federal Reserve Banks were asked to review the situation within the Federal Reserve System. The results of this survey show that, between December, 1970, and December, 1971, total Bank employment increased by 1.7 per cent, while black employment rose by 3.7 per cent. However, the results also indicated that the turnover rate among black employees was nearly 1½ times as high as that for all employees (30 per cent vs. 21 per cent). The turnover rate was particularly high among blacks in the lower grades. For example, among black men in grades 1–5, the turnover rate was 43 per cent, compared with 15 per cent for all men in that category. For black men in grades 6 and over, the turnover rate was 16 per cent, compared with 13 per cent for all men in the same brackets. In the case of black women, a similar pattern prevailed for those in the lower grades (39 per cent for black women vs. 34 per cent for all females). But in the higher grades, black women had a somewhat lower turnover rate than was true of all women employees (11 per cent vs. 13 per cent).

These data for the Federal Reserve Banks are probably indicative of the behavior of black employment in the Federal Government as well. So, when the census of Federal employment is conducted later this year, the results should be studied to see whether the high turnover among blacks has been translated into high attrition rates—and thus into a decline in the percentage of blacks employed in the Federal Government.

In the case of State and local governments, the number of workers on their payrolls expanded by 744 thousand (7.9 per cent) during the two years 1970 and 1971. Most of this growth was at the local level—especially in large urban areas with sizable black populations. Again this background, one would have expected blacks to obtain a significant share of the rise in public service employment at the State and local level.

In conclusion, when these different employment trends are pulled together, a fairly clear—but far from comfortable—picture emerges: the depressed conditions in manufacturing industries (only partially offset by growth in other sectors) have had a seriously adverse effect on black employment in the last two years. The net result has been a halt in the vigorous growth of black employment registered during the last half of the 1960's.

TREND OF UNEMPLOYMENT

In 1971, an average of 919 thousand blacks were unemployed; this represented 9.9 per cent of the black civilian labor force. In the case of whites, unemployment average 4.1 million, equivalent to an unemployment rate of 5.4 per cent. For all groups combined, unemployment in 1971 averaged 5.0 million, or 5.9 per cent of the total civilian labor force. Over the last two years—and reflecting the impact of the recession—the total number of unemployed workers rose by 2.2 million, an increase of nearly four-fifths. Among blacks, unemployment climbed by 348 thousand, a rise of more than three-fifths.

Almost 60 per cent of the two-year rise in total unemployed occurred in 1970—which encompassed most of the downward phase of the recession. But in the case of blacks, the increase in joblessness was about evenly divided between 1970 and 1971. On the other hand, black unemployment as a proportion of all unemployed workers declined from 20.2 per cent in 1969 to 18.4 per cent in both 1970 and 1971. Of course, this decline reflected the fact that the number of unemployed whites rose much faster in 1970 than was the case in the black community. And it is noteworthy that by the end of 1971, the proportion had risen back to 19.0 per cent. Nevertheless, while blacks represented 11 per cent of the labor force, they still accounted for nearly one-fifth of total unemployment in 1971.

Of the total rise in black unemployment over the 1970–71 period, half was accounted for by adult men, a third by adult women, and a sixth by teenagers. Unemployment of adult men and teenagers rose more rapidly in 1971. The cutback in manufacturing jobs accounts for much of the rise in black adult male unemployment in the recession year 1970. In 1971, adult females increased their participation in the labor force slightly (most likely in an effort to improve family income at a time when many men were out of work), but the slack job market resulted in increased female unemployment. Black teenagers, on the other hand, significantly reduced their participation in the labor force after experiencing rising joblessness in 1970 and, thus, their unemployment did not rise as rapidly in 1971.

A brief comparison of the unemployment experience during the recent cyclical period and the recession and recovery years of 1960–61 points up several significant facts. As noted earlier, blacks fared relatively better than whites in the recession phase of the cycle in both periods. The level of black unemployment rose 26 per cent from the peak quarter to the trough quarter in the 1960–61 period compared to a rise of 32 per cent for whites. In the recent period, the level of black unemployment rose 50 per cent from peak to trough compared with a rise of almost 70 per cent for whites.[4]

In both periods, the ratio of black to white unemployment rates declined during the recession phase of the cycle. From the mid-1950's through the 1960's (except for 1965), the black unemployment rate was more than double the white rate. The black-white ratio was still 206 in 1969, but it declined to 182 in 1970.

In the first year of recovery from the trough in 1970, whites fared relatively better than blacks as evidenced by a rise in the ratio of black to white unemployment rates from 164 in November, 1970, to 200 in January of this year. However, of equal note is the fact that in the recent recovery year, unemployment levels

[4] It might be noted that the larger rise in unemployment for blacks and for whites in the recent cycle has been due in large part to the faster growth of the civilian labor force. This has been a result of the entrance of the members of the post-war baby boom into working age groups, the changing working habits of women (particularly white women), and the return of numerous Vietnam veterans to civilian life.

for both blacks and whites continued to rise (by 11.1 per cent for blacks and by 1.7 per cent for whites) whereas in the first year of recovery in the earlier period, unemployment levels declined (by 8.7 per cent for blacks and by 19.6 per cent for whites). The continued low rate of activity in the manufacturing sector of the economy and the only modest growth in other sectors has resulted in a much less dynamic recovery process for employment in the current period.

One further difference between the two cyclical periods which has implications for employment prospects is that teenagers are a much more important factor in the economy today than ten years ago. Between 1961 and 1971, as a result of a sharp increase in the number of youths in the total population, black teenagers (age 16–19) grew from just over 7 per cent to just over 8 per cent of the black civilian labor force. However, because of their lack of training and work experience, teenagers have remained at about 6 per cent of black employment. As a result, teenagers accounted for 27 per cent of black unemployment in 1971 compared with 16 per cent in 1961.

Clearly, the high and persistent level of black unemployment is a serious matter, and I will return to the subject in the closing section of these comments.

INCOME TRENDS IN THE BLACK COMMUNITY

Another way of looking at the economic situation of blacks is to examine their income. Data for 1970 (the most current year available) show that total money income for black families and unrelated individuals was $42 billion. This was 6.5 per cent of total money income which amounted to $649 billion in that year. This share should be weighed against the fact that blacks compose about 11.3 per cent of the total population. The median family income of blacks in 1970 was $6,516, a rise of 5.3 per cent over 1969—but still only 64 per cent of the white median income of $10,236.

In general, black families made great strides over the last decade in increasing their income. Black median family income in 1970 was more than double the level in 1961 which appears to compare favorably with a rise of 71 per cent for white families over the same period. However, in absolute terms, black families received an average of $3,720 less than white families in 1970—whereas they receive $2,790 less in 1961. This difference in 1970 was equal to 57 per cent of black families' median income. Thus, although blacks have been gaining relative to whites over the decade (and this progress does not appear to have been seriously interrupted by the recent recession in 1970), they still lag far behind the average American white family.

A second way of comparing income differences is to look at how income is distributed among the respective black and white populations. The most common way of doing this is to use a statistical measure (referred to by economists as the "Gini" coefficient) showing how equally income is distributed within a population. If a given percentage of the population receives an equal percentage of the total income and this holds true for all groups in the population, then the degree of income inequality would be zero. Calculations of this measure by the Bureau of the Census for black and white families indicate that black income has historically been less equally distributed than white family income even though the differences between the two have narrowed slightly over the last decade. However, in recent periods of declining or slow economic growth, the differences in the income distribution for black and white families have increased. This was true during the brief period of declining economic activity in 1967 and also in 1970.

In general, this pattern of income distribution implies that lower income black families receive an even smaller proportion of total money income than do lower income white families in periods of reduced economic growth. Some of the greater sensitivity of the income of black families to cyclical slowdowns may be explained partially by the fact that a rapidly increasing proportion of black families is headed by females (3¼ times as many as white families in 1970 compared with 2½ times as many in 1960). The fact that the average number of earners in black families has actually been declining in the last few years (in contrast to a rise in the average number of earners of white families) may also contribute to the observed results. Thus, although income of blacks appears to have held up quite well in the recent period, it still lags far behind white income. In addition, averages for blacks as a whole may disguise a deteriorating situation for lower income black families.

FEDERAL INCOME TAXES PAID BY BLACKS

Another perspective on the economic situation of blacks is provided by an analysis of the Federal income taxes paid by them. I have estimated that Negroes and other races paid about $4.68 billion in Federal income taxes in 1969, while their income amounted to $41.22 billion. White families and individuals received $562.33 billion in income and paid Federal income taxes of approximately $81.92 billion. Thus, while blacks and other races constituted about 13 per cent of the population, they received about 6.8 per cent of the adjusted gross income, filed 11.5 per cent of the tax returns, and paid roughly 5.4 per cent of the Federal income taxes in 1969.

This estimate of Federal income taxes paid by blacks was derived on the basis of special tabulations of household sample data collected by the Bureau of the Census for its 1969 report on consumer income.[5] Since Dr. Herman Miller and Mr. Roger Herriot (both of the Census Bureau) had already devised a means of linking Census data to Internal Revenue Service (IRS) statistics relating to Federal income taxes,[6] I applied their method to estimate taxes paid by race. For this purpose, the special tabulations by the Census Bureau were required.

While the method devised by Miller and Herriot (and used by me) has limitations,[7] it seems accurate enough to yield reasonable results. For example, IRS reports show that there were 75.8 million returns filed in 1969.[8] Of this total, 63.7 million returns were taxable, and they represented $603.5 billion in adjusted gross income. From this income, earners paid $86.6 billion in taxes. Thus, the task was to estimate the proportion and amount of these taxes that were paid by black and white earners, separately. The application of the Miller-Herriot method produced the following distribution of returns in 1969.

Adjusted gross income	Percentage distribution of returns[1]	
	Negroes and other races	Whites
Less than $3,000	41	27
$3,000 to $6,000	24	17
$6,000 to $10,000	20	23
$10,000 to $15,000	9	20
Over $15,000	5	14

[1] Totals do not add to 100 because of rounding.

When these percentages are applied to the actual returns reported by the IRS, the estimates of taxes paid by blacks and whites separately are obtained. The fact that Negroes and other races received about 6.8 per cent of the adjusted gross income and paid about 5.4 per cent of the Federal income taxes in 1969 should not be surprising. The reason is that blacks have a lower percentage of persons in the upper income ranges. The special Census calculations show that, for the income measure used for tax purposes, 41 per cent of returns filed by Negroes and other races were in the lowest income category, compared to 27 per cent for whites. In the upper income brackets, 14 per cent of the black returns fell in the $10,000 or more class, while there were 34 per cent of the

[5] U.S. Bureau of the Census, *Current Population* Reports, Series P–60, No. 75, "Income in 1969 of Families and Persons in the United States," 1970.

[6] See their paper, "Who Paid Taxes in 1968" (Mimeo), March 1971.

[7] For example, capital gains are not recorded in the Census data, but they do play an important part in the calculation of Federal income taxes. However, this may be indirectly compensated for by an adjustment in the Census data to account for trusts and underreported income in the sample. Furthermore, we found that our estimates of dollar amounts of taxes and adjusted gross income are higher than the actual figures—since there is some income that is simply not reported to the IRS. Our adjusted gross income was 3 per cent above the actual IRS figures. The amount of taxes paid varied by method of estimation. The Miller-Herriot Method gave a figure 9 per cent above the reported level. A second method of estimation that uses effective tax rates (instead of average tax by return) gives taxes within 4 per cent of the amount actually reported. The estimated percentages of taxes paid by race do not vary with the procedure used.

[8] U.S. Internal Revenue Service, *Statistics of Income 1969,* Individual Tax Returns.

white returns in this range. Thus, when the progressive tax rates are applied to each group, the whites paid proportionately more.[9]

Finally, these estimates represent only one tax. Although the Federal personal income tax is the largest single revenue source, it is also among the most progressive of taxes. State and local sales taxes and property taxes tend to hit the lower income groups proportionately more than the higher income groups. For the year 1969, 36 per cent of all government revenue was from State and local taxation. Moreover, Social Security taxes probably hit black families much harder than white families. This is suggested by several considerations: black incomes are lower, and the participation rates are higher for black families. This means that minority groups have more multiple earners than white families. Combined with the fact that Social Security taxes have an income cut-off point, the families of low-earning multiple earners will have to pay more than single earners.

Consequently, when other taxes are combined with Federal income taxes, the gap between income received and Federal income taxes paid by blacks (6.8 per cent vs. 5.4 per cent) is probably narrowed considerably.

THE ECONOMIC OUTLOOK FOR BLACKS

Given these recent developments affecting the economic situation of blacks, the question naturally arises about their prospects in the future. The general economic outlook as contained in the *Economic Report* of the Council of Economic Advisers and supported by the consensus of private forecasters is for an acceleration of real economic growth in 1972 to somewhere in the neighborhood of 6 per cent, compared to the 2.7 per cent rate of growth achieved in 1971.

In particular, the expected strengthening of activity in the manufacturing sector (in which such a large proportion of black men have found jobs) is of special interest. Thus, the question to which I wish to address myself at this point is this: How will this outlook for the national economy as a whole affect the black community?

It seems fairly certain that a rise in manufacturing activity will increase black employment and income. However, how large the improvement might be cannot be estimated. On the basis of press reports—as well as informal soundings among businessmen—one gets the impression that many manufacturing firms are still moving slowly in expanding their payrolls. Among other factors, a strong desire to control costs by meeting increased output demands through higher productivity rather than higher employment—at least for the present—appears to be moderating the pace at which factory jobs are growing.

I have been particularly interested in trying to gauge the prospects for blacks. In general, from numerous conversations I have had with businessmen, I get the impression that the environment in industry today is much more hospitable toward the hiring and upgrading of blacks than it was even a few years ago. At the same time, I also get the feeling that, although many of the leaders in industry are very conscious of the need to promote equal employment opportunity by increasing their percentage of black employment, in many cases, the rehiring of workers (because of trade union agreements) would have to be done on a seniority basis which would generally not favor blacks or other minority groups that are still relative newcomers in some sectors.

In some industries in which blacks are heavily concentrated, there was a drop in the percentage of minority employment in 1971. This seems to have occurred despite the fact that many of the leading companies in some of these industries are known to have strong programs to increase the percentage of minority workers. This was particularly true in the basic durable goods manufacturing industries where, as mentioned earlier, blacks are heavily represented. A review of the statistics in Table 4 provided by the Bureau of Labor Statistics

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[9] Again, it must be remembered that these are estimates and subject to error. In the case of the percentage of returns in the income ranges, we may error on the low side rather than on the high income side because all persons reporting money income of $1 or more are included in the Census sample. Some of these are taken out when finding adjusted gross income but probably not all.

shows that the percentage of employment accounted for by blacks in the basic durable goods industries declined in both 1970 and 1971. Similar figures (although not included in the table) show that the ratio had risen steadily since 1962 (the first year data were available). In contrast, the percentage of employment accounted for by blacks in the nondurable goods industries continued to increase on average in 1970 but declined in 1971. The better showing in the nondurable industries in 1970 was partially a result of the fact that the nondurable industries showed less of a decline in total employment in 1970 than the durable goods industries. In addition, some nondurable goods industries (notably foods, textiles, and apparel) have been experiencing fairly rapid increases in their proportion of minority employment. However, this pattern conceals the fact that some of those industries (such as textiles and apparel which maintained their black percentages in the recent period) have been declining industries in relation to the economy as a whole. Thus, although the proportion of minority workers employed by them has held up quite well, the actual number of blacks employed in these industries may not expand rapidly.

But on the whole, to the extent that manufacturing industries do participate in the economic growth expected this year, the outcome will have a positive impact on black employment. Continued gains in employment in the service and trade industries as well as by State and local governments will also add to an improvement in black employment. But, again, this expansion might not be large enough to enable the black community to resume the strides in employment and income gains they were beginning to achieve in the second half of the 1960's.

In addition, although employment of blacks can be expected to resume an upward trend in 1972, it can also be expected that the black labor force will grow more rapidly this year than last. Besides the longer-term growth in the labor force based on the rapid growth of the young age groups, the declining participation rate for blacks (particularly evident in the second half of 1971) can be expected to show a return to more normal long-term trends if employment prospects improve. Thus, even with a more rapid growth in employment, over the short-term, rises in the civilian labor force could well result in continued high levels of unemployment and high unemployment rates for blacks.

As mentioned above, the unemployment rate for blacks has traditionally been about twice as high as that for whites. Only in a few years (such as 1965, 1970 and 1971—neither of which was a year of especially vigorous economic growth) has the black-white unemployment ratio been less than 2 to 1. It will be recalled that the general outlook for the economy in 1972 presented by the Council of Economic Advisers does not expect the total unemployment rate to be below 5 per cent by year-end. The unemployment rate for blacks was 10.6 per cent in January—compared with 5.3 per cent for whites—a ratio of 2 to 1. So given the outlook for the economy as a whole in 1972, there appears to be no basis for expecting blacks to improve their relative unemployment position in the course of this year.

In my judgment, the single most important contribution that can be made this year to enable blacks to make further economic progress is at least to assure the sizable expansion, projected by the CEA, in the national economy in 1972 while at the same time pressing on with the campaign to check inflation.

TABLE 1.—EMPLOYED PERSONS BY MAJOR OCCUPATION GROUP AND COLOR

[Numbers in thousands]

Occupation	Total employment: 1960					Total employment: 1970					Total employment: 1971				
	Total		Negro and other races			Total		Negro and other races			Total		Negro and other races		
	Number	Percentage distribution	Number	Percentage distribution	Percent of total number	Number	Percentage distribution	Number	Percentage distribution	Percent of total number	Number	Percentage distribution	Number	Percentage distribution	Percent of total number
Total employed	65,778	100.0	6,927	100.0	10.5	68,627	100.0	8,445	100.0	10.7	79,120	100.0	8,403	100.0	10.6
White collar workers	28,522	43.3	1,113	16.1	3.9	37,997	48.3	2,356	27.9	6.2	38,252	48.3	2,444	29.1	6.4
Professional and technical	7,469	11.4	331	4.7	4.4	11,140	14.2	766	9.1	6.9	11,070	14.0	756	9.0	6.8
Managers, officials, and prop.	7,067	10.7	178	2.6	2.5	8,289	10.5	297	3.5	3.6	8,675	11.0	342	4.1	3.9
Clerical workers	9,762	14.8	503	7.3	5.2	13,714	17.4	1,113	13.2	8.1	13,440	17.0	11,154	13.7	8.6
Sales workers	4,224	6.4	101	1.5	2.4	4,854	6.2	180	2.1	3.7	5,066	6.4	191	2.3	3.8
Blue collar workers	24,057	36.6	2,780	40.1	11.6	27,791	35.3	3,561	42.2	12.8	27,184	34.4	3,353	39.9	12.3
Craftsmen and foremen	8,554	13.0	415	6.0	4.8	10,158	12.9	692	8.2	6.8	10,178	12.9	663	7.9	6.5
Operatives	11,950	18.2	1,414	20.4	11.8	13,909	17.7	2,004	23.7	14.4	12,983	16.4	1,821	12.7	14.0
Nonfarm laborers	3,553	5.4	951	13.7	26.8	3,724	4.7	866	10.3	23.2	4,022	5.1	868	10.3	21.6
Service workers	8,023	12.2	2,196	31.7	27.4	9,712	12.4	2,199	26.0	22.6	10,676	13.5	2,321	27.6	21.7
Private household	1,973	3.0	982	14.2	49.8	1,558	2.0	652	7.7	41.8	1,486	1.9	615	7.3	41.4
Other service workers	6,050	9.2	1,214	17.5	20.1	8,154	10.4	1,546	18.3	19.0	9,189	11.6	1,706	20.3	18.6
Farmworkers	5,176	7.9	841	12.1	16.2	3,126	4.0	328	3.9	10.5	3,008	3.8	285	3.4	9.5
Farmers and farm managers	2,776	4.2	219	3.2	7.9	1,753	2.2	87	1.0	5.0	1,666	2.1	63	0.7	3.8
Farm laborers and foremen	2,400	3.7	622	8.9	25.9	1,373	1.8	241	2.9	47.6	1,342	1.7	222	2.6	16.5

Source: Data for 1960 and 1970, U.S. Department of Labor, Manpower Report of the President, April 1971, tables A-9 and A-10, pp. 215-217. Data for 1971, Bureau of Labor Statistics, U.S. Department of Labor.

TABLE 2.—1970 LEVELS AND PERCENTAGE DISTRIBUTION OF MANUFACTURING EMPLOYMENT, BY RACE [1]

	Total [2]	Negro [2]	Negro as a percent of total	Percentage distribution of manufacturing employment	
				Total	Negro
Total employment	28,882	2,965	10.3		
Total manufacturing	14,533	1,445	9.9	100.0	100.0
Durable goods	9,043	872	9.6	62.2	60.3
Ordnance and accessories	183	16	8.7	1.2	1.1
Lumber and wood products	321	44	13.7	2.2	3.0
Furniture and fixtures	270	36	13.3	1.9	2.5
Stone, clay, and glass products	460	46	10.0	3.2	3.2
Primary metal industries	1,139	151	13.2	7.8	10.4
Fabricated metal products	913	92	10.1	6.3	6.4
Nonelectrical machinery	1,560	101	6.5	10.7	7.0
Electrical machinery	1,822	148	8.1	12.5	10.2
Transportation equipment	1,767	194	11.0	12.2	13.4
Instruments and related products	373	21	5.6	2.6	1.4
Miscellaneous manufacturing	235	23	9.9	1.6	1.6
Nondurable goods	5,490	573	10.4	37.8	39.7
Food and indred products	1,086	142	13.1	7.5	9.8
Tobacco manufactures	69	16	23.2	.5	1.1
Textile mill products	817	112	13.7	5.6	7.8
Apparl and other textile products	678	73	10.8	4.7	5.0
Paper and allied products	566	54	9.5	3.9	3.7
Printing and publishing	579	37	6.4	4.0	2.6
Chemicals and allied products	933	80	8.6	6.4	5.5
Petroleum and coal products	180	12	6.7	1.2	.8
Rubber and plastic products	374	35	9.4	2.6	2.4
Leather and leather products	208	12	5.8	1.4	.8

[1] Source: U.S. Equal Employment Opportunity Commission Report EEO-1. These data are collected annually under title VII of the Civil Rights Act of 1964. In most cases, reports are received from companies with 100 or more permanent employees. Consequently, the coverage varies substantially from industry to industry, depending on the prevalence of small firms.

[2] Thousands of persons.

TABLE 3.—PERCENTAGE DISTRIBUTION OF EMPLOYED PERSONS BY INDUSTRY[1]

	1968		1969		1970		1971	
	Total	Negro and other	Total	Negro and other	Total	Negro and other	Total	Negro and other
Total number	[2] 75,920	8,169	77,902	8,384	78,627	8,445	79,120	8,403
Total percent	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Agriculture	5.0	5.4	4.6	4.6	4.4	4.4	4.3	3.9
Mining	.7	.2	.7	.2	.6	.2	.7	.2
Construction	6.1	5.5	6.2	5.5	6.1	5.2	6.3	5.5
Manufacturing	27.5	24.7	27.3	25.6	26.4	25.0	24.7	23.0
Durable goods	16.3	14.4	16.3	15.2	15.6	14.2	14.5	12.9
Lumber and wood products	.9	1.8	.8	1.6	.8	1.6	.8	1.5
Furniture and fixtures	.6	.6	.6	.6	.6	.6	.6	.7
Stone, clay, and glass products	.8	.9	.9	.9	.8	.8	.8	.9
Primary metal industries	1.7	2.2	1.6	2.4	1.6	2.2	1.5	2.1
Fabricated metal products	2.2	1.8	2.2	1.8	2.1	1.6	1.7	1.2
Machinery, except electrical	2.9	1.2	2.9	1.5	2.9	1.4	2.5	1.1
Electrical machinery	2.6	1.8	2.6	2.0	2.6	1.9	2.4	1.5
Transportation equipment	3.2	3.3	3.2	3.5	2.9	3.3	2.6	2.9
Instruments and related products	.7	.3	.6	.3	.6	.3	.5	.3
Miscellaneous manufacturing	.6	.6	.6	.6	.6	.5	.9	.7
Nondurable goods	11.2	10.3	11.0	10.5	10.8	10.7	10.3	10.1
Food and kindred products	2.4	2.7	2.3	2.7	2.2	2.7	2.1	2.5
Tobacco manufactures	.1	.3	.1	.3	.1	.3	.1	.3
Textile mill products	1.4	1.2	1.3	1.5	1.2	1.6	1.2	1.4
Apparel and other textile products	1.7	2.1	1.7	2.0	1.7	2.0	1.7	2.1
Paper and allied products	1.0	.7	.9	.7	.9	.7	.8	.7
Printing and publishing	1.5	.9	1.5	.8	1.5	.8	1.5	.8
Chemicals and allied products	1.6	1.2	1.5	1.3	1.5	1.3	1.4	1.2
Petroleum and coal products	.3	.2	.3	.2	.4	.2	.3	.3
Rubber and plastic products	.7	.6	.8	.6	.7	.7	.7	.6
Leather and leather products	.5	.4	.4	.4	.4	.4	.4	.3
Transportation and public utilities	6.7	5.6	6.7	5.9	6.8	6.4	6.7	6.6
Trade	18.6	13.5	18.6	13.1	19.1	13.3	20.1	14.2
Wholesale	3.4	2.4	3.4	2.4	3.4	2.3	3.8	2.4
Retail	15.3	11.0	15.2	10.8	15.7	11.0	16.3	11.8
Finance, insurance, and real estate	4.8	2.6	4.8	2.8	5.0	3.2	5.2	3.6
Services	19.0	29.6	19.4	28.7	19.6	28.2	20.1	29.1
Government	11.4	12.8	11.5	13.4	11.8	14.1	11.8	13.9
Federal	3.0	4.3	3.0	4.4	2.9	4.6	2.8	4.6
State and local	8.4	8.5	8.5	9.0	8.9	9.4	9.0	9.3

[1] Derived from unpublished household data from the current population survey provided by the Bureau of Labor Statistics, totals may not add due to rounding.
[2] Thousands of persons.

TABLE 4.—PRIVATE NONAGRICULTURAL EMPLOYMENT

	Private nonagricultural employment [1]				Percent change			Negro and others as a percentage of total employment in each industry [2]			
	December 1968	December 1969	December 1970	December 1971 [3]	1968-69	1969-70	1970-71	1968	1969	1970	1971
Total	69,039	70,912	70,313	72,030	+2.7	−0.8	+2.4	10.7	10.8	10.7	10.7
Mining	616	626	623	604	+1.6	−.5	−3.0	3.0	3.8	3.7	3.3
Contract construction	3,386	3,474	3,302	3,160	+2.6	−5.0	−4.3	9.8	9.6	9.1	9.3
Manufacturing	20,010	20,068	18,796	18,602	+.3	−6.3	−1.0	9.7	10.1	10.2	9.9
Durable goods	11,769	11,777	10,738	10,579	+.1	−8.8	−1.5	9.6	10.1	9.8	9.4
Ordnance and accessories	342	283	212	186	−17.3	−25.1	−12.3	(4)	(4)	(4)	(4)
Lumber and wood products	613	599	560	593	−2.3	−6.5	+5.9	21.9	21.5	22.0	20.0
Furniture and fixtures	479	478	450	478	−.2	−5.9	+6.2	10.7	11.4	11.3	11.5
Stone, clay, and glass products	654	657	627	627	+.4	−4.6	0	11.3	10.9	10.6	11.9
Primary metal industries	1,321	1,383	1,260	1,172	+4.7	−8.9	−7.0	14.1	15.3	14.4	14.4
Fabricated metal products	1,419	1,440	1,333	1,346	+1.5	−7.4	+1.0	8.5	8.6	8.4	7.7
Machinery, except electrical	1,987	2,062	1,854	1,788	+3.8	−10.1	−3.6	4.4	5.4	5.1	4.7
Electrical equipment	1,982	1,952	1,816	1,804	−1.5	−7.0	−.7	7.7	8.1	8.0	6.8
Transportation equipment	2,058	1,998	1,773	1,742	−2.9	−11.3	−1.8	11.0	11.8	12.1	11.6
Instruments and related products	471	476	438	435	+1.1	−8.0	−.7	5.0	4.5	4.6	5.2
Miscellaneous manufacturing	443	449	415	410	+1.4	−7.6	−1.2	9.1	7.9	7.7	8.0
Nondurable goods	8,241	8,291	8,058	8,023	+.6	−2.8	−.4	9.9	10.2	10.7	10.5
Food and kindred products	1,790	1,792	1,763	1,740	+.1	−1.6	−1.3	12.2	12.7	13.0	12.4
Tobacco manufacturers	83	81	79	74	−2.4	−2.4	−6.6	26.3	28.8	27.5	32.5
Textile mill products	1,006	1,002	961	977	−.4	−4.1	+1.7	9.5	11.7	13.8	12.9
Apparel and other textile products	1,410	1,400	1,360	1,354	−.7	−2.8	−.4	12.8	12.2	13.0	13.2
Paper and allied products	702	717	695	694	+2.1	−.5	−.2	7.9	8.2	8.3	8.2
Printing and publishing	1,079	1,110	1,099	1,090	+2.9	−1.0	−.8	6.6	6.1	5.6	5.4
Chemicals and allied products	1,049	1,064	1,033	1,001	+1.4	−2.9	−3.1	8.2	8.9	9.1	8.7
Petroleum and coal products	188	190	191	188	+1.1	+.5	−1.6	7.4	7.8	6.4	8.5
Rubber and plastic products	581	601	566	599	+3.4	−5.8	+5.8	8.7	7.9	10.7	9.4
Leather and leather products	353	334	311	307	−5.4	−6.9	−1.3	8.5	9.0	9.2	9.5
Transportation and public utilities	4,355	4,474	4,450	4,468	+2.7	−.5	+.4	9.1	9.4	10.2	10.5
Wholesale and retail trade	14,255	14,844	14,952	16,100	+4.1	+.7	+7.7	7.8	7.6	7.5	7.5
Wholesale trade	3,664	3,792	3,832	3,911	+3.5	+1.0	+2.1	7.7	7.5	7.3	6.8
Retail trade	10,591	11,052	11,120	12,189	+4.4	+.6	+9.6	7.8	7.6	7.5	7.7
Finance, insurance, and real estate	3,463	3,637	3,731	3,832	+5.0	+2.6	+2.7	5.8	6.3	6.8	7 3
Services	10,925	11,456	11,776	12,023	+4.9	+2.8	±2.1	16.7	15.9	15.4	15.4

[1] Source: Bureau of Labor Statistics establishment data for employees on private nonagricultural payrolls, seasonally adjusted, thousands of persons.

[2] Source: Derived from unpublished Bureau of Labor Statistics household data from the current population survey. Because of differences in the method of data collection and the definitions of categories, these data are not strictly comparable with the Bureau of Labor Statistics establishment data. In particular, categories include some public employment although adjustments have been made where possible.

[3] Preliminary.

[4] Not available.

Chairman PROXMIRE. Thank you for a brilliant analysis. We have already introduced you, Mrs. Kreps. We are delighted to have you appear.

STATEMENT OF JUANITA KREPS, PROFESSOR OF ECONOMICS AND DEAN, THE WOMAN'S COLLEGE, DUKE UNIVERSITY

Mrs. KREPS. Thank you. As you know, professors are generally programed for an hour; however, I will respect your 15-minute request.

I shall deal here to some extent with the particular plight of black women, whose employment levels and earnings rank below those of any other sex or racial group.

I call to your attention, in particular, Mr. Brimmer's comments on the large proportion of black families which are headed by women; in fact among the blacks, more than three times as many families are headed by women as in the case among white families.

This audience is well aware of the rising labor force activity of women during the 20th century. The proportion of all women in the work force rose from 20 percent of the females aged 14 and over in 1900 to 43.3 percent of those aged 16 and over in 1970; as a proportion of all workers, women constituted 18.1 percent in 1900 and 38.1 percent in 1970.

Despite the dramatic increases in numbers of women in market jobs, however, there is little drama in most of the jobs they do. They continue to staff the clerical jobs, the elementary classrooms, the sales jobs; they are almost never the vice presidents or high school principals or hospital administrators. Their pay is lower than that of men. The market is clearly divided into men's jobs and women's jobs. There are significant wage differentials even when both are employed on the same job.

In contrast to other minority or disadvantaged groups who suffer an educational handicap, women are overeducated for most of the jobs they do.[1]

The lower market job status is compounded by a higher level of unemployment: in 1971, a 5.7 percent rate for women aged 20 and over, as compared with 4.4 percent for men of the same age group.

The persistence of heavier unemployment among women is due in part to their larger representation in the lower occupational groups, which suffer greater unemployment for both sexes, and, in part, to the traditional view that women, being only marginally attached to the work force and having other sources of support, may be let off from jobs with the least hardship to families and a minimum disruption of the permanent, full-time labor supply.

Yet, it is quite clear that women are increasingly forming permanent attachment to market work; that they are much more frequently heads of families than heretofore; and that their low occupational status and earnings mean that female-headed families have come to comprise a disproportionate share of all low-income families. Specifically,

—Dropping out of the labor force occurs less and less frequently, even on the part of women in the childbearing and early childrearing state. (See figure 1 attached to my statement.)

[1] Some of the discussion which follows is taken from Juanita Kreps, *Sex in the Marketplace: American Women at Work* (Baltimore: the Johns Hopkins Press, 1971).

—The number of female-headed families increased by 24 percent during the past decade; the increase for all families was 14 percent.

—Families headed by women made up 37 percent of all low-income families in 1970, as compared with 23 percent in 1959. Moreover, 45 percent of all poor children under 18 years of age were in families with female heads in 1970.

I. SEX DIFFERENCES IN EARNINGS

A recent review of sex differences in pay found that on the average, hourly earnings for females were about 60 percent of those for males. The proportion increased to about two-thirds when differences in key variables—notably occupation and marital status—were taken into account.[2]

Since women's lower earnings are attributed in part to their intermittent labor force pattern, comparisons of male-female earnings need to correct as nearly as possible for work experience, thereby allowing for the fact that married women, particularly, tend to observe a work-life style different from that of men.

One analysis of earnings of women who have worked at least 6 months out of every year since leaving school—women who have thus had a major attachment to the labor force throughout worklife—revealed a strong association of earnings and work experience. Much higher earnings appear for such women who stay at work; when compared with earnings of men in the same occupation, the proportion averaged about 73 percent.

The author concludes that when occupation, length of work service, and age are taken into account, about three-fourths of the difference between earnings of men and women can be explained, leaving a residual of about 25 percent attributable to all other factors.[3]

The unexplained 25 percent is increasingly apparent to women, who are prepared to argue that their earnings should not continue to reflect both their needs to meet family obligations and a prejudice in the job market. That such prejudice exists has been argued[4] cogently:

> The coefficients for "career" women are in fact closer to those for men, but they are far from equal. The inability of women to convert occupation status into income to the same extent as men suggests that much of the remaining unexplained difference in male-female earnings could be attributable to discrimination in payment for jobs of equal status level as men.[5]

II. HIS AND HER JOBS

But women's protests are only partly directed at employers who pay women and men different rates for the same job; women now point to the fact that many of the better jobs remain virtually closed to them.

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[2] Victor Fuchs, "Differences in Hourly Earnings Between Men and Women," *Monthly Labor Review* XCIV (May 1971), pp. 9–15.

[3] Larry E. Suter and Herman P. Miller, "Components of Income Differences Between Men and Career Women," a paper presented at the annual meeting of the American Sociological Society, Sept. 1, 1971, p. 6.

[4] From her studies of the economics of discrimination, Prof. Barbara Bergmann concludes that—

> * * * Most acts of discrimination by employers take the form of segregation by race and sex. Employers tend to view certain occupations as "fitting" for black males, others as "fitting" for black females and still others as appropriate to white females and white males * * *. There has been remarkable stability in the racial and sexual classification of most jobs through time and across the country: craftsmen's jobs and the upper echelons of managerial ranks are reserved for white males; certain clerical jobs have been the preserve of white women; black men and women are thought to be "in their proper place" when doing jobs involving cleaning.

Statement of the Federal Communications Commission in the *Bell Telephone* case, December 1971.

[5] Suter and Miller, *op. cit.*, pp. 10–11.

As a result, they are relegated to low-level work which, even if rewarded equally with male laborers in those occupations, would leave them with low earnings. In the absence of a wider range of job opportunities, women's compensation will continue to lag far behind that of men.

The balkanization of labor markets into male and female jobs has been credited with a large part of the growth in women's labor force participation during the past two decades.[6]

With the rising demand for clerical, sales, and service workers, women have been pulled into the marketplace at the same time they were being pushed by improved household technology, smaller family size, and urbanization.

The segregation of male and female labor markets have been given implicit sanction in our thinking: The job classification "secretary," for example, denotes not just job skills, but female gender; nursing is so sex-typed that one must make explicit the exception by specifying "male nurse." Neither of these jobs, though professional, is well paid.

Certain supply conditions have fostered the continuation of such segregated markets: The availability of low-priced female labor, both skilled and unskilled; women's reliance on the utilization of skills acquired in the course of performing their traditional roles; lack of prejob training for women; their geographical immobility; most of all, perhaps, the attitudes of both sexes as to what constitutes appropriate male and female jobs.

These supply conditions, however, have had an impact on demand; for if employers adapt themselves to such a labor supply so that the job in question acquires a "female only" label, then the demand is not just for cheap labor, but for cheap female labor.[7]

III. IMPROVING WOMEN'S JOB OPTIONS

Earnings and occupational opportunities of women are clearly limited by the demands of home and family. Moreover, the period of heaviest domestic responsibility occurs fairly early in a women's worklife, when she is likely to be forced to make some quite long-range decisions: Whether to acquire further job training, or additional formal education; how many children to have; whether to continue working, at least part time, during the childbearing period.

In the face of the demands on her time, the young wife is likely to find that the scheduling of her job is the most important single consideration. Her immediate job choice is dictated in large measure by the time constraint imposed in the short run, and this choice in turn directs her subsequent career development.

Laments for wasted womanpower have now reached the popular press. Privately, women have mourned their underutilized and underpaid talents and education for decades.

Although the implied understatement of the present worth of women's work in the nonmarket sphere calls for reexamination, a recognition of the constraints on women's career choices is a first step in unravelling the complex problem of the low wages accorded to women's jobs, and the tendency for women to remain in those jobs.

[6] Valerie K. Oppenheimer, *The Female Labor Force in the United States* (Berkeley: Population Monograph Series, No. 5, University of California 1970), chapters 3 and 5. For an earlier analysis of balkanization, see Clark Kerr, "The Balkanization of the Labor Market," in E. Wight Bakke et al., *Labor Mobility and Economic Opportunity* (New York: John Wiley and Sons, Inc., 1954).

[7] Oppenheimer, *op. cit.*, p. 120.

Why do women not opt more often for occupations that are dominated by males, yet, include some women in their ranks? Is it inevitable that in insurance companies men sell insurance and women do the typing?

That in banks men make mortgage loans while women are tellers?

Where does the resistance to women entering men's jobs actually lie?

And when women are admitted, how is a wage differential justified?

Employers may reason that men merit higher salaries (and additional investments in training) or preference in hiring regardless of pay because males will not withdraw for marriage and childbearing; that men can give more time and effort to the job because they have no domestic responsibilities; that they are more useful because of their greater mobility; that they need more money to support their families.

The threat of discontinuity in a woman's worklife is perhaps the greatest single barrier to higher wages for young women. For the older woman, whose children have demanded her attention in earlier years, the lack of job experience is equally damaging to her earnings potential.

The woman who is considering the occupational options may be discouraged from trying to enter a male's field because she accurately perceives employers' reluctance to hire women for these jobs, or because the investment required of her may exceed her estimate of the return, given her expectation of withdrawal from work for a time, and the uncertainty surrounding her subsequent worklife.

She may discount too heavily the future stream of earnings accruing from say, 2 years of education or training, and thus invest too little in human capital. But perhaps not. For the stream of earnings is usually not very high for a woman, and she is well aware of this hazard.

Study might reveal that women have been quite realistic in appraising their potential earnings under different assumptions as to the level of investment in education, or in many cases that they have erred in the direction of overinvesting in education, given the career opportunities that are compatible with their lifestyles.

It is significant that many women are now challenging the traditional lifestyles by posing some fundamental questions: Why should women assume the obligation for child care?

It is now possible (through day care centers and sharing domestic responsibilities with husbands) for women to have uninterrupted worklives.

Such challenges are the first concerted attempts to remove these major constraints imposed on the market activities of women. To the extent that the efforts bear fruit, and women opt for worklife patterns more nearly like those of men (and those of women in certain other countries, notably Sweden), the career aspirations of women will surely rise. The impact will likely be felt not only on the participation rate of women, but also on the types of jobs women seek. Additional investments of resources in education and job training for women, under these circumstances, would seem to bear high rates of return.

IV. SUMMARY: THE SPECIAL NEEDS OF WORKINGWOMEN

In a summary of the many problems facing women workers, at least three circumstances are of special significance: One, they lack proportionate representation among the better paying jobs, whereas they dominate most of the occupations that offer low wages; two, governmental job training activities have been aimed largely at male workers and private industry has been reluctant to invest time and money in the training of women, arguing that female employees were likely to leave their jobs before such investments were recouped; and three, the childbearing responsibilities of married women in a particular age range limit them to work that can be performed at certain hours of the day, or in given locations, whether or not these jobs maximize their contribution and earnings.

Evidence of women's lower job status has been presented repeatedly. From various studies the following facts stand out:

—Women have lost ground in the professional and technical areas in recent decades; in 1940, they held 45 percent of the jobs so classified, but in 1969 they had only 37 percent.

—Within the professional area, women's proportion of specific jobs which they have traditionally held has also declined; they represented 28 percent of the faculty in institutions of higher education in 1940, but only 22 percent in 1969.

—In the same period, women's share of service workers increased by almost one-half: From 40 to 50 percent of the service jobs, except private household workers.[8]

—Women make up the bulk of the household workers: 97 percent in 1970, or a total of about 1.5 million women. Their median wage for year-round, full-time employment was $1,851 in 1969; three-fifths of women of households who worked primarily in domestic service had incomes below the poverty level.[9]

—Women's underutilization in relation to their education is shown by the facts: 48 percent of women workers with 1–3 years of college and 14 percent of those with 4 years of college are clerical workers; over two-thirds of the 1–3 years of college females and one-fifth of the female college graduates were in clerical, sales, operative, and service jobs, including private household.[10]

—It is not surprising, then, that the earnings gap between men and women has widened in recent years.[11]

The impact of low female earnings is particularly severe in female-headed families, which in 1970 contained 4.8 million children under 18 years of age living in poverty—of a total of 10.5 million poverty-level children.

Among Negro families headed by women, 68 percent of the children were poor. The extent of poverty within families headed by women was significantly greater than that in males' families. For male-headed families in poverty the median income deficits were $955 for

[8] "Underutilization of Women Workers," U.S. Department of Labor, Women's Bureau, 1971.

[9] "Women Private Household Workers Fact Sheet," U.S. Department of Labor, Women's Bureau, 1971.

[10] "Underutilization of Women Workers," *op. cit.*, 1971.

[11] "Fact Sheet on the Earnings Gap," U.S. Department of Labor, Women's Bureau. February 1971.

white and $1,109 for Negroes; the comparable deficits for families headed by women were $1,219 and $1,492.[12]

Women and their children whose incomes are at these levels obviously qualify for AFDC payments; in many instances these transfers constitute their sole source of income. Questions immediately arise: What is the earnings potential of these women? To what extent is their failure to hold jobs due to lack of education or job skill? Would job training enable them to go into jobs? Or are these child-care obligations or other deterrents that prevent them from working?

Studies of the employability of AFDC mothers have reported numerous barriers, including poor health, lack of day care for children, lack of confidence and motivation to work, shortage of jobs.

Although the employment potential of these women, as measured by educational level and previous job experience, improved during the 1960's, the barriers to their employment also increased.[13]

Reviewing the effects of job training provided under the Manpower Development and Training Act on AFDC women, the authors found that women who were able to enroll and complete their programs were those who had friends, relatives, or community provisions for child care.

For such women, the employment gains from training were striking, particularly for high school graduates. But both white and Negro women who lacked high school education saw a sharp increase in employment and earnings: "* * * When the post-training hourly earnings are adjusted for annual increases in wages, all groups were earning substantially above the minimum wage and persons with a high school education significantly so."[14]

The employability of any group of women is dependent on their training, job experience, and educational level, just as is true for men. But women workers with young children must meet the further need for child care, and the numbers of such women are rapidly increasing. The mothers of 26 million children under 18 years of age were in the work force in 1970; almost 6 million of these children were under 6 years. One-third of all mothers with at least one child under 6 were in the labor force, as were about half the mothers of older children.[15]

It is difficult to estimate with any precision the extent of the need for group child care centers, since such facilities have been meager up to now.

In contrast to the 6 million young children of working mothers, a tentative estimate indicates that licensed Government day care centers and family day care homes could care for about 750,000 children in 1970.[16]

Since most children of working mothers are cared for in their own home, the number of children's spaces actually needed in day care centers is unknown. Nor is it clear whether the availability of such facilities would increase the labor force participation of mothers.

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[12] "Fact Sheet on the American Family in Poverty," compiled from Census data by the Women's Bureau, U.S. Department of Labor, 1971.

[13] Perry Levinson, "How Employable Are AFDC Women?" *Welfare in Review,* 8 (July–Aug., 1970), pp. 12–16.

[14] Edward Prescott, William Tash, and William Usdane, "Training and Employability: The Effects of MDTA on AFDC Recipients," *Welfare in Review,* 9 (Jan.–Feb., 1971), pp. 1–6.

[15] Elizabeth Waldman and Kathryn R. Gover, "Children of Women in the Labor Force," *Monthly Labor Review,* 94 (July 1971), pp. 19–25.

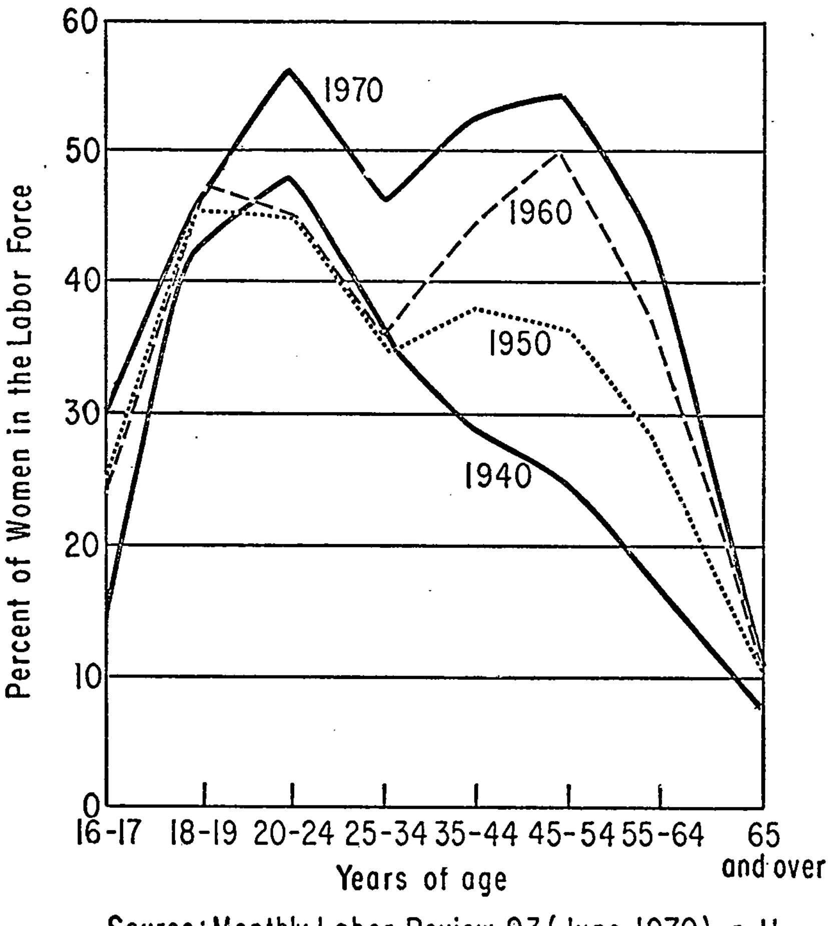
[16] *Ibid.,* p. 25.

At a minimum, however, publicly financed care centers for the children of women heads of families on poverty incomes would surely improve the employability of these mothers and make it possible for them to raise their living standards. Until day care centers are available to these mothers, and until education and job training are also provided, there is little hope of improving the lot of these families.

Thank you.

(The figure referred to in Mrs. Kreps' statement follows:)

Figure I. LABOR FORCE PARTICIPATION RATES OF WOMEN BY AGE, 1940–70



Source: Monthly Labor Review 93 (June, 1970), p. 11.

Chairman PROXMIRE. Thank you very much, Mrs. Kreps.

Our next witness is Mr. Ximenes.

STATEMENT OF VICENTE T. XIMENES, VICE PRESIDENT FOR FIELD OPERATIONS, THE NATIONAL URBAN COALITION

Mr. XIMENES. Thank you, Mr. Chairman.

I want to take the time to just briefly explain where we live. Data on the Spanish-speaking people are rather scarce, and I have to dig in rather deeply to find information relevant to the Spanish people of the Nation.

There are about 10 million persons of Spanish surname in this Nation.

Chairman PROXMIRE. Is this chart on the easel yours?

Mr. XIMENES. Yes, sir. The Spanish-speaking people are located throughout the United States, the Southwestern States as well as the Midwest. In the eastern seaboard we find the Cubans and Puerto Ricans in New York and the Eastern States.

After carefully reviewing the administration's economic report and the budget, I can only conclude that they do not contain the ingredients necessary to correct the significant unemployment rates of the Spanish speaking of our Nation.

Even if the 6-percent national unemployment rate declines to 5 percent in accordance with the President's economic policy, the economic status of a preponderant number of Spanish-speaking people will not significantly improve.

The President's economic plan sets out to cut the unemployment rate as standardly defined by government. That is, a person is unemployed if he is actively seeking work and is registered with the Employment Service or with an employment agency.

This definition of unemployed is one that excludes a vast number of Spanish speaking. I will tell you shortly why and how it does this. The administration proposed corrective aggregate measures to cause the unemployment rate to decline. These corrective measures may very well be successful for the groups of people actively engaged in the pursuit of employment. For the Mexican Americans, Puerto Ricans, blacks, and others in the barrios and ghettos of the Nation, the corrective measures will have little or no effect. I would like to explain why.

THE EMPLOYMENT SERVICE AND THE DISADVANTAGED

The lawyers' committee for civil rights under law and the National Urban Coalition late last year completed a study entitled, "Falling Down on the Job: The U.S. Employment Service and the Disadvantaged." The report states that the employment service offices have been unable to recruit the disadvantaged unemployed. As the report illustrates with Labor Department figures, the Employment Service has been unable to find jobs for individuals who do come to it for help.

According to the study, the inefficiency and incompetence of Employment Service staffs have deterred employers from listing job openings with them. In addition, the report notes, the experience of dealing with this insensitive bureaucracy in many States has generated mistrust, hostility, and discouragement among the disadvantaged, and resulted in more individuals dropping out of the labor force, thereby contributing to the very problem the manpower programs were designed to solve. (See appendix No. 1 attached to my statement.)

Add to this the fact that many Employment Service offices were found to be blatantly discriminatory in their dealing with blacks, Chicanos, and other minorities. During my term as Commissioner of the Equal Employment Opportunity Commission, I found that the Employment Service hired very few Spanish speaking. During the EEOC Houston hearings, I found the Employment Service in Houston did not have a single Mexican American in any supervisory position and had hired only a few in the last 6 years.

So the unemployment problem is aggravated by Employment Service not hiring Spanish-speaking persons who can provide service to non-English speaking disadvantaged persons. The Mexican American simply does not actively seek out the services of the Employment Service. (See appendix No. 2 attached to my statement.)

POVERTY AMONG THE SPANISH SPEAKING

I estimate that about one-third of the Spanish-speaking persons in the United States have incomes below the poverty level. According to the 1970 census and the employment profiles the poverty cutoffs ranged from $1,556 for a female unrelated individual 65 years old and over living on a farm to $6,904 for a nonfarm family with a male head and with seven or more persons (none under 18 years old). The poverty cutoff for a nonfarm family of four, headed by a male with a wife and two children under 18 years, was $3,990.

Substantial numbers of heads of families worked from 27 to 52 weeks full time and had an income below the poverty level. Where the census survey covered large numbers of Spanish speaking within an area we could determine the extent of poverty among the Spanish speaking.

In San Antonio the census survey covered an area which is 73 percent Mexican-American. Of the 53,572 persons in the census area below the poverty level, 41,800 of 78 percent were Mexican-Americans. Of the male heads of households that worked 27 to 49 weeks full time, 45 percent remained below the poverty level in the San Antonio surveyed area. (See table No. 1 attached to my statement.) In Los Angeles, 62 percent of the surveyed population was Mexican-American. Of the 22,900 persons with incomes below the poverty level, 62 percent were Mexican-American.

In Texas, the Department of Labor classified 21 counties with high unemployment. Eighteen of those counties are in the Greater South Texas Culural Basin, according to a report by Governor Smith. (The Greater South Texas Cultural Basin is another way of saying Chicano or Mexican-American populated counties.) The incidence of poverty in the Mexican-American populated Texas counties is 35 percent.

The information contained in the census employment profiles of selected low-income areas show that the Mexican-American and the Spanish-speaking persons in the Nation are generally in about the same economic conditions as the black, except that there are at the moment no mechanisms or plans in government or in private industry to move the people into the economic mainstream. The President's budget and projections offer little hope for the 10 million Spanish-speaking of the Nation.

COMPETITION WITH FOREIGN LABOR

Fred H. Schmidt, of the institute of 'ndustrial relations, UCLA, wrote in an EEOC publication that—

> The economic problems of Spanish speaking are exacerbated by the policies of the U.S. Government with respect to immigration and contacting and commuting of workers from Mexico. No other region contends with these problems on a similar scale. No other group in the population is placed in the same continuing competition with the poverty of another Nation.

We well understand Mexico's willingness to export some of its unemployment in exchange for trade. What we do not understand is why the costs of this arrangement are saddled on a group of people that cannot afford it. The U.S. Mexican-American citizen has been burdened for years with these foreign aid costs in the form of loss of jobs, low pay, migrancy, and discrimination.

Manufactured goods or agriculture products that have difficulty competing in world markets are granted selective tariffs, subsidies, or some type of preferential treatment by our Government. The Mexican-American people have had to compete with the poverty and unemployment of another Nation for more than 50 years and there is no relief in sight. We can understand liberal trade policies, but we suggest a more equitable formula for distributing the costs resulting from this policy.

THE EMPLOYMENT PROFILES

The Bureau of Census has just issued employment profiles on selected low income areas in 60 cities in the Nation. I think this is some of the finest information we have received so far. The interviews from which the information was obtained were carried out during the latter part of 1970 and beginning of 1971. For the first time in history, meaningful employment data is available for the Spanish-speaking people.

I refer to meaningful employment data because I heard Professor Krepps say that the unemployment among black females was the highest in the Nation. For the black female it is 12.3 percent unemployment in these various areas, and for the Spanish female it is 12.7. For the white female it is 7.4 percent. This is the kind of information we want to furnish to people so that they can understand what is happening here in regard to the statistics that are presented to us every day.

The employment profiles of the Spanish-speaking people in the cities of Los Angeles, San Antonio, Miami, San Diego, Chicago, Denver, San Francisco, Houston, and other urban areas form an ugly pattern of extreme unemployment and underemployment. Hopelessness, poverty, discrimination, sickness, and separateness are the rule in these islands of vast numbers of unemployed and underemployed.

I want to explain that these are low income selected areas of problem plagued people. There is no question about that.

According to the survey, if the standard definition of labor force, employment, and unemployment are used to calculate the unemployment rate, the percentage of unemployment among the Spanish speaking is twice as high as the national average. The unemployment rates in the surveyed areas during the survey period in selected cities were as follows:

San Diego, 12.7; Miami, 12.2; Los Angeles, 12.1; New York City (Puerto Ricans), 11.3; San Antonio, 10.1, and Denver 9.1.

The unemployment rate for the Nation was between 5.5 and 6 percent during the census survey period. Of course, the Spanish speaking and black high rates of standard unemployment increases the national rate. Or we can say that the white has an unemployment rate that is less than the national average. From the information we have now, we can generalize that no matter what part of the Nation he resides, the Spanish-speaking person is on about the same economic level as the black. There may be areas where the economic status of the Spanish speaking approximates the national average, but these are the exception rather than the rule.

The employment profiles produced more than simply the standard labor forces, employment, and unemployment data for the Spanish speaking and black low income areas of the Nation. The profiles show us that real picture of unemployment, which is the one missing in the President's economic and budget reports.

The employment profiles determined the number of persons in the income areas who were not in the labor force. Then the profiles show that a significant number desire to work but for a number of reasons do not become part of the labor force. Age, retirement, sickness, transportation, family responsibility, and many other reasons are given as reasons for not actively seeking work.

I researched information for several cities on the subject of persons not in the labor force and their desire for work.

Mr. Chairman, could I show you briefly what it shows on the charts?

Chairman PROXMIRE. Yes.

Mr. XIMENES. These are the unemployment rates for the white Spanish-speaking person in these selected areas.

Those are the figures that I just read to you a moment ago. But if we add those persons that are not in the labor force but desire to work, those who want a regular job now, and who say that if they could they would get into the labor force but for various reasons cannot, then the unemployment rate—I better not say rate. The underemployment situation would come up to 31 percent in Denver, to 35 percent in San Antonio, to 43 percent in New York, to 31 percent in Los Angeles, to 27 percent in Miami, and 37 percent in San Diego.

Chairman PROXMIRE. Isn't it true that many of these people can't work, that is, they are sick?

Mr. XIMENES. Yes.

Chairman PROXMIRE. Or they are old.

Mr. XIMENES. I want to make clear that what I am saying here is that the unemployment situation in these areas may be anywhere between 9.1 and 31.6, but it isn't 9.1. That is for sure.

If we could gather the data, or if the Bureau of Labor Statistics could really zero in on those persons who desire to work but because of discrimination, because of transportation problems, because of the situation in which they find themselves and would probably be in the labor force if they had the opportunity, then we may come up to perhaps 25 percent.

I would like for somebody to challenge those figures. I would like the Department of Labor to challenge the figures and say no, it is not 31 percent, it is 25 percent, or something like that.

This is what I am looking for. It is my data, my information and my calculations. I am saying that the economic report, the attempt by aggregate means to resolve the problem of unemployment, does not touch these groups that I am talking about that are from 9.1 to 31.8 percent unemployed and underemployed.

The same situation occurs with the blacks and I have the information on this chart. It is contained in my report. It is very similar, incidentally, to the Spanish speaking situation. There is no difference, really.

My conclusion is that insofar as unemployment for white Spanish surnamed and blacks it is about the same. If we could take a look at their economic status over the Nation, it is about the same.

I focused on persons 16 to 64 years of age not in the labor force who said they "intend to look for work, may look—it depends, may want a job—it depend, would want a job if no problem." I excluded persons who said, "do not intend to look and do not want job even if no problem." If we add up the persons who desire work in the above categories with exclusions as indicated above, we would arrive at a figure that shows a reasonable estimate of the true unemployment in the low income areas surveyed by the census.

About one-half of the persons reported as not in labor force are excluded from my calculation—mostly women who do not want a job because of family responsibility and young persons in school.

The unemployment and underemployment situation for cities with data for Spanish-speaking and blacks is shown in charts Nos. 1 and 2 attached to my statement. Included in these figures is a heavy concentration of females who desire to work.

I have already mentioned some of the reasons for the nonparticipation of the Spanish-speaking in the mainstream of economic life. Heretofore, we had given the reasons, but were never able to substantiate them with data. Now we have that data, and we can say that discrimination is at the heart of the problem. People simply cannot face denial of employment on a daily basis. They retreat at some point to the protection of the island of poverty. They, as the publication, Falling Down on the Job, clearly points out, have no faith in a system of job placement that constantly rejects them.

For the Spanish-speaking person who speaks only Spanish, there is an added deterrent to seeking employment through the standard avenues of job placement. If there is a test involved, there is no way to induce a Spanish-speaking person to actively seek employment. He is, therefore, not in the national calculations on employment, unemployment, and he certainly is not in the labor force even though he may be willing to work.

The noncitizen in this country is only partly included and the migrant laborer is, of course, out the mainstream and constantly underemployed.

The illegal immigrant Mexican seeks the islands of low-income Spanish-speaking persons and, of course, does not actively seek work through established channels. Rather, he competes for the menial tasks and other jobs sought by the Mexican-American citizen.

The green- and blue-card carrier that lives in Mexico and works in the United States is another competitor of the citizen Mexican-American who not only must compete in a strange system, but with persons willing to work for poverty wages.

Noncitizens from Mexico are the subject of heavy-handed discrimination which is easily applied to citizens as well, for there are no differences in the names, features, and general characteristics of the Mexican-American citizen. The Naturalization and Immigration Service shuttles illegal aliens back across the border every day and those of us who are citizens can only say that, there but for the grace of God, go I.

Height requirements effectively keep out the Mexican-American from employment in thousands of law enforcement agencies of the land. These and other reasons too numerous to relate here, cause the high rates of unemployment among the Spanish-speaking people of the Nation.

THE EMPLOYED SPANISH-SPEAKING

The employed Spanish-speaking persons are heavily concentrated in the blue collar operatives, laborers, and service categories. Of those male persons included in the industry reports to EEOC, 32 percent are operatives, and 26 percent are laborers as compared to only 2.5 percent officials and managers and 2.4 percent in the professional category. (See table No. 2 attached to my statement.)

The effect of limited upward mobility in the employed ranks means that qualified Spanish-speaking persons compete for lower salaried jobs or give up and drop out of the labor force. He then joins the pool of small business mom and pop establishments usually located within the poverty areas. He remains in this pool until he can find suitable employment.

I see very little in the budget or in the economic report that is going to change the employment patterns for the Spanish-speaking of the Nation.

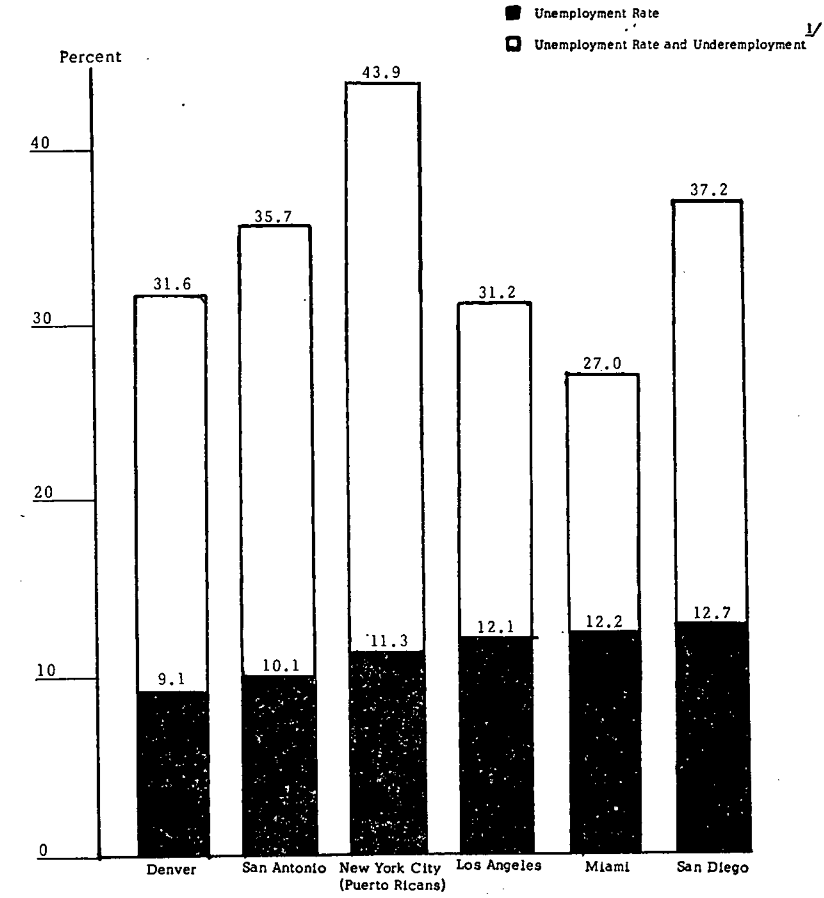
The data in the employment profiles was gathered during a period in 1970 when the standard unemployment rates for the Nation were between 5 and 6 percent. If the measures to cut down unemployment in 1972 from 6 to 5 percent are effective, for the Spanish-speaking person it means a slight change to a condition such as I have shown above and as recorded in the employment profiles published by the U.S. Census.

Thank you.

(The attachments referred to in Mr. Ximenes' statement follow:)

CHART NO. 1

UNEMPLOYMENT RATE
AND
UNDEREMPLOYMENT
WHITE SPANISH
1970

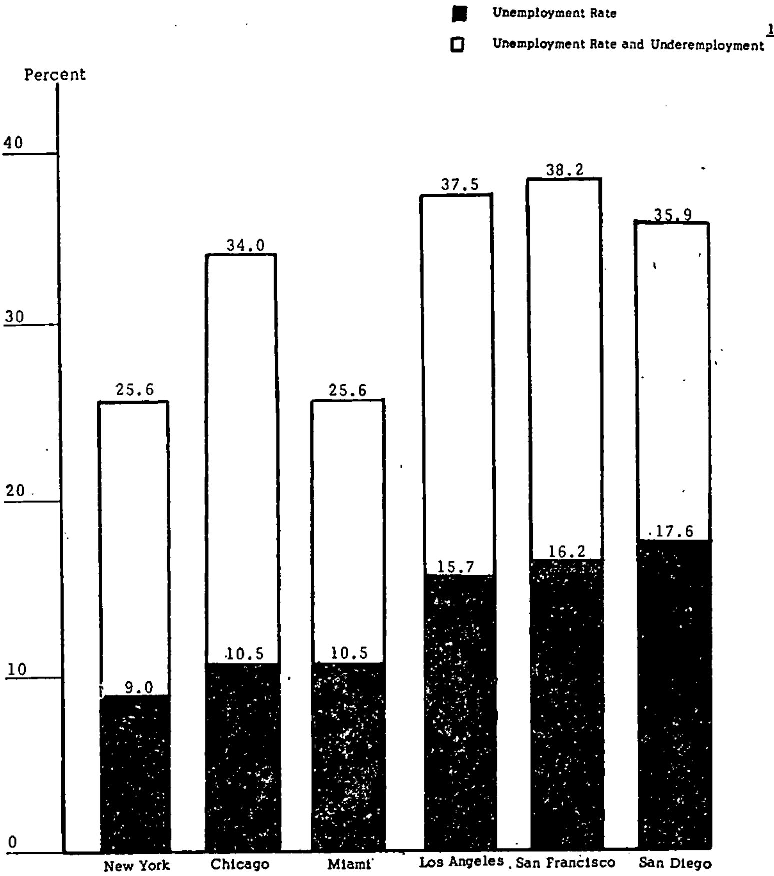


1/ Persons not in the labor force who want regular job now and intend to look for work, may look, may want a job, would want a job if no problem existed.

SOURCE: U. S. Department of Commerce Bureau of the Census, 1970 Employment Profiles of Selected Low Income Areas.

UNEMPLOYMENT RATE
AND
UNDEREMPLOYMENT
NEGRO
1970

CHART NO. 2



1/ Persons not in the labor force who want regular job now and intend to look for work, may look, may want a job, would want a job if no problem existed.

SOURCE: U. S. Department of Commerce Bureau of the Census, 1970 Employment Profiles of Selected Low Income Areas.

TABLE 1.—EXTENT OF POVERTY IN FAMILIES OF CIVILIAN NONINSTITUTIONAL POPULATION

City	Total poverty families	Total Spanish poverty families	Percent
San Antonio	20,155	16,552	82

PERCENT OF SPANISH-SPEAKING FAMILIES WITH INCOME BELOW THE POVERTY LEVEL

	Male heads	Female heads
Head worked 50 to 52 weeks, full time	19.0	26.1
Head worked 27 to 49 weeks, full time	45.5	43.6
Head worked 1 to 26 weeks, full time	59.9	93.9
Head worked part time	54.0	80.3
Head did not work at all	52.8	74.9

Source: "Employment Profiles," Bureau of Census, 1970.

TABLE 2.—JOB PATTERNS IN PRIVATE INDUSTRY[1]

PARTICIPATION RATES, MALE SPANISH SPEAKING, NEGRO AND ANGLO, 1969

[In percent]

	Spanish-speaking male	Negro male	Anglo male
Officials and managers	2.5	1.0	12.0
Professional	2.4	.9	9.0
Technicians	2.3	1.2	4.8
Sales	3.0	1.3	7.4
Office and clerical	5.1	2.7	7.1
Craftsmen	13.9	7.9	20.4
Operatives	32.1	37.2	2.5
Laborers	26.4	29.8	8.4
Service workers	12.2	18.1	5.4

[1] For industries reporting to EEOC and subject to title VII requirements.

Source: Equal Employment Opportunity Commission hearings on the utilization of minority and women workers in certain industries, Houston, Tex.

APPENDIX No. 1*

TERMINATING REFERRALS TO PARTICULAR FIRMS BY TEXAS EMPLOYMENT SERVICE

Commissioner XIMENES. Can you recall how many years you have served Cameron Iron Works for referrals or testing?

Mr. JACKSON. I don't have the exact number here.

Commissioner XIMENES. Would you say you have served the company in the last five years?

Mr. JACKSON. Oh, yes, sir.

Commissioner XIMENES. Did you have knowledge that this particular company had segregated facilities?

Mr. JACKSON. Segregated clubs?

Commissioner XIMENES. Facilities.

Mr. JACKSON. No.

Commissioner XIMENES. If you received information from this Commission that as of this date, Cameron Iron Works had segregated facilities, would you terminate referrals and testing for that company?

Mr. JACKSON. Commissioner Ximenes, as I told you at the meeting before, I think that our Commission will be guided largely by any findings that you gentlemen have on this.

Now, to get this—I have no authority to deviate from the procedural instructions I get from my Commission, but I will certainly call it to their attention, I will get a ruling, and I will give you an answer on it, sir, but I cannot give you an answer on something I do not have knowledge of.

* Source: EEOC Houston Hearings, 1970.

Commissioner XIMENES. Have you ever, at any time in the past three years, terminated referrals to companies because of discrimination?

Mr. JACKSON. Yes, sir.

Commissioner XIMENES. Which ones?

Mr. JACKSON. Well, sir——

Commissioner XIMENES. Can you recall one?

Mr. JACKSON. No, sir, I'm unable to give you the names of them.

Commissioner XIMENES. Would you give us that, then, for the record at a later date? (This information was not received.)

Mr. JACKSON. Sure, and I have—I think that, Commissioner Ximenes in your interrogation you are going beyond the preparation. I think that if you'll bear with me in my administrative position—I've got these managers out there to work. I do not come in direct contact. I cannot. I'm not infallible. I cannot give you specific answers to specific questions on some points.

Now, to say, generally, "Aren't you responsible?" Yes, sir, I'm responsible for a whole lot of things, but by the same token, I can't give you a specific answer on something that I haven't looked up.

Obviously, in the material here, I have had to do some preparation, digging, to get the material together, because I can't carry all of this information in my head.

Commissioner XIMENES. Well, this apepars to be fairly common knowledge in the Houston area, that Cameron Iron Works, did have, for a number of years, segregated facilities—water fountains, et cetera, and you say you were not aware of this?

Mr. JACKSON. No, sir, I was not aware of it. I have never visited that plant in person.

Commissioner XIMENES. No employee of yours ever told you that this was taking place?

Mr. JACKSON. No, sir.

EMPLOYMENT OF MINORITIES BY TEC

Commissioner XIMENES. Would you tell us what the employment situation is, for the minorities in the Houston region?

Mr. JACKSON. Repeat the question. I didn't follow it.

Commissioner XIMENES. Could you tell us the number of Mexican American or Negro employees that you have in the Houston region?

Mr. JACKSON. I don't have the figures available with me. I can give you that if you desire that information to finalize your findings. I can secure it for you, but I do not have it with me.

Commissioner XIMENES. Do you have any Mexican American managers?

Mr. JACKSON. Do I have a Mexican as a manager? No, I do not have.

Commissioner XIMENES. Or black?

Mr. JACKSON. I don't have any managers, no, sir, but I have some—I think I've furnished you a list of all of our minority members. It gives a classification. I think I did relate to you—but it probably slipped your memory—in that first meeting, that one of the assistants—he's actually acting assistant manager—is a Mr. Jack Motley.

Mr. Motley was offered a managerial position in Dallas and turned it down for personal reasons. He preferred to stay in Houston. But you take a Mr. Isaiah Kasseteras, a supervising interviewer of the Northwest Office—that's out in the Spring Branch area—and that's the office that serves Cameron, incidentally.

Commissioner XIMENES. Would you say that the employment patterns of the Employment Security Commission in the Houston area or in the State of Texas are any different from the employment patterns of private industry?

Mr. JACKSON. Oh, I beg your pardon. I didn't understand your question a while ago, Commissioner Ximenes.

I would say this: That from the standpoint of the Texas Employment Commission which has approximately 17% minority personnel—I had 108 as a total minority—and that is 35 Mexican Americans and 73 Negroes. We have, as I mentioned a while ago, approximately 500 employees.

Now, this is district-wide. This is Houston and Galveston SMSA's, and out of a total of 500, so I believe that that figure, right around 20%, as I further mentioned, considering the fact that only eight of these 108 are in the so-called traditional area—in the janitorial positions.

Each one of the other 100, it was necessary for them to qualify in our merit examination system, so that has been one of the points that we have had to adhere to even in these community service agencies.

Commissioner XIMENES. Well, the Civil Rights Commission made a study of employment by the Texas Employment Security Commission. And in 1969 it showed that blacks were hired at the rate of 5%, or about 150 in the entire state; and 261 Mexican Americans—or about 8%—and the largest number are concentrated in clerical work.

Now, that's the pattern in the State.

And that pattern is similar to the pattern that we get from the people who testified here today.

Mr. JACKSON. You mean in the Houston office?

Commissioner XIMENES. In the State. That was a State figure that I just gave you.

Mr. JACKSON. Yeah. Well, I can't say. All I can give you is the positions that these people occupy. I don't think that you can say that interviewer three and interviewer one and a technician or a supervising interviewer, or a Community Service Aide one, two or three, are clerical. The Community Service Aide, as I mentioned to you before—I related the fact that they are pre-professional.

In other words, they can attain a professional position by in-service performance, length of service, and passing an examination to qualify, but the matter of counselors—for example, a counselor is a very highly qualified position, requiring an excellent education in the area of social studies. There are special studies.

Now, realize this: As I mentioned to you gentlemen before, we are bound by the rules of this merit system, and in making the selections that I am making, I must look at the certificate, and I have to hire, based on the grade—on the grade points—the first three out of that. I think I also told you that one way that I was able to secure some Mexican Americans, was to request and obtain a Spanish-speaking certificate. I was to get some Mexican Americans who have made valuable employees, because of their ability to speak Spanish, and otherwise who would not have been reached on a regular certificate.

Commissioner XIMENES. That must have been done fairly recently, because as of 1967, you only had ten Mexican Americans.

Mr. JACKSON. Yes, that's right. I couldn't get any.

Commissioner XIMENES. Seven were in clerical and the other four, I'm not sure. So that up until 1967, you had not done anything in regard to the employment of Mexican Americans, and not much in regard to Negroes, either.

Mr. JACKSON. No, sir. You're putting a statement to that that's not fact. Don't say that I never did anything. I was not able to obtain the necessary results, and likewise, I discussed this with you and told you why I was unable to do any recruitment to get any Mexican Americans to take the merit system examination.

I was unable to induce any Mexican Americans, living in other parts of the State, and the Valley area, to transfer to Houston. I'm in the record on that, sir.

Commissioner XIMENES. You're trying to tell me that you could not get Mexican Americans?

Mr. JACKSON. No, sir.

Commissioner XIMENES. In 1967?

Mr. JACKSON. No, sir.

Commissioner XIMENES. From the Houston area?

Mr. JACKSON. No, sir.

Commissioner XIMENES. You couldn't get Negroes either, because you only had 36 in 1967.

Mr. JACKSON. The Negro—as I told you before—he has to take the examination, just the same as anyone else, and I have to make my selection from the top three. I would not have been able to have gotten some of the Negroes that I did put on back in the early days, had I not got them to start in another office—in Galveston, for example, let them work for six months, and then transfer into Houston.

Commissioner XIMENES. What I'm trying to tell you is that it appears to me that the employment patterns of the State, the City, and the various government agencies, are similar to those of private industry, and let me give you an example of what I'm talking about.

The City of Houston employment pattern shows that 60% of the laborers are black, as compared to Memphis with 54%; Atlanta, 69%; Baton Rouge, 64%.

Now, when we get up to the official and manager category in Houston, 1% are black; in Memphis, zero; in Baton Rouge, zero; in Atlanta, zero; and then, in the professionals and technical category: Atlanta, none are blacks; in Houston, 1.9%; Memphis, 9%; Baton Rouge, 15%, and the Mexican Americans comprise, 34% of the laborer category in the city of Houston as compared to San Francisco with 10% Mexican Americans in labor categories.

In Houston, Mexican American officials and managers are barely 1.9% of the total.

This is the pattern we see here in Houston. That is a pattern we see in all these other cities, and I don't see that it's any different in your agency.

APPENDIX No. 2*

INABILITY TO ATTRACT APPLICANTS

Mr. OGDEN. And I'm sure that they are subject to various viewpoints as to the relative adequacy or inadequacy. It is our feeling—and this is a sincere one—that as far as the hourly group is concerned, that they represent good progress. We're free to admit that as far as attracting qualified applicants in the salaried categories, we haven't been as successful as we'd like to be.

Commissioner XIMENES. Well, there are a number of companies that testified that have stated to us that they can do it and have done it and they have a better record than the one you presented to us. They're in business, just like you are, and they recruit just like you do. They sell for profit just like you do and they're operating right here in the Houston area. Some of them are not as good as we'd like, but nevertheless, they operate in Houston and do the same things that you do, but your company doesn't seem to be able to attract a Mexican American for professional or even for clerical work. Can you imagine that? Is that so difficult to do?

Mr. OGDEN. The applicants have been very few.

Commissioner XIMENES. Could it be that there is a sense of futility on the part of the applicants, in view of the data that's presented here, that there is this sense, among the minorities, that this company discriminates? Could that be the case?

Mr. OGDEN. Well, of course, I don't know what is in the minds of the potential applicants, but I don't think that we have given them reason to have that feeling.

Commissioner XIMENES. Could it be that the history of this company, in its thirty years in Houston, has shown that there have been discriminatory patterns by the company, in terms of segregated facilities?

Mr. OGDEN. There are not segregated facilities, and if that were—that has not discouraged the male applicants for the hourly jobs.

SEGREGATED SOCIAL CLUBS

Commissioner XIMENES. Did you have segregated facilities at one time?

Mr. OGDEN. At one time, yes, sir.

Commissioner XIMENES. Did you have segregated clubs?

Mr. OGDEN. There are now two segregated clubs.

Commissioner XIMENES. They are in existence today?

Mr. OGDEN. Yes, sir.

Commissioner XIMENES. A segregated club for what purpose?

Mr. OGDEN. They're social clubs.

Commissioner XIMENES. What is the reason for having them segregated?

Mr. OGDEN. Sir, I—the company has nothing to do with the employees' social clubs. They're separate organizations of the employees themselves, over which the company actually has no control, except to the extent that the company can and does withhold any subsidy.

Commissioner XIMENES. Are they within the company premises?

Mr. OGDEN. No, sir.

Commissioner XIMENES. Where are the clubs located?

Mr. OGDEN. Oh, out the north end of—I believe it's in another county, or partly in another county and partly in the portion——

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* Source: EEOC Houston Hearings, 1970.

Commissioner XIMENES. Are these maintained and assisted, in any way, by the company?

Mr. OGDEN. No, sir, not at this time. Formerly, they were.

Commissioner XIMENES. What other segregated facilities do you have?

Mr. OGDEN. Oh, at one time, there were segregated restrooms, drinking fountains, I believe some locker rooms.

Commissioner XIMENES. What happened to the Mexican American? Where did he go?

Mr. OGDEN. I can't honestly answer that.

Commissioner XIMENES. He really was out. Well, Mr. Ogden, I think that you may get, then, from that, perhaps some idea of the lack of applicants. I certainly wouldn't apply to your company if I thought that you, even as recently as a few years ago, practiced this, and your personnel were used to this sort of thing. I certainly wouldn't apply. I'll tell you that.

Mr. OGDEN. Well, to follow that line of reasoning, of course, there never were segregated facilities in the office areas serving the—both the non-exempt and the exempted salaried employees, so that certainly, I don't think, would be a reason for, at this time, potential minority applicants not to apply for that type of employment, and notwithstanding the fact that in years past there were segregated facilities in the shop areas. That has not seemed to interfere with applications by minority groups in the hourly category.

Commissioner XIMENES. Did you deduct dues for these club members?

Mr. OGDEN. No, sir.

Commissioner XIMENES. They deduct them on their own or—

Mr. OGDEN. I don't actually know just how they handle their dues collection. We do deduct dues for the Negro Social Club.

Commissioner XIMENES. You deduct dues for the Negro Social Club?

Mr. OGDEN. Yes, sir.

Commissioner XIMENES. And not for the other—

Mr. OGDEN. That is true.

Commissioner XIMENES. And, again, how about the Mexican American?

Mr. OGDEN. There is none.

Chairman PROXMIRE. Thank you, Mr. Ximenes.

We haven't had, I think, this kind of a panel before. I think all three of you have done really extraordinary work this morning, disabusing me of some of the ideas I had that were wrong.

Mr. Brimmer, I want to make sure I understand you. You said there was a decline of 43,000 jobs for blacks in 1971, even though the total number of jobs continued to expand and expand rather vigorously.

Mr. BRIMMER. That is what I said.

Chairman PROXMIRE. The number of jobs?

Mr. BRIMMER. Yes. The number of jobs for blacks, and I want to be precise on this——

Chairman PROXMIRE. I think the figure of 43,000 is correct.

Mr. BRIMMER. The figure is 43,000.

Chairman PROXMIRE. You laid great emphasis on the assertion that the blacks are very heavily employed in manufacturing, and that manufacturing was not expanding the way some of the other employment categories are. Is the decline of jobs for blacks in manufacturing precisely paralleling the decline in jobs in manufacturing generally, or was it greater or less?

Mr. BRIMMER. It paralleled. But since the proportion of blacks, particularly black men, found in manufacturing is higher, the impact was somewhat greater.

Mr. Chairman, let me ask you, please, to look at table 1 of my prepared statement. You cannot see this precisely in table 1, but the statement I made was based on table 1.

If you look at total employment in 1971, you will notice the number was 8.4 million, 8,403,000. In 1970, as the middle panel of table 1 shows, total employment for blacks was 8,445,000. So there you see rounded off the drop of 43,000 or so which I mentioned.

If you look at the total employment in the economy as a whole in 1971, that number was 79,120,000; in 1970 it was 78,627,000. If you look at the table showing private nonagricultural employment, table 4 to my prepared statement, taking manufacturing, which is the fourth row down from the top, you will notice that in 1970, the second column from the right, blacks constituted 10.2 percent of the total manufacturing employment, and in 1971 it was 9.9. That is the basis of my statement.

Chairman PROXMIRE. Let me ask this: One spectacular figure was the turnover rate for black men in grades 1 to 5 as compared with whites in the Federal Government. Blacks suffered a turnover rate as I understand it of a shocking 43 percent compared to 15 percent.

The turnover rates were greater in other categories, too, than they were for whites, but there wasn't anything like that kind of discrepancy. In fact, they were rather close. How do you explain that?

Mr. BRIMMER. These are figures for the Federal Reserve banks. I could not get figures for the Federal Government.

Chairman PROXMIRE. These are only blacks who work in the banks?

Mr. BRIMMER. These are the statistics for the Federal Reserve banks taken as a group.

Chairman PROXMIRE. You are talking about the employees of the banks?

Mr. BRIMMER. The employees of the Federal Reserve System. We are talking about some 20,000 or 22,000 people. I am talking about the Federal Reserve banks, which I said were roughly comparable in some respects, so one can use these figures to get a rough idea of turnover in Government.

Chairman PROXMIRE. That is a very large sample. It is still a tremendously shocking discrepancy.

Mr. BRIMMER. I found it so.

Chairman PROXMIRE. Three times as high a turnover for black men as for white. With women there was a higher turnover for blacks, but not much. For those in grade 6 and above the turnover was very close for blacks and white.

Mr. BRIMMER. Yes. That reflects the structure of employment.

Chairman PROXMIRE. The last hired and first fired, is that it?

Mr. BRIMMER. Well, blacks are concentrated, heavily concentrated, in the low-grade level. They are typically the people who work in the currency and coin sections at the banks; they are the janitors, the messengers, the food handlers, and so on, in the lower grades. That is what you typically find. There are a few clerks in these lower grades, but not very many.

Chairman PROXMIRE. I can't understand why it is so much higher for blacks than whites. Whites have similar problems.

Mr. BRIMMER. Mr. Chairman, my own explanation is that it goes back to the kind of characteristics of the low-income population with relatively low skills. These jobs do not require great skills.

Chairman PROXMIRE. But these are grades 1 to 5 and the whites have low incomes and low skills, too.

Mr. BRIMMER. Typically. I do not know how to explain it. My purpose was to take note of the fact that the overall turnover was very high.

Chairman PROXMIRE. Mrs. Kreps?

Mrs. KREPS. The heavier concentration of black males in the lower-level jobs would mean that the turnover rate for black males would reflect that concentration. If you could hold constant the type of job and compare black and white men——

Chairman PROXMIRE. That is what I thought he did. He said the turnover rate for blacks grades 1 to 5 was 48 percent and for whites it was 15 percent.

Mr. BRIMMER. May I go back to this, Mr. Chairman? What is being held constant is the grade level. The grades would apply to different kinds of jobs as well. For example, I could pick a grade 5 data processor and I could also pick, say, a grade 5 chauffeur. I would expect that the tenure of the data processor, in general, would tend to be higher than that of a chauffeur. In that case, it may be a bad example because a grade 5 chauffeur is a good job for a chauffeur. I will be glad to look further into the matter.

(The following information was subsequently supplied for the record:)

BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM,
February 28, 1972.

Hon. WILLIAM PROXMIRE,
Chairman, Joint Economic Committee,
New Senate Office Building,
Washington, D.C.

DEAR MR. CHAIRMAN: I have looked further into the question of turnover rates for blacks in Federal Reserve Banks which arose during my appearance before the Joint Economic Committee on February 23.

Upon further checking, an error was discovered in the underlying statistics on which the analysis was based. The turnover rate for all men in grades 1–5 was 49 per cent—not 15 per cent as originally indicated. The turnover rate of 43 per cent for black men in grades 1–5 was correct. For all black employees in grades 1–5, the turnover rate was 40 per cent vs. 37 per cent for all employees. In contrast, in grades 6 and over, the turnover rate for blacks was below that for all employees—10 per cent vs. 13 percent.

The general conclusion still holds: The turnover rate for blacks as a group was higher for all employees (30 per cent vs. 21 percent).

I have furnished a copy of this letter to the committee staff for insertion in the record of the hearings.

Sincerely yours,

ANDREW F. BRIMMER.

Chairman PROXMIRE. Mrs. Kreps, does your 75-percent figure, where you say women's incomes are 75 percent of men, reflect the discrimination in the same work, or does it reflect the fact that women's employment has been in different and often in terms of income lower paid categories?

Mrs. KREPS. This proportion assumes that we are holding the occupation constant.

Chairman PROXMIRE. Constant the kind of job?

Mrs. KREPS. Yes.

Chairman PROXMIRE. So you would say if there are women tellers in banks or women attorneys or women employed on faculties of universities or in schools, that the man doing the same work, fulfilling the same capacity, would get about one-third more; is that right?

Mrs. KREPS. Yes. These are figures cited by Herman Miller.

Chairman PROXMIRE. That is about as shocking a statistic as I have heard. It is amazing. We all know about the discrimination against women in positions of executive capacities, professional positions, and so forth. But there is absolutely no excuse for this. There is no excuse for the other either, for that matter, but at least we can understand that there has been discrimination over a longer period of time in the case of professionals. I am startled at the enormous discrepancy.

Mrs. KREPS. Let the record show that the Senator is shocked.

Chairman PROXMIRE. It certainly should.

Mrs. KREPS. The usual explanation, of course, is that men have had longer service in these jobs and they less frequently have interrupted worklife patterns. In Miller's case, he tries to correct for that variable by giving you statistics only on those women who had shown a consistent pattern of staying in the labor force for at least 6 months of the year for a certain period of time. So he even rules out those women only marginally attached to the work force.

Chairman PROXMIRE. Another very valuable figure that you have given us that I didn't have before is the underutilization of women in relationship to their education. What this shows to me is that there has been a great deal of emphasis on training and more education. They say you can't hire these unemployed people because they are not educated, not trained, they don't have the capacity to go out and get a job.

In the case of women, what you are showing us is that in many cases they are underutilized. They have college degrees and are doing work they could do with a partial high school education. That seems to rebut or refute the argument that the main structural problem is a matter of discrimination, and not that the women, the blacks or the Mexican-Americans who are discriminated against don't have the skills.

I think in view of the enormous improvement of skills for all the population in the last 20 years that the typical member of the minority group, whichever it is, is likely to be better trained, considerably, than the white male was 20 years ago.

On the basis of this statistic, this would seem to underline the argument that it isn't so much a matter of lack of skills unless we have had a technological revolution I am underestimating.

Mrs. KREPS. Business has traditionally not had middle-level jobs for women. It has had clerical and secretarial jobs for women but it has had none of the higher paying jobs. Therefore, it is easy to see why college educated women, unless they go into the professions, simply have to go into industry at jobs lower than their education would allow.

Chairman PROXMIRE. There is going to be a long, long, hard struggle. I recently saw an analysis written by a young lady who worked as an intern briefly in my office. She graduated from Harvard Law School. The thesis was on the experience of Harvard Law School graduates over the last 20 years, men and women, comparing incomes.

76-150—72——15

It is just about as shocking or more shocking than the figure you have given us today. I thought this was just discrimination by lawyers, but it appears it is quite universal.

Did you want to comment?

Mr. BRIMMER. Just briefly, Mr. Chairman. The census data would reinforce what Mrs. Kreps said. In general, if you take income by education, by race, and by sex and take men separately, it is roughly on the order of magnitude suggested by Mrs. Kreps. In general, a black man with a college education would have a median income roughly equivalent to that of a white man, the same age, with a high school education.

As you get into the higher levels of education, the discrepancy becomes a little less but not appreciably less, so the general pattern would still hold. If one were to take three-quarters as a benchmark, it would turn out roughly as Mrs. Kreps stated. I do not know what the most recent data would show, but my hunch is that that is the general pattern.

Chairman PROXMIRE. Congressman Conable.

Representative CONABLE. Thank you, Mr. Chairman.

Mrs. Kreps, I would like to pursue the chairman's line of inquiry a little bit. In your statement you say evidence of women's lower job status has been presented repeatedly in various studies and the following facts stand out: Women have lost jobs in the professional and technical areas in recent decades. In 1940, they held 45 percent of the jobs so classified and in 1969 had only 37 percent. In the professional area, you say women's proportions of specific jobs they have traditionally held also declined. They represent 28 percent of the faculty of institutions of higher learning in 1940 but only 22 percent in 1969.

That is even more distressing to me than the money angle. I would like to know what the reason for this downward trend is? It would appear to me that the most probable reason for the first, the loss of ground in the professional and technical areas, might be discrimination in the professional schools. As far as the second is concerned, it would appear that it is probable that the faculties of our great liberal institutions are not as liberal as we might think, that they show certain sexist characteristics, judging from the fact that the proportion of women on faculties has actually declined. Would you like to comment on that?

Mrs. KREPS. I agree completely with your analysis of what has been happening, particularly in institutions of higher learning. It is even worse than that simple statistic indicates; if one looks at the composition of that 22 percent which we have now, she would find that there is a heavier concentration of women at the instructor and assistant professor level, a very low sprinkling of full professors, and practically no administrators. The explanation lies in part in certain market constraints that apply here. Some women were not able to go to institutions which would hire them because they are married and are staying with their husbands. There are other constraints.

Obviously, the presence of small children is an important one. But college teaching is one of the few professions which a woman can pursue on a part-time basis and still bring up a family; yet even here women have, in fact, lost jobs.

Universities clearly have a strong preference for male professors, despite the fact that women have been teachers for quite a long time.

Representative CONABLE. It would seem to me that if we are to have progress in the high paying jobs it is most likely to come in the professions, because the professions are generally self-employed, and, therefore have more flexibility for part-time involvement.

A woman doctor, for instance, can drop out of her profession for a few years if she has family responsibilities and can return. She should be able to move back into high-income status quickly and be able to maintain her professional competence there. One can understand why there might be some difficulty about industry employment of women, for instance, if their work is a part-time thing.

To me this is particularly distressing. I would expect women to make progress in the professions more easily than in areas which are not self-employed.

Is there anything I am overlooking here as far as the professional status of women is concerned?

Mrs. KREPS. No, I think that is a reasonable expectation, particularly in view of the fact that we have needed so much more professional talent of this kind in the recent past.

One would have thought that in the period of the 1950's and 1960's, when there was such a heavy demand for college professors, that women would have been hired more often rather than less often.

Representative CONABLE. Have you made any analysis of the different attitudes of the different professions? For instance, I should think that women would find it much easier to break into the medical profession than, for instance, the legal profession, let's say, where the status of women lawyers has always been an unfortunate one. They have spent most of their time working on estate and real estate matters and find it difficult to invade the courtroom.

But as far as doctors are concerned, there are many countries in which women doctors almost predominate—not many, but some. Russia, for instance. I am wondering if you made any analysis among the professions.

Mrs. KREPS. Not in any depth, but the figures are as you indicated; in certain countries, notably Russia, women are the medical profession by and large, whereas they constitute a very small proportion of the total numbers of physicians in this country. One of the reasons for the paucity of women doctors in the United States is the failure of women to enter the medical profession in any large numbers. It has been very hard for them to get into medical schools. It has been very hard for them to combine the long training period with having a family and children.

With respect to the legal field, of course, things are changing very rapidly in terms of the numbers of women who are going to law schools. I share, however, your own worry about what these women will do when they get law degrees. It has been my observation that television shows notwithstanding, women have not had access to the top jobs in the legal profession.

Representative CONABLE. Mr. Ximenes, I am interested in the statistical base on which you are forced to operate here. I imagine it is quite faulty. It occurs to me that I saw somewhere the figure, for instance, that 375,000 illegal immigrants in the United States have been identified and deported last year. I assume a very large number of these are Mexicans.

Mr. XIMENES. The preponderant number are; yes.

Representative CONABLE. I assume that many of these people are forced by the insecurity of their position while they are here to accept very poor jobs and are coming over primarily as migrants.

Mr. XIMENES. Correct.

Representative CONABLE. They have to keep moving in order to avoid detection. This must very much affect the labor statistics, in considering the actual status of the Spanish-American.

Mr. XIMENES. Mr. Conable, it would not affect the labor statistics for arriving at standard employment, because these individuals certainly are not going to go to the Employment Service or to be registered anywhere—none of them. It will not affect them one way or another.

They might show up in my data over there, because these people would be out of the labor force. As far as your statement in regard to migrants: a lot of them are not migrants.

There is a large number that are household workers, large numbers that work in filling stations, and in manufacturing concerns if they are close to the border.

There is another group besides the illegals that we can add to that, and that is people who can live in the United States because they have a valid visa but prefer to live in Mexico and work in the United States. That is another group.

Representative CONABLE. It must be a very complicated statistical problem.

Mr. XIMENES. It is very complicated.

There is another group that comes over on a card for purpose of purchasing goods for I am not sure how many hours. Many stay for 10 years.

Representative CONABLE. Have you any idea what proportion of the 6 percent of Americans who are unemployed are Mexican Americans?

Mr. XIMENES. I am not sure——

Chairman PROXMIRE. 5,182,000 people were unemployed last month. How many are Mexican Americans?

Mr. XIMENES. The data doesn't break it down. I could not tell you.

Chairman PROXMIRE. Mr. Ximenes, you are not satisfied with the state of the economic information as it is described and the changing status of various groups of the labor force, employment status, and unemployment status. Your exhibits are very impressive.

I had a member of the press ask me about a month ago to question Mr. Moore on this. There was a very interesting article in the Washington papers pointing out that one analysis showed that unemployment in Washington, D.C., is not the 3 percent or 3½ percent generally reported but 15 percent, using these kind of figures.

Mr. XIMENES. Yes; they used the same information that I used for these charts.

Chairman PROXMIRE. Would you be a little more detailed and specific as to what can be done about it? Suppose you were Mr. Moore. Suppose you were in charge of the Bureau of Labor Statistics. What kind of an analysis would you have your people put together? What would you have them do?

Mr. XIMENES. I would do the same thing that the Bureau of the Census did to arrive at some of these figures. They would have to sample some of these low-income areas.

Chairman PROXMIRE. But they wouldn't accept this as a fair definition of unemployment.

Mr. XIMENES. I know that.

Chairman PROXMIRE. How would you describe unemployment to make it better? You see, there are arguments on both sides of this. We have been through this so much before this committee, because we have testimony every month and have had for a year now on the unemployment statistic.

While you can argue that you are considering people employed who only worked 1 hour in the whole week, on the other hand, you are also considering people unemployed who just take a glance at the help wanted ads or just apply maybe for some work down the street and don't make a real effort to get a job.

You have to have some criteria. The criteria has the virtue at least of being consistent and I think the people who gather it are honest.

Mr. XIMENES. There is no question about that.

Chairman PROXMIRE. How would you change this to be more accurate? You wouldn't, I presume, include people who are actually sick, who say they would like to work but are ill and unable to work, or people who are obviously incapacitated because they are either too old or have some other disqualifying difficulty.

Mr. XIMENES. What I did, Mr. Chairman, is that I tried to exclude substantial numbers of people who would fit the categories you have mentioned. For example, when the person said, "I would not take a job because I have a problem." So in my estimates here I excluded about 50 percent of the people who are out of the labor force, just excluded them completely. Then I took those categories in which the individual said, "I want a regular job now, I intend to look for a job now," and one or two other categories that were shown in the Bureau of the Census breakdowns.

But you could refine these things to include only those persons that say that they intend to look for a job now.

Chairman PROXMIRE. Then what you are doing is shifting it from some kind of overt act. At least at some time in the past week they have to have taken some action to look for a job, to look at the help wanted ads or made inquiry of the employment service, or have gone to a firm and asked for employment.

You are asking anybody who just gives a state of mind, that they would like to work. I think you would be troubled to some extent by the fact that all of us, regardless of our backgrounds, tend to have some kind of a Puritan ethic. If somebody would say, "Do you want a job?" then you would say, "Sure, I like to work." You wouldn't get as objectives and realistic a picture as you do under the present circumstances, deficient as the present statistics are.

Mr. XIMENES. I will have to agree with you that there has to be a system devised. There is no problem about that. I am saying that the one at present just does not cover those individuals such as the Spanish-speaking person who may have a language difficulty, who is willing to work. He is not going to register with the employment service.

A Spanish-speaking person who does not know how to speak English, very qualified, a perfectly fine craftsman, if it is necessary for him to take a test, is not going to register.

Chairman PROXMIRE. Now I think you have something we can work with. Where you have a person who has qualifications but there is a language barrier preventing him from getting a job, there it seems to me we have the statistics on that and we understand that. There is no reason in the world why we shouldn't invest the relatively modest resources required to give these people the language facility they need to get a job; it is a specific and limited skill that they have to get, which you can acquire in a reasonable amount of time.

Those statistics would be immensely valuable. We will do all we can to press for that.

Mr. XIMENES. That is a very concrete one. Then we go to the fuzzy areas, like the person who doesn't go and register because he has been discriminated against three or four times.

Chairman PROXMIRE. The bill passed in the Senate yesterday will help to some extent. At long last there is a bill with teeth in it.

Mr. XIMENES. Yes. I would have wanted the cease and desist powers, but it is an improvement.

Chairman PROXMIRE. Yes.

Mr. Brimmer, the Labor Department recently discontinued publication of the statistics on the employment situation in urban poverty areas. Conveniently for those not wishing to face the facts, especially in an election year, these data will not be available now until 1973.

Do you think this step was necessary? Why couldn't the existing data be continued while the new information based on the 1970 census data was developed?

Mr. BRIMMER. I do think the step was necessary. I reached that conclusion after some exchange with Mr. Moore when I heard the series would be discontinued. I asked him about the plan, the reasons, and he wrote me a nice letter. Then we had a conversation in person about it. His argument went as follows, and I think there is some merit to it: "As you know, Mr. Chairman and members of the committee, they shifted over to the 1970 census as a base."

Chairman PROXMIRE. Yes, but in the meanwhile, why can't we continue? The cost is relatively modest and the information is very valuable for the kind of decisions that are made every day in the Congress.

Why can't we continue on the basis of the 1960 census and then when we get the information next year for the 1970 census then discontinue the old one, but not until then?

Mr. BRIMMER. I asked the same question, Mr. Chairman, why not run the two series parallel for a time? I could dig through my files and get out the letter, but the argument he made to me was technical and seemed persuasive. He was running that shop. I could not make an independent judgment about the wisdom of what he was doing.

Chairman PROXMIRE. He made those technical arguments to us but they were not persuasive, at least to this Senator.

Mr. BRIMMER. I simply wanted to report that I was concerned about it. We shared some conversations on it. Since he is the man trying to do a very good technical job, I would not dispute it.

Chairman PROXMIRE. He is a very fine man, a very able man.

Mr. BRIMMER. But I agree with you. I was distressed at the prospect that the series would not be available.

Chairman PROXMIRE. Another similar situation is that the Labor Department also discontinued family budget cost data for urban U.S. families. We have had many inquiries as to why this was done, particularly by unions, welfare workers, and similar groups interested in helping low-income people.

Have you had a similar experience? I am sure people helping the disadvantaged need this.

Mr. BRIMMER. I must say I have not focused on that question. I did not know that. I am ignorant of it. Again, I find personally that every scrap of information we can get to illuminate the situation among the minority groups is helpful. I am clearly in favor of more, rather than less data. But, again, I simply know nothing about why they discontinued it and I did not even know they had.

Chairman PROXMIRE. Mrs. Kreps, I think many people have the impression that the entry of more women in the labor force is because it is some women's lib movement or because women all of a sudden feel they ought to get independent and work. Some say that they ought to stay at home and tend to their own knitting.

You stress in your statement the demand for women workers in our economy has shifted toward a service economy, as we all know, and Mr. Brimmer stressed that very well in pointing out what has happened in manufacturing, and that has meant a sharp increase in demand for clerical workers and sales workers, jobs traditionally held by women.

Would you agree that much of the entry of women into the labor force has been in response to the demand for women to work?

Mrs. KREPS. Yes; there has been a definite pull from the demand side, just as there has been a push from the fact that families have been smaller and household technology has improved.

Chairman PROXMIRE. What puzzles me is that the figures that you gave for 1920, I think, indicated that there was a lesser degree of unemployment among women at that time than among men. Here we have relatively strong demands for the type of work usually performed by women and yet women seem to have a higher unemployment rate than men.

Mrs. KREPS. The gross unemployment rate by sex is not very revealing, really, about any particular group of women workers, such as clerical workers. I don't know offhand what the unemployment rate is in clerical jobs.

Chairman PROXMIRE. With the demand increasing for the work that women have traditionally done is what I meant. Let me ask a male chauvinist pig type of question. This was suggested by one of the distinguished women economists on the staff.

The question is this: As women raise their aspirations and take over men's jobs, who will work as secretaries, sales workers, nurses, and so forth? That is not my question.

Mrs. KREPS. I could suggest that males do some of these jobs.

Chairman PROXMIRE. Who?

Mrs. KREPS. Men.

Chairman PROXMIRE. That is the answer that occurred to me.

Mrs. KREPS. I don't know whether you want me to take this question seriously, but I shall do so, nevertheless. It does seem to me that what is at issue here is not any kind of a standoff as to who will get the best jobs, but, rather, a question of widening the career and job options for both sexes. It may very well be that a lot of men would like to do many of the jobs that women typically have been assigned to, including even homework.

I think it is not advantageous to dwell on further balkanizing the labor marketing and saying men will now do this and women will now do this. Rather, we should raise the question of whether jobs cannot be awarded on the basis of qualification other than sex, and the more flexible we are with respect to our views on which sex does which job, the greater we satisfy human potential. As I say, I take the question seriously.

Chairman PROXMIRE. I am glad you took the question seriously.

Congressman Conable.

Representative CONABLE. Mr. Brimmer, one industry you didn't discuss is construction. What has been the impact of the Philadelphia plan on black employment in the construction industry? Do you think that is a good approach? Would it elevate the earning power of blacks, or will it bring highly competent blacks from other industries into the construction industry?

Mr. BRIMMER. You are right, Mr. Conable, I did not discuss the construction industry. The reason is straightforward. I know very little about it. The table did show that blacks made up roughly 9 percent or 10 percent of all construction workers. That is on table 4 of my prepared statement.

The Philadelphia plan, so far as I understand it, is focused on trying to set some kind of targets which would be implemented, and that seems to be the main stress, the implementation, for blacks in the construction trades, with emphasis on upgrading as well as on the basic number of jobs.

As I said, the proportions are not essentially different from other industries. I gather, and this is more hearsay than anything else, that the implementation of the Philadelphia plan, or variations on it, is rather spotty around the country. Again from conversations from time to time with people who are close to it, I get the impression that where the plan or a variation on it has been adopted and implemented, it has made a difference. But that is the extent of my knowledge.

Chairman PROXMIRE. Would the Congressman yield?

Representative CONABLE. Yes.

Chairman PROXMIRE. I think that table 4 of Mr. Brimmer's prepared statement has some interesting statistics on this. It says that the 9.8 percent of those employed in contract construction in 1968 were Negroes and declined to 9.6 percent in 1969, declined to 9.1 percent in 1970, and came back a little, to 9.3 in 1971.

It seems to me this is just exactly the reverse of everything I had assumed and the reverse of all the effort of the Federal Government to try to get the blacks into construction.

Mr. BRIMMER. Mr. Chairman, I would not want to go deeply into this, but——

Representative CONABLE. You don't know what jobs you are talking about in the construction area?

Mr. Brimmer. That is right. It also reflects, as the committee members will recall, that the demand for labor in construction is derived from the rate of construction. The overall level or rate of expansion in construction in 1969 was somewhat less than 1968, certainly in the housing component.

Then in 1970 there was a turn-around, but it came on later. Given the swings in the industry and the extent to which blacks are more or less casually a part of the industry, I would have expected the profile over time, over the last few years, in terms of blacks as a proportion of the industry, to be precisely what we see.

In other words, the blacks get the large proportion of their jobs during the expansion period. Again, I have not examined that industry in detail as I have examined the manufacturing sector, so I think I should be cautious in talking about it.

Representative Conable. Mr. Brimmer, you have the reputation of being not only a good statistician and good economist but also something of a social philosopher. I wonder if you want to say anything about the general thrust of the economic policy at this point.

As I see it, we have all kinds of dilemmas in the various trade-offs that face us in Government economic policy nowadays, and particularly with respect to the underprivileged. Quite obviously, as John Gardner said, you are not going to have major advances in social justice and social progress generally unless we have a fairly high level of prosperity.

Quite obviously, also, inflation hurts the poor more than it does any other element because they don't own any property and, therefore, have no way of protecting themselves from the ravages of inflation.

Quite obviously, though, the general thrust of economic policy has to be addressed to the terrible human insecurity that comes from unemployment. You can't afford to let your unemployment stay at a high level. It is the semiskilled and unskilled who will suffer the most.

So you come out with the conclusion that you have to have a balanced program, that just training people for jobs is not enough if there are no jobs when they get through with their training, but that there has to be training just the same or you have no long-term improvement in the cyclical pattern of employment and unemployment that affects most seriously the underskilled.

Do you have any comments about the general thrust of Government economic policy and what we should be seeking as our goal, where we should put our emphasis, what values we should try to fulfill through our policies here?

Mr. Brimmer. Mr. Conable, I appreciate the comments you made earlier about my work in economics and statistics generally. But let me put that aside and say that with respect to overall national economic policy, macroeconomic policy, I would not want to go into that. I said in my statement that the projections made by the Council of Economic Advisers are reasonable. I share those.

The Chairman of the Federal Reserve appeared before this committee and gave a general statement on behalf of the Board, and I share that. So let me look a little at the last part of your question.

I am concerned about the extent to which specific structural policies are adequate or inadequate to accomplish the kind of improvement which I focused on, Mrs. Kreps focused on and Mr. Ximenes focused on.

Speaking for myself, personally, and you certainly realize this must be my judgment because the Federal Reserve Board has not commented on this at this point, I do believe it is far more critical to make certain that manpower programs are focused on the whole area and not training people for jobs that will not be there.

I am concerned about the structural questions of the meshing of job opportunities with available labor along the lines Mr. Ximenes described. I am particularly interested also in the role of the Government in perhaps providing public service jobs on a much greater scale than we are doing now for people who, in fact, cannot find the openings into the private sector just now.

I could go on making a list, but you asked for a kind of philosophical comment, and I am giving you one. What I am saying is this: Having done what we can with general economic policies (and I am not talking about the adequacy of the present macro-policies), it is still absolutely necessary to go on with a specialized policy, with more money, to deal with the problems of the left out groups.

I share the kind of concern you are talking about.

Mr. Ximenes. I find from the information available now that the minority groups, the blacks, the Spanish-speaking person, oriental, and Indian, is heavily concentrated in the blue-collar category. Our blue-collar job participation is way above our population percentage. We are now trying to develop more manpower programs to get more of the minorities into these same blue-collar operations.

I would suggest certainly that we attempt to improve on the entire spectrum of job categories rather than to have us polarized within the various blue-collar job categories.

Mr. Schmidt, from the University of California, did a study on the Spanish-speaking people of the Nation and found that we were already heavily concentrated in blue-collar jobs and made more or less the same recommendations I am making now.

Representative Conable. But isn't that the job of the general education system to a substantial extent? You are obviously not going to take a man 50 years old and send him to medical school, but he is still trainable for subprofessional work. Of course, the basic equalizer is still going to have to be our education system.

Mr. Ximenes. I agree. I would make a further recommendation in terms of the minorities and that is that they be given the opportunity to go to college if they make it through high school. In fact, as I call it, there could be an educational bill that could go something like this: Tuition, as on the GI bill, plus an allotment to the family of that particular student. There would be no particular reason why we couldn't do that. We do it in many other cases.

If you want a real program that would also stimulate the demand side of the economy this would be one way to do it.

Representative Conable. Thank you, Mr. Chairman.

Mr. Brimmer. Mr. Chairman, may I impose on the committee for a minute, to go back to the kind of question you asked Mr. Ximenes about what can be done in the short run to improve the unemployment statistic?

Chairman Proxmire. Yes.

Mr. Brimmer. May I make a plea before this committee for support in the Congress for proposals that have been made for improving the unemployment statistics? This is a proposal which has broad basic support in the economic profession.

Chairman PROXMIRE. What proposal are you talking about?

Mr. BRIMMER. I am talking about the proposal made, which the Council of Economic Advisers addressed itself to and which the Budget Bureau addressed itself to, suggesting that we have a major effort in the coming year to fund and upgrade the employment-unemployment statistics. I hope this will be taken seriously.

Representative CONABLE. Would you add to that a request that we do more with the CPI? I think that is faulty, too. I am in sympathy with your request. It seems to me this committee should take more of a role than it does in this area of statistics. Economic statistics generally is obviously one which has reflected the great changes taking part in our economy and takes into account the specific spots that we have been talking about today.

Mr. BRIMMER. I did not come today to talk specifically to that point, but I thought I would just put in that request.

Chairman PROXMIRE. This committee has not done the job it should do, but I used to be chairman of the subcommittee on statistics of this committee a few years ago, and I thought that was the most significant subcommittee we had. Of course, it is the least glamorous, the least exciting. But the great improvement, and I think there has been an improvement in economic policy in spite of all our shortcomings, economic policy has improved primarily because of more and better economic statistics. We have a better idea of our economy and understand it better than we did before.

I hope this committee will become far more aggressive, as Congressman Conable wishes it to do. I certainly endorse enthusiastically the suggestion that has been made by the Council of Economic Advisers.

Representative CONABLE. Mr. Brimmer, let me make a further point on that. We are all generalists on this committee. By definition, a Member of Congress is a generalist. It seems to me surprising that there isn't more initiative taken in the economic community, itself, to get an upgrading of our statistical economic reporting. Admittedly, we can do some pushing here, but you are not going to find the expertise among a group of Congressmen to be able to make any great contribution except for the push.

It is surprising to me that we don't hear more from other sources. As we held these hearings this year it has been apparent that we are dealing with statistics that are pretty mushy and economists who use these statistics must be aware of it. I am surprised that there are so few who seem to be dissatisfied with the extent to which their science is magic instead of science. That fault should be apparent to them when they are dealing with statistics that are not hard.

Mr. BRIMMER. As I said, I did not want to take the time, but I wanted to mention that. As Assistant Secretary of Commerce, I had some oversight of the Office of Business Economics, and the Bureau of the Census. I got to know a number of people in Government who were concerned with these data, who were working hard on them.

Chairman PROXMIRE. I get the impression from each of you in different ways that there really is not much being done in a positive fashion at the Federal level to aid minority groups in achieving employment. Perhaps it is because of what you are not able to comment on. None of you seem to point to any bright, new initiative. You leave me with the impression that what happens to blacks and other disadvantaged groups follows almost inexorably the course of economic events.

Am I wrong about this?

Mr. XIMENES. I certainly agree with your statement. I would just like to make some recommendations, if you will give me that opportunity, in terms of what might be done by Congress, the President, or policy by the President. I am quite interested in this matter of our relations with Mexico and how it affects a rather large group of people.

I think an agreement ought to be made with Mexico to see if we could develop the border from Texas to California. This would be a significant thing for our entire Nation as well as for 200 million people to the south. What happens in Mexico is going to be reflected in the other countries. This is an unemployment situation that I think I would like to see geared to our relations with Mexico as well as the improvement of the Spanish-speaking people of this Nation.

Mrs. KREPS. My only suggestions are increased support for job training and upgrading the skills of women; and providing for day care centers, to allow low-income women and women heads of families to work.

Within the realm of higher education, the development guidelines by HEW which will instruct universities to develop affirmative action plans, will be very helpful. But for lower income women workers, I think job training and day care are the big needs.

Chairman PROXMIRE. Mr. Brimmer.

Mr. BRIMMER. Mr. Chairman, I would like to take note again of the observation you made earlier. The Senate's approval yesterday of the strengthening of the enforcement machinery of the Equal Employment Opportunity Commission is a landmark. If it survives the conference in the House and State, and if that Commission had some money, that can be a major contribution in really working to upgrade part of jobs for minority groups.

I just wanted to stress that, because the business is not complete as yet and it is a vital piece of legislation.

Secondly, as you know, at times I had looked generally at problems of blacks—rather than analyzing them primarily in economic terms as I did today. In that perspective, the biggest form of assistance which I can see on the horizon in terms of new initiative would be the passage of a comprehensive family assistance program. This would provide a lot of economic help, even with the proposed minimum income of $2,400 or $3,000.

That plan—and I have done some work on it and strongly supported it, though there has been a great deal of controversy—that kind of minimum-income approach would go quite far in terms of economics. That is one innovation I hope will come about. I share Mrs. Kreps' comments about manpower training.

Let me say that the Opportunity and Industrialization Centers, headed by Mr. Leon Sullivan, are doing exactly the kind of thing which many of the programs are doing less successfully. They work with industry and with the black communities.

They need help. They are doing it. There have been bills before this Congress from time to time, but they haven't come through.

I am suggesting that, if we can identify the financial resources and support, there are many initiatives that could be taken which have a short-term payout that are quite striking. I would rather not try to compile another catalog, but explore the initiatives we already have.

Chairman PROXMIRE. Both Mrs. Kreps and Mr. Brimmer stressed the training program. Frankly, I am very, very disappointed in the training programs because the weakness there is that you can have all the training in the world but if you don't have a job at the end of that training it is perverse; it does more harm than good. You get somebody who has gone through the discipline, and it is painful for all of us to take training or education—he goes through this and there is no job at the end of it. He is probably worse off psychologically, more miserable, than he would have been had he never taken it.

What is wrong with having a fully effective job creation program by the Federal Government? You talked about a guaranteed income. What is wrong with having a guaranteed job? The Federal Government could be the employer of the last resort whenever the unemployment gets above 5 percent, until it gets below 5 percent, 100,000 jobs every month until we get unemployment down below 5 percent.

This is something that I think the American people would buy. I think there is great disagreement on whether or not we ought to have welfare reform programs both on the left and the right. You know how controversial it is.

But I think there is very little disagreement that those who want to work ought to have a chance to get a job. If the Federal Government is the only institution in our society, perhaps we ought to do it.

Mr. BRIMMER. You will notice in my comments to Mr. Conable, in responding to his question, I indicated that I personally favor a much more comprehensive public service employment program, expanded over what we already have.

I did not want to repeat that, but I share your view on that. I share your concern about training which simply goes no place. That is why I cited specifically the program of the Opportunities Industrialization Centers which is tied in with industry, so that the training is supported by industry. People are training for jobs which exist. I would not want to tell you which witnesses to have come before you, Mr. Chairman, but——

Chairman PROXMIRE. There is a distinguished New York economist-administrator, Mr. Sugarman, who testified before Congress recently that we ought to have a job creation program with just as much priority as space, defense, or anything else we have put emphasis on, saying we are going to achieve it regardless of consequences. What is wrong with that?

Mr. BRIMMER. I have not assessed it in those terms.

Chairman PROXMIRE. For instance, there have been two programs that have been smashing successes in the 15 years I have been in the U.S. Senate. Both of them were because the President of the United

States said we were going to achieve them come hell or high water. One of them was the highway program and the other was the space program. We achieved a miracle in the space program; 15 years ago no one would have believed it to have been possible. Why can't we devote the same kind of determination, though it would take more resources, to making sure that unemployment just doesn't go above 5 percent? This committee was created by the Full Employment Act of 1946. We have never come close to making that an effective achievement by our Government except in wartime or shortly after wartime.

Mr. BRIMMER. Mr. Chairman, I certainly do not doubt the capacity of this Government to accomplish a program assigned that high a priority. I would certainly like, personally, to see employment and jobs given a priority far higher than is now the case. If you ask me whether I can say to you on this day "give it a priority over everything else"—that is what I find it hard to say now.

Chairman PROXMIRE. What does it conflict with? It doesn't conflict with anything else, except inflation, perhaps. We would have to hold the controls on longer, perhaps. I am talking about getting down below 5 percent. I am not saying get it down to 0, 3, 4, or 4.5.

I am saying get it below the level where everybody agrees—I don't know of anybody would say that above 5 percent is acceptable.

Mr. BRIMMER. You will notice how I concluded my statement, Mr. Chairman: "It is important that we have a substantial expansion this year." I see no reason to back off of that.

Chairman PROXMIRE. Mrs. Kreps.

Mrs. KREPS. To have the Government be the employer is one to which I would subscribe. I think we have only one conflict on this type of approach and that is the conflict in our minds with respect to the degree of tolerable inflation.

It is my personal view that we are paying a very high price for attempting to improve the terms of the trade-off in the direction of cutting down inflation. It would seem to me that a firm policy endorsing the Government as employer of last resort—though I think perhaps we could find a better term for it—is something that we should push at this time. I share your discontent with the quality of training. However, manpower training is not designed just for the purpose of getting a man or woman a job—any job—but also, in its more comprehensive aspects, it is designed to enable workers to improve their skills and their productivity through a lifetime of work.

A comprehensive manpower program which speaks to this broader problem implies training of a much more basic sort.

The question of whether the unemployment problem lies with the structure or with aggregate demand is a familiar one. All I am suggesting here is that improving the quality of the labor force, particularly at the lower levels, is absolutely essential in an era such as this, and in combination with a governmental policy of employer of last resort, it might very well get us down, not to 5 percent, but to 3.5 percent unemployment.

Chairman PROXMIRE. Thank you very much.

Mr. Ximenes.

Mr. XIMENES. My comment in regard to border development coincides with yours on job creation. I would certainly go further than border development in terms of public works projects which should include the barrios and ghettos of this Nation. We should rebuild those barrios and ghettos with libraries, cultural centers, public works and things that have to do with the uplifting of the spirit of the people who live in those areas.

In addition to that, include transportation facilities, as well as beautification programs, that are much needed in these areas. In short, a revitalization of the cities.

Chairman PROXMIRE. What you are saying is that we have a great deal to do in this country that is constructive and useful. We don't have to make work; we need, in addition to what you said, mass transit and rebuilding of the cities. We have an enormous need for improving our environment, preventing pollution. The cost and the number of jobs to clean up the Great Lakes alone is immense.

In the health services we need huge numbers of paramedical personnel badly. We need doctors, of course, but we also need people who can do some of the work that doctors do but would require training for relatively short times.

There are so many areas where we need people to provide services we don't have that it would take little imagination to make sure that this work was completely constructive, and we will be building a better and stronger country.

I want to thank all of you. This has been a most helpful day. So many of the top administration witnesses have been before our committee and have blamed heavy unemployment on blacks, or women or other minority groups, and it is very refreshing to get such a constructive analysis of what the situation is, and many useful suggestions as to what we can do about it.

The committee will stand in recess until 10 o'clock tomorrow morning.

(Thereupon, at 12:10 p.m., the committee recessed, to reconvene at 10 a.m., Thursday, February 24, 1972.)

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