THE 1975 ECONOMIC REPORT OF THE PRESIDENT

HEARINGS

BEFORE THE

JOINT ECONOMIC COMMITTEE

CONGRESS OF THE UNITED STATES

NINETY-FOURTH CONGRESS

FIRST SESSION

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THE 1975 ECONOMIC REPORT OF THE PRESIDENT

THURSDAY, JANUARY 23, 1975

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

The committee met, pursuant to notice, at 10:10 a.m., in room 1202, Dirksen Senate Office Building, Hon. Hubert H. Humphrey (chairman of the committee) presiding.

Present: Senators Humphrey, Proxmire, Kennedy, and Taft; and Representatives Bolling, Reuss, and Brown of Ohio.

Also present: John R. Stark, executive director; Loughlin F. McHugh and Courtenay M. Slater, senior economists; William A. Cox, Robert D. Hamrin, Jerry J. Jasinowski, and Carl V. Sears, professional staff members; Michael J. Runde, administrative assistant; and George D. Krumbhaar, Jr., minority counsel.

OPENING STATEMENT OF CHAIRMAN HUMPHREY

Chairman HUMPHREY. Gentlemen, and members of the committee, today we begin the annual hearings of the Joint Economic Committee on the President's economic program. Normally, our hearings follow immediately after the President submits his Budget and Economic Report to the Congress. But this year, the President has made his basic economic recommendations in the state of the Union message and delayed his report until early February.

In these circumstances, this committee has no alternative but to proceed at once to consider the administration's program.

Our inquiry is particularly crucial this year. As all of us know, the economy is in trouble. In the last quarter of 1974, real output declined at an annual rate of 9.1 percent. Most forecasts predict that real GNP may well continue to drop during the first half of 1975, a prospect which administration spokesmen have not denied. In the absence of strong government initiatives, the beginning of a recovery in the second half of the year will be very weak.

Unemployment has increased by 1 million in the last 2 months and 7.1 percent of the labor force is now jobless. That is, of course, the most recent official figure.

In the current climate of continued output declines, the rate of unemployment could go above 8 percent during 1975. In the face of a severe recession, prices continue to increase at an unacceptable rate, although most indicators point to a slight improvement in the rate of inflation in the next several months. The rate of increase in the

Wholesale Price Index, for example, has moderated from a 35 percent annual rate of increase in the third quarter to a 13 percent rate of increase in the fourth quarter.

Nevertheless, the combination of inflation and recession has made the policy choices especially difficult. I am heartened that the President has finally recognized the serious threat of deep recession and has abandoned his WIN campaign of exclusive concentration on inflation. Inflation is still a major problem, but it must be considered as only one of the problems along with the major problem of recession.

As I said last evening, we need new thinking and new answers. Moreover, the Nation needs political responsibility and not partisan argument, not a Democratic or Republican policy but a national economic policy that will work. It was good news indeed when the President promised the country compromise and conciliation. I credit him with his effort to cope with the problems that beset us and I want very much to cooperate with him. Might I say that it is my hope that this committee will serve in a useful advisory capacity, being contentious or argumentative when we need to be, but hopefully being constructive all along the way.

However, I have serious reservations—speaking for myself—about the President's tax and energy proposals. Some of the issues which we expect to explore with our witnesses today include:

How large a tax cut is needed to put the economy back on a sustainable growth path?

On both equity and fiscal policy grounds, how should a tax cut be structured? The President's proposed tax cut benefits most high-income taxpayers, those least in need of it and least likely to spend it.

What impact will the President's energy proposals have on inflation and on economic growth?

And can tax cuts be the only instrument of fiscal policy when many low-income families, retired and disabled persons and the unemployed pay little or no taxes? What is the appropriate mix of tax relief and government spending?

Today it is our pleasure to welcome to the committee three eminently qualified economists who have had long and distinguished careers in formulating economic policy.

Mr. Gardner Ackley served as Chairman of the Council of Economic Advisers under President Johnson and in that position strengthened the level of economic policymaking and debate manyfold.

Mr. Paul McCracken, our second witness, now professor of economics at the University of Michigan, has often provided this committee with incisive analyses of the economic situation. Mr. Paul McCracken, also professor at the University of Michigan, served as CEA Chairman from 1969 to 1971. While we have not always agreed with your recommendations in the past, Mr. McCracken, we value your honest assessment of policy alternatives.

Mr. Charles Schultze, now a senior fellow at the Brookings Institution, was Director of the Bureau of the Budget during the Johnson administration. Mr. Schultze is one of the foremost experts on fiscal policy and has frequently testified before this committee on budget priorities. He is now in the process of completing a study of U.S. energy problems.

Gentlemen, we look forward to receiving your testimony. Before you begin, I will insert in the record at this point the President's state of the Union message and the accompanying fact sheet, House Speaker Albert's statement on the report of the Democratic Task Force in the House of Representatives and the program prepared by the Democratic Task Force in the House of Representatives, and House Speaker Albert's address in response to President Ford's economic speech.

[The information referred to for the record follows:]

PRESIDENT FORD'S STATE OF THE UNION MESSAGE TO THE CONGRESS OF THE UNITED STATES, JANUARY 15, 1975

Twenty-six years ago, a freshman Congressman, a young fellow, with lots of idealism who was out to change the world, stood before Speaker Sam Rayburn in the well of this House and solemnly swore to the same oath you took yesterday. That is an unforgettable experience, and I congratulate you all.

Two days later, that same freshman sat in the back row as President Truman, all charged up by his single-handed election victory, reported as the Constitution requires on the State of the Union.

When the bipartisan applause stopped, President Truman said:

"I am happy to report to this Eighty-first Congress that the State of the Union is good. Our Nation is better able than ever before to meet the needs of the American people and to give them their fair chance in the pursuit of happiness. It is foremost among the nations of the world in the search for peace."

Today, that freshman Member from Michigan stands where Mr. Truman stood and I must say to you that the State of the Union is not good.

Millions of Americans are out of work. Recession and inflation are eroding the money of millions more. Prices are too high and sales are too slow.

This year's Federal deficit will be about $30 billion; next year's probably $45 billion. The national debt will rise to over $500 billion.

Our plant capacity and productivity are not increasing fast enough. We depend on others for essential energy.

Some people question their government's ability to make the hard decisions and stick with them. They expect Washington politics as usual.

Yet, what President Truman said on January 5, 1949, is even more true in 1975.

We are better able to meet the peoples' needs.

All Americans do have a fairer chance to pursue happiness. Not only are we still the foremost nation in pursuit of peace, but today's prospects of attaining it are infinitely brighter.

There were 59,000,000 Americans employed at the start of 1949. Now there are more than 85,000,000 Americans who have jobs. In comparable dollars, the average income of the American family has doubled during the past 26 years.

Now, I want to speak very bluntly, I've got bad news, and I don't expect any applause. The American people want action and it will take both the Congress and the President to give them what they want. Progress and solutions can be achieved. And they will be achieved.

My message today is not intended to address all the complex needs of America. I will send separate messages making specific recommendations for domestic legislation, such as General Revenue Sharing and the extension of the Voting Rights Act.

The moment has come to move in a new direction. We can do this by fashioning a new partnership between the Congress, the White House and the people we both represent.

Let us mobilize the most powerful and creative industrial nation that ever existed on this earth to put all our people to work. The emphasis of our economic efforts must now shift from inflation to jobs.

To bolster business and industry and to create new jobs, I propose a one-year tax reduction of $16 billion. Three-quarters would go to individuals and one-quarter to promote business investment.

This cash rebate to individuals amounts to 12 percent of 1974 tax payments—a total cut of $12 billion, with a maximum of $1,000 per return.

I call today on the Congress to act by April 1. If you do, the Treasury can send the first check for half the rebate in May and the second by September.

The other one-fourth of the cut, about $4 billion, will go to businesses, including farms, to promote expansion and create more jobs. The one-year reduction for businesses would be in the form of a liberalized investment tax credit increasing the rate to 12 percent for all businesses.

This tax cut does not include the more fundamental reforms needed in our tax system. But it points us in the right direction—allowing us as taxpayers rather than the Government to spend our pay.

Cutting taxes, now, is essential if we are to turn the economy around. A tax cut offers the best hope of creating more jobs. Unfortunately, it will increase the size of the budget deficit. Therefore, it is more important than ever that we take steps to control the growth of Federal expenditures.

Part of our trouble is that we have been self-indulgent. For decades, we have been voting ever-increasing levels of Government benefits—and now the bill has come due. We have been adding so many new programs that the size and growth of the Federal budget has taken on a life of its own.

One characteristic of these programs is that their cost increases automatically every year because the number of people eligible for most of these benefits increases every year. When these programs are enacted, there is no dollar amount set. No one knows what they will cost. All we know is that whatever they cost last year, they will cost more next year.

It is a question of simple arithmetic. Unless we check the excessive growth of Federal expenditures or impose on ourselves matching increases in taxes, we will continue to run huge inflationary deficits in the Federal budget.

If we project the current built-in momentum of Federal spending through the next 15 years, Federal, State, and local government expenditures could easily comprise half of our gross national product. This compares with less than a third in 1975.

I am now in the process of preparing the budget submissions for fiscal year 1976. In that budget, I will propose legislation to restrain the growth of a number of existing programs. I have also concluded that no new spending programs can be initiated this year, except those for energy. Further, I will not hesitate to veto any new spending programs adopted by the Congress.

As an additional step toward putting the Federal government's house in order, I recommend a five percent limit on Federal pay increases in 1975. In all Government programs tied to the consumer price index—including social security, civil service and military retirement pay, and food stamps—I also propose a one-year maximum increase of 5 percent.

None of these recommended ceiling limitations, over which the Congress has final authority, are easy to propose, because in most cases they involve anticipated payments to many deserving people. Nonetheless, it must be done. I must emphasize that I am not asking you to eliminate, reduce or freeze these payments. I am merely recommending that we slow down the rate at which these payments increase and these programs grow.

Only a reduction in the growth in spending can keep Federal borrowing down and reduce the damage to the private sector from high interest rates. Only a reduction in spending can make it possible for the Federal Reserve System to avoid an inflationary growth in the money supply and thus restore balance to our economy. A major reduction in the growth of Federal spending can help to dispel the uncertainty that so many feel about our economy, and put us on the way to curing our economic ills.

If we do not act to slow down the rate of increase in Federal spending, the United States Treasury will be legally obligated to spend more than $360 billion in Fiscal Year 1976—even if no new programs are enacted. These are not matters of conjecture or prediction, but again of simple arithmetic. The size of these numbers and their implications for our everyday life and the health of our economic system are shocking.

I submitted to the last Congress a list of budget deferrals and recissions. There will be more cuts recommended in the budget I will submit. Even so, the level of outlays for fiscal year 1976 is still much too high. Not only is it too high for this year but the decisions we make now inevitably have a major and growing impact on expenditure levels in future years. This is a fundamental issue we must jointly solve.

The economic disruption we and others are experiencing stems in part from the fact that the world price of petroleum had quadrupled in the last year. But we cannot put all of the blame on the oil-exporting nations. We in the United States are not blameless. Our growing dependence upon foreign sources has been adding to our vulnerability for years and we did nothing to prepare ourselves for an event such as the embargo of 1973.

During the 1960s, this country had a surplus capacity of crude oil, which we were able to make available to our trading partners whenever there was a disruption of supply. This surplus capacity enabled us to influence both supplies and prices of crude oil throughout the world. Our excess capacity neutralized any effort at establishing an effective cartel, and thus the rest of the world was assured of adequate supplies of oil at reasonable prices.

In the 1960s, our surplus capacity vanished and, as a consequence, the latent power of the oil cartel could emerge in full force. Europe and Japan, both heavily dependent on imported oil, now struggle to keep their economies in balance. Even the United States, which is far more self-sufficient than most other industrial countries, has been put under serious pressure.

I am proposing a program which will begin to restore our country's surplus capacity in total energy. In this way, we will be able to assure ourselves reliable and adequate energy and help foster a new world energy stability for other major consuming nations.

But this Nation and, in fact, the world must face the prospect of energy difficulties between now and 1985. This program will impose burdens on all of us with the aim of reducing our consumption of energy and increasing production. Great attention has been paid to considerations of fairness and I can assure you that the burdens will not fall more harshly on those less able to bear them.

I am recommending a plan to make us invulnerable to cut-offs of foreign oil. It will require sacrifices. But it will work.

I have set the following national energy goals to assure that our future is as secure and productive as our past:

First, we must reduce oil imports by 1 million barrels per day by the end of this year and by 2 million barrels per day by the end of 1977.

Second, we must end vulnerability to economic disruption by foreign suppliers by 1985.

Third, we must develop our energy technology and resources so that the United States has the ability to supply a significant share of the energy needs of the Free World by the end of this century.

To attain these objectives, we need immediate action to cut imports. Unfortunately, in the short-term there are only a limited number of actions which can increase domestic supply. I will press for all of them.

I urge quick action on legislation to allow commercial production at the Elk Hills, California, Naval Petroleum Reserve. In order that we make greater use of domestic coal resources, I am submitting amendments to the Energy Supply and Environmental Coordination Act which will greatly increase the number of power plants that can be promptly converted to coal.

Voluntary conservation continues to be essential, but tougher programs are also needed—and needed now. Therefore, I am using Presidential powers to raise the fee on all imported crude oil and petroleum products. Crude oil fee levels will be increased $1 per barrel on February 1, by $2 per barrel on March 1 and by $3 per barrel on April 1. I will take action to reduce undue hardship on any geographical region. The foregoing are interim administrative actions. They will be rescinded when the necessary legislation is enacted.

To that end, I am requesting the Congress to act within 90 days on a more comprehensive energy tax program. It includes:

Excise taxes and import fees totalling $2 per barrel on product imports and on all crude oil.

Deregulation of new natural gas and enactment of a natural gas excise tax.

Enactment of a windfall profits tax by April 1 to ensure that oil producers do not profit unduly. At the sime time I plan to take Presidential initiative to decontrol the price of domestic crude oil on April 1.

The sooner Congress acts, the more effective the oil conservation program will be and the quicker the Federal revenues can be returned to our people.

I am prepared to use Presidential authority to limit imports, as necessary, to assure the success of this program.

I want you to know that before deciding on my energy conservation program, I considered rationing and higher gasoline taxes as alternatives. Neither would achieve the desired results and both would produce unacceptable inequities.

A massive program must be initiated to increase energy supply, cut demand and provide new standby emergency programs to achieve the independence we want by 1985. The largest part of increased oil production must come from new frontier areas on the Outer Continental Shelf and from the Naval Petroleum Reserve No. 4 in Alaska. It is the intention of this Administration to move ahead with exploration, leasing and production on those frontier areas of the Outer Continental Shelf where the environmental risks are acceptable.

Use of our most abundant domestic resource—coal—is severely limited. We must strike a reasonable compromise on environmental concerns with coal. I am submitting Clean Air Act amendments which will allow greater coal use without sacrificing our clean air goals.

I vetoed the strip mining legislation passed by the last Congress. With appropriate changes, I will sign a revised version into law.

I am proposing a number of actions to energize our nuclear power program. I will submit legislation to expedite nuclear licensing and the rapid selection of sites.

In recent months, utilities have cancelled or postponed over 60 percent of planned nuclear expansion and 30 percent of planned additions to non-nuclear capacity. Financing problems for that industry are growing worse. I am therefore recommending that the one year investment tax credit of 12 percent be extended an additional two years to specifically speed the construction of power plants that do not use natural gas or oil. I am also submitting proposals for selective changes in State utility commission regulations.

To provide the critical stability for our domestic energy production in the face of world price uncertainty, I will request legislation to authorize and require tariffs, import quotas or price floors to protect our energy prices at levels which will achieve energy independence.

Increasing energy supplies is not enough. We must also take additional steps to cut long-term consumption. I therefore propose:

Legislation to make thermal efficiency standards mandatory for all new buildings in the United States. These standards would be set after appropriate consultation with architects, builders and labor.

A new tax credit of up to $150 for those home owners who install insulation equipment.

The establishment of an energy conservation program to help low income families purchase insulation supplies.

Legislation to modify and defer automotive pollution standards for 5 years to enable us to improve new automobile gas mileage 40 percent by 1980.

These proposals and actions, cumulatively, can reduce our dependence on foreign energy supplies to 3-5 million barrels per day by 1985. To make the United States invulnerable to foreign disruption, I propose standby emergency legislation and a strategic storage program of 1 billion barrels of oil for domestic needs and 300 million barrels for defense purposes.

I will ask for the funds needed for energy research and development activities. I have established a goal of 1 million barrels of synthetic fuels and shale oil production per day by 1985 together with an incentive program to achieve it.

I believe in America's capabilities. Within the next ten years, my program envisions:

200 major nuclear power plants.
250 major new coal mines.
150 major coal-fired power plants.
30 major new oil refineries.
20 major new synthetic fuel plants.

The drilling of many thousands of new oil wells.

The insulation of 18 million homes.

And construction of millions of new automobiles, trucks and buses that use much less fuel.

We can do it. In another crisis—the one in 1942—President Franklin D. Roosevelt said this country would build 60,000 aircraft. By 1943, production had reached 125,000 airplanes annually.

If the Congress and the American people will work with me to attain these targets, they will be achieved and surpassed.

From adversity, let us seize opportunity. Revenues of some $30 billion from higher energy taxes designed to encourage conservation must be refunded to the American people in a manner which corrects distortions in our tax system wrought by inflation.

People have been pushed into higher tax brackets by inflation with a consequent reduction in their actual spending power. Business taxes are similarly distorted because inflation exaggerates reported profits resulting in excessive taxes.

Accordingly, I propose that future individual income taxes be reduced by $16.5 billion. This will be done by raising the low income allowance and reducing tax rates. This continuing tax cut will primarily benefit lower and middle income taxpayers.

For example, a typical family of four with a gross income of $5,600 now pays $185 in Federal income taxes. Under this tax cut plan, they would pay nothing. A family of four with a gross income of $12,500 now pays $1,260 in Federal taxes. My plan reduces that by $300. Families grossing $20,000 would receive a reduction of $210.

Those with the very lowest incomes, who can least afford higher costs, must also be compensated. I propose a payment of $80 to every person 18 years of age and older in that category.

State and local governments will receive $2 billion in additional revenue sharing to offset their increased energy costs.

To offset inflationary distortions and to generate more economic activity, the corporate tax rate will be reduced from 48 percent to 42 percent.

Now, let me turn to the international dimension of the present crisis. At no time in our peacetime history has the state of the Nation depended more heavily on the state of the world. And seldom if ever has the state of the world depended more heavily on the state of our Nation.

The economic distress is global. We will not solve it at home unless we help to remedy the profound economic dislocation abroad. World trade and monetary structure provides markets, energy, food and vital raw materials—for all nations. This international system is now in jeopardy.

This Nation can be proud of significant achievements in recent years in solving problems and crises. The Berlin Agreement, the SALT agreements, our new relationship with China, the unprecedented efforts in the Middle East—are immensely encouraging. But the world is not free from crisis. In a world of 150 nations, where nuclear technology is proliferating and regional conflicts continue, international security cannot be taken for granted.

So let there be no mistake about it: international cooperation is a vital fact of our lives today. This is not a moment for the American people to turn inward. More than ever before, our own well-being depends on America's determination and leadership in the world.

We are a great Nation—spiritually, politically, militarily, diplomatically and economically. America's commitment to international security has sustained the safety of allies and friends in many areas—in the Middle East, in Europe, in Asia. Our turning away would unleash new instabilities and dangers around the globe which would, in turn, threaten our own security.

At the end of World War II, we turned a similar challenge into an historic achievement. An old order was in disarray; political and economic institutions were shattered. In that period, this Nation and its partners built new institutions, new mechanisms of mutual support and cooperation. Today, as then, we face an historic opportunity. If we act, imaginatively and boldly, as we acted then, this period will in retrospect be seen as one of the great creative moments of our history.

The whole world is watching to see how we respond.

A resurgent American economy would do more to restore the confidence of the world in its own future than anything else we can do. The program that this Congress will pass can demonstrate to the world that we have started to put our own house in order. It can show that this Nation is able and willing to help other nations meet the common challenge. It can demonstrate that the United States will fulfill its responsibility as a leader among nations.

At stake is the future of the industrialized democracies, which have perceived their destiny in common and sustained it in common for 30 years.

The developing nations are also at a turning point. The poorest nations see their hopes of feeding their hungry and developing their societies shattered by the economic crisis. The long-term economic future for the producers of raw materials also depends on cooperative solutions.

Our relations with the Communist countries are a basic factor of the world environment. We must seek to build a long-term basis for coexistence. We will stand by our principles and our interests; we will act firmly when challenged. The kind of world we want depends on a broad policy of creating mutual incentives for restraint and for cooperation.

As we move forward to meet our global challenges and opportunities, we must have the tools to do the job.

Our military forces are strong and ready. This military strength deters aggression against our allies, stabilizes our relations with former adversaries and protects our homeland. Fully adequate conventional and strategic forces cost many billions, but these dollars are sound insurance for our safety and a more peaceful world.

Military strength alone is not sufficient. Effective diplomacy is also essential in preventing conflict and building world understanding. The Vladivostok negotiations with the Soviet Union represent a major step in moderating strategic arms competition. My recent discussions with leaders of the Atlantic Community, Japan and South Korea have contributed to our meeting the common challenge.

But we have serious problems before us that require cooperation between the President and the Congress. By the Constitution and tradition, the execution of foreign policy is the responsibility of the President.

In recent years, under the stress of the Vietnam War, legislative restrictions on the President's capability to execute foreign and military decisions have proliferated. As a member of the Congress, I opposed some and approved others. As President, I welcome the advice and cooperation of the House and Senate.

But, if our foreign policy is to be successful we cannot rigidly restrict in legislation the ability of the President to act. The conduct of negotiations is ill suited to such limitations. For my part, I pledge this Administration will act in the closest consultations with the Congress as we face delicate situations and troubled times throughout the globe.

When I became President only five months ago, I promised the last Congress a policy of communication, conciliation, compromise and cooperation. I renew that pledge to the new members of this Congress.

To sum up:

America needs a new direction which I have sought to chart here today—a change of course which will:

Put the unemployed back to work.

Increase real income and production.

Restrain the growth of government spending.

Achieve energy independence.

Advance the cause of world understanding.

We have the ability. We have the know-how. In partnership with the American people, we will achieve these objectives.

As our 200th anniversary approaches, we owe it to ourselves, and to posterity, to rebuild our political and economic strength. Let us make America, once again, and for centuries more to come, what it has so long been—a stronghold and beacon-light of liberty for the world.

Fact Sheet to President Ford's State of the Union Message, January 15, 1975

The President's Economic and Tax Program

The President's State of the Union Address outlined the nation's current economic situation and outlook, and his economic and tax program which are designed to wage a simultaneous three-front campaign against recession, inflation and energy dependence.

BACKGROUND

The U.S. economy is faced with the closely linked problems of inflation and recession. During 1974, the economy experienced the highest rate of inflation since World War II. Late in 1974, when a recession set in, unemployment rose sharply to over 7 percent, the highest level in 13 years.

Accelerated inflation had its roots in the policies of the past and several recent developments not subject to U.S. control. Specifically:

Excessive Federal spending and lending for over a decade and too much money and credit growth.

Unusually poor harvests contributed heavily to world-wide food shortages and escalating food prices.

World petroleum product prices increased dramatically due to the Arab nations' embargo on shipments of oil to the U.S., the quadrupling of the price of crude oil by the OPEC nations, and their sharp reductions in crude oil production to maintain higher prices. Higher energy prices were passed through in the prices of other products and services.

The decline in U.S. domestic production of oil and natural gas that began in the 1960's also contributed to higher energy prices.

An economic boom occurred simultaneously in the industrialized nations of the world.

There were two international devaluations of the dollar.

Inflation contributed strongly to the forces of recession:

The real purchasing power of workers' paychecks was reduced.

Inflation also reduced consumer confidence, contributing to the most severe slump in consumer purchasing since World War II.

Inflation forced interest rates to very high levels, draining funds out of financial institutions that supply most mortgage loans and thus sharply reducing construction of homes.

Federal Government spending and lending programs, accounting for over half the funds raised in capital markets, reduced the amount of money available for capital investments needed to raise productivity and increase living standards.

CURRENT SITUATION AND NEAR-TERM OUTLOOK

The economy is now in a full-fledged recession and unemployment will rise further. Inflation continues at a rapid pace and the need to take immediate steps to conserve energy will further complicate the problem initially.

There are no instant cures. A careful and balanced policy approach is required. It will take time to yield full results. There is, however, no prospect of a long and deep economic downturn on the scale of the 1930's.

MAJOR ELEMENTS OF THE PRESIDENT'S ECONOMIC AND TAX PROGRAM

I. *A $16 Billion Temporary, Anti-Recession Tax Reduction.* This major reduction in taxes proposed for individuals and businesses is designed to restore consumer confidence and promote a recovery of production and employment. The recession is deeper and more widespread than expected earlier, but the tax reduction—together with the easing of monetary conditions that has already taken place—will support a healthy economic recovery. The tax reduction must be temporary to avoid excessive stimulus resulting in a new price explosion and congested capital markets. The temporary nature of the reduction is consistent with the long-term economic goals of achieving and maintaining reasonable price stability and raising the share of national output devoted to saving and capital formation.

II. *Energy Taxes and Fees.* Energy excise taxes and fees on petroleum and natural gas will reduce use of these energy sources and reduce the nation's need for importing expensive and insecure foreign oil. Removal of price controls from domestic crude oil (together with other energy actions) will encourage domestic oil production. A windfall profits tax would recover windfall profits resulting from crude oil decontrol. Energy taxes and fees are expected to raise $30 billion in new Federal revenues on an annual basis.

III. *Permanent Tax Reduction Made Possible By Energy Taxes and Fees.* The $30 billion annual revenue from energy conservation excise taxes and fees and the windfall profits tax on crude oil would be returned to the economy through a major tax cut, a cash payment for non-taxpayers, and direct distribution to governmental units. Tax reductions are designed to go mainly to low- and middle-income taxpayers.

IV. *One Year Moratorium on New Federal Spending Programs.* The moratorium on new spending programs proposed by the President will permit the Federal Government to move toward long-term budget responsibility and to avoid refueling inflation when the economy begins rising again.

V. *Budget Reductions.* The President will propose significant spending reductions in his Fiscal Year 1976 Budget. The reductions total more than $17 billion, including $7.8 billion savings from reductions proposed last year and $6.1 billion from the 5 percent ceiling to be proposed on Federal employee pay increases and on Federal benefit programs that rise automatically with the Consumer Price Index.

SPECIFIC PROPOSALS ANNOUNCED BY THE PRESIDENT

I. *A Temporary, Anti-Recession Tax Cut of $16 Billion.* The President proposed a temporary, tax reduction of approximately $16 billion to provide prompt stimulus to consumer spending and business investment. The tax cut is divided 75 percent to individuals and 25 percent to corporations, which is approximately the ratio that individual income taxes bear to corporate income taxes. The cuts would be:

A. A Tax Reduction for Individuals of $12 Billion.

1. Individuals will receive a cash refund equal to 12 percent of their 1974 tax liabilities, as reported on their 1974 tax returns now being filed, up to a limit of $1,000. Married couples filing separately would receive a maximum refund of $500 each.
2. The temporary reduction will be a uniform 12 percent for all taxpayers up to about the $41,000 income level where the $1,000 maximum takes effect, and will then be a progressively smaller percentage for taxpayers above that level.
3. The refund will be paid in two equal installments in 1975 with payments of the first installment beginning in May and the second in September.
4. The proposal does not affect in any way the manner in which taxpayers complete and file their 1974 tax returns. They will file and pay their tax in accordance with existing law, without regard to the tax reduction. Later they will receive their refund checks from the Internal Revenue Service. Because no changes in deductions and other such items are involved, the Internal Revenue Service will be able to determine the amount of the refund and mail the checks without requiring further forms and computations from taxpayers.
5. The effect of the tax refund can be illustrated for a family of four as follows:

Adjusted gross income	Present tax	Proposed refund	Percent saving
$5,000	$98	$12	−12.0
7,000	402	48	−12.0
10,000	867	104	−12.0
12,500	1,261	151	−12.0
15,000	1,699	204	−12.0
20,000	2,600	319	−12.0
40,000	7,958	955	−12.0
50,000	11,465	1,000	−8.7
60,000	15,460	1,000	−6.5
100,000	33,340	1,000	−3.0
200,000	85,620	1,000	−1.2

Although the taxpayer will not figure his own refund, it is a simple matter for him to anticipate how much the Internal Revenue Service will be sending him, by calculating 12 percent of his total tax liability for the year (on Form 1040 for 1974, it is line 18, page 1, and on Form 1040A, line 19).

B. A Temporary Increase in Investment Tax Credit for Business and Farmers of $4 billion.

1. There will be an increase for one year in the investment tax credit to 12 percent for all taxpayers, including utilities (which presently have, in effect, a 4 percent credit). Utilities will continue to receive a 12 percent credit for two additional years for qualified investment in electrical power plants other than oil- or gas-fired facilities.

2. This increase in the credit will provide benefits of $4 billion in 1975 to immediately stimulate job-creating investment. (In view of the need for speedy enactment and the temporary nature of the increased credit, this change does not include the basic restructuring of the credit as proposed on a permanent basis in October, 1974.)

3. With respect to utilities, it includes a temporary increase in the amount of credit which may be used to offset income tax. Under current law, not more than 50 percent of the income tax liability for the year may be offset by the investment credit. Since many utilities have credits they have been unable to use because of this limitation, under this proposal utilities will be permitted to use the credit to offset up to 75 percent of their tax liability for 1975, 70 percent for 1976, 65 percent for 1977, and so on, until 1980, when they will in five annual steps have returned to the 50 percent limitation applicable to industry generally.

4. The 12 percent credit will apply to property placed in service during 1975 and to property ordered during 1975 if placed in service before the end of 1976. The credit will also be available to the extent of construction, reconstruction or erection of property by or for a taxpayer during 1975, without regard to the date ultimately placed in service. Similar rules will apply to investment in electrical power plants other than oil- or gas-fired facilities, for which the 12 percent credit will continue through 1977.

II. *Energy Conservation Taxes and Fees.* Energy taxes and fees, in conjunction with domestic crude oil price decontrol and the proposed windfall profits tax, would raise about $30 billion on an annual basis. The fees and taxes and related actions (discussed more fully in Part Two of this Fact Sheet) include:

A. Administrative Actions.

1. *Import Fee*—The President is acting immediately within existing authorities to increase import fees on crude oil and petroleum products. These new import fees will be modified upon passage of the President's legislative package.

(a) Import fees on crude oil and petroleum products will be increased by $1 effective February 1, 1975; an additional $1 effective March 1; and another $1 effective April 1, for a total increase of $3.00 per barrel. Currently existing fees will also remain in effect.

(b) FEA's "Old Oil Entitlements" program will be utilized to spread price increases on crude among all refiners, and to lessen disproportionate regional effects, such as New England, or in any specific industries or areas of human need where oil is essential.

(c) As of February 1975, product imports will cease to be covered by FEA's "Old Oil Entitlements" program. In order to overcome any severe regional impacts that could be caused by large fees in import dependent areas, imported products will receive a fee rebate corresponding to the benefit which would have been obtained under that program. The rebate should be approximately $1.00 in February, $1.40 in March, and $1.80 per barrel thereafter.

(d) The import fee program will reduce imports by an estimated 500,000 barrels per day and generate about $400 million per month in revenues by April.

2. *Crude Oil Price Decontrol*—To stimulate domestic production and further cut demand, steps will be taken to remove price controls on domestic crude iol by April 1, 1975, subject to congressional disapproval as provided by §4(g) of the Emergency Petroleum Allocation Act of 1973.

3. *Control of Imports*—The energy conservation measures to be imposed administratively outlined above, the energy conservation taxes outlined below and other energy conservation measures covered in Part Two below, will be supplemented by the use of Presidential power to limit oil imports as necessary to fully achieve the President's goals of reducing foreign oil imports by one million barrels a day by the end of 1975 and by two million barrels before the end of 1977.

B. Taxes Proposed to the Congress.

The President asked the Congress to pass within 90 days a comprehensive energy conservation tax program which will raise an estimated $30 billion in revenues on an annual basis. The taxes proposed are:

1. *Petroleum Excise Tax and Import Fee*—An excise tax on all domestic crude oil of $2 per barrel and a fee on imported crude oil and product imports of $2 per barrel.

2. *Natural Gas Excise Tax*—An excise tax on natural gas of 37¢ per thousand cubic feet (mcf), the equivalent on a Btu basis to the $2 per barrel petroleum excise tax and import fee.

3. *Windfall Profits Tax*—To ensure that the end of controls on crude oil prices does not result in one sector of the economy benefitting unfairly at the expense of other sectors, a windfall profits tax will be levied on the profits realized by producers on domestic oil. This tax is intended to recapture excessive profits which would otherwise be realized by producers as a result of the rise in international oil prices. This tax does not itself cause price increases, but simply recaptures the profits from price increases otherwise induced. It will, together with the income tax on such profits, produce revenues of approximately $12 billion. In aggregate, the windfall profits tax is sufficient to absorb all the profits that would otherwise flow from decontrolling oil prices, plus an additional $3 billion. More specifically the tax will operate as follows:

(a) A windfall profits tax at rates graduated from 15 percent to 90 percent will be imposed on that portion of the price per barrel that exceeds the producer's adjusted base price and therefore represents a windfall profit. The initial "adjusted base price" will be the producer's ceiling price per barrel on December 1, 1973 plus 95 cents to adjust for subsequent increased costs and higher price levels generally. Each month the bases will be adjusted upward on a specified schedule, which will gradually raise the adjusted base price to reflect long-run supply conditions and provide the incentive for new investment in petroleum exploration. Percentage depletion will not be allowed on the windfall profits tax liability.

(b) The windfall profits tax rates will be applied to prices per barrel in excess of applicable adjusted base prices as follows:

Portion of price per barrel in excess of base and subject to tax and amount of tax

Less than $0.20, 15% of amount within bracket; $0.20, under $0.50, $0.03 plus 30% of amount within bracket; $ .50, under $1.20, $0.12 plus 60% of amount within bracket; $1.20, under $3,00, $0.54 plus 80% of amount within bracket; $3.00 and over, $1.98 plus 90% of amount within bracket.

(c) The windfall profits tax does not include a "plowback" provision, nor does it contain exemptions for classes of production or producers. It does, however, include the limitation that the amount subject to tax may not exceed 75 percent of the net income from the barrel of crude oil. The tax will be retroactive to January 1, 1975.

(d) The windfall profits tax reduces the base for the depletion allowance.

III. *Permanent Tax Reductions and Payments to Non-Taxpayers Made Possible by Energy Conservation Taxes.* Of the $30 billion in revenue raised annually by the proposed conservation taxes outlined above, about $5 billion is paid by governments through the higher costs of energy in their purchases. This $5 billion includes: $3 billion by the Federal government and $2 billion by state and local governments.

The President is proposing to the Congress that $2 billion of the revenues be paid to State and local governments, pursuant to the distribution formulas applicable to general revenue sharing. The other $25 billion will be returned to the economy mostly in the form of tax cuts. As in the case of the temporary tax reduction, this permanent change will be divided between individuals and corporations on a 75-25 percent basis, about $19 billion for individuals and about $6 billion for corporations. Specifically, this would include:

A. *Reductions for Individuals in 1975*—Tax cuts for individuals will be achieved in two ways: (1) through an increase in the Low Income Allowance and (2) a cut in the schedule of tax rates. In this way, tax-paying individuals will receive a reduction of approximately $16½ billion, with proportionately larger cuts going to low- and middle-income families. The Low Income Allowance will be increased from the present $1,300 level to $2,600 for joint returns and $2,000 for single returns. That will bring the level at which returns are nontaxable to what is approximately the current "poverty level" of $5,600 for a family of 4. In addition, the tax rates applicable to various brackets of income will be reduced. The aggregate effects of these changes are as follows:

[1975 levels—dollars in billions]

Adjusted gross income class	Income tax paid under present law	Amount of income tax reduction	Percentage reduction in income tax
$0 to $3,000	$3	−$0.25	−83.3
$3,000 to $5,000	1.8	−1.20	−66.7
$5,000 to $7,000	4.0	−1.96	−49.0
$7,000 to $10,000	8.9	−3.38	−38.0
$10,000 to $15,000	21.9	−4.72	−21.6
$15,000 to $20,000	22.8	−2.70	−11.8
$20,000 to $50,000	44.4	−2.15	−4.8
$50,000 to $100,000	13.5	−.11	−.8
$100,000 and over	13.3	−.03	−.2
Total	130.9	[1] −16.50	−12.6

[1] Does not include payments to nontaxpayers.

EFFECT OF TAX CHANGES FOR A FAMILY OF 4

Adjusted gross income	Present tax [1]	New tax	Tax saving	Percent saving
$5,600	$185	0	$185	100.0
7,000	402	$110	292	72.6
10,000	867	518	349	40.3
12,500	1,261	961	300	23.8
15,000	1,699	1,478	221	13.0
20,000	2,660	2,450	210	7.9
30,000	4,988	4,837	151	3.0
40,000	7,958	7,828	130	1.6

[1] Calculated assuming low income allowance or itemized deductions equal to 17 percent of income, whichever is greater.

B. *Residential Conservation Tax Credit* (Discussed in the Energy Section of this Fact Sheet). The President seeks legislation to provide incentives to homeowners for making thermal efficiency improvements, such as storm windows and insulation, in existing homes. This measure, along with a stepped-up public information program, could save the equivalent of over 500,000 barrels of oil per day by 1985. Under this legislation:

1. A 15 percent tax credit retroactive to January 1, 1975 for the cost of certain improvements in thermal efficiency in residences would be provided. Tax credits would apply to the first $1,000 of expenditures and can be claimed during the next three years.
2. At least 18 million homes could qualify for these tax benefits, estimated to total about $500 million annually in tax credits.

C. *Payments to Nontaxpayers of $2 billion.* The final component of the $19 billion distribution to individuals is a distribution of nearly $2 billion to nontaxpayers and certain low-income taxpayers. For this low-income group, a special distribution of $80 per adult will be provided, as follows:

1. Adults who would pay no tax, even without the tax reductions in A above, will receive $80.

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2. Adults who receive less than $80 in such tax reductions will receive approximately the difference.

3. Persons not otherwise filing returns but eligible for these special distributions will make application on simple forms provided by the Internal Revenue Service on which they would furnish their name, address, social security number, and income.

4. For purposes of the special distribution, "adults" are individuals who during the year are at least 18 years old and who are not eligible to be claimed as a dependent under the Federal income tax laws.

5. Since most taxpayers will receive their 1975 income tax reductions in 1975 through reductions in withholding on wages and estimated tax payments, the special distribution to non-taxpayers and low-income taxpayers will also begin in 1975. It is anticipated that disbursement, based on 1974 income can be made in the summer of 1975.

D. *Tax Reductions for Corporations.* The corporate rate will be reduced by 6 percentage points, effectively lowering the corporate rate from 48 percent to 42 percent for 1975. The resulting benefit in 1975 is estimated at about $6 billion.

IV. *Moratorium on New Federal Spending Programs.* The President announced that he would propose no new Federal spending programs except for energy. He also indicated that he would not hesitate to veto any new spending programs passed by the Congress. The need for the moratorium is demonstrated by preliminary FY 1976 Budget estimates:

	Fiscal years—			Percent change	
	1974	1975	1976	1975–74	1976–75
Revenues	264.9	280	303	5.7	8.2
Outlays	268.4	314	349	17.0	11.1
Deficit	−3.5	32–34	45–47		

NOTE.—Estimates for 1975 and 1976 are subject to a variation of $2,000,000,000 in the final budget.

V. *Budget Reductions.* The budget figures shown above assume that significant budget reductions proposed by the President are effected. Including reductions proposed in a series of special messages sent to the last session of Congress, these budget reductions total more than $17 billion. Of this total, over $6 billion will result from the proposed 5% ceiling on Federal pay increases and on those Federal benefit programs that rise automatically with the Consumer Price Index.

The following summarizes reductions in 1976 spending to be included in the upcoming budget:

	Outlays (in billions)
Effect of budget reductions proposed last year (including administrative actions)	$8.9
Amounts overturned by the Congress	−1.1
Remaining savings	7.8
Further reductions to be proposed:	
Ceiling of 5 percent on Federal pay and programs tied to the CPI	6.1
Other actions planned	3.6
Total reductions	17.5

The following lists those programs to which the 5% ceiling will apply and shows spending amounts for them:

EFFECT OF 5 PERCENT CEILING ON PAY INCREASES AND PROGRAMS TIED TO CPI

[Fiscal year estimates; dollars in billions]

Programs affected	1975 outlays	1976 outlays: Without ceiling	1976 outlays: With ceiling	Difference 1975–76 (with ceiling)
Social security	64.5	74.3	71.8	+7.3
Railroad retirement	3.0	3.4	3.3	+.3
Supplemental Security Income	4.7	5.5	5.4	+.7
Civil service and military retirement payments	13.5	16.2	14.9	+1.4
Foreign Service retirement	.1	.1	.1	(1)
Food stamp program	3.7	3.9	3.6	−.1
Child nutrition	1.3	1.8	1.6	+.3
Federal salaries:				
Military	23.2	23.1	22.5	−.7
Civilian	35.5	38.9	38.0	+2.5
Coal miner benefits	1.0	1.0	1.0	(1)
Total	15 .5	168.2	162.1	+11.7

[1] Less than $50,000,000.

The 5% ceiling will take into account increases that have already occurred since January 1, 1975. Under the plan, after June 30, 1976, adjustments would be resumed in the same way as before the establishment of the 5% ceiling. However, no catchup of the increases lost under the ceiling would take place.

SUMMARY OF THE BUDGET IMPACT OF THE NEW TAXES AND FEES AND THE TAX CUTS

The following table summarizes the estimated direct budget impact, on a full-year-effective basis, of the tax and related changes proposed by the President to deal with the economic and energy situations:

	Estimated amounts (billions)
Revenue raising measures:	
Oil excise tax and import fee	+$9½
Natural gas excise tax	+ 8½
Windfall profits tax	+12
Total	+30
Revenue disbursing measures:	
Energy rebates:	
Income tax cuts, individuals	−16½
Residential tax credit	− ½
Nontaxpayer distribution	− 2
Corporate tax cut	− 6
State and local governments	− 2
Federal Government costs	− 3
Subtotal	−30
Temporary economic stimulus:	
Individual tax refunds	−12
Investment credit increase	− 4
Subtotal	−16
Total Revenue Disbursing Measures	−46

The tax and related changes will go into effect at different times, but all of them during the year 1975:

The energy conservation taxes are proposed to go into effect April 1.

The increase in import fees would go into effect: $1 per barrel February 1 to $2 per barrel March 1 to $3 per barrel, if the energy taxes have not been enacted, April 1.

The windfall profits tax on crude oil would be effective as of January 1, 1975. First payments of the tax would be made in the third quarter.

The permanent tax cuts for individuals and corporations made possible by the revenues from the energy conservation taxes would be effective as of January 1, 1975. The changes in withholding rates for individuals are expected to go into effect on June 1. The withholding changes will be adjusted so that 12 months reduction is accomplished in the 7 months from June through December.

The tax credit for energy-saving improvements to existing residences would go into effect as of January 1, 1975.

The special distribution to nontaxpayers is expected to be paid out in the summer of 1975.

The $2 billion distribution to State and local governments would be effective with the second quarter of 1975.

The temporary anti-recession tax cut for individuals will be paid out in two installments, in the second and third quarters.

The one-year increase in the investment tax credit becomes effective retroactively to January 1, 1975.

The timing of the various changes suggests a pattern of direct budget changes as follows. The timing of the economic stimulus or restraint will depend, as well, on such factors as the indirect effects of the budget changes, the timing of the pass-through of higher energy costs to final users, the extent to which the changes are anticipated, and a variety of monetary and financial developments that arise out of these changes.

TIMING OF DIRECT BUDGET IMPACT

[Dollars in billions]

	Calendar years—							
	1975				1976			
	I	II	III	IV	I	II	III	IV
Energy taxes	+0.2	+4.1	+12.6	+7.6	+7.6	+7.5	+7.5	+7.5
Return of energy revenues to economy:								
Tax reduction	0	−3.2	−9.0	−9.0	−5.6	−7.9	−6.3	−6.4
Nontaxpayers			−2.0				−2.0	
S. & L. Governments	0	−.5	−.5	−.5	−.5	−.5	−.5	−.5
Federal government	0	0	−.8	−.7	−.8	−.7	−.8	−.7
Temporary tax cut	0	−6.1	−7.9	−.6	−.8	−.9	0	0
Net effect	+.2	−5.7	−7.6	−3.2	−.1	−2.5	−2.1	−.1

INFLATION IMPACT

Both major parts of the tax package require inflation impact analysis. The excise taxes on crude oil and natural gas, combined with the tariff and decontrol of prices of both "old" oil and new natural gas, will add to the general price level immediately. The consumer price index is expected to rise by about two percent when these tax and price increases go into effect. However, this increase has a one-time impact on the price level that, with exceptions in some areas, should not add materially to inflationary pressures in future years.

The inflationary impact of the $16 billion anti-recession tax cut is more difficult to assess. While some economists may argue that a tax cut will add to the rate of inflation during the year ahead, others would contend that under present economic conditions, with unemployment high and many factories operating well below capacity, the predominant effect of the tax cut will be to stimulate spending, and that additional spending will have only a slight impact on prices.

Whatever the precise price impact of this $16 billion tax cut during 1975, the most important fact about it from the standpoint of inflation is that it is temporary. With the recession still under way, the rate of inflation will be coming down—it will be too high, but nevertheless moving in the right direction. After the economy gets well into recovery, however, too much stimulus would be sure to reverse the slowing of the inflation rate and, indeed, start a new acceleration. Thus, the tax stimulus must be remporary rather than permanent.

The President has declared a moratorium on new Federal spending programs for this same reason. Budget expenditures are rising rapidly this year, in part, because of programs to aid the unemployed. That is acceptable and highly desirable in a recession to relieve the burden on workers who are affected. It is also desirable because spending under those programs phases out as the economy recovers and unemployment falls. The increased Federal spending is only temporary.

Over the long-term, however, both Federal spending and lending have been rising much too fast, a fact that accounts for a substantial part of our current economic problems. A new burst of expenditure programs cannot help the Nation recover from the current recession—the impact would come much too late—but it would surely do much inflationary harm as the economy returns to prosperous conditions in the years ahead. Therefore, at the same time that taxes are being reduced to support a healthy recovery, policies that would revive inflationary pressures must be avoided after the recovery is underway. The size must be avoided after the recovery is underway. The size of currently projected Federal budget deficits precludes introduction of new spending programs now that would raise inflationary pressures later. For this reason, the President requested that no new spending programs, except as needed in the energy area, be enacted so that we can regain control of the budget over the long-run and permit a gradual return to reasonable price stability.

The President's Energy Program (Including Energy Taxes and Fees)

In addition to the comprehensive set of economic and energy policies discussed in the State of the Union Message, the President asked that the new Congress pass quickly certain legislative proposals originally requested in his October 8, 1974, message. Those proposals would:

1. Remove restrictions on the production of rice, peanuts, and extra-long-staple cotton.
2. Amend P.L. 480 to waive certain restrictions on shipments of food under that Act to needy countries for national interest or humanitarian reasons.
3. Amend the Antitrust Civil Process Act to strengthen the investigation powers of the Antitrust Division of the Department of Justice.
4. Eliminate the U.S. Withholding tax on foreign portfolio investments to encourage such investment.
5. Allow dividends paid on qualified preferred stock to be an authorized deduction for determining corporate income taxes to increase incentives for raising needed capital in the form of equity rather than debt.
6. Create a National Commission on Regulatory Reform and take prompt action on other reforms of regulatory and administrative procedures that will be recommended in the future.
7. Strengthen our financial institutions and provide a new tax incentive for investment in residential mortgages.
8. Permit more competition between different modes of surface transportation (The Surface Transportation Act).
9. Amend the Employment Act of 1946 to make explicit the goal of price stability. (Substitute "to promote maximum employment, maximum production, and stability of the general price level" in place of the present language, "to promote maximum employment, production and purchasing power.")

The President's Energy Program (Including Energy Taxes and Fees)

The President's State of the Union Address outlined the Nation's energy outlook, set forth national energy policy objectives, and described actions he is taking immediately and indicated proposals he is asking the Congress to pass.

BACKGROUND

Over the past two years, progress has been made in conserving energy, expanding energy R&D and improving Federal government energy organization. Despite such accomplishments, we have not succeeded in solving fundamental problems and our National energy situation is critical. Our reliance on foreign sources of petroleum is contributing to both inflationary and recessionary pressures in the United States. World economic stability is threatened and several industrialized nations dependent upon imported oil are facing severe economic disruption.

With respect to the U.S. energy situation:

Petroleum is readily available from foreign sources—but at arbitrarily high prices, causing massive outflow of dollars, and at the risk of increasing our Nation's vulnerability to severe economic disruption should another embargo be imposed.

Petroleum imports remain at high levels even at present high prices.

Domestic oil production continues to decline as older fields are depleted and new fields are years from production; 8.8 million barrels per day in 1974 compared to 9.2 million in 1973.

Total U.S. petroleum consumption is increasing, although at slower rates due to higher prices.

Natural gas shortages are forcing curtailment of supplies to many industrial firms and denial of service to new residential customers. (14% expected this winter versus 7% last year.) This is resulting in unemployment, reductions in the production of fertilizer needed to increase food supplies, and increased demand for alternative fuels—primarily imported oil.

Coal production is at about the same level as in the 1930's.

Nuclear energy accounts for only 1 percent of total energy supply and new plants are being delayed, postponed or cancelled.

Overall energy consumption is beginning to increase again.

U.S. vulnerability to economic and social impact from an embargo increases with higher imports and will continue to do so until we reverse current trends, ready standy plans, and increase petroleum storage.

Economic impacts of the four-fold increase in OPEC oil prices include:

Heavy outflow of U.S. dollars (and, in effect, jobs) to pay for growing oil imports—about $24 billion in 1974 compared to $2.7 billion in 1970.

Tremendous balance of payments deficits and possible economic collapse for those nations of Europe and Asia that must depend upon expensive imported oil as a primary energy source.

Accumulation of billions of dollars of surplus revenues in oil exporting nations—approximately $60 billion in 1974 alone.

U.S. ENERGY OUTLOOK

I. *Near-Term* (1975–1977): In the next 2-3 years, there are only a few steps that can be taken to increase domestic energy supply particularly due to the long lead time for new production. Oil imports will thus continue to rise unless demand is curbed.

II. *Mid-Term* (1975–1985): In the next ten years, there is greater flexibility. A number of actions can be taken to increase domestic supply, convert from foreign oil to domestic coal and nuclear energy, and reduce demand—if the Nation takes tough actions. Vulnerability to an embargo can be eliminated.

III. *Long-Term* (Beyond 1985): Emerging energy sources can play a bigger role in supplying U.S. needs—the results of the Nation's expanded energy research and development program. U.S. independence can be maintained. New technologies are the most significant opportunity for other consuming nations with limited domestic resources.

NATIONAL ENERGY POLICY GOALS AND PRINCIPLES ANNOUNCED BY THE PRESIDENT

I. *Near-Term* (1975–1977): Reduce oil imports by 1 million barrels per day by the end of 1975 and 2 million barrels by the end of 1977, through immediate actions to reduce energy demand and increase domestic supply.

(A) With no action, imports would be about 8 million barrels per day by the end of 1977, more than 20 percent above the 1973 pre-embargo levels.

(B) Acting to meet the 1977 goal will reduce imports below 1973 levels, assuring reduced vulnerability from an embargo and greater consumer nation cooperation.

(C) More drastic short-term reductions would have unacceptable economic impacts.

II. *Mid-Term* (1975–1985): Eliminate vulnerability by achieving the capacity for full energy independence by 1985. This means 1985 imports of no more than 3-5 million barrels of oil per day, all of which can be replaced immediately from a strategic storage system and managed with emergency measures.

(A) With no action, oil imports by 1985 could be reduced to zero at prices of $11 per barrel or more—or they could go substantially higher if world oil prices are reduced (e.g., at $7 per barrel, U.S. consumption could reach 24 million barrels per day with imports of above 12 million, or above 50% of the total.)

(B) The U.S. anticipates a reduction in world oil prices over the next several years. Hence, plans and policies must be established to achieve energy independence even at lower prices—countering the normal tendency to increase imports as the price declines.

(C) Actions to meet the 1985 goal will hold imports to no more than 3-5 million barrels per day, even at $7 per barrel prices. Protection against an embargo of the remaining imports can then be handled most economically with storage and standby emergency measures.

III. *Long-Term* (Beyond 1985): Within the century, the U.S. should strive to develop technology and energy resources to enable it to supply a significant share of the Free World's energy needs.

(A) Other consuming nations have insufficient fossil fuel resources to reach domestic energy self-sufficiency.

(B) The U.S. can again become a world energy supplier and foster world energy price stability—much the same as the nation did prior to the 1960's when it was a major supplier of world oil.

IV. *Principles*: Actions to achieve the above national energy goals must be based upon the following principles:

Provide energy to the American consumer at the lowest possible cost consistent with our need for secure energy supplies.

Make energy decisions consistent with our overall economic goals.

Balance environmental goals with energy requirements.

Rely upon the private sector and market forces as the most efficient means of achieving the Nation's goals, but act through the government where the private sector is unable to achieve our goals.

Seek equity among all our citizens in sharing of benefits and costs of our energy program.

Coordinate our energy policies with those of other consuming nations to promote interdependence, as well as independence.

ACTIONS ANNOUNCED TODAY BY THE PRESIDENT

I. Actions announced by the President to meet near-term goals (1975–1977)

To meet the national goals, the President outlined a comprehensive program of legislative proposals to the Congress which he requested be enacted within 90 days and administrative actions that he will begin implementing immediately. The legislative package is more effective and equitable than the administrative program, but the President indicated that the seriousness of the situation demanded immediate action. These actions will reduce overall energy demand, increase domestic production, increase conversion to coal, and reduce oil imports. They include:

(A) Administrative Actions

1. *Import Fee*—Because of the seriousness of the problem and because time is required for Congressional action on his legislative proposals, the President is acting immediately within existing authorities to increase the import fees on crude oil and petroleum products. These new import fees would be modified upon passage of the President's legislative package.

(a) Import fees on crude oil and petroleum products under the authority of the Trade Expansion Act of 1962, as amended, will be increased by $1 effective February 1, 1975; an additional $1 effective March 1; and another $1 effective April 1, for a total increase of $3.00 per barrel. Currently existing fees will also remain in effect.

(b) FEA's "Old Oil Entitlements" program will be utilized to spread price increases on crude among all refiners and to lessen disproportionate regional effects, particularly in the Northeast.

(c) As of February 1975, product imports will cease to be covered by FEA's "Old Oil Entitlements" program. In order to overcome any severe regional impacts that could be caused by large fees in import dependent areas, imported products will receive a rebate corresponding to the benefit which would have been obtained under that program. The rebate should be approximately $1.00 in February, $1.40 in March, and $1.80 per barrel in April.

(d) This import fee program would reduce imports by about 500,000 barrels per day. In April it would generate about $400 million per month in revenues.

2. *Backup Import Control Program*—The energy conservation measures and tax proposals will be supplemented by the use of Presidential power to limit oil imports as necessary to achieve the near-term goals.

3. *Crude Oil Price Decontrol*—To stimulate production and further cut demand, steps will be taken to remove price controls on domestic crude oil by April 1, 1975, subject to congressional disapproval as provided by §4(g) of the Emergency Petroleum Allocation Act of 1973.

4. *Increase Public Education on Energy Conservation*—Energy Resources Council will step up its efforts to provide information on energy conservation methods and benefits.

(B) Legislative Proposals

1. *Comprehensive Tax and Decontrol Program*—The President asked the Congress to pass within 90 days a comprehensive legislative package which could lead to reduction of oil imports of 900,000 barrels per day by 1975 and 1.6 million barrels by 1977. Average oil prices would rise about $4.00 per barrel of $.10 per gallon. The package which will raise $30 billion in revenues on an annual basis includes:

(a) *Windfall Profits Tax*—A tax on all domestic crude oil to capture the windfall profits resulting from price decontrol. The tax would take 88% of the windfall profits on crude oil and would phase out over several years. The tax would be retroactive to January 1, 1975.

(b) *Petroleum Excise Tax and Import Fee*—An excise tax on all domestic crude oil of $2 per barrel and a fee on imported crude oil and product imports of $2 per barrel. The new, administratively established import fee of $3 on crude oil would be reduced to $2.00 and $1.20 fee on products would be increased to $2.00 when the tax is enacted. The product import fee would keep the excise tax from encouraging foreign refining and the related loss of jobs to the U.S.

(c) *New Natural Gas Deregulation*—Remove Federal interstate price regulation on new natural gas to increase domestic production and reduce demand for scarce natural gas supplies.

(d) *Natural Gas Excise Tax*—An excise tax on natural gas of 37¢ per thousand cubic feet (mcf), which is equivalent on a Btu basis to the $2 per barrel petroleum excise tax and fee. This will discourage attempts to switch to natural gas and acts to reduce natural gas demand curtailments. Since the usual results of gas curtailments is a switch to oil, this will limit the growth of oil imports.

2. *Elk Hills Naval Petroleum Reserve.* The President is asking the Congress to permit production of the Elk Hills Naval Petroleum Reserve (NPR #1) under Navy control. Production could reach 160,000 barrels per day early in 1975 and 300,000 barrels per day by 1977. The oil produced would be used to top off Defense Department storage tanks, with the remainder sold at auction or exchanged for refined petroleum products used by the Department of Defense. Revenues would be used to finance further exploration, development and production of the Naval petroleum reserves and the strategic petroleum storage.

3. *Conversion to the Use of Domestic Coal.* The President is asking the Congress to amend the Clean Air Act and the Energy Supply and Environmental Coordination Act of 1974 to permit a vigorous program to make greater use of domestic coal to reduce the need for oil. This program would reduce the need

for oil imports by 100,000 barrels per day in 1975 and 300,000 barrels in 1977. These amendments would extend FEA's authority to grant prohibition orders from 1975 to 1977, prohibit powerplants early in the planning process from burning oil and gas, extend FEA enforcement authority from 1978 to 1985, and make clear that coal burning installations that had originally planned to convert from coal to oil be eligible for compliance date extensions. It would give EPA authority to extend compliance dates and eliminate restrictive regional environmental limitations. A plant could convert as long as its own emissions do not exceed ambient air quality standards.

II. Actions announced by the President to meet mid-term goals (1975–1985)

These actions are designed to meet the goal of achieving the capability for energy independence by 1985. The actions include measures to increase domestic energy production (including measures to cope with constraints and strike a balance between environmental and energy objectives), reduce energy demand, and prepare for any future emergency resulting from an embargo.

(A) Supply Actions

1. *Naval Petroleum Reserve No. 4 (Legislative proposal)*—The President is asking the Congress to authorize the exploration, development and production of NPR-4 in Alaska to provide petroleum for the domestic economy, with 15-20% earmarked for military needs and strategic storage. The reserves in NPR-4 which are now largely unexplored could provide at least 2 million barrels of oil per day by 1985. Under the legislative proposal:

(a) The President would be authorized to explore, develop and produce NPR-4.

(b) The Government's share of production (approximately 15-20%) would be used to help finance the strategic storage system and to help fulfill military petroleum requirements. Any other receipts go to the United States Treasury as miscellaneous receipts.

2. *OCS Leasing (Administrative)*—The President reaffirmed his intention to continue an aggressive Outer Continental Shelf leasing policy, including lease sales in the Atlantic, Pacific, and Gulf of Alaska. Decisions on individual lease sales will await completion of appropriate environmental studies. Increased OCS leasing could add domestic production of 1.5 million barrels of oil and additional supplies of natural gas by 1985. There will be close cooperation with Coastal states in their planning for possible increased local development. Funding for environmental studies and assistance to States for planning has been increased in FY 1975.

3. *Reducing Domestic Energy Price Uncertainty (Legislative proposal)*—Legislation will be requested authorizing and requiring the President to use tariffs, import quotas, import price floors, or other measures to achieve domestic energy price levels necessary to reach self-sufficiency goals. This legislation would enable the President to cope with possible large-scale fluctuations in world oil prices.

4. *Clean Air Act Amendments (Legislative proposal)*—In addition to the amendments outlined earlier for short-term goals, the President is asking for other Clean Air Act amendments needed for a balance between environmental and energy goals. These include:

(a) Legislative clarification to resolve problems resulting from court decisions with respect to significant air quality deterioration in areas already meeting health and welfare standards.

(b) Extension of compliance dates through 1985 to implement a new policy regarding stack gas scrubbers—to allow use of intermittent control systems in isolated power plants through 1985 and requiring other sources to achieve control as soon as possible.

(c) A pause for 5 years (1977–1981 model years) for nationwide auto emission standards at the current California levels for hydrocarbons (0.9 grams per mile) and carbon monoxide (9 grams per mile), and at 1975 standards (3.1 grams per mile) for oxides of nitrogen (with the exception of California which has adopted the 2.0 standard). These standards for hydrocarbons (HC) and carbon monoxide (CO) are more stringent than now required nationwide for 1976 model year's cars. The change from the levels now required for 1977–1981 model years in the law will have no significant impact on air quality standards, yet they will facilitate attainment of the goal of 40% increase in auto fuel efficiency by the 1980 model year.

(d) EPA will shortly begin comprehensive hearings on emission controls and fuel economy which will provide more detailed data for Congressional consideration.

5. *Surface Mining (Legislative proposal)*—The President is asking the Congress to pass a surface mining bill which strikes a balance between our desires for reclamation and environmental protection and our need to increase domestic coal production substantially over the next ten years. The proposed legislation will correct the problems which led to the President's veto of a surface mining bill last year.

6. *Coal Leasing (Administrative)*—To assure rapid production from existing leases and to make new, low sulfur coal supplies available, the President directed the Secretary of the Interior to:

(a) Adopt legal diligence requirements to assure timely production from existing leases.

(b) Meet with Western Governors to explore regional questions on economic, environmental and social impacts associated with new Federal coal leases.

(c) Design a program of new coal leasing consistent with timely development and adequate return on public assets, if proper environmental safeguards can be provided.

7. *Electric Utilities*—The President is asking the Congress for legislation concerned with utilities. In recent months, 60% of planned nuclear capacity and 30% of non-nuclear capacity additions have been postponed or cancelled by electric utilities. Financing problems are worsening and State utility commission practices have not assured recovery of costs and adequate earnings. The transition from oil and gas-fired plants to coal and nuclear has been slowed greatly—contributing to pressure for higher oil imports. Actions involve:

(a) *Uniform Investment Tax Credit (Legislative)*—an increase in the investment tax credit to eliminate the gap between utilities and other industries—currently a 4% rate applies to utilities and 7% to others.

(b) *Higher Investment Tax Credit (Legislative)*—An increase in investment tax credit for all industry, including utilities, for 1 year—to 12%. The 12% rate would be retained for two additional years for all power plants except oil and gas-fired facilities.

(c) *Preferred Stock Dividend Deductions (Legislative)*—A change in tax laws applicable to all industries, including utilities, which allows deductions of preferred stock dividends for tax purposes to reduce the cost of capital and stimulate equity rather than debt financing.

(d) *Mandated Reform of State Utility Commission Processes (Legislative)*—The legislation would selectively reform utility commission practices by: (1) setting a maximum limit of 5 months for rate or service proceedings; (2) requiring fuel adjustment pass-throughs, including taxes; (3) requiring that construction work in progress be included in a utility's rate base; (4) removing any rules prohibiting a utility from charging lower rates for electric power during off-peak hours; and (5) allowing the cost of pollution control equipment to be included in the rate base.

(e) *Energy Resources Council Study (Administrative)*—Review and report to the President on the entire regulatory process and financial situation relating to electric utilities and determine what further reforms or actions are needed. ERC will consult with State utility commissions, governors, public utilities and consumers.

8. *Nuclear Power*—To accelerate the growth of nuclear power which supplies only one percent of our energy needs, the President is proposing, in addition to actions outlined above:

(a) *Expedited Licensing and Siting (Legislative)*—A Nuclear Facility Licensing Act to assure more rapid siting and licensing of nuclear plants.

(b) *1976 Budget Increase (Legislative)*—An increase of $41 million in appropriations for nuclear safety, safeguards, and waste management.

9. *Energy Facilities Siting (Legislative)*—Legislation would reduce energy facility siting bottlenecks and assure sites for needed facilities with proper land use considerations:

(a) The legislation would require that states have a comprehensive and coordinated process for expeditious review and approval of energy facility applications; and state authorities which ensure that final State energy facility decisions cannot be nullified by actions of local governments.

(b) Provision for owners of eligible facilities or citizens to sue States for inaction.

(c) Provide no Federal role in making case by case siting decisions for the States.

(B) Energy Conservation Actions

The President announced a number of energy conservation measures to reduce demand, including:

1. *Auto Gasoline Mileage Increases (Administrative)*—The Secretary of Transportation has obtained written agreements with each of the major domestics automobile manufacturers which will yield a 40 percent improvement in fuel efficiency on a weighted average for all new autos by 1980 model year. These agreements are contingent upon relaxation of Clean Air Act auto emission standards. The agreement provides for interim goals, Federal monitoring and public reporting of progress.

2. *Building Thermal Standards (Legislative)*—The President is asking Congress for legislation to establish national mandatory thermal (heating and cooling) efficiency standards for new homes and commercial buildings which would save the equivalent of over one-half million barrels of oil per day by 1985. Under this legislation:

(a) The Secretary of Housing and Urban Development shall consult with engineering, architectural, consumer, labor, industry, and government representatives to advise on development of efficiency standards.

(b) Thermal standards for one and two-family dwellings will be developed and implementation would begin within one year. New minimum performance standards for energy in commercial and residential buildings would be developed and implemented as soon thereafter as practicable.

(c) Standards would be implemented by State and local governments through local building codes.

(d) The President also directed the Secretary of Housing and Urban Development to include energy conservation standards in new mobile home construction and safety standards.

3. *Residential Conservation Tax Credit*—The President is asking Congress for legislation to provide incentives to homeowners for making thermal efficiency improvements in existing homes. This measure, along with a stepped-up public information program, could save the equivalent of over 500,000 barrels per day by 1985. Under this legislation:

(a) A 15 percent tax credit retroactive to January 1, 1975 for the cost of certain improvements in thermal efficiency in residences would be provided. Tax credits would apply to the first $1,000 of expenditures and can be claimed during the next three years.

(b) Improvements such as storm windows, and insulation, would qualify for the tax credit.

4. *Low-Income Energy Conservation Program (Legislative)*—The President is proposing legislation to establish a Low-Income Energy Conservation Program to offer direct subsidies to low-income and elderly homeowners for certain energy conservation improvements such as insulation. The program is modeled upon a successful pilot program in Maine.

(a) The program would be administered by FEA, under new legislation, and the President is requesting supplemental appropriations in 1975 and $55 million in fiscal year 1976.

(b) Acting through the States, Federal funds would be provided to purchase materials. Volunteers or community groups could install the materials.

5. *Appliance Efficiency Standards (Administrative)*—The President directed the Energy Resources Council to develop energy efficiency goals for major appliances and to obtain agreements within six months frmo the major manufacturers of these appliances to comply with the goals. The goal is a 20%

average improvement by 1980 for all major appliances, including air conditioners, refrigerators and other home appliances. Achievement of these goals would save the equivalent of over one-half million barrels of oil per day by 1985. If agreement cannot be reached, the President will submit legislation to establish mandatory appliance efficiency standards.

6. *Appliance and Auto Efficiency Labelling Act (Legislative)*—The President will ask the Congress to enact a mandatory labelling bill to require that energy efficiency labels be placed on new appliances and autos.

(C) Emergency Preparedness

The President announced that comprehensive energy emergency legislation will be proposed, encompassing two major components.

1. *Strategic Petroleum Storage (Legislative)*—Development of an energy storage system of one billion barrels for domestic use and 300 million barrels for military use. The legislation will authorize the government to purchase and prepare the storage facilities (salt domes or steel tanks), while complex institutional questions are resolved and before oil for storage is actually purchased. FEA will develop the over-all program in cooperation with the Department of the Interior and the Department of Defense. All engineering, planning, and environmental studies would be completed within one year. The 1.3 billion barrels will not be complete for some years, since time is required to purchase, prepare, and fill the facilities.

2. *Standby and Planning Authorities (Legislative)*—The President is requesting a set of emergency standby authorities to be used to deal with any significant future energy shortages. These authorities would also enable the United States to fully implement the agreement on an International Energy Program between the United States and other nations signed on November 18, 1974. This legislation would include the authority to:

(a) Implement energy conservation plans to reduce demand for energy.

(b) Allocate petroleum products and establish price controls for allocated products.

(c) Ration fuels among end users.

(d) Allocate materials needed for energy production where such materials may be in short supply.

(e) Increase production of domestic oil.

(f) Regulate petroleum inventories.

III. Actions announced by the President to meet long-term goals (beyond 1985)

The expanded research and development program on which the nation is embarked will provide the basis for increasing domestic energy supplies and maintaining energy independence. It will also make it possible in the long run for the U.S. to export energy supplies and technology to others in the free world. Important elements are:

(A) *Synthetic Fuels Program (Administrative)*—The President announced a National Synthetic Fuels Commercialization Program to ensure at least one million barrels per day equivalent of synthetic fuels capacity by 1985, using technologies now nearing commercial application.

1. Synthetic fuel types to be considered will include synthetic crude from oil shale and a wide range of clean solid, liquid, and gaseous fuels derived from coal.

2. The Program would entail Federal incentives (possibly including price guarantees, purchase agreements, capital subsidies, leasing programs, etc.), granted competitively, and would be aimed at the production of selected types of gaseous and liquid fuels from both coal and oil shale.

3. The program will rely on existing legislative authorities, including those contained in the Federal Non-Nuclear Energy Research and Development Act of 1974, but new legislative authorities will be requested if necessary.

(B) Energy Research and Development Program—In the current fiscal year, the Federal Government has greatly increased its funding for energy research and development programs. These Federal programs are a part of a much larger national energy R & D effort and are carried out in cooperation with industry, colleges and universities and others. The President stated that his 1976

Budget will continue to emphasize these accelerated programs which include research and the development of technology for energy conservation and on all forms of energy including fossil fuels, nuclear fission and fusion, solar and geothermal.

(C) Energy Research and Development Administration—(ERDA). The President has signed an Executive Order which activates, effective January 19, 1975, the Energy Research and Development Administration. ERDA will bring together in a single agency the major Federal energy R & D programs which will have the responsibility for leading the national effort to develop technology to assure that the U.S. will have an ample and secure supply of energy at reasonable prices. ERDA consolidates major R & D functions previously handled by the AEC, Department of the Interior, National Science Foundation and Environmental Protection Agency. ERDA will also continue the basic research, nuclear materials production and weapons programs of the AEC.

IMPACTS OF NEAR AND MID-TERM ACTIONS ON PETROLEUM CONSUMPTION AND IMPORTS

Near term program (MMB/D)

	1975	1977
Consumption if no new actions	18.0	18.3
Imports if no new actions	6.5	8.0
IMPORT SAVINGS		
Less service savings by short-term actions:		
Production from Elk Hills	.2	.3
Coal conversion	.1	.3
Tax package	.9	1.6
Total import savings	1.2	2.2
Remaining imports	5.3	5.8

MID-TERM PROGRAM

	MMB/D
Consumption if no new actions	23.9
Imports if no new actions	12.7
1985 IMPACT ON IMPORTS	
Less savings achieved by following actions:	
OSC leasing	1.5
NPR-4 development	2.0
Coal conversion	.4
Synthetic fuel commercialization	.3
Auto efficiency standards	1.0
Continuation of taxes	2.1
Appliance efficiency goals	.1
Insulation tax credit	.3
Thermal standards	.3
Total import savings by actions	8.0
Remaining imports	4.7
Less:	
Emergency storage	3.0
Standby authorities	1.7
Net import vulnerability	0

International Energy Policy and Financing Arrangements

BACKGROUND

The cartel created by the Organization of Petroleum Exporting Countries (OPEC) has successfully increased their governments' price for exports of oil from approximately $2 per barrel in mid 1973 to $10 per barrel today. Even after paying for their own increased imports, OPEC nations will report a surplus of over $60 billion in 1974, which must be invested. Oil price increases have created serious problems for the world economy. Inflation pressures have been intensified. Domestic economies have been disrupted. Consuming nations have been reluctant to borrow to finance their oil purchases because of current balance of payments risks and the burden of future interest costs and the repayment of massive debts. International economic relations have been distorted by the large flows of capital and uncertainties about the future.

U.S. POSITION

The United States believes that the increased price of oil is the major international economic problem and has proposed a comprehensive program for reducing the current exorbitant price. Oil importing nations must cooperate to reduce consumption and accelerate the development of new sources of energy in order to create the economic conditions for a lower oil price. However, until the price of oil does decline, international stability must be protected by financing facilities to assure oil importing nations that financing will be available on reasonable terms to pay for their oil imports. The United States is active in developing these financing programs. Once a cooperative program for energy conservation and resource development and the interim financing arrangements are agreed upon, it will be possible to have constructive meetings with the oil producers.

ACTIONS TAKEN BY OIL CONSUMING NATIONS

The oil consuming nations have already created the International Energy Agency to coordinate conservation and resource development programs and policies for reacting to any future interruption of oil exports by producing nations. The four major elements of this cooperative program are:

An emergency sharing arrangement to immediately reduce member vulnerability to actual or threatened embargoes by producers;

A long-term cooperative program to reduce member-nation dependence on imported oil;

A comprehensive information system designed to improve our knowledge about the world oil market and to provide a basis for consultations among members and individual companies; and

A framework for coordinating relations with producing nations and other less developed consuming countries.

The International Energy Agency has been established as an autonomous organization under the OECD. It is open to all OECD nations willing and able to meet the obligations created by the program. This international agreement establishes a number of conservation and energy resources development goals but each member is left free to determine what domestic measures to use in achieving the targets. This flexibility enables the United States to coordinate our national and international energy goals.

OTHER U.S. ACTIONS AND PROPOSALS

The United States has also supported programs for protecting international stability against distorting financial flows created by the sudden increase of oil prices. Although the massive surplus of export earnings accumulated by the producing nations will have to be invested in the oil consuming nations, it is unlikely that these investments will be distributed so as to match exactly the financing needs of individual importing nations. Fortunately the existing complex of private and official financial institutions has, in the case of the industrialized countries, been effective in redistributing the massive oil export earnings to date. However, there is concern that some individual industrialized nations may not be able to continue to obtain needed funds at reasonable interest rates and terms during the transition period until supplies are increased, conservation efforts reduce oil imports and the price of oil declines. Therefore, the United States has supported various proposals for "reshuffling" the recycled funds among oil consuming nations, including:

Modification of International Monetary Fund (IMF) rules to permit more extensive use of existing IMF resources without further delay;

Creation of a financial solidarity facility as a "safety net" for participating OECD countries that are prepared to cooperate in an effort to increase conservation and energy resource development actions to create pressure to reduce the present price of oil;

Establishment of a special trust fund managed by the IMF which would extend balance of payments assistance to the most seriously affected developing nations on a concessional basis not now possible under IMF rules. The United States hopes that oil exporting nations might contribute a major share of the trust fund and that additional resources might be provided through the sale of a small portion of the IMF's gold holdings in which the differential between the original cost of the gold and the current market price would be added to the trust fund; and

An increase in IMF quotas which would make more resources available in 1976.

These proposals will be discussed at ministerial level meetings of the Group of Ten, the IMF Interim Committee and the International Monetary Fund/International Bank for Reconstruction and Development Committee in Washington, D.C. January 14 to 17.

In these meetings, the United States will continue to press its views concerning the fundamental importance of international cooperation to achieve necessary conservation and energy resources development goals as a basis for protecting our national security and underlying economic strength.

STATEMENT OF HON. CARL ALBERT, THE SPEAKER, U.S. HOUSE OF REPRESENTATIVES, WASHINGTON, D.C., JANUARY 13, 1975, ON THE REPORT OF A TEN-MEMBER TASK FORCE OF THE HOUSE DEMOCRATIC STEERING AND POLICY COMMITTEE

I am pleased to present to you today the report of a ten member task force of the House Democratic Steering and Policy Committee which I appointed last month to draft a comprehensive program of action for the Democratic Majority to pursue in the 94th Congress.

The Task Force, chaired by Congressman Jim Wright of Texas, has done an outstanding job. Their report is excellent and I wholeheartedly endorse and support its recommendations.

The full Steering and Policy Committee has approved the Committee's report and Congressman Wright will present it to the Democratic Caucus today.

This report is the most comprehensive statement ever made at the beginning of a new Congress by the Democratic Majority. It reenforces the Democratic Majority's strong commitment to take immediate and effective action to counter our nation's growing economic problems. The program sets a number of quick-action goals and calls upon specific committees to report the necessary legislation within ninety days. Beyond that, the program calls for enactment of new laws on other urgent matters within the lifetime of the 94th Congress.

The ninety-day program is aimed directly at the immediate problems facing Americans today: rising joblessness, eroded consumer purchasing power, declining production and the imperative need for some form of energy conservation and development of new energy supplies.

The action program will include a tax cut for middle and lower income families. I welcome indications from President Ford that he has revised his position and will now support a tax cut. His support will considerably enhance our chance for quick enactment.

During the initial ninety days of this Congress I have asked Congressman Wright to keep his task force monitoring the progress of this legislation through the various committees of the House. I have also asked the Committee to continue to develop middle and long range programs for consideration by the Steering and Policy Committee.

I will now call on Congressman Wright to explain the Democratic action program in more detail.

TO REVIVE THE ECONOMY: A CONGRESSIONAL PROGRAM OF ACTION

The 94th Congress, convening at a moment of historic challenge to the American economy, must assume a responsibility for decisive and resourceful leadership. The critical problems of this immediate time will not yield to half-way measures, timid initiatives or public relations appeals to voluntarism. The nation at this juncture could ill afford a passive Congress which did no more than await and then react in leisurely, piecemeal fashion to Executive recommendations. The public expects and is fully entitled to a coordinated program of legislative action beginning immediately and clearly designed to rebuild a healthy and stable economy in the United States. We are determined that the American people shall not be disappointed in this rightful expectation.

For too long has the economy been allowed to drift, devoid of purposeful direction. For four consecutive quarters the gross national product has shrunk. Unemployment has mounted steadily while the debilitating increase in the basic cost of living continues, its rate abated only slightly. During the past year, the purchasing power of real wages has declined by 5.6 percent. Bankruptcies and foreclosures have grown alarmingly. Residential housing starts have been cut approximately in half. Waning business investments in new plant and equipment and sagging consumer purchases reflect a lack of confidence in the future.

Mirroring the general economic malaise, the Federal budget has become a principal victim of the inflation-recession. Declining economic output and rising joblessness have diminished government revenues while the extortionate and unprecedented level of interest rates has added many billions of dollars to the cost of public debt service and the swelling ranks of unemployed have added extra billions to the cost of providing unemployment compensation and public assistance. It is clear that the government cannot realistically expect to balance its budget until it comes to grips with the recessionary forces which have contributed so massively to the budgetary imbalance.

The Democratic majority in the 94th Congress totally rejects the theory that the tides of economic decline are inexorable. We do not believe that the nation has grown old and tired and incapable of a vigorous economic revival. We shall not recline in supine acquiescence to forecasts which point toward an 8 percent unemployment rate by the end of 1975. We believe that there are things which can be done to reverse the trends of deterioration. We are determined that these things shall be done. To the maximum extent consistent with the responsibility of careful legislative draftsmanship, we shall insist that several of them be done very quickly.

As one of the three equal and coordinate branches of government, we invite and wholeheartedly welcome the cooperation of the Executive branch in supporting the following legislative recommendations, in suggesting refinements and improvements, and finally in faithfully and diligently executing such programs as we shall enact. Meanwhile, the Democratic congressional leadership calls upon various committees of the Congress to begin immediately in the implementation of the following agenda.

I. Immediate action goals

Due to the critical state of the nation's economy, we urgently request the committees of respective jurisdiction to prepare for presentation to the House the following items as soon as possible and in no case later than 90 days after our convening:

A. *Tax Relief and Reform*—The quickest way to generate the added purchasing power needed to counter the current recession and to ease the burden of those most damaged by inflation is through *tax relief* for low and middle income families. This can be achieved by increasing the personal income tax exemption, the standard deduction and minimum income allowance, by reducing the weight of payroll tax liabilities upon the working poor, and/or by a system of individual tax credits. The committee may wish to consider alternate or additional proposals. In any event, the amount of purchasing power released to the hands of Americans of modest income should be substantial and made quickly available.

The revenue loss thus suffered should be recouped to the extent reasonably possible by closing the loopholes that now enable large corporations and wealthy individuals to pay little or no taxes at all.

Action: Committee on Ways and Means.

B. *Lower Interest Rates*—A primary cause of the nation's simultaneous suffering from both inflation and recession is the misbegotten and prolonged policy of attempting to halt inflation solely by monetary restrictions and high interest rates. Manifestly, this policy has been counter-productive. It has not abated inflation. It has fed its fires, adding an extra layer of cost at every level of the market place. It has contributed cruelly to the massive tide of small business bankruptcies, brought homebuilding to a virtual halt, dipped a heavy hand into the pockets of most American families, added a multi-billion dollar burden to the national budget through increased debt service costs, and actually set in motion a retrogressive redistribution of national income, widening the gap between rich and poor and largely undoing the beneficial results of a decade of costly public programs.

Two immediate steps are needed to reduce interest rates and stimulate the flow of credit to vital economic sectors:

(1) *Increase the supply of credit*—Between July 1 and October 1 of 1974, the Federal Reserve Board constricted the growth of the money supply to less than 2 percent per year at an annual rate, far below the 4-6 percent growth rate needed to finance the long-run needs of the economy. Furthermore, the stop and go policies of the Federal Reserve Board and the uncertainty generated by these policies have contributed in a major way to excessive inflation, combined with excessive unemployment. Steady and stable economic growth requires a steady and stable policy and gradual but determined reduction of interest rates to a liveable level.

(2) *Credit Allocation*—With any given supply of new money overall, a credit allocation program is needed to channel credit *away from* speculative and inflationary uses—ranging from conglomerate take-overs to gambling in foreign exchange or gold—and *toward* vital credit-starved areas, such as housing, small business, food production, power generation, state and local governments, and productive capital investment. The expanded supply of credit for these purposes could be expected to lower interest rates for these necessary activities, thus lowering costs and reducing inflationary pressures, stimulate production of vital commodities and generate jobs in the private sector.

Action: Committee on Banking, Currency and Housing.

If the combination of these actions has not begun an appreciable reversal in interest rates by July 1 of this year, we recommend the serious consideration of more dramatic remedies, including the possibility of a progressive tax on interest income which would be prohibitive on income derived from excessive rates of interest (9 percent and above) and evolving downward to nominal on income derived from low rates of interest (below 6 percent).

Action: Committee on Ways and Means.

C. *The Problem of Rising Unemployment*—The Democratic majority in the Congress is unequivocally dedicated to the task of increasing productive jobs and reducing unemployment. The rate of unemployment hovers today at approximately 7.1 percent. Even by the optimistic forecasts of Administration economists, this figure is expected to exceed 7.5 percent by mid-1975. This is intolerable. The recent report of the Joint Economic Committee portrays an even grimmer picture, estimating that the modest goal of a 5 percent unemployment rate cannot be expected before 1980 in the absence of a sustained overall economic growth rate of 5 to 6 percent. As a direct immediate attack on this problem we propose two approaches:

(1) *Additional public service jobs*—The Joint Economic Committee last month estimated the overall national need for public service jobs at 750,000. Since then the number of unemployed has increased dramatically and the need for public service jobs is correspondingly greater, outstripping even the emergency programs enacted by the 93rd Congress. The stagnating state of the economy is distressingly revealed in the ratio of funds provided in the most recent appropriation, which earmarked roughly three times as much for unemployment compensation as for public service employment. While clearly the duty of a humane nation which cannot provide useful and remunerative work, unemployment compensation is by comparison economically non-productive and personally unsatisfying. Public service jobs, admittedly second best to gainful and lasting employment in private industry, should be provided in an adequate dimension to fill the slack productively while other policies are generating a revival of the private sector.

Action: Committee on Education and Labor.

(2) *Acceleration of approved public works*—It is ironic that the nation suffers increasing unemployment in the building trades and a growing inventory of idle construction equipment, with ever mounting public costs for unemployment payments, at the very time that literally billions of dollars worth of

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badly needed and Congressionally approved civil works projects (water pollution abatement, flood control, highway, public mass transit and other constructive works) suffer unconscionable delays in administrative processing of grant applications. Legislation should be enacted to mandate early administrative funding of such projects already authorized by Congress. Such legislation should dramatically reduce the time lag created by redundant reports and proliferating paperwork and mandate a swift acceleration of construction starts.

Action: Committee on Public Works and Transportation.

D. *An Emergency Housing Program*—Probably the most seriously depressed sector of our economy is the housing and construction industry. Performance has fallen fully 60 percent below our national commitment to meet the need for 2.3 million new housing starts each year. As in the automotive industry, depression in housing starts has widespread "ripple" effects throughout countless other sectors of the economy. It is imperative, therefore, that significant stimulus be applied rapidly. We ask the appropriate committees to consider and recommend emergency housing measures, including such alternatives as (1) increasing the ability of savings and loan and thrift institutions to attract adequate capital in this era of escalating interest rates which have starved the mortgage markets, (2) interest rate subsidies for low and medium priced housing for the near term until concerted effort succeeds in reducing interest rates to an acceptable level, (3) incentives for the preservation and rehabilitation of older existing housing, including multi-family dwellings, and (4) short term assistance to homeowners having difficulty making mortgage payments because of unemployment or a significant drop in income. Recognizing the complexities of the housing market and the mortgage market which fuels it, we expect the appropriate committees to exercise broad judgment and discretion in weighing these and other alternatives and to report specific recommendations to the Congress for action early in this session.

Action: Committees on Banking, Currency and Housing, Ways and Means.

E. *Emergency Energy Conservation Measures*—It now is apparent to all with the will to see that the alarmingly increasing gap between domestic production and domestic consumption of energy (especially petroleum) in the United States threatens not only our basic national economy but our national security as well. Just as the long term solution must lie in discovering ways to increase our production of energy, our interim salvation can be found only in vastly more effective conservation measures. We must control runaway energy consumption if the nation is to retain economic independence, let alone achieve stable and enduring economic growth. Voluntary restrictions simply have not worked. More stringent short-term measures are imperative.

To reduce our immediate energy usage and our resulting dependence on foreign oil sources, we commend to the appropriate committees for their consideration and recommendation one or more of the following courses: (1) mandatory allocation of petroleum and other forms of energy, (2) enactment of higher gasoline taxes, (3) gasoline and home fuel oil rationing, (4) higher manufacturer's excise taxes on pleasure craft and private automobiles of high horsepower, (5) restricting the sale of gasoline on certain days such as week-ends, (6) long term, low interest loans for home insulation improvements, and (7) a national examination of utility rate structures of a type that encourage energy wastefulness by rewarding large usage with low rates.

We recognize that the above include hard and in some cases unpalatable choices and that the range of options should not be limited to those here enumerated. In specific connection with (2) above, we urge very cautious and careful consideration of the effect of any proposed fuel tax increase upon the millions of working Americans who have no available or practical alternative to the use of their automobiles in getting to and from their daily work and in the conduct of their necessary business activities. A punitive retail sales tax in the range of an additional 20¢ per gallon on gasoline, as advocated by some, predictably would penalize most harshly those whose consumption of fuel is directly related to their essential employment, while providing a relatively negligible disincentive to the use of scarce fuel by the wealthy for purposes of pleasure. We suggest, therefore, that some consideration might be given to dedicating revenues from any increase in the retail gasoline tax to a Trust

Fund for a sharply accelerated program to develop alternative fuel sources (See II B below). In the alternative, we would strongly recommend rebates adequate to compensate workers for their loss of income.

Action: Committees on Commerce and Health, and Ways and Means.

F. *Wage and Price Stability*—We need a tough but selective program to halt the current wage-price spiral. Phases I and II of the Nixon Administration program controlled wages with a vengeance while permitting prices to rise, resulting in a cruel diminution of the wage earner's purchasing power. There must be no return to such a policy. The present Council on Wage and Price Stability is a toothless tiger. The need is for an independent agency with subpoena power, the resources to hold extensive hearings, the authority to delay price increases up to 90 days, and in extreme cases the authority to impose controls more permanently on a selective basis. The selectivity should be aimed at those industries where near-monopoly and "administered" prices render the forces of true competition inoperable.

Action: Committees on Banking, Currency and Housing, and Government Operations.

G. *Programs for the Needy*—While utilizing every effective means to bring about a national economic revival, we cannot lose sight of the anguish of those whose vulnerability to the twin menaces of recession and inflation has made them the principal victims of the nation's present economic plight. We urge in particular the early enactment of legislation to forestall the apparent intention of the Administration to increase the price of food stamps to low income Americans, and a more realistic measure of help to the needy aged, blind, and disabled.

Action: Committees on Agriculture, and Ways and Means.

II. Other imperative goals of the 94th Congress

While the six goals listed above claim a priority of very early attention due to the impelling need for swift and decisive action to begin the economic revival, there are other goals no less imperative and no less important to the nation's economic growth and health. These goals, too, should be effectively addressed by the 94th Congress during its 1975 session.

A. *Health and Medical Care*—Circumstances dictate the timely enactment of a comprehensive national program to assure adequate health and medical care for all. The ravages inflicted upon family income by the steadily rising costs of medical care are well known to most Americans. Less well recognized is the significant impact such a plan could have on the nation's economy. The job-creating effects of public works programs, housing and other construction activities are easily apparent, but none of these exceeds health and medical care programs in the potential for generating useful employment. Health care is one of the most labor-intensive industries in the entire economy.

Action: Committee on Ways and Means, and Commerce and Health.

B. *New Sources of Energy*—In addition to the strictly conservation methods outlined above (Part I, Item E) it is obvious that the nation urgently needs to take major steps toward energy self-sufficiency. We ask the appropriate committees to consider and report their recommendations on ways to encourage exploration for new domestic oil and gas supplies, to encourage the development of secondary and tertiary recovery techniques for existing wells, to develop a national strategic energy reserve, and to mandate a concentrated program of research and development aimed at other sources and methods of energy production.

In the intermediate time frame, it is obvious that the nation shall depend to a profoundly greater degree upon coal and nuclear power. We, therefore, recommend to the appropriate Committees the early perfection of responsible surface mining legislation and the improvement of regulatory procedures relative to the construction of energy production facilities.

The long term solution must of necessity feature the earliest possible development of energy alternatives to petroleum. This concentrated effort should include the rapid perfection of economically viable methods of coal conversion and levels of funding adequate to accelerate pure and applied research in solar energy, nuclear fusion, geothermal power, the environmentally acceptable recovery of oil from shale, and any other alternatives that committees may choose to consider.

Twice before in our history we have made monumental achievements through concentrated "crash" programs: the Manhattan Project which resulted in unlocking the secrets of the atom and the Space Program spurred by President Kennedy's audacious promise to put a man on the moon in less than a decade. Our present crisis involving the need for energy self-sufficiency is surely no less urgent and is vastly more complicated and predictably more costly. To guarantee the steady and consistent maintenance of effort, free from starts and stops, we have suggested the possibility of a Trust Fund dedicated expressly to this singularly vital endeavor.

Action: Committees on Science and Technology, Interior, Ways and Means, Appropriations, and the Joint Committee on Atomic Energy.

C. *Anti-Trust Legislation*—Mindful of the recent action of Congress in increasing penalties under existing anti-trust laws, we feel the time has come for a broad new look aimed at tightening and strengthening these basic laws. Increasing sectors of our economy have become alarmingly vulnerable to monopoly and effective oligopoly conducive to administered pricing practices based solely on the seller's determination regardless of the efficiency of production. We have witnessed the systematic development of planned obsolescence in a variety of products and a growing tendency to reduce output rather than prices and thus make the growing unit of profit compensate for a declining volume of sales.

These practices manifestly contribute to inflation and mitigate against national economic recovery and against the best interest of consumers everywhere. The fundamental laws of competitive marketplace economics are effectively repealed where such concentrated economic might is permitted to operate. Without attempting an all-inclusive list, we feel that this condition has come to apply particularly in the sectors of steel, automobile production, communications, food processing, banking, oil and electrical production and marketing, as well as in certain multi-national corporations. We ask the appropriate committee to initiate careful oversight hearings on the effectiveness of present anti-trust laws and where justified to report new legislation to tighten and strengthen those laws so as to make these economically destructive practices impossible.

Action: Committee on the Judiciary.

D. *Consumer Protection*—It is manifestly in the interests of the consumer that safeguards be established against inferior goods as well as deceptive advertising and merchandizing techniques. Equally important to the long-run health and vibrancy of our economy is insistence that the nation's manpower and material resources be expanded to produce durable, high-quality goods and services at prices affordable by the mass market. In pursuit of this goal, the Congress should promptly enact legislation establishing an effective and workable *Consumer Protection Agency.*

Action: Committee on Government Operations.

E. *Food Production*—In the past decade sweeping changes have dictated dramatic reversal in our basic agricultural policies—away from efforts aimed at curtailing excess production to avoid surpluses and toward the new goal of maximizing the nation's agricultural production to avoid shortages. The old programs contained certain built-in incentives not to produce. The new programs must feature incentives to achieve greater production from the nation's agricultural acreage. We request the appropriate committees therefore to conduct a careful review of such basic agricultural programs as acreage allotments, soil bank and acreage reserves in light of the nation's present and future requirements.

We also recommend that consideration be given to: (1) establishing a food export monitoring and management system to anticipate and prevent the development of domestic food shortages, (2) reestablishing a national grain reserve system to stabilize supplies, and (3) appropriate ways to guarantee a significant increase in competition and efficiency in the processing and distribution sectors of the food industry and an equitable rate of return to the growers themselves.

Action: Committee on Agriculture.

F. *Aid to Specific Industries*—Some industries that are presently depressed due to the slack economy and/or the energy shortage may in fact be faced with even more profound long term problems. Automobile production, where massive lay-offs recently have occurred, is a prime example. This particular industry looks to Congress for future guidance and direction. We request the appropriate committees to consider carefully what incentives may be provided to assist this industry in meeting the public need for less expensive and more energy efficient vehicles.

We also ask the appropriate Committees to consider and recommend means of assistance to such other industries as are vital to the nation's economic health, including both existing programs and the possible need for new programs.

Action: Committees on Banking, Currency and Housing, Commerce and Health, Ways and Means.

G. *Help for Senior Citizens*—Of all of our population, the elderly are among the hardest hit by inflation. Most of them are living on fixed incomes, and the cost of living adjustments provided in Social Security benefits in the past have not been sufficient nor made quickly enough to prevent extreme hardship in many cases. Improvements in the Social Security system are thus urgently needed.

Action: Committee on Ways and Means.

The above action agenda is not intended as an exhaustive recitation of the problems confronting the nation or of the important legislation to be considered by the 94th Congress. Its purpose is to bring direct and immediate focus upon the truly urgent problems of the nation's economy which demand creative initiative and swift, decisive action on the part of the people's elected representatives in Congress. Some of the problems have been years in developing. They cannot be solved in a day. But they are not insoluble. Every day of unnecessary delay in coming directly to grips with them will only aggravate their dimensions. So let us begin.

ADDRESS OF HON. CARL ALBERT, THE SPEAKER, U.S. HOUSE OF REPRESENTATIVES, WASHINGTON, D.C., JANUARY 20, 1975, IN RESPONSE TO PRESIDENT FORD'S ECONOMIC SPEECH

Good evening. This is a time of historic challenge to the American economy and to the strength, the wisdom and the resourcefulness of the nation's leadership.

I realize that you are now looking to the Congress, the institution most directly responsive and responsible to the people, to find the constructive measures we now so desperately need. You demand that we legislate well, that we legislate with urgency and that we meet four square the complex and varied miseries that afflict our country.

Tonight I want to talk with you about the national agenda for economic action which the Democratic Leadership has presented to the 94th Congress.

In activating this program we want and need the cooperation of the President. Our economic plight is neither a Democratic problem nor a Republican problem. It is a national problem. We are not seeking confrontation. We are seeking solutions.

Our first goal is to help the more than six and one-half million Americans who are out of work find a good job. We propose four things. First, a substantial tax cut that will encourage people to put money back into the economy so that production can be increased and people put back to work. Second, we seek a lowering of excessively high interest rates that have increased both inflation and unemployment. Third, we want to see credit channeled into productive rather than non-productive enterprise. Fourth, we propose a strong public service jobs program to take people away from unemployment compensation and put them back into productive jobs.

To stimulate purchasing power, we propose a tax cut. President Ford's proposal for a rebate of 1974 taxes puts 43% of the refund into the hands of the richest 17% of the population. The Democratic Leadership has asked the House to pass a substantial tax reduction bill for middle and lower income persons only early in March. In addition we need to provide for effective tax reform to recoup as much of the lost tax revenues as possible, to provide for long term tax relief to middle and lower income families, to close loopholes and to distribute the tax burden more equitably.

To lower unemployment we must find ways to lower interest rates and channel credit into productive enterprise. Excessively high interest rates, which are inflationary in themselves, have contributed cruelly to the massive tide of small business bankruptcies, brought homebuilding to a virtual halt, and have dipped a heavy hand into the pockets of many American families.

Interest rates must be reduced. Also, credit must be channeled into productive areas such as housing, food production, power generation, small business, state and local governments.

Responsible and stable federal reserve policies are essential in lowering interest rates and channeling credit. If administrative action has not begun in these two areas by July 1 of this year we will seek legislative remedies, possibly asking for a progressive tax on interest income.

In addition to taking action to reduce interest rates, the Democratic Congress is committed to formulating emergency housing programs to break the downward course of this great sector of our economy.

But, one of the most direct ways to put people back to work is through public service jobs. In these extraordinary times when millions of Americans cannot find work and their families face the frightening prospect of going without food, without heat and without shelter, the federal government should provide work through public service employment. These jobs will keep Americans working and eating until the economy is revived to the point where jobs open in private business.

Last month, the 93rd Congress enacted emergency legislation to send 330,000 Americans back to work. But more jobs are needed and the 94th Congress will work quickly to provide them. Legislation should also be enacted to mandate early administrative implementation of public works projects already authorized by Congress.

In addition to action in the areas of taxes, interest rates, credit allocation, and employment, we must guard against a new round of inflationary price increases through a tough but selective price control policy. The Democratic leadership proposes the establishment of an independent agency with subpoena power, the resources to hold extensive hearings, and the authority to delay price increases for up to 90 days, and in extreme cases the power to impose controls for a longer period on a selective basis. This action is necessary to counter price increases in those industries where concentrated economic power makes the free play of competition impossible. In addition to a price policy the Congress will take a broad new look at tightening and strengthening our antitrust laws.

Central to the entire economic picture is energy. We commend the President for insisting on some form of mandatory energy conservation. However, we in Congress have serious reservations about the method of energy conservation. The President's energy proposals, including a tax on all fuel, would have an astounding inflationary impact, and would seriously disrupt many industries. Under his proposal you would pay not only as much as 25% more for gasoline but also more for heating oil, electricity, food, fertilizer and other products as well.

This huge rise in prices would more than wipe out the positive effect of a tax cut. What conceivable good will it do for a family to receive a $75 to $100 tax rebate if that same family is then required to pay $250 to $300 more during the year for gasoline to get to and from work and to heat their home. This program would be inflationary; it would hit the average family hardest; and it would contribute to a worsening of the recession. Furthermore, there is no assurance that it would cut gasoline consumption.

Both the President and Congress see energy conservation as a short-term necessity. But there is much we can do—much that is effective—that lies between doing nothing at all and doing things which are so drastic as to endanger our economic stability. Before we resort to higher gasoline prices to reduce consumption, we should consider a more moderate approach. This might include gasoline rationing, gasless days, excise taxes on high horsepower vehicles, and any other measures the Congress may deem advisable.

Not only must we conserve energy but we must also cut down on the waste of energy. The Congress will act to combat energy waste. We will give incentives for installation of home heating insulation, heat pumps, solar energy systems, and demand increased gas mileage from automobiles.

Furthermore, the Congress will continue its support of energy development. We will examine ways to encourage exploration for new domestic oil and gas supplies, further improve recovery from existing wells, develop a national strategic energy reserve and increase research and development methods aimed at finding alternative sources of energy.

Going hand in hand with the health of our economy is the health of the American people. When President Ford took office last August he asked the Congress to enact a national health insurance program. Last week he left the inference that he would veto such a program if passed by the Congress. I ask the President to join the Congress in giving national health insurance the high priority it deserves.

Recession and inflation attack the old and poor harder than anyone else. I am convinced that the worst thing we could do during this difficult time is to burden social security and food stamp recipients with the brunt of the recession as the President suggests. Those least able to protect themselves will be treated fairly and equitably by the Congress.

Missing from the Administration's program has been any real expression of concern about the depression in American agriculture. Rising costs have forced many producers of food out of business, raising the possibility of shortages and even higher prices to the consumer.

If the Administration fails to act, many farmers, ranchers and dairymen face the loss of their entire capital investment and productive capacity which will take years to replace. I am asking the appropriate committees of the Congress and our Special Democratic Task Force to give special emphasis to these problems in the early days of this session.

Tonight I have talked about some of the problems affecting our economy and what the Congress intends to do about them. The task is great, but the Congress you elected in November is equal to the challenge.

Indeed this is only an outline of the beginning of our work. But we will prevail in our task of bringing order and prosperity back to our ecomony. And we will go on from there, as the Democratic Party in Congress has always done, to work toward greater justice and greater freedom and greater opportunity for all the people of our nation.

Chairman HUMPHREY. We will lead off with Mr. Ackley.

Senator PROXMIRE. Mr. Chairman, may I place in the record your excellent television address of last night. It was realistic, it was constructive, it was positive, and I thought it was a most useful presentation.

I also want to congratulate the new chairman. Having served as chairman of this committee for a few years I think it is a wonderful committee with great potentiality. I think it is in the best possible hands now of a man of great intelligence and also a man who understands our economy, as few people in the country do; also a man with great respect for the experts of the kind that we have testifying here this morning.

[The address referred to follows:]

REMARKS BY SENATOR HUBERT H. HUMPHREY IN RESPONSE TO THE PRESIDENT'S ENERGY, ECONOMIC MESSAGE, JANUARY 22, 1975, BROADCAST ON CBS-TV

Good evening. If it were possible for *you* to talk with me tonight, I think I know what you'd probably say.

"No more speeches, Mr. Humphrey. In the past months all we've heard are words. What we want is some action."

Well if that's your message to me, I hear you loud and clear.

Both Congress and the President have wasted valuable time in getting our economy soundly on the road to recovery. There's no sense denying it. And it's futile arguing over who's more to blame.

We can't change the past. But if you can stand one more speech, I believe you'll be surprised to learn what Congress is planning for the immediate future . . . the decisive action that is long overdue.

I can report broad agreement among Congress and the President as to the need for an individual and corporate tax cut—to stimulate purchasing power, to accelerate business investment, to lower unemployment, to restore economic growth. Moreover, this tax cut can be a reality within four to six weeks—and that's what we mean by action.

Until the President's remarks last week, our country was like a seriously ill person whose doctors in the Executive Branch and Congress could agree on neither the diagnosis of the illness nor the proper treatment. President Ford initially proposed a curious remedy—his five-percent surtax. A tax increase in the midst of recession would have bled the country of its economic strength, weakening the patient still further.

Fortunately, Congress rejected this remedy. But while the doctors were arguing over the cure, the patient's health deteriorated rapidly.

At last, the doctors agreed on the source of the disease—the most serious recession since World War II—and at least part of the proper treatment—a large dose of economic penicillin in the form of tax cuts to bring the patient back to full health and normal activity.

The first action of this Congress must be a tax reduction for individuals and business. This can and must be done in the next 30 days.

We have now only to decide on the size and frequency of the tax cut and—most importantly—who gets the benefits.

Under the President's tax cut plan, a family of four with an income of $10,000 a year would receive only $100. Under a bill I have introduced the same family of four would receive a tax cut of $300.

President Ford's tax cut puts 43 percent of the benefits into the hands of the richest 17 percent of the population. This is not only unfair, it is bad economics because it will not stimulate the economy. Congress will not accept the President's plan.

I recommend an overall tax cut of about $20 billion. While some people may consider this too much, they should recall that in 1964 the Congress cut taxes by about $12 billion—when the economy was smaller and the recession less severe. In today's economy, that would be equal to a tax cut of about $26 billion.

If economic penicillin is needed to combat the recession, then we should prescribe a dose large enough to help the patient. And we cannot afford to wait until May and September to get extra money into your pocketbook, as the President advocates. Instead, Congress should provide a reduction of withholding rates, retroactive to January 1, 1975, to increase your take-home pay and to keep it coming on a weekly basis.

The tax cut I have proposed would reduce taxes by 61 percent for those earning under $5,000, by 32 percent for families with incomes ranging from $5,000 to $10,000, by 21 percent for those earning from $10,000 to $15,000, and by 16 percent for taxpayers with $15,000 to $20,000 incomes.

In addition to these individual tax cuts, business and farms need an increased investment tax credit—to provide new buildings, new machinery and equipment, and most importantly, new jobs. On this issue the President and the majority of Democrats stand together.

Next, the Congress should turn its attention to tax reform to provide greater fairness in our tax structure. By this, I mean phasing out the oil depletion allowance, strengthening the minimum tax to ensure that the rich pay their share, and eliminating foreign tax preferences that send jobs and capital abroad. And there are many more.

People have a right to expect that the tax laws will be fair.

Prompt action on a tax cut is only the first step on the Congressional agenda. Six and one-half million persons are presently out of work and that number will surely increase. One thing is certain: a tax cut is of little direct help to a person without a job.

In Congress, Democrats and Republicans alike, are committed to putting more people to work, to getting them off unemployment lines and into jobs where they can support their families and pay their share of taxes.

What America needs are jobs, not "Win" buttons. What Americans want is work, not welfare.

On its own initiative, Congress passed an expanded public service employment program providing 300,000 jobs in hospitals, schools, day-care centers, and other public facilities. Since this program was passed in December, half a million more people have become unemployed.

This simply means that more must be done. Democrats propose that Congress immediately authorize an additional 500,000 public service jobs. And an additional 250,000 jobs for each one-half percentage point rise in the unemployment rate.

Yes, I know that this will cost money, but it costs more to have people unemployed. When you're working, you're producing—you're both a consumer and a taxpayer—you're self-sufficient.

Unemployment is not only the loss of a job and income; it is being told you are not needed. This violates the promise of America.

The President has said that he will veto any new federal spending. He proposed that those on social security shall not receive more than a five percent increase in benefits, even though the cost of living has increased by 12 percent. Those on fixed incomes—the elderly, the blind, and the disabled—have suffered the most from inflation. To deny them an increase in benefits equal to the rise in the cost of living is wrong and unacceptable. The Congress will not permit it.

There is no sense punishing people who rely on a small social security check or raising the price of food stamps for people who are already struggling to feed their families.

Congress is no less concerned than the President over the growth in federal spending and in controlling a large and wasteful bureaucracy. Last year, for example, we cut the President's budget requests by $5 billion.

There is one basic reason for the record-breaking deficits that hav aeccumulated since 1969.

On two occasions, in 1969–70 and 1973–74, former President Nixon attempted to control inflation by slowing down economic growth. During these deliberately-engineered recessions, as production declined, incomes also went down, profits fell, people lost their jobs and, as a result, federal tax receipts dropped sharply. Unemployed workers and businessmen and farmers operating at a loss don't pay taxes.

In these recession years, the federal deficit grew by leaps and bounds. In just this year and the next we can expect a federal deficit of $80 billion. This is frightening.

The way to end these deficits is to get the economy moving—to get people back to work and business to invest. And we can do this with a prompt tax cut, sensible federal spending, and ample credit with lower interest rates.

These are among the major items on the Congressional economic agenda. They will offer each of you a greater measure of security as America begins the long period of economic recovery. But lasting economic health is impossible unless wise actions are taken in several additional areas.

First, let me discuss money and credit. Tight money and high interest rates have not halted inflation. They have added to it. That's obvious to everyone. But they *have* choked off economic growth, brought homebuilding to a virtual halt, increased bankruptcies among businessmen and farmers, and created havoc in our capital markets.

Yet in his remarks last week, President Ford was totally silent on the money and credit policies that will make economic recovery possible. I propose that the President convene an emergency conference on monetary policy, attended by the Federal Reserve Board and representatives of business, labor, banking, farming, and the investment community.

This conference should be convened for the express purpose of arriving at monetary policies that are fully consistent with the goal of economic recovery. Unless this is done, the desired economic effect of the tax cut and other economic recovery measures will be largely wasted.

I further propose that the President use the Credit Control Act of 1969 to channel credit into sectors of the economy now starved for funds, primarily housing, state and local government, small businesses, and agriculture.

Now let me say a word about housing.

There is no way out of a national recession while housing is in a depression. Today hundreds of thousands of skilled construction workers are out of their jobs and thousands of contractors are without work.

Yet America needs homes and many of our cities need massive reconstruction.

As early as 1949, Congress established a national goal of a decent home and a suitable living environment for every American family. To achieve these goals and rescue the housing industry, strong action is necessary.

First, Mr. President, release the funds that the Congress has provided for housing.

Second, Congress should consider establishing a National Housing Bank with sufficient funds to provide interest subsidies and other financing for low- and middle-income taxpayers. Third, the President should use the authority he now has under public law to allocate credit for housing.

Economic recovery also depends on a sound national energy policy that can be supported by every American. This will require a policy that is fair and a policy that works.

I recognize that President Ford and his advisers are grappling with a very difficult problem. Each course of action brings with it certain problems and difficulties. But on the basis of the evidence presented so far, the President appears to have chosen the least desirable set of alternatives. The President's plan would add to our inflation and deepen the recession with no assurance of substantially reducing energy consumption.

The President's energy plan will increase the price of imported oil. It removes price controls from domestic oil and gas and it places heavy new taxes on imported and domestic oil. This means higher prices.

There is simply no hard evidence that consumption of energy would be significantly reduced under the President's plan. But there is no doubt whatever as to its economic impact. A new wave of inflation would sweep through the economy.

In the past 18 months, the price of oil shot up from about $4.50 per barrel to the current average of about $9.50. President Ford's plan would increase oil prices by that much again—to over $14 per barrel.

The direct effects of this price increase add up to about $45 billion, or $15 billion more than the President's proposed tax reductions. Others estimate that the cost may be $55 to $60 billion. But whatever the figures, this simply means that you will be paying out a lot more in higher energy costs than you will be getting back in lower taxes.

For example, for a family of four earning $15,000, the proposed $220 tax reduction under the Ford plan will fall far short of the estimated $800 more you will be paying for gasoline, heating oil, electricity, and natural gas. Not to mention the added costs for transportation, food, and even clothing. I don't believe your family can afford this extra $580 that the President's plan asks you to pay.

Looked at another way, this will mean consumers and businesses will have to pay an additional 19% for gasoline, 28% for home heating fuel, 20% for diesel fuel, and 42% for jet fuel.

While your costs will increase, the energy industries will profit handsomely—perhaps more than the President himself realizes. Coal and natural gas producers stand to gain at least $12 billion per year in extra profits. The proposed windfall tax on oil producers will be phased out over several years, leaving $2-$3 billion in excess profits to the producers annually.

I can't believe the President and his advisors really thought through what his energy plan will do to consumers and the economy.

Before Congress agrees to travel down the road proposed by the President, we are going to examine the energy map for some alternate routes.

Any course of action will require sacrifice and inconvenience—that's not the issue. But the sacrifices must be fair and they must move us toward the goal of increased energy conservation and independence.

Senator Henry Jackson, for example, suggests an alternate route that merits the most careful consideration. He proposed quarterly targets for gradual, but definite, reduction in oil imports. The steps to achieve these reductions are ranked in order of increasing severity, beginning with voluntary and mandatory conservation action, followed by import quotas, petroleum allocations and gasoline rationing.

If the measures enacted in one quarter fail to achieve their objective, the President is empowered to move to stronger programs to cut consumption in the next quarter. If the first steps succeed, the harsher remedies can be avoided.

This plan seems to make good sense, especially since this approach avoids the economic damage of the President's plan. Congress is at work considering this proposal and a full range of other alternatives.

Cutting energy demand is only half the battle. We must also support a balanced program of expanding domestic energy supplies. This could be done through a National Energy Production Board, similar to the War Production Board in World War II, that would accelerate research and development of new domestic energy sources.

Our goal is to develop a workable and fair energy policy that has the support of the American people. Not one that will increase the cost of living and add to unemployment and recession.

It is only by restoring economic growth that we will make progress against inflation, increase labor productivity, reduce overhead costs, and reduce interest and capital costs.

But we must also restore competition with a vigorous anti-trust policy.

Finally, we need a tough and selective program to short-circuit the inflationary spiral. The current Council on Wage and Price Stability is a toothless tiger that has no ability to restrain outrageous price and wage increases. We need an agency with subpoena power, the resources to hold extensive public hearings, the authority to delay price or wage increases up to 90 days, and, in extreme cases, to roll back prices and impose controls on a selective basis.

Recession fuels inflation and unchecked inflation brings about recession. It is a difficult task to deal with these twin afflictions, but I believe we can make genuine progress with the program I have outlined tonight.

I began these remarks with the analogy of our country as a person who had been taken seriously ill—and that a diagnosis of the illness had finally been agreed upon by Congress and the President.

I'm sure we agree on another point: that we are not faced with a terminal illness. America is basically strong, quite capable of full recovery. But part of the treatment will be for all of us to understand the importance of work productivity, elimination of waste, and self-discipline.

These are unusual times—we have both inflation and recession—we have a Democratic Congress and a Republican President—we have a trillion and a half dollar economy amidst growing unemployment and poverty.

These unusual times require new thinking and new answers.

As Lincoln once said:

"The dogmas of the quiet past are inadequate to the stormy present. The occasion is piled high with difficulty. We must rise with the occasion. As our case is new, we must think anew."

Part of our new thinking should be to put our political differences aside in developing a national economic policy.

What America wants and needs is not partisan argument, but political responsibility.

But we must also remember that government alone cannot provide us with the answers. It must be a partnership of government and the people. We can here and now resolve to put America back to work—to conserve and develop our human and physical resources.

Our present difficulties offer us the opportunity to build a better America.

Senator PROXMIRE. I would also like to take this occasion, if it is not too presumptuous, to welcome two new members of the committee, who have a particular kind of qualification in common. They are both, of course, outstanding U.S. Senators and we are very proud of them and I think everybody in the country knows about them. Senator Ted Kennedy follows his brother who was a member of this committee and who, of course, went on to great distinction. But President Kennedy said something when he was a member of this committee that I have always treasured as one who is fond of the committee. He said this committee gave him the most pleasure and fun of any committee he served on, and I think that that is the case.

This is the committee that not only gives wisdom to the Congress and guidance, but also can be very enjoyable. Also, of course, the other new member, Senator Taft, son of the man who had the most to do with the formation of this committee, giving it force and direction.

We have had great people—Paul Douglas and Wright Patman—who influenced this committee profoundly. Senator Taft gave it real clout and gave it a strong staff and direction and force which I think has been very important to the committee.

Chairman HUMPHREY. Senator Proxmire, we thank you and I am sure that every member of the committee is indebted to you for your dynamic leadership of the committee.

As yet we have not had, as you know, our organizational meeting. As some of us said, we are sort of here by sufferance. Congressman Patman permitted me to conduct these hearings today in this role as acting chairman.

I want to have this record note our great respect for Congressman Patman and for the work he has done and his efforts to make this committee a meaningful instrument of advice and counsel to the Congress of the United States. and also to Senator Proxmire who more than anyone else has typified the activities of the Joint Economic Committee. And I do welcome these two new members who will find it is a most interesting committee and there is lots of work that we intend to do this year.

I have already had the opportunity to visit this morning with Congressman Brown and also, of course, with Congressman Bolling, and we are going to try to make this committee do its job. And now, with enough of the encomiums for all of us here before you, we want to welcome the witnesses that we have today.

Mr. Ackley, will you proceed and we will go in the sequence of Mr. Ackley, Mr. McCracken, and Mr. Schultze, if that is agreeable with you.

STATEMENT OF GARDNER ACKLEY, PROFESSOR OF ECONOMICS, UNIVERSITY OF MICHIGAN

Mr. ACKLEY. Senator Humphrey, lest the predominance of University of Michigan economists here today should disturb you, you might wish to know that last summer, your Governor, Mr. Anderson, issued a proclamation making me an honorary citizen of Minnesota. Indeed, his action also made Paul McCracken one as well because the proclamation annexed the University of Michigan to the State of Minnesota by making it a community college under that jurisdiction.

Chairman HUMPHREY. I am very pleased to have these historic events recorded in our proceedings here. I thought possibly what was happening here is that since Ohio State sort of euchred Michigan out of the Rose Bowl opportunities that this was the consolation prize Bob Taft was getting. [Laughter.]

Mr. ACKLEY. I am pleased and honored by the invitation to testify once again before this distinguished committee, and to express my views regarding both the difficult economic problems which this nation faces, and the important proposals which the President has made for a sharp change in the direction of our economic policy.

In order to stay within reasonable time bounds, Mr. Chairman, I intend to omit some passages of my prepared statement. Moreover, I will not deal with the energy problem, although I would be happy to comment on that later if desired.

I welcome and support the President's belated recognition that our overriding economic problem today is recession, and its attendant economic waste and human tragedy. Although I do not believe that his proposals are adequate to deal with the problem, at least the direction of his proposed policies is now clearly correct: The economy does need a large and prompt stimulus from fiscal policy, supported—I may add—by an expansionary monetary policy.

It is not commonly understood that Federal fiscal policy has been highly restrictive over the past year. Nominal expenditures have continued to rise—but in many cases less rapidly than prices—so that real expenditures have declined or at best risen slightly. Meanwhile, real tax burdens have increased sharply through the effects of inflation.

By now, there is a large potential surplus in the Government's accounts at reasonable.and desirable levels of output. We need to convert this potential surplus into a substantial potential—and actual—deficit if we are to provide an economic stimulus sufficiently robust to counter—and then to reverse—the economy's now rather frightening rate of deterioration.

In principle, this could be done either by raising expenditures or by reducing taxes, or some combination; but expenditures cannot possibly be adjusted with the needed quick and massive effectiveness. Thus, our only practicable tool is tax policy, and the President was clearly right to recommend a major tax cut. However, the specific cuts which the President has proposed are neither large enough nor effective soon enough to meet our needs: I should judge a cut of $25 to $30 billion more nearly appropriate than the $16 billion which the President proposes—and it could and should become fully effective in April, rather than half in May and half in September.

What the exact nature of the individual income tax cut should be seems to me far less important than its size and its speed. I happen to have no serious quarrel with the President's proposal for a percentage rebate of 1974 taxes, subject to some ceiling, such as $1,000 per return. To be sure, you can easily calculate that a substantial percentage of the total rebate would go to taxpayers with 1974 incomes above $25,000. But these people are paying a considerably larger percentage of total 1974 income taxes, a distribution, by the way, which Congress judged fair only a couple of years ago when it revised the bracket rates in the tax schedule.

A quick, temporary tax cut, made to deal with a recession emergency, is neither the time nor place to reach agreement on and to achieve a desired redistribution of income. Whatever tax cut of $20 to $30 billion which Congress and the President can quickly agree on, I'll buy, whether it takes the form of a uniform cash payment of $400—or whatever the figure should be—paid on April 1 to every 1974 taxpayer, regardless of income; or whether it is 20 percent—or whatever the figure should be—of withheld 1974 income tax, paid on April 1; or whether it is a 3-month moratorium—or whatever the duration should be—on withholding against 1975 income taxes, beginning on April 1. It could also be a moratorium on or rebate of payroll taxes, with social insurance funds reimbursed from general revenues.

We surely need to find ways to get extra income into the hands of the lowest-income recipients of all—those who paid no income tax in 1974 and will not in 1975. But this is an extremely difficult technical problem, which will not be solved between now and March 1, when emergency tax legislation should be passed. And if you can't put extra money into the hands of those people who most need it, you can't make a great moral principle of precisely how you should refund taxes to those sufficiently well off to be able to pay taxes.

The idea of paying a uniform social dividend of $\$x$ per capita—as one means of boosting consumer incomes and consumer spending in a recession—has been discussed during every recession for at least 35 years. It is a crime, perhaps, that—so far as I know—no one has ever seriously studied how this might be done—on the one hand, without intolerable fraud, and, on the other, without overlooking many of the most needy—in a society which rejects any form of universal registration. But these problems cannot be solved next week or next month. They may not even be fully resolved in time for the President's proposed $80-per-adult negative tax payment later this year.

But to return to the main thread, I find it indeed fortunate that both Congress and the President now appear to be agreed in principle on the need for a large, immediate tax cut. It is not unreasonable for the public to expect that they will submerge differences of detail and will make whatever compromises are necessary to assure very prompt action.

This is only the first order of business, however. The need for net tax reduction will not end with year 1975, and the President's proposals limit net tax reduction to that period. However, I believe it essential that we decide first what is needed now—and act quickly on that. There will then be time for Congress to consider longer-term changes in both the level and the structure of taxation, in the light of prospects for the economy, of the prospective growth of expenditures, and of the burdens imposed on different groups by whatever energy policy is eventually agreed upon.

The conversion of the President to this view is thus, to me, a most important and welcome development. Yet I find it disturbing that the President and some of his advisers appear not fully to understand why a tax cut is necessary and how it will contribute to reversing the recession and creating jobs. It seems to me important not merely that we do the right thing, but that we explain properly why we are doing it. Otherwise we will continue a process of public miseducation which has already contributed significantly to the tragic loss of public confidence in Government's capacity to deal with the Nation's problems. Surely it is miseducation for the President to say:

> Cutting taxes, now, is essential if we are to turn the economy around. A tax cut offers the best hope of creating more jobs. Unfortunately, it will increase the size of the budget deficit. Therefore, it is more important than ever that we take steps to control the growth of Federal expenditures.

Referring to the budget he will submit for fiscal year 1976—provisionally estimated at around $349 billion—the President said, "It is still much, much too high." And referring again to the budget, "The size of these numbers and their implications for our everyday life and the health of our economy are shocking."

It is a similar act of miseducation—and a direct blow to citizen and consumer confidence—for the Secretary of the Treasury to say that he is horrified by the huge deficit implied by the President's program, and to predict that it will squeeze private borrowers out of the market and raise interest rates.

He is also reported as saying: "We have to get this crazy government spending under control." Not only are views like these damaging to confidence, they are factually and analytically wrong. They thus make it difficult for the Government to develop and for the American people to understand and support economic policies which will deal adequately and effectively with our problems. Let me remind you of a few relevant facts, first about Federal budget trends.

The first fact is that, no matter how you slice it, Federal spending simply has not been increasing over the past two decades, when measured in the only meaningful way—relative to the size of the economy. Federal Government purchases of goods and services were 15.6 percent of GNP in 1953; they fell to 10.9 percent in 1963; they then fell further to 8.2 percent in 1973. Including transfer expenditures—which do not take any output away from the private sector—along with grants and subsidies, the Federal budget went nowhere: From 21.1 percent of GNP in 1953, to 19.3 percent in 1963, to 20.4 percent in 1973.

The President's "still much, much too high" proposed expenditure budget of $349 billion for fiscal year 1976 would amount to about 19½ percent of what I estimate to be the potential output of that period at 5 percent unemployment, valued in estimated prices of that period, which assume a steady and substantial reduction in the rate of inflation. Actual budget expenditures in fiscal year 1974 were an almost identical 19½ percent of the potential output of that period at 5 percent unemployment, valued in that period's actual prices. And fiscal year 1974 expenditures did not include the large, but temporary, unemployment-insurance and public-employment outlays which are reflected in the budget for fiscal year 1976—and which alone would justify making that budget an appreciably larger percentage of potential GNP.

Although data are not easily available in fully comparable form, governments in the United States—Federal, State, and local—probably spend a smaller share of the Nation's GNP than is the case for any major free-market country except Japan. Moreover, again with the exception of Japan, the United States is probably the only major free-market economy in which government spending as a percentage of GNP has not risen appreciably during either the past decade or the past quarter century.

Some who complain about increasing government spending are instead really worried about government deficits; and I would agree that this is a more relevant consideration than the mere size of budgets. But the fact is that only once in the past quarter century, in

1967 and 1968, has the size of Federal deficits been other than insignificant—except when, as now, tax revenues were depressed by recession and high unemployment. And the only legitimate complaint about the size of U.S. deficits in periods of recession is that they have been too small. The deficit is too small right now. That is why we need a large tax cut. I may add, however, that government surpluses have also sometimes been too small—in periods of boom. The substantial deficits of 1967 and 1968, in particular, of course should instead have been substantial surpluses.

Will a $50 billion annual deficit for the next year or two be disastrous? Must it, as Secretary Simon asserted, either rob private borrowers of funds needed for investment and expansion of production, or else require an inflation of the money supply which will guarantee faster-than-ever inflation of prices in the future? I assert that neither outcome is necessary or likely.

All recent forecasts predict that the gap between actual GNP and potential GNP will grow throughout most or all of 1975, and diminish only modestly in 1976—even with a tax cut. The very minimum assignment for monetary policy in such a period, in my judgement, should be to expand the money supply about in line with the growth of potential output valued in then current prices—certainly, so long as the rate of inflation is continually and appreciably diminishing—which most forecasters expect to occur. This describes what would be an essentially neutral stance for monetary policy.

With a GNP gap of the size we anticipate—which is why we need large Federal deficits—with private investment declining—possibly even in dollar terms—and quite inadequate in amount, with residential construction still very low, and with consumers not buying very many cars or other durables, private borrowing will be exceedingly weak. Even with a neutral monetary policy, there should be no significant problem in marketing the Federal securities necessary to cover prospective deficits, and at interest rates lower than now.

Look at it in another way. Suppose there were no recession, and no Federal deficits, over the next year and a half—because private investments in plant, equipment, inventories, and housing, and consumer purchases of autos and other durables had continued strong and were trending smoothly upward at a rate such that total output would grow in parallel with growing potential output. The volume of private borrowing associated with that kind of economy would be far larger than what in fact will be the sum of private borrowing and government deficits in the period now ahead. What would be the appropriate monetary policy for the hypothetical economy just described? Certainly, it ought to permit private borrowing to be financed without strain, so long as output was moving only in parallel with potential and the rate of inflation were significantly diminishing. Monetary policy should do no less in the face of recession.

I personally would argue that Federal Reserve policy now and in the next year or two ought not merely to be neutral, but instead strongly expansionary. I favor a discretionary monetary policy, both in booms and recessions, rather than a steady, mechanical expansion of some variant of M. Thus, if M_1 should expand at a 9 percent or 10 percent rate over the next year, it would not disturb me at all. However, those who predict that Federal deficits will place intolerable pressures on our money and capital markets seem to be expecting—and assenting to—a discretionary policy designed to deepen the recession and delay recovery. I cannot believe that this is what the Federal Reserve intends to do or will do, although it has done so in a number of past recessions—and apparently has been doing it again over the past 6 months.

So I wish that the President and members of his administration would stop their doomsaying. If they need to be "shocked" and "horrified" about anything, let it be about the impacts of unemployment on the poor, the minorities, and the young people just entering the labor force. Let them lead a crusade not against the deficits which they are appropriately encouraging, nor against an inflation which they propose no appropriate means to combat—and which would be given an extra fillip from their proposed energy policy; let them crusade instead against recession, unemployment, and economic distress, which economic policy surely can do something about. Incidentally, that crusade will do a lot more to restore public confidence in Government than one directed against deficits at a time when deficits are badly needed, or against undefined "crazy government expenditures."

I have said nothing so far about inflation, which the administration considers still our No. 1 long-range problem. In a sense, I agree; for I have long believed that a strong bias toward inflation is now deeply rooted in our political, social, and economic structure. Thus, even if the current recession brings, as it probably will, the byproduct of a substantial reduction in inflation's rate, the danger of revival of serious inflation will remain. How can we best assure against such a revival?

First of all, we must guard against renewed mistakes of fiscal and monetary policy in an expansionary direction at times when aggregate demand is already close to potential output. Unfortunately, it is far easier for fiscal and monetary policies which are overexpansionary at the wrong time to kick off or accelerate an inflation, than for highly restrictive policies to stop, or even to slow down an inflation, once underway. The inertia of the inflationary process is incredibly strong in a society like ours.

This means that we must be sure that the expansionary policies which we initiate now against recession can be and, when the time comes, will be throttled back before expansion begins to put too much pressure on productive resources. We should be quite conservative, for quite awhile, in judging what is a safe margin of unemployment and capacity utilization.

This view embodies what I consider to be the small kernel of truth in the administration's rhetoric about the budget. Neither economic analysis nor our own nor foreign experience gives any support to the view that the rate of increase of government spending by itself has any important causal significance for inflation. Countries where government spending has risen rapidly—whether in absolute terms or as a percentage of GNP—have, on the average, neither better nor worse records on inflation than countries where government spending has risen slowly. The important question is how tax policy is adjusted to the growth of government spending.

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Second, it seems to me that much closer attention than in the past must be paid by Government to monitoring the rate of capacity expansion in basic industries; and there must be readiness to move in with special assistance and encouragement when the growth of capacity in a particular industry appears inadequate for the most plausible forecast of long term growth of its demand.

This, again, embodies what I see as the small kernel of truth in the administration's position that inflation can be inhibited by a higher rate of investment and capacity growth. Administration spokesmen invariably express this in overall terms, which I regard as quite irrelevant to the question of inflation. The rate of overall investment is surely relevant for the long term growth of potential output. But neither economic analysis nor our own nor foreign experience gives any support to the view that either the share of GNP devoted to investment, or the overall growth rate of potential output, bears any significant relationship to inflation. Since 1950, the two major countries with the highest average rates of inflation are France and Japan. Japan has the highest investment share and highest growth rate of any major country, and those of France are among the highest. Clearly it is the balance between the growth of capacity and the growth of demand that is important; and on an overall basis, high and rising investment generates fast expansion both of capacity and of demand. But recent experience does make clear that capacity bottlenecks in specific basic industries can be an important cause of inflation, in a society like ours. This is where our attention needs to be addressed.

Third, we need to stop talking about, and start enacting, the long list of structural reforms which will strengthen competition in labor, product, and service markets; which will eliminate the many governmental and private protections which directly raise or support particular costs and prices; and which will assist lagging sectors and industries to improve their productivity.

Fourth, and finally, we must accept the necessity for a permanent and prominent Government agency which will actively and continuously monitor important wages and prices, equipped with specific legal powers not available to the present Council on Wage and Price Stability: Which can strengthen the agency's ability to get the full facts and to influence private decisions; which permit it to require advance notice of and to delay the effectiveness of particular wage and price increases; and even emergency power, in very special situations, to invoke temporary and highly selective mandatory controls over specific wages or prices.

As important as the machinery, however, is the recognition of the need for the Government at all times to have a clearly expressed wage and price policy, formulated and negotiated through continuing consultation with leading representatives of the great economic interest groups in our society.

I believe that a genuine and active "incomes policy" must be an essential ingredient of our longer-run defense against inflation. Short of that I see no justification for an incomes policy which affects only Government workers and social security and food-stamp recipients.

Thank you.

Chairman HUMPHREY. Thank you very much, Mr. Ackley.

[The prepared statement of Mr. Ackley follows:]

PREPARED STATEMENT OF GARDNER ACKLEY

I am pleased and honored by the invitation to testify once again before this distinguished Committee, and to express my views regarding both the difficult economic problems which this Nation faces, and the important proposals which the President has made for a sharp change in the direction of our economic policy. Although the seriousness of our economic situation is often exaggerated in the press and elsewhere, and some of the more apocalyptic projections are exceedingly far-fetched, there can be no doubt that our economic problems demand immediate attention, prompt decisions, and energetic action.

For reasons of time—as well as because I am genuinely uncertain about some aspects of a desirable long-term energy policy—I intend to confine this statement to the problems of recession and inflation, and not to deal with energy problems and policies.

I welcome and support the President's belated recognition that our overriding economic problem today is recession, and its attendant economic waste and human tragedy. Although I do not believe that his proposals are adequate to deal with the problem, at least the direction of his proposed policies is now clearly correct: the economy does need a large and prompt stimulus from fiscal policy, supported—I may add—by an expansionary monetary policy.

It is not commonly understood that Federal fiscal policy has been highly restrictive over the past year. Nominal expenditures have continued to rise—but in many cases less rapidly than prices—so that real expenditures have declined or at best risen slightly. Meanwhile, real tax burdens have increased sharply through the effects of inflation (and from the increase in the base of the payroll tax). The increase in budgetary restraint has been concealed not only by inflation, but also by the adverse impact of the recession on aggregate tax collections. In the third quarter of 1974, the Federal budget on national income and product account (which is the relevant measure of the budget for assessing its economic impact) showed a trivial deficit of $1.9 billion, with the unemployment rate at 5½%. It would have been in appreciable surplus had the unemployment rate been even 5%. By now, there is a considerably larger potential surplus in the government's accounts at reasonable and desirable levels of output. We need to convert this potential surplus into a substantial potential (and actual) deficit if we are to provide an economic stimulus sufficiently robust to counter—and then to reverse—the economy's now rather frightening rate of deterioration. In principle, this could be done either by raising expenditures or by reducing taxes, or some combination; but expenditures cannot possibly be adjusted with the needed quick and massive effectiveness. Thus, our only practicable tool is tax policy, and the President was clearly right to recommend a major tax cut. However, the specific cuts which the President has proposed are neither large enough nor effective soon enough to meet our needs: I should judge a cut of $25 to $30 billion more nearly appropriate than the $16 billion which the President proposes—and it could and should become fully effective in April, rather than half in May and half in September.

What the exact nature of the individual income tax cut should be seems to me far less important than its size and its speed. I happen to have no serious quarrel with the President's proposal for a percentage rebate of 1974 taxes, subject to some ceiling, such as $1,000 per return. To be sure, you can easily calculate that a substantial percentage of the total rebate would go to taxpayers with 1974 incomes above $25,000. But these people are paying a considerably *larger* percentage of total 1974 income taxes. A quick, temporary tax cut, made to deal with a recession emergency, is neither the time nor place to reach agreement on and to achieve a desired redistribution of income. Whatever tax cut of $20 to $30 billion which Congress and the President can quickly agree on, I'll buy—whether it takes the form of a uniform cash payment of $400 (or whatever the figure should be) paid on April 1 to every 1974 taxpayer, regardless of income; or whether it is 20 percent (or whatever the figure should be) of withheld 1974 income tax, paid on April 1; or whether it is a three months' moratorium (or whatever the duration should be) on withholding against 1975 income taxes, beginning on April 1. (It could also be a moratorium on or rebate of payroll taxes, with social insurance funds reimbursed from general revenues.)

We surely need to find ways to get extra income into the hands of the lowest-income recipients of all—those who paid no income tax in 1974 and will not in 1975. But this is an extremely difficult technical problem, which will not be solved between now and March 1, when emergency tax legislation should be passed. And if you can't put extra money into the hands of those people who *most* need it, you can't make a great moral principle of precisely how you should refund taxes to those sufficiently well off to be able to pay taxes.

The idea of paying a uniform "social dividend" of $X per capita—as one means of boosting consumer incomes and consumer spending in a recession—has been discussed during every recession for at least 35 years. It is a crime, perhaps, that (so far as I know) no one has ever seriously studied how this might be done—on the one hand, without intolerable fraud, and, on the other, without overlooking many of the most needy—in a society which rejects any form of universal registration. But these problems cannot be solved next week or next month. They may not even be fully resolved in time for the President's proposed $80-per-adult negative tax payment later this year.

But to return to the main thread, I find it indeed fortunate that both Congress and the President now appear to be agreed in principle on the need for a large, immediate tax cut. It is not unreasonable for the public to expect that they will submerge differences of detail and will make whatever compromises are necessary to assure very prompt action. This is only the first order of business, however. The need for net tax reduction will not end with year 1975, and the President's proposals limit net tax reduction to that period. However, I believe it essential that we decide first what is needed now—and act quickly on that. There will then be time for Congress to consider longer-term changes in both the *level* and the *structure* of taxation, in the light of prospects for the economy, of prospective growth of expenditures, and of the burdens imposed on different groups by whatever energy policy is eventually agreed upon.

A great many economists have favored an immediate tax cut for many months (even though we did not realize how large it would need to be—especially when so long delayed). The conversion of the President to this view is thus, to me, a most important and welcome development. Yet I find it disturbing that the President and some of his advisors appear not fully to understand why a tax cut is necessary and how it will contribute to reversing the recession and creating jobs. It seems to me important not merely that we *do* the right thing, but that we explain properly *why* we are doing it. Otherwise we will continue a process of public mis-education which has already contributed significantly to the tragic loss of public confidence in government's capacity to deal with the Nation's problems. Surely it is mis-education for the President to say:

"Cutting taxes, now, is essential if we are to turn the economy around. A tax cut offers the best hope of creating more jobs. Unfortunately, it will increase the size of the budget deficit. Therefore, it is more important than ever that we take steps to control the growth of Federal expenditures."

Referring to the budget he will submit for FY 1976 (provisionally estimated at around $349 billion), the President said "It is still much, much to high". And referring again to the budget, "The size of these numbers and their implications for our everyday life and the health of our economy are shocking".

It is a similar act of mis-education—and a direct blow to citizen and consumer confidence—for the Secretary of the Treasury to say that he is "horrified" by the huge deficit implied by the President's program, and to predict that it will squeeze private borrowers out of the market and raise interest rates. He is also reported as saying: "We have to get this crazy government spending under control". Not only are views like these damaging to confidence, they are factually and analytically wrong. They thus make it difficult for the government to develop and for the American people to understand and support economic policies which will deal adequately and effectively with our problems.

Let me remind you of a few relevant facts, first about Federal budget trends. The first fact is that, no matter how you slice it, Federal spending simply has not been increasing over the past two decades, when measured in the only meaningful way—relative to the size of the economy. Federal government purchases of goods and services were 15.6% of GNP in 1953; they fell to 10.9% by

1963; they then fell further to 8.2% in 1973. Including transfer expenditures—which do not take any output away from the private sector—along with grants and subsidies, the Federal budget went nowhere: from 21.1% of GNP in 1953, to 19.3% in 1963, to 20.4% in 1973.

The President's "still much, much too high" proposed expenditure budget of $349 billion for FY 1976 would amount to about 19½% of what I estimate to be the potential output of that period at 5% unemployment, valued in estimated prices of that period, which assume a steady and substantial reduction in the rate of inflation. Actual budget expenditures in FY 1974 were an almost identical 19½% of the potential output of *that* period at 5% unemployment, valued in that period's actual prices. And FY 1974 expenditures did *not* include the large, but temporary, unemployment-insurance and public-employment outlays which are reflected in the budget for FY 1976—and which alone would justify making that budget an appreciably larger percentage of potential GNP.

Although data are not easily available in fully comparable form, governments in the United States (Federal, State, and local) probably spend a smaller share of the Nation's GNP than is the case for any major free-market country except Japan. Moreover, again with the exception of Japan, the United States is probably the only major free-market economy in which government spending as a percentage of GNP has not risen appreciably during either the past decade or the past quarter century.

Some who complain about increasing government spending are instead really worried about government deficits; and I would agree that this is a more *relevant* consideration than the mere size of budgets. But the fact is that only once in the past quarter century (in 1967 and 1968) has the size of Federal deficits been other than insignificant—*except* when, as now, tax revenues were depressed by recession and high unemployment. And the only *legitimate* complaint about the size of U.S. deficits in periods of recession is that they have been too small. The deficit is too small right now. That is why we need a large tax cut. (I may add, however, that government surpluses have also sometimes been too small—in periods of boom. The substantial deficits of 1967 and 1968, in particular, of course should instead have been substantial surpluses.)

Will a $50 billion annual deficit for the next year or two be disastrous? Must it, as Secretary Simon asserted, either rob private borrowers of funds needed for investment and expansion of production, or else require an inflation of the money supply which will guarantee faster-than-ever inflation of prices in the future? I assert that *neither* outcome is necessary or likely.

All recent forecasts predict that the gap between actual GNP and potential GNP will grow throughout most or all of 1975, and diminish only modestly in 1976—*even with a tax cut*. The *very minimum assignment for* monetary policy in such a period, in my judgment, should be to expand the money supply about in line with the growth of potential output valued in then current prices—certainly, so long as the rate of inflation is continually and appreciably diminishing (which most forecasters expect to occur). This describes what would be an essentially *neutral* stance for monetary policy.

With a GNP gap of the size we anticipate (which is why we need large Federal deficits), with private investment declining (possibly even in dollar terms) and quite inadequate in amount, with residential construction still very low, and with consumers not buying very many cars or other durables, *private* borrowing will be exceedingly weak. Even with a *neutral* monetary policy, there should be no significant problem in marketing the Federal securities necessary to cover prospective deficits and at interest rates lower than now.

Look at it in another way. Suppose there were no recession, and no Federal deficits, over the next year and a half—because private investments in plant, equipment, inventories, and housing, and consumer purchases of autos and other durables had continued strong and were trending smoothly upward at a rate such that total output would grow in parallel with growing potential output. The volume of *private borrowing* associated with *that kind of economy* would be far larger than what in fact will be the sum of private borrowing and government deficits in the period now ahead. What would be the appropriate monetary policy for the hypothetical economy just described? Certainly, it ought to permit private borrowing to be financed without strain, so long as output was moving only in parallel with potential and the rate of inflation were significantly diminishing. *Monetary policy should do no less in the face of recession.*

I personally would argue that Federal Reserve policy now and in the next year or two ought not merely to be neutral, but instead strongly expansionary. I favor a *discretionary* monetary policy, both in booms and recessions, rather than a steady, mechanical expansion of some variant of M. Thus, if M_1 should expand at a 9% or 10% rate over the next year, it would not disturb me at all. However, those who predict that Federal deficits will place intolerable pressures on our money and capital markets seem to be expecting—and assenting to—a *discretionary* policy designed to *deepen the recession and delay recovery.* I cannot believe that this is what the Federal Reserve intends to do or will do (although it has done so in a number of past recessions—and apparently has been doing it again over the past six months).

So I wish that the President and members of his Administration would stop their doomsaying. If they need to be "shocked" and "horrified" about anything, let it be about the impacts of unemployment on the poor, the minorities, and the young people just entering the labor force. Let them lead a crusade not against the deficits which they are appropriately encouraging, nor against an inflation which they propose no appropriate means to combat (and which would be given an extra fillip from their proposed energy policy); let them crusade instead against recession, unemployment and economic distress, which economic policy surely *can* do something about. Incidentally, that crusade will do a lot more to restore public confidence in government than one directed against deficits at a time when deficits are badly needed, or against undefined "crazy government expenditures".

I have said nothing so far about inflation, which the Administration considers still our number-one long-range problem. In a sense, I agree; for I have long believed that a strong bias toward inflation is now deeply rooted in our political, social, and economic structure. Thus, even if the current recession brings, as it probably will, the by-product of a substantial reduction in inflation's rate, the danger of revival of serious inflation will remain. How can we best assure against such a revival?

First of all, we must guard against renewed mistakes of fiscal and monetary policy in an expansionary direction at times when aggregate demand is already close to potential output. And although I emphatically reject Mr. Simon's diagnosis of our present economic plight as the result of a "decade of irresponsible policies", fiscal policy was surely wrong in 1966–68 (when I had something to do with it), and the pre-election fiscal policy of 1972 was clearly over-expansionary as well. Unfortunately, it is far easier for fiscal and monetary policies which are over-expansionary at the wrong time to kick-off or accelerate an inflation, than for highly restrictive policies to stop, or even to slow down an inflation, once underway. The inertia of the inflationary process is incredibly strong in a society like ours.

This means that we must be sure that the expansionary policies which we initiate now against recession can be and, when the time comes, will be throttled back before expansion begins to put too much pressure on productive resources. We should be quite conservative, for quite a while, in judging what is a safe margin of unemployment and capacity utilization.

This view embodies what I consider to be the (small) kernel of truth in the Administration's rhetoric about the budget. Neither economic analysis nor our own foreign experience gives any support to the view that the rate of increase of government spending *by itself* has any important causal significance for inflation. Countries where government spending has risen rapidly (whether in absolute terms or as a percentage of GNP) have, on the average, neither better nor worse records on inflation than countries where government spending has risen slowly. The important question is how tax policy is adjusted to the growth of government spending.

Second, it seems to me that much closer attention than in the past must be paid by government to monitoring the rate of capacity expansion in basic industries; and there must be readiness to move in with special assistance and encouragement when the growth of capacity in a particular industry appears inadequate for the most plausible forecast of long-term growth of its demand.

This, again, embodies what I see as the (small) kernel of truth in the Administration's position that inflation can be inhibited by a higher rate of investment and capacity growth. Administration spokesmen invariably express this in over-all terms, which I regard as quite irrelevant to the question of inflation. The rate of over-all investment is surely relevant for the long-term growth of potential output. But neither economic analysis nor our own nor foreign experience gives any support to the view that either the share of GNP devoted to investment, or the over-all growth rate of potential output, bears any significant relationship to inflation. Since 1950, the two major countries with the highest average rates of inflation are France and Japan. Japan has the highest investment share and highest growth rate of any major country, and those of France are among the highest. Clearly it is the balance between the growth of capacity and the growth of demand that is important; and on an over-all basis, high and rising investment generates fast expansion both of capacity and of demand.

But recent experience does make clear that capacity bottlenecks in specific basic industries can be an important cause of inflation, in a society like ours. *This* is where our attention needs to be addressed. I may also add that, much as I welcome the dismantling of our old agricultural policies and (more important) our attitudes toward agriculture, we still need a policy which will attempt to cushion price movements from sudden shifts, in either direction, in supply of or demand for particular major farm products.

Third, we need to stop talking about, and start enacting, the long list of structural reforms which will strengthen competition in labor, product, and service markets; which will eliminate the many governmental and private protections which directly raise or support particular costs and prices; and which will assist lagging sectors and industries to improve their productivity.

Fourth, and finally, we must accept the necessity for a permanent and prominent government agency which will actively and continuously monitor important wages and prices, equipped with specific legal powers not available to the present Council on Wage and Price Stability, which can strengthen the agency's ability to get the full facts and to influence private decisions; which permit it to require advance notice of and to delay the effectiveness of particular wage and price increases; and even emergency power, in very special situations, to invoke temporary and highly selective mandatory controls over specific wages or prices. As important as the machinery, however, is the recognition of the need for the Government at all times to have a clearly-expressed wage and price policy, formulated and negotiated through continuing consultation with leading representatives of the great economic interest groups in our society. I believe that a genuine and active "incomes policy" must be an essential ingredient of our longer-run defense against inflation. Short of that I see no justification for an incomes policy which affects only government workers and social security and food-stamp recipients.

Chairman HUMPHREY. I believe, if it is agreeable with the members of the committee, we will just proceed with the statements and then come to the questions.

Please proceed, Mr. McCracken.

STATEMENT OF PAUL W. McCRACKEN, EDMUND EZRA DAY UNIVERSITY PROFESSOR OF BUSINESS ADMINISTRATION, UNIVERSITY OF MICHIGAN

Mr. McCRACKEN. Thank you very much, Mr. Chairman. I welcome this opportunity to appear before the Joint Economic Committee.

The economic program which will take shape this year, and whose basic strategy will be heavily influenced by your committee, is as crucial for the vitality of the American economy as any in the last quarter of a century.

Economic policy in 1975 must do three interrelated things. It must provide enough stimulus to reverse the sharp deterioration of economic activity that was underway as the year opened. It must continue to make progress toward a more stable cost-price level. And it must fashion an energy policy that will reduce our reliance on insecure supplies, at the same time permitting the economy to maintain orderly, strong and sustained expansion.

This is a large order. It will require some decisions that are popular, but it will also require some that will not be popular in the short run if the longer-run economic interests of the Nation are to be well-served.

The dimensions of the short-run economic problem are themselves large. Most projections for the recession put the low point of the economy somewhat around midyear, and with an unemployment rate at that time approaching 8 percent, as the chairman of the committee indicated.

Since the visible effects of policy changes do not usually show up in the economy for 6 to 12 months, the profile of economic developments during the first half of this year is really reflecting policies during the first half of this year is really reflecting policies during the latter half of 1974, and this profile cannot be greatly altered by policy changes now.

What can be influenced now is the vigor and sustainability of the upturn. While the economy never moves along precisely delineated target paths, it is still essential for the managers of economic policy to have in mind the general profile of their objective for renewed economic expansion. If the unemployment rate is 8 percent at the economy's lower turning point, and Okun's law that a 3 percentage point rise in output is required to lower the unemployment rate 1 point, real output at that point will be about 8 percent or so below that which would be consistent with a 5 percent unemployment rate.

Ours is, of course, an economy whose capacity to increase real output should also be rising at the rate of 3½ to 4 percent each year. If we were to set as a target a 5 percent unemployment rate after 2 years of recovery and expansion, real output would need to expand at 7 to 8 percent per year during those 2 years. And if prices were to rise, say, 5 percent in the first of the 2 years and 3 percent in the second, I suggest those less as a prediction than as a conservative target or estimate of what might happen, the target rate for the rise in GNP in current dollars would be about 12 percent in the first year of expansion and 10 percent in the second.

If this expansion in GNP is to be achieved, there must be a sharp and prompt further increase in the rate of monetary expansion.

The relationship between the money supply broadly defined to include net time deposits and GNP has been quite stable, and historical experience suggests that for us to achieve the projected 12 and 10 percent rises in GNP—in current dollars—during these 2 years of expansion an essentially parallel increase in M_2 would be needed, and it would mean a somewhat slower rise in M_1. Moreover, it is monetary policy during these early months of 1975 that is establishing the basic path for the economy toward the latter part of the year. Judgments vary about the extent to which monetary policy has the capability itself to take the initiative and produce the needed economic expansion, but there would at least be broad agreement that this rate of monetary expansion is a necessary condition. And the trend of thinking has been to assign an increasingly important role to monetary policy as a determinant of the course for the economy.

The 3 percent per year path for M_1 during the last 3 months and the 6½ percent path for M_2 are far short of what we should be seeing now if the latter part of 1975 is to have reasonable assurance of resuming vigorous expansion.

Fiscal policy, particularly in periods such as the present when swings of economic activity break out of the normal boundaries, must also play a vigorous role. Whatever the theoretical capabilities of monetary policy, it cannot be relied upon to do the whole job.

Moreover, to the extent that the managers of monetary policy have regard for other things than simply the rate of monetary and credit expansion—such as, for example, interest rates—a weakening of the economy may itself tend to produce the lower interest rates even with such sluggish rates of monetary expansion that the subsequent expansion is weak and delayed. And conversely during an expansion the heavy demands for credit may press so hard against supplies of funds that higher interest rate targets are achieved even with rates of monetary expansion so rapid as to contribute to further inflation.

Economic policy must, therefore, include adaptations of fiscal policy to changing economic conditions. There are the obvious and conventional effects, through some combination of tax reductions which increase take-home pay and through higher public outlays—both seemingly increasing the demand for output directly.

The word "seemingly" is important because whether a net increase in the demand for output occurs does depend on whether the added Treasury borrowing to cover the deficit does or does not preempt funds that would otherwise have been used by private borrowers. If it does preempt funds from other borrowers, private demands for output are forced back to the extent that Treasury borrowing increases, and the total demand for output is not enlarged. Housing is, of course, apt to be particularly vulnerable to this Treasury competition for funds.

If the financial community has been slow to appreciate the role of fiscal policy in the management of the economy, economists have been slow to face fully the implications of the fact that Treasury financing and private borrowing do compete for funds in the same money and capital markets. And Treasury requirements are now large enough so that their impact on financing in the private sector must be faced quite explicitly.

If something like the President's two-stage tax rebate is enacted early in this session of the Congress, the fiscal operations of Government will themselves—before any allowance for adverse effects of Treasury financing on private borrowers—be exerting substantial upward pressure on the economy. The magnitude of this upward pressure cannot, of course, be measured by the size of the deficit. A deficit can be the cause of an overly strong economy—as in 1966–67—or the result of an overly weak economy—as in the early 1960's or 1970. Nor can it be measured by the size of the full employment surplus. The fiscal operations of Government can be exerting a strongly expansive influence on the economy even if the full employment budget shows a large surplus. The most unambiguous measure of the magnitude of fiscal pressures on the economy in any period—pressures which themselves, apart from other influences, would cause the economy to move upward or downward—is the rise in outlays plus the revenue decline—the rise in after-tax incomes—from any changes in tax rates. If outlays rise during the year ahead by $40–$45 billion, the total fiscal thrust will be in the range of $55–$60 billion after allowing also for tax reductions.

While proposals have been made for both larger and smaller tax reductions, the size of the administration's package seems to represent a reasonable balance between the need for action and the need to avoid excessive Treasury competition for funds in the financial markets.

My own preference would have been for permanent tax reduction. Evidence from the limited experience that we have had with one-shot injections of purchasing power does not permit firm conclusions, but even one-shot injections of purchasing power do seem to result in more spending.

Here I went back to look at the experience in the 1930's. There was nothing very interesting on the veteran's bonus because that was equal to about 2 percent of personal income. In other words, it was a massive injection relatively to the size of the economy at that time and it is interesting that this did seem to have a quite stimulative effect on retail sales during that period.

The tax reduction should, of course, also be concentrated in the middle- and low-income range. The cap on the rebate limits the value of the tax rebate for those with large incomes, but the program could be tilted even more toward middle and lower incomes.

There is a larger issue here and we do not want to lose sight of this as we talk about the incidents in the short run or the near-term incidents of the effect of the program itself.

The primary benefit of this action for middle and lower income people is the expansion of job opportunities and income as the economy is stimulated, not the incidence of the tax package as such.

The important thing, therefore, is prompt action. A prompt two-staged rebate would be far better for the economy than long delays endeavoring to develop a more nearly perfect package.

In the contemporary national environment proposals to reduce corporate profits taxes are not apt to produce strong applause from the galleries. Yet some actions here are urgently needed if the economy is to have the additional facilities which offer the new job opportunities that our growing labor force requires, and also the new investment required if expectations for continuing improvement in levels of living are to be realized. Our record of investment in recent years must be a matter of social concern. The amount of nonresidential capital formation per person added to the civilian labor force in the 1970's has been running about 22 percent below that of the decade from the mid-1950's to the mid-1960's. Table 1 in my prepared statement reflects this in much greater detail.

Chairman HUMPHREY. Are those figures in Table 1 of your prepared statement current dollars or adjusted?

Mr. MCCRACKEN. That is a good point. Those are all in 1958 dollars, constant dollars.

Chairman HUMPHREY. Thank you.

Mr. McCRACKEN. As I have indicated in my prepared statement, we seem to be running some quarter below what we were back in the earlier years.

We also need to remember in the 1970's more of our capital formation has been allocated to environmental and safety objectives, which however laudable do not result in added plants and higher measured productivity—increased productivity which is essential if the economy is to deliver rising real wages.

With a rough allowance for the capital formation in the 1970's required for these purposes that do not expand capacity or improve measured productivity, the remaining capital formation per person added to the civilian labor force would be roughly 25 percent below that of 1955–65.

This is almost certainly part of the explanation for the fact that even as recently as a year ago we were seeing an economy with many evidences of pressures on capacity even though the unemployment rate was above 5 percent. Our plant capacity was too small to offer the number of job opportunities required for reasonably full employment of the work force.

Clearly the erosion of corporate profits and retained earnings during this period has played a role. This shows up even in the conventionally reported data of the national income accounts where corporate profits after taxes as a percentage of gross corporate product declined from 9.7 percent in 1965–66 to 5.1 percent by 1971 and to about 4 percent last year.

When we allow for the current value of capital expiring in the process of production, in place of depreciation charges based on historical costs, we find that true retained earnings dropped from about $15 billion in the mid-1960's, to a negative figure in excess of $10 billion last year. Nonfinancial corporations last year, in short, fell short of even making their dividends.

The straightforward approach would be to revise definitions and accounting procedures so that profits are measured accurately, with the tax rate applied to these profits that the political and social process finds appropriate.

Pending this more fundamental change, in which the accounting profession needs to give more vigorous intellectual leadership, reliance on a larger investment tax credit makes sense.

It is those wanting places to work and wanting rising real incomes who will be the beneficiaries. This committee could play an urgently needed role by exploring these interrelated issues of the magnitude of needed capital formation and the more accurate measurement of corporate income.

The performance of the price level in these early weeks of 1975 has had its encouraging aspects. Prices of raw materials continue generally downward. In December the industrial wholesale price index remained unchanged apart from seasonal factors. And even the more tardy and slow-moving CPI was beginning to move upward more slowly. During the final 2 months of last year, for example, the CPI was rising at a 9½ percent per year rate, well below the peak rate of 15 percent in the July–October period.

Moreover, it is reasonable to expect further progress. I would like to emphasize this because it is so universally misunderstood. The usual historical pattern has been for the rate of inflation to remain high pretty well through the recedence phase of a recession but to decline as the economy resumes expansion.

This has been our experience in all such periods during the last quarter of a century, and it is reasonable to expect a recurrence of this pattern as the economy resumes expansion in 1975.

I only emphasize this because the popular image of the historical pattern is that a continuation of inflation during a recession is quite abnormal.

I have table 2 in my prepared statement which indicates this showing the annual rate of rise of the consumer price index 12 months before the peak in business activity was reached, the annual change in the CPI from peak to trough, and then the change the first 12 months of the rise and the second 12 months, and I will not allude to 1969 and 1970 because the end of that period gets into the period of wage price control. Take 1957 and 1958. In the 12 months before the peak the CPI was running at a rate of 3.3 percent per year. I think it is worth pointing out, Mr. Chairman, the extent to which one period's problem becomes another period's target. We thought 3.3 percent was a rather serious problem in 1957, now, we yearn to get back to that.

The CPI rose at a 3.5 percent rate during the declining business activity, no recedence in the rate of inflation at all.

The interesting thing is that as economic activity resumed expansion the CPI rose at a rate of two-tenths of a percent the first year and three-tenths of a percent the second. That is the more dramatic of the three periods given here, the other two being 1960–61, 1969–70, but the general point I think is worth emphasizing because it addresses itself to a bona fide concern on the part of a great many people that we have to stay with restrictive policies because if we start to pursue more expansionist policies inflation will just take off again.

I do not see from historical experience any justification for that concern, providing, of course, the expansionist policies are not overdone.

The Joint Economic Committee should press hard for an exploration of the extent to which the vast regulatory activities of government have themselves become a major source of inflation. The committee should keep up pressure for carrying through on its own recommendation made last year.

A strong statement from this committee opposing wage-price controls would make for a more rapid decline in the rate of inflation during the months ahead. The threat that these controls may be reimposed is itself causing an upward bias to wage and salary adjustments, and it is also creating resistance to price adjustments that today's market forces would otherwise tend to produce.

Just a few quick comments on the energy program since that extends well beyond the scope of my prepared statement and it is a complex matter.

The first requirement for the Nation's energy program is that it must enable orderly and sustained economic expansion as it makes progress toward reducing our reliance on external energy supplies.

A weak and disorganized economy is not an economy that can serve our energy policy. For one thing the resulting unemployment and generalized economic distress that would go along with these conditions would erode support for the energy program itself. Such a program would have no staying power and one would court the risk of finding ourselves a few years down the way with a weak economy and an aborted energy program.

Moreover, greater self-sufficiency in energy supplies will mean having capital formation and it is only a strong and orderly economy which can hope to accommodate itself to these large requirements.

For the basic strategy of our energy program the Nation must make a choice. It can place basic reliance on direct controls. Both logic and history suggest that a strategy which places basic reliance on market forces will accomplish more in terms of encouraging reduced usage and expanded supplies than is usually expected, and reliance on a strategy of rationing and allocation—however beguiling in prospect—always produces greater dislocations and smaller intended results than expected.

Any real solution to this problem must mean higher energy prices. However much we would like that reality to go away, it is an ineluctable fact of life. The major objection to this is fear of its effects on those with moderate incomes.

While the President's energy program makes reasonable provision for moderating the effect on those with lower incomes, further adjustments could be made along those lines.

What this great debate really emphasizes, however, is the urgent need for an explicit, generalized, systematic income maintenance program that can give expression to society's quite legitimate concerns about income redistribution. The Congress ought to give the development of such a program urgent priority in this session.

Such a system could replace the polyglot of programs we now have, restoring to beneficiaries the dignity of being income recipients rather than on the dole.

Moreover, such a systematic program could then be used to handle income redistribution concerns, and we would thereby gain scope for using market forces and prices to do what clearly they do best—namely, to be the communications system of an efficient and dynamic economy. If we use the pricing system to take care of income distribution problems, we shall continue to have neither a good income distribution program, nor will we have an efficient economy—nor for that matter, an effective strategy for energy policy either.

Thank you very much.

Chairman HUMPHREY. Thank you very much, Mr. McCracken.

[The prepared statement of Mr. McCracken follows:]

PREPARED STATEMENT OF PAUL W. MCCRACKEN

Mr. Chairman. I welcome this opportunity to appear before the Joint Economic Committee. The economic program which will take shape this year, and whose basic strategy will be heavily influenced by your Committee, is as crucial for the vitality of the American economy as any in the last quarter of a century.

Economic policy in 1975 must do three interrelated things. It must provide enough stimulus to reverse the sharp deterioration of economic activity that was under way as the year opened. It must continue to make progress toward a more stable price-cost level. And it must fashion an energy policy that will reduce our reliance on insecure supplies, at the same time permitting the economy to maintain orderly, strong, and sustained expansion.

This is a large order. It will require some decisions that are popular, but it will also require some that will not be popular in short run if the longer-run economic interests of the nation are to be well-served.

I

The dimensions of the short-run economic problem are themselves large. Most projections for the recession put the low point of the economy somewhat around mid-year, and with an unemployment rate at that time approaching 8 percent. Since the visible effects of policy changes do not usually show up in the economy for 6 to 12 months, the profile of economic developments during the first half of this year is really reflecting policies during the latter half of 1974, and this profile cannot be greatly altered by policy changes now.

What can be influenced now is the vigor and sustainability of the upturn. While the economy never moves along precisely delineated target paths, it is still essential for the managers of economic policy to have in mind the general profile of their objective for renewed economic expansion. If the unemployment rate is 8 percent at the economy's lower turning point, and Okun's law that a 3 percentage point rise in output is required to lower the unemployment rate 1 point, real output at that point will be about 8 percent or so below that which would be consistent with a 5 percent unemployment rate. Ours is, of course, an economy whose capacity to increase real output should also be rising at the rate of 3½-4 percent each year. If we were to set as a target a 5 percent unemployment rate after two years of recovery and expansion, real output would need to expand at 7-8 percent per year during those two years. And if prices were to rise, say, 5 percent in the first of the two years and 3 percent in the second, the target rate for the rise in GNP in current dollars would be about 12 percent in the first year of expansion and 10 percent in the second.

II

If this expansion in GNP is to be achieved, there must be a sharp and prompt further increase in the rate of monetary expansion. The relationship between the money supply broadly defined to include net time deposits and GNP has been quite stable, and historical experience suggests that for us to achieve the projected 12 and 10 percent rises in GNP (in current dollars) during these two years of expansion an essentially parallel increase in M_2 would be needed, and it would mean a somewhat slower rise in M_1. Moreover it is monetary policy during these early months of 1975 that is establishing the basic path for the economy toward the latter part of the year. Judgments vary about the extent to which monetary policy has the capability itself to take the initiative and produce the needed economic expansion, but there would at least be broad agreement that this rate of monetary expansion is a necessary condition. And the trend of thinking has been to assign an increasingly important role to monetary policy as a determinant of the course for the economy. The 3 percent per year path for M_1 during the last three months and the 6½ percent path for M_2 are far short of what we should be seeing now if the latter part of 1975 is to have reasonable assurance of resuming vigorous expansion.

Fiscal policy, particularly in periods such as the present when swings of economic activity break out of the normal boundaries, must also play a vigorous role. Whatever the theoretical capabilities of monetary policy, it cannot be relied upon to do the whole job. Moreover, to the extent that the managers of monetary policy have regard for other things than simply the rate of monetary and credit expansion—such as, for example, interest rates—a weakening of the economy may itself tend to produce the lower interest rates even with such sluggish rates of monetary expansion that the subsequent expansion is weak and delayed. And conversely during an expansion the heavy demands for credit may press so hard against supplies of funds that higher interest rate targets are achieved even with rates of monetary expansion so rapid as to contribute to further inflation.

Economic policy must, therefore, include adaptations of fiscal policy to changing economic conditions. There are the obvious and conventional effects, through some combination of tax reductions which increase take-home pay and through higher public outlays—both seemingly increasing the demand for output directly. The word "seemingly" is important because whether a net increase in the demand for output occurs does depend on whether the added Treasury borrowing to cover the deficit does or does not preempt funds that would otherwise have been used by private borrowers. If it does preempt funds from other borrowers, private demands for output are forced back to the extent that Treasury borrowing increases, and the total demand for output is not enlarged. (Housing is, of course, apt to be particularly vulnerable to this Treasury competition for funds.) If the financial community has been slow to appreciate the role of fiscal policy in the management of the economy, economists have been slow to face fully the implications of the fact that Treasury financing and private borrowing do compete for funds in the same money and capital markets. And Treasury requirements are now large enough so that their impact on financing in the private sector must be faced quite explicitly.

If something like the President's two-stage tax rebate is enacted early in this session of the Congress, the fiscal operations of government will themselves (before any allowance for adverse effects of Treasury financing on private borrowers) be exerting substantial upward pressure on the economy. The magnitude of this upward pressure cannot, of course, be measured by the size of the deficit. A deficit can be the cause of an overly strong economy (as in 1966–67) or the result of an overly weak economy (as in the early 1960's or 1970). Nor can it be measured by the size of the full employment surplus. The fiscal operations of government can be exerting a strongly expansive influence on the economy even if the full employment budget shows a large surplus. The most unambiguous measure of the magnitude of fiscal pressures on the economy in any period—pressures which themselves (apart from other influences) would cause the economy to move upward or downward—is the rise in outlays plus the revenue decline (the rise in after-tax incomes) from any changes in tax rates. If outlays rise during the year ahead by $40-45 billion, the total fiscal thrust will be in the range of $55-60 billion after allowing also for tax reductions. While proposals have been made for both larger and smaller tax reductions, the size of the Administration's package seems to represent a reasonable balance between the need for action and the need to avoid excessive Treasury competition for funds in the financial markets.

My own preference would have been for permanent tax reduction. Evidence from the limited experience that we have had with one-shot injections of purchasing power does not permit firm conclusions, but even one-shot injections of purchasing power do seem to result in more spending. There is some evidence, for example, that the veteran's bonus payment in 1936 (of which $1.2 billion, or almost 2 percent of personal income, was cashed promptly) did have a stimulating effect on retail sales. These sales in the first quarter of that year were running 11 percent ahead of year-earlier levels, but for the second half of 1936 the year-to-year gain was 16 percent. And even if the money were simply to be "put in the bank" and saved, it would still stimulate the economy through such avenues as more housing. Even so the impact on consumer spending would be more assured if the tax reduction were a permanent increase in after-tax incomes rather than a windfall receipt of purchasing power. The tax reduction should, of course, also be concentrated in the middle and low-income range. The cap on the rebate limits the value of the tax rebate for those with large incomes, but the program could be tilted even more toward middle and lower incomes.

The primary benefit of this action for middle and lower income people is the expansion of job opportunities and income as the economy is stimulated, not the incidence of the tax package as such. The important thing, therefore, is prompt action. A prompt two-staged rebate would be far better for the economy than long delays endeavoring to develop a more nearly perfect package.

In the contemporary national environment, proposals to reduce corporate profits taxes are not apt to produce strong applause from the galleries. Yet some actions here are urgently needed if the economy is to have the additional facilities which offer the new job opportunities that our growing labor force requires, and also the new investment required if expectations for continuing improvement in levels of living are to be realized. Our record of investment in recent years must be a matter of social concern. The amount of nonresidential capital formation per person added to the civilian labor force in the 1970's

TABLE 1.—*Nonresidential fixed investment per person added to civilian labor force*

[In 1958 dollars]

Period:	*Amount*
1956 to 1960	$49,500
1961 to 1965	55,300
1966 to 1970	46,400
1971 to 1974	[1] 41,000

[1] Estimate based on incomplete data for 1974.

Source: Basic data from the Department of Commerce and Labor.

has been running about 22 percent below that of the decade from the mid-1950's to the mid-1960's. And in the 1970's more of our capital formation has been allocated to environmental and safety objectives, which however laudable do not result in added plants and higher measured productivity—increased productivity which is essential if the economy is to deliver rising real wages. With a rough allowance for the capital formation in the 1970's required for these purposes that do not expand capacity or improved measured productivity, the remaining capital formation per person added to the civilian labor force would be at least 25 percent below that of 1955–65. This is almost certainly part of the explanation for the fact that even as recently as a year ago we were seeing an economy with many evidences of pressures on capacity even though the unemployment rate was above 5 percent. Our plant capacity was too small to offer the number of job opportunities required for reasonably full employment of the work force.

Clearly the erosion of corporate profits and retained earnings during this period has played a role. This shows up even in the conventionally reported data of the national income accounts where corporate profits after taxes as a percentage of gross corporate product declined from 9.7 percent in 1965–66 to 5.1 percent by 1971 and to about 4 percent last year. When we allow for the current value of capital expiring in the process of production, in place of depreciation charges based on historical costs, we find that true retained earnings dropped from about $15 billion in the mid-1960's to a negative figure in excess of $10 billion last year. Nonfinancial corporations last year, in short, fell short of even making their dividends.

The straightforward approach would be to revise definitions and accounting procedures so that profits are measured accurately, with the tax rate applied to these profits that the political and social process finds appropriate. Pending this more fundamental change, in which the accounting profession needs to give more vigorous intellectual leadership, reliance on a larger investment tax credit makes sense. It is those wanting places to work and wanting rising real incomes who will be the beneficiaries. This Committee could play an urgently needed role by exploring these interrelated issues of the magnitude of needed capital formation and the more accurate measurement of corporate income.

III

The performance of the price level in these early weeks of 1975 has had its encouraging aspects. Prices of raw materials continue generally downward. In December the industrial wholesale price index remained unchanged apart from seasonal factors. And even the more tardy and slow-moving CPI was beginning to move upward more slowly. During the final two months of last year, for example, the CPI was rising at a 9½ percent per year rate, well below the peak rate of 15 percent in the July-October period.

Moreover, it is reasonable to expect further progress. The usual historical pattern has been for the rate of inflation to remain high pretty well through the recedence phase of a recession but to decline as the economy resumes expansion. This has been our experience in all such periods during the last quarter of a century, and it is reasonable to expect a recurrence of this pattern as the economy resumes expansion in 1975. (The popular image of the historical pattern is, of course, that a continuation of inflation during a recession is quite abnormal, but this is incorrect.)

TABLE 2.—ANNUAL RATE OF CHANGE IN CONSUMER PRICE INDEX DURING AND FOLLOWING RECESSIONS

[In percent]

Recessions	12 months before peak	Peak to trough	12 months after trough	2d 12 months after trough
1957–1958	3.3	3.5	0.2	0.3
1960–1961	1.9	1.3	.9	1.2
1969–1970	5.8	5.6	3.5	3.4

The Joint Economic Committee should press hard for an exploration of the extent to which the vast regulatory activities of government have themselves become a major source of inflation. The Committee should keep up pressure for carrying through on its own recommendation made last year.

A strong statement from this Committee opposing wage-price controls would make for a more rapid decline in the rate of inflation during the months ahead. The threat that these controls may be reimposed is itself causing an upward bias to wage and salary adjustments, and it is also creating resistance to price adjustments that today's market forces would otherwise tend to produce.

IV

The implications of the President's energy program extend beyond the scope of this statement, but a few comments are in order here. The first requirement for the Nation's energy program is that is must enable orderly and sustained economic expansion as it makes progress toward reducing our reliance on external energy supplies. A weak and disorganized economy is not an economy that can serve our energy policy. For one thing the resulting unemployment and generalized economic distress that would go along with these conditions would erode support for the energy program itself. Such a program would have no staying power and one would court the risk of finding ourselves a few years down the way with a weak economy and an aborted energy program. Moreover, greater self-sufficiency in energy supplies will mean having capital formation and it is only a strong and orderly economy which can hope to accommodate itself to these large requirements.

For the basic strategy of our energy program the Nation must make a choice. It can place basic reliance on the use of market forces, or it can place basic reliance on direct controls. Both logic and history suggest that a strategy which places basic reliance on market forces will accomplish more in terms of encouraging reduced usage and expanded supplies than is usually expected, and reliance on a strategy of rationing and allocation (however beguiling in prospect) always produces greater dislocations and smaller intended results than expected.

Any real solution to this problem must mean higher energy prices. However much we would like that reality to go away, it is an ineluctable fact of life. The major objection to this is fear of its effects on those with moderate incomes. While the President's energy program makes reasonable provision for moderating the effect on those with lower incomes, further adjustments could be made along those lines.

What this Great Debate really emphasizes, however, is the urgent need for an explicit, generalized, systematic income maintenance program that can give expression to society's quite legitimate concerns about income redistribution. The Congress ought to give the development of such a program urgent priority in this session. Such a system could replace the polyglot of programs we now have, restoring to beneficiaries the dignity of being income recipients rather than on the dole. Moreover, such a systematic program could then be used to handle income redistribution concerns, and we would thereby gain scope for using market forces and prices to do what clearly they do best—namely, to be the communications system of an efficient and dynamic economy. If we use the pricing system to take care of income distribution problems, we shall continue to have neither a good income distribution program, nor will we have an efficient economy—nor for that matter, an effective strategy for energy policy either.

APPENDIX

PERSONAL INCOME AND RETAIL SALES, 1936

[Seasonally adjusted annual rates in billions]

Month	Personal income Total	Personal income Year increase	Retail sales Total	Retail sales Year to year increase
January	$64.0	$8.4	$34.6	$4.1
February	63.9	7.2	35.3	3.0
March	64.0	6.3	36.9	4.5
April	64.7	5.0	37.1	4.7
May	65.6	5.6	38.3	6.2
June	76.3	16.5	39.0	6.5
July	72.8	12.7	39.5	6.9
August	69.1	7.8	38.4	5.6
September	68.7	7.0	39.4	5.9
October	69.3	7.0	40.2	6.0
November	70.8	8.0	40.6	6.3
December	72.1	8.3	40.8	7.1

Source: Data from Geoffrey H. Moore, "Business Cycle Indicators," vol. II (N.B.E.R., 1961), pp. 139, 141.

Chairman HUMPHREY. I think we are proceeding along all right. I trust that Mr. Ackley has been listening attentively as we come around on the second round. And now, Mr. Schultze, we look forward to hearing you.

STATEMENT OF CHARLES L. SCHULTZE, SENIOR FELLOW, THE BROOKINGS INSTITUTION [1]

Mr. SCHULTZE. Thank you, Mr. Chairman and members of the committee.

The American economy is in serious trouble. You know that, I know that, and in the last several months the President and his advisers have come to know that.

In view of the rapid deterioration in the economy, let me start by urging the Congress to separate the problem of economic recovery from the problem of energy conservation, and to concentrate initially on the former. If I put the current economic troubles of the country on an index of 100, I would count the problems of recession and inflation as 95 and the problem of oil conservation as 5. However important it is in the longer run to reduce oil imports, success in doing so is not a necessary condition of economic recovery. Indeed, unless the oil conservation program is very carefully worked out it can get in the way of licking the problems of recession and inflation. I think the urgency of measures to promote economic recovery is so great, that they should get immediate attention, and not be delayed by what will inevitably be a very difficult economic and political struggle over what to do about oil. My own remarks will be consequently directed principally to the problem of ending the recession. I realize, however, that the President's announced intention of unilaterally

[1] The views presented in this statement are those of the witness and not necessarily those of the officers, trustees, or other staff members of the Brookings Institution.

imposing a fee on imported oil does require the Congress to take some action, and I shall return to this problem at the end of my statement.

WHAT KIND AND HOW BIG A FISCAL STIMULUS?

The first set of questions facing the Congress is: How big a fiscal stimulus is needed to turn the economy around; and how much of it should be temporary and how much permanent? Is the President's $16 billion one-shot tax rebate, paid in May and September, large enough and persistent enough to do the job?

On the one hand, we are faced with an economy which is already operating far below capacity and deteriorating rapidly. In the fourth quarter of 1974 the gross national product was $170 billion below what would have been produced by a fully employed economy with a 4 percent unemployment rate. Output and employment are continuing to fall and by the spring of this year the gap between actual GNP and full employment GNP will be in excess of $210 billion. If, for conservatism's sake, we define full employment as a situation not of 4 percent but of 5 percent unemployment, the gap this spring would still be over $170 billion. Even should economic recovery begin promptly around midyear, and if the real output of the Nation rose steadily by 8 percent in the first year of recovery and 7 percent a year thereafter, it would not be until 1978 that the unemployment rate fell to 5 percent. In short, by the time any fiscal stimulus begins to take hold the economy will be operating far below its desirable potential, even conservatively defined, and will have a long way to go before approaching a decent level of output and employment. Judged by this criterion alone a very large stimulus is necessary to do the job.

At the same time several other facts need to be taken into consideration in designing a recovery package. First, once the economy is turned around, a number of forces will begin to operate in support of the fiscal stimulus. We face in the immediate future unfortunately, a period of inventory liquidation and adjustment. A large tax cut, by putting additional purchasing power in consumer hands, and thereby increasing sales of consumer goods can ease and shorten that adjustment process. And once it is complete, production and employment will be spurred as inventory investment begins to increase. A policy of reasonably easy money and further reduction in interest rates—a subject to which I shall return—can help spur a substantial recovery in housing. If we can get the economy turned around, therefore, there can be important recovery forces set in motion. Fiscal stimulus does not have to do the whole job itself.

Second, we need to worry about the longer run implications of this year's fiscal package. One of the major depressing forces now acting on the economy is the drain in purchasing power caused by last year's huge increase in oil prices. The price of oil in the United States went from about $4 a barrel in October 1973 to about $9.50 a barrel in late 1974. These price increases were passed on into the final prices of virtually all products made from oil. The proceeds of these increases, in turn, went chiefly abroad to the OPEC countries and into the profits of domestic oil producers. Most of them have not been respent on purchases of goods and services. While OPEC countries did increase their imports from the United States, the increase in 1974 was only a small part of their higher revenues. And while investment in domestic oil and gas production rose, it too absorbed only a fraction of the increased profits. As a consequence, jobs lost in consumer goods industries, because of the oil-induced drain of consumer purchasing power, were not offset by new jobs in the export and investment goods industries. In 1975 the net drain of purchasing power will probably amount to $25 or $30 billion. But in succeeding years the drain, and the consequent job losses, should get smaller, as OPEC countries increasingly use their higher revenues to buy imports from us and as domestic energy investment rises. The stimulus we need now is more than the stimulus we will need in later years.

Third, in designing this year's fiscal package, it is necessary to look at the expenditure side of the budget, in 1976 and in subsequent years. The White House has released some budget numbers but we will not get the full budget until February 3. As a consequence it is difficult to be very precise in discussing budget numbers. But with the aid of the recently released budget study by the Joint Economic Committee, it is possible to make a rough stab at evaluating the overall budget.

The President has indicated that his budget proposals would yield 1976 budget expenditures of $349 billion, up $312–$314 billion in 1975. A realistic estimate, however, would require several adjustments to these numbers. On the one side the $349 billion contains $7 billion of expenditures resulting directly from the President's energy program, which are offset by higher oil taxes.[1] To construct a budget excluding the energy program one has to deduct this $7 billion. On the other hand the President has proposed a number of major cuts in Federal outlays. Some of them simply repeat proposals already sent to the Congress. Others reflect the President's proposal to put a 5 percent ceiling on all expenditure programs that are automatically escalated with the cost-of-living, or with private wages—such as social security, the new supplemental security income, and Federal pay raises. On the basis of past history and reading of congressional responses to these proposals, I think it is eminently realistic—and in my view sensible policy—to assume that the majority of these cuts will not materialize. I think it likely that the President's budget, adjusted for all of these factors would show expenditures of $354 billion. Before allowing for any tax cuts, revenues would be about $310 billion. The deficit therefore, before any economic stimulus would be in the neighborhood of $44 billion.

This large deficit is not the result of a large burst of spending, but flows directly from the recession. If the unemployment rate were 4 percent rather than the 7 or 8 percent on which the budget is based, Federal outlays would be at least $10 billion lower. Expenditures on unemployment compensation, food stamps, and public employment programs would be much less. Similarly, with a full employment

[1] $2 billion extra grants to State and local governments to repay the higher oil prices; $2 billion in cash rebated to low-income citizens; and $3 billion in higher Federal outlays for oil.

level of output, revenues would be much higher. While it is difficult to make estimate without the budget document at hand, I would judge that the fiscal 1976 Fedaral budget would be in surplus by perhaps $25 to $30 billion, were the economy operating at full employment. The shortfall in national output and income has turned this potential budget surplus into the prospect of a $44 billion deficit.

Part of the current full-employment surplus arises from the peculiarities of corporate inventory accounting, which generate large paper profits on inventories during period of rapid inflation. Corporations are rapidly shifting their accounting procedures to eliminate these paper profits. As this occurs, and as inflation moderated, perhaps $5 to $10 billion of Federal revenues will disappear. Hence a better estimate of the Federal full-employment surplus, on which to base long-run policy, might be $20 to $25 billion.

Even after correction for corporate accounting practices, this is a very large full-employment surplus. The rapid inflation of the past 2 years has pushed taxpayers into even higher tax brackets, even though, on the average, their real incomes are down. The average tax rate has been rising while real income has been falling. Inflation has, in effect, legislated a tax increase. While the budget is now in deficit, it has been put there by recession. The full-employment surplus has risen sharply, and is helping to depress the economy.

An economy put on the path to recovery would generate large increases in Federal revenues. This is what the full-employment surplus tells us. But in designing a fiscal package to help toward recovery it would be wise, I think, not to give away so much revenue on a permanent basis as to eliminate the full-employment surplus. Predictions of the future are inevitably very uncertain. New expenditures for national health insurance or for welfare reform, for example, are sure to arise. Hence, commonsense would dictate a middle course. Recognizing the long-run-depressing effects of a large full-employment surplus, we need and can afford to have some of the fiscal stimulus take the form of a permanent tax cut. But discretion would suggest that the permanent part of the fiscal package be relatively modest, leaving a significant part of that surplus for the known and unknown contingencies of future years.

DESIGNING A FISCAL STIMULUS

The problem is to fashion a package of fiscal stimulus which takes into account several objectives and several sets of relevant facts:

One, the immediate stimulus should be large enough to arrest the current economic decline and begin a rapid economic recovery, in an economy which is already operating some $200 billion below its potential.

Two, only part of the 1976 fiscal stimulus should be permanent. Some of the forces now depressing the economy are transient in nature, and the long-run need for fiscal stimulation is less than the immediate need.

In light of these considerations I would suggest that an overall package along the following general lines would have the desired mix of temporary and long-run economic stimulation.

First, an immediate tax rebate on 1974 personal income tax liabilities of $12 billion should be enacted. And enacted promptly.

This is the same size as the President has proposed, but it should be paid in one installment, as soon as possible. Splitting the rebate into two payments, one in May and one in September as the President has proposed was presumably suggested to avoid the impact on the money and capital markets of a large Federal deficit concentrated in a single month. But there is no earthly reason why the Federal Reserve cannot accommodate an extra large Treasury borrowing in one particular month. The appropriate increase in the money supply for the year as a whole can be timed to coincide with the special needs of Treasury borrowing. In an economy now operating almost $200 billion below potential, and falling rapidly, it would indeed be a travesty if some fetish about monthly rates of increase in the money supply should stand in the way of the Federal Government doing what was needed to arrest the decline.

The $12 billion rebate should, in my view, be more concentrated on lower and middle income groups than the President has suggested. A cutoff of $700 instead of $1,000 might be reasonable, with the funds thereby released used to increase the size of reduction for the lower end of the scale. Since, however, the permanent tax cut I propose below is heavily concentrated among lower and middle income groups, I think the immediate injection of a temporary stimulus can best be done in terms of a simple rebate of 1974 taxes.

Second, a permanent cut of $10 billion in personal income taxes should be enacted to be reflected in withholding rates as soon as possible. Since it is a permanent tax cut, it should be one which improves the long-run structure of the tax system. While a number of possibilities suggest themselves, I would urge a tax credit of 1½ percent on the first $14,000 of earned income. In effect, this returns to workers, through the individual income tax system, a part of their social security payroll taxes. Without disturbing the social security system, it effectively reduces the burden of the regressive payroll tax and concentrates the tax relief in the bottom half of the income distribution. Arrangements could be made to provide cash rebates to workers whose income was too low to incur individual income tax liabilities. Such a tax cut would be the equivalent of adding 1½ percent to most workers' take-home pay. Without wishing to pursue the point too far, such a pay increase would make up some of the loss in purchasing power recently suffered by workers, and thereby help moderate pressure for large and inflationary wage increases over the next several years.

An additional component of the permanent tax cut should be an increase in the investment credit from 7 percent to 10 percent, including a provision allowing public utilities to take full advantage of the 10 percent credit. This would cost an additional $2.5 to $3 billion.

A third element of the fiscal stimulus should be a countercyclical revenue sharing program, which provides additional funds to State and local governments during periods in which unemployment is high and local revenues are hard hit. One cannot pick up the newspapers without reading about some State or local government which is having to raise taxes or pare current expenditures. The budget position of State and local governments has taken a sharp turn for the worst. Excluding their own social insurance funds, State and local governments had a budget surplus of $4 billion in calendar 1972, partly as a result of the enactment of revenue sharing. By the third quarter of 1974 this had swung to a deficit of almost $8 billion. Just at a time when the economy calls for maintaining employment and avoiding tax increases, State and local governments are having to do just the opposite. A $6 billion countercyclical revenue sharing program for calendar 1976 should help arrest this trend. The total amount to be distributed should be tied to the unemployment rate, so that with economic recovery and a resurgence of State and local revenues, the grants would be automatically reduced, falling to zero when the unemployment rate reached 4.5 percent. I note this is on top of, not a substitute for, the existing permanent revenue sharing program.

Chairman HUMPHREY. This is an add on?

Mr. SCHULTZE. An add on, not a substitute. I would make it a permanent part of the law so that automatically as recession occurs we would fill that gap and automatically as recession comes back it would taper off.

If these proposals were enacted by April 1, they could put approximately $25 billion of stimulus into the economy in the current calendar year. But only $13 billion of the cuts would be permanent. The counter-cyclical revenue sharing would eventually decline and disappear as a healthy economy was reattained. The $13 billion permanent reduction would still leave a significant full-employment surplus as a cushion against future contingencies.

There are several possible objections to a $25 billion stimulus during the coming year. Would it be inflationary? In most senses of the word, clearly not. The rate of inflation has been receding, and barring bad luck on food prices, is likely to continue to do so in the year ahead. The economy is operating so far below capacity that additional output and spending, of the magnitudes contemplated, would not threaten excessive demand or bottlenecks. Clearly, of course, a fiscal policy which provided little stimulus, and which condemned the Nation to a long period of unemployment at 8 percent or more, might succeed in wringing inflation out of the economy. And in that sense, promoting a healthy recovery may indeed make possible in 1976 and 1977 larger wage and price increases than would be likely under a draconian policy of steady recession. But the human costs of such a policy are far too high, and the risks of suffering larger recession far too great to make it an acceptable option. In 1976 and 1977 continued recovery may indeed begin to generate inflationary risks. The Congress, and this committee in particular, might wish to give particular attention during the year ahead to devising workable means of reducing the structural inflationary factors in the economy, and to thinking about feasible means of selective wage and price intervention.

Would $25 billion of fiscal stimulus in 1975 lead to a Federal deficit so large as to produce a rise in interest rates and a sharp competition for capital with private industry and housing? Both Professor Ackley and Professor McCracken have addressed this. I will, therefore, be brief in my own comments about the same problem.

There is absolutely no need for this to happen. In the first place, the characteristic of a recession economy is a fall in the demand for loanable funds by private business. We are now witnessing that. There is room for substantial amounts of Federal borrowing. Moreover, in the economy of 1975 there is absolutely no reason for the Federal Reserve to keep monetary conditions so tight that financing a large Federal deficit need drive up interest rates. Over the past year the real supply of money in the economy; that is, the supply of money adjusted for price inflation has fallen by about 7 percent. This increased the stock of money by a sufficient amount to ease interest rates somewhat further, and at the same time accommodate a large Federal deficit would not be inflationary in an economy with 8 percent unemployment and very substantial excess capacity. During the year ahead, therefore, the large Federal deficit that will necessarily accompany a stimulative fiscal policy need not interfere with the goal of some further reduction in interest rates.

Let me turn just briefly to oil policy. What this Nation should do in the short run and over the long run about energy policy, and specifically about reducing our vulnerability to heavy oil imports raises a host of extremely complex questions. As I indicated at the beginning of my testimony, I think the Nation would be much better off if the debate about this difficult question had been postponed for 3 months while the more urgent task of enacting a recovery program was completed. But the President has foreclosed that option. He has presented a very major energy program to the Congress, incorporating $30 billion of energy taxes and $30 billion of rebates. Moreover he has announced his intention to take administrative action to increase the fee on oil imports by $2 over the next 2 months and by $3 in April if the Congress has not by that time acted on his proposals. Should he do so, and should the Congress have not yet enacted its own oil program, then starting in April the President's import fees, and the rise in new oil prices that would simultaneously take place, would raise the crude oil price sufficient to drain $10 to $11 billion of purchasing power from the economy—at annual rates. This could offset a substantial part of the proposed economic stimulus and seriously reduce the prospects for economic recovery. Hence it is impossible for the Congress to postpone action on oil. If I could interpolate, Mr. Chairman, it is even more complicated than that because if the authority to extend price controls on old oil, which expires in April, is not extended, then the rise in oil prices that occurs if the President went ahead with his program unilaterally would be $30 billion coming out of the economy. If the Congress passed a bill extending price controls over oil and the President vetoed and you couldn't override and he insisted on going ahead, you could not get $10 billion coming out without rebate, you could get $30 billion coming out without rebate. It is a very large gun over the Congress' head, hence I am forced to address oil policy and you cannot avoid, much as I think the Nation would have been better off to wait for 3 months, so let me briefly address oil policy.

The total energy program proposed by the President suffers I think from misplaced emphasis. It is indeed highly desirable for this Nation to take strong and affirmative action to demonstrate our fixed intention to reduce dependence on vulnerable oil imports. But it is not critical that a large reduction of imports take place immediately. This economy can adjust to lower imports. The stock of high gas consumption automobiles on the road can be replaced with ones consuming less gas. Many commuters can shift to mass transit. Industrial process can be changed so as to consume less energy. But this cannot happen quickly. An attempt to achieve it very rapidly through large immediate price increases, will not work—but it could add to inflationary pressure and hinder recovery.

A sensible program would set long-run targets for production, consumption, imports, and stockpiles, say for 1980 and 1985. These long-run targets could be quite close to what the President has proposed, since his longer run objectives seem sensible. A series of measures could be enacted in this session of Congress designed firmly to reach those targets by the stipulated dates. But in careful stages. For example, a series of taxes and subsidies on automobiles could be enacted. Purchases of low-gas consumption autos would be subsidized and high gas consumption cars taxed. The break-even point, where subsidies end and taxes begin, would change over time so that high-gas consumption autos are increasingly penalized. Alternatively a stage shift to low-gas consumption autos could be accomplished by legislative mandate, although I think the tax subsidy route is better.

Other measures, such as a gradually rising tax on gasoline could be enacted now, to take hold in predetermined stages. In this way, both business and consumers would be put on notice that changes would occur. They would have the time to take the necessary actions to adjust their activities and living habits. At the same time the rest of the world—producers and consumers alike—would be put on notice that the United States is definitely committed, in legislation, to a strong energy program. We gain much from adapting our measures to the economy's capability of adjustment. We gain little, and stand to lose much, by seeking to achieve a legitimate long-run target overnight.

The first needed action is for the Congress to remove or at least postpone, by legislation, the President's power to impose the oil import fee administratively. This would give the Congress time to consider alternatives to the President's program, as well as the President's program itself.

It is entirely possible however, that the required legislation will be vetoed and that the necessary two-thirds vote to override cannot be mustered. In that case, the President's administrative actions, the first stages of it, removing some $10 billion to $11 billion in purchasing power a year from consumers, must be offset by an additional tax reduction, so that the impact of the recovery program is not seriously weakened. That is what is critical. In that case the $10 billion tax credit on earned income I suggested earlier should be raised to $20 billion, to last so long as the President's import fee remains in effect. Having done this, the Congress might then proceed to consider its own energy package.

Let me add, Mr. Chairman, before I conclude, that, as I indicated earlier on this energy thing, it is very difficult to sort out what might happen if the President goes down his appointed self-announced path. It is possible he could be taking $30 billion out of the economy, not $10 billion, if a certain series of actions happen. To ask Congress both to pass a recovery program and to enact an incredibly complicated energy program and to put a gun at its head to do so by April 1 is in my view unconscionable. I would hope that the Congress would urge by negotiation, by legislation, by trying to muster every force to override a possible veto, that a minimum period of 90 days additional grace be granted in which the Congress can really review the program, come up with its own, whatever it be, whatever the pros and cons on specific energy measures are. It is going to be so difficult, that to allow this recovery to be short-circuited by unilateral Presidential action while the Congress can't act or because a veto gets overridden on things it tries to do, is just plain dynamite. It is truly dangerous and I would urge at a minimum negotiation, legislation, whatever is needed, to try to convince the President to give you 90 more days at least.

Thank you.

Chairman HUMPHREY. Thank you very much, Mr. Schultze, that was a remarkable statement and covered a vast area of our concern about the economy and about energy policy.

I would like to ask one brief question of each of you and I would like to get as simple and direct answers as possible.

Let's start with a simple basic question, which will allow you to sum up what you have said this morning in a way that will help this committee.

Is, in your judgment, the President's antirecession program adequate, will it get the economy moving again, and does it have the means to bring down unemployment?

First, Mr. Ackley.

Mr. ACKLEY. I think the program as proposed is not adequate. I believe that the size of the immediate fiscal stimulus needs to be substantially larger than the President has proposed. If we are to succeed in influencing, as Professor McCracken suggests, the pace of recovery late in this year and into 1976, nothing we do immediately will have much effect on what happens in the next 6 months; but I think a larger program can indeed make a significant difference in the pace of expansion later this year and in 1976. Inasmuch as there are so many uncertainties anyway about any forecast, I think we ought to simply be doing everything we can to assure that the upturn will in fact occur even though my best view is that it will. We ought to err at this point on the side of stimulus.

Chairman HUMPHREY. Mr. McCracken, you heard the question. Your response, please.

Mr. MCCRACKEN. Yes; the President's program in my judgment is adequate to promote an expansion of economic activity by the later part of the year, providing it is accompanied by appropriate monetary policy. If it is not accompanied by appropriate monetary policy an even larger fiscal package will also produce disappointing results. At the same time I would have no serious problem in quantitative terms with the magnitude of fiscal stimulus somewhat larger than the President proposed, but I would consider the President's package adequate with that very important proviso about monetary policy.

Chairman HUMPHREY. Didn't I perceive in your testimony your concern over the temporary nature, the one time, one shot nature of the tax cut?

Mr. MCCRACKEN. Yes, that is a very good point, I would add that. I would include that caveat in my remarks.

Chairman HUMPHREY. The President did not address himself to the Nation at all on monetary policy, credit, money supply or interest rates. I personally felt that was an inadequacy in the address.

Mr. Schultze.

Mr. SCHULTZE. Is the President's program adequate? No. Adequate in a sense of getting unemployment down as rapidly as we should get it down. It is clearly not adequate.

Secondly, will it turn the economy around? Probably. But not fast enough and not far enough.

I add to that the proviso, however, that if we get into this oil embargo then not only will it not be adequate but by unilaterally removing almost, not quite, but almost as much money as is being put in, it won't even help turn the economy around.

So subject to what happens on oil I would say, yes, it might turn us around but in any event it will not turn us around fast enough and far enough.

Chairman HUMPHREY. I understand in your testimony you do support a tax rebate in one shot?

Mr. SCHULTZE. Correct.

Chairman HUMPHREY. Second, some permanent change in the tax law that relates to tax credit on earned income?

Mr. SCHULTZE. Correct.

Chairman HUMPHREY. So as to ameliorate some of the pressure of the social security tax in particular?

Mr. SCHULTZE. And pump additional money into the economy.

Chairman HUMPHREY. Again just a question that will go down the line. We are going to operate on the 10-minute rule, may I say to my colleagues.

There was discussion here of the need for monetary policy to get us out of the recession. Mr. Ackley, let me put it this way. What specific increase in the money supply would you recommend that the Federal Reserve System provide, let's say, for calendar year 1975?

Mr. ACKLEY. I think I suggested in my testimony that a rate of increase in M_1——

Chairman HUMPHREY. The trouble with that language, if I may say, is that folks don't understand M_1. They think this is a gun in Vietnam.

Mr. ACKLEY. I am not sure they will understand better if I say that a growth of the sum of currency and demand deposits of 9 and 10 percent would be entirely appropriate. However I don't think anybody should get hooked to a particular number. It seems to me they ought to do what needs to be done to help assure recovery. If they should take 12 instead of 10 it still wouldn't disturb me.

Chairman HUMPHREY. Is the present money supply or rate of money growth adequate?

Mr. ACKLEY. It seems to me the recent rate of growth of money supply is inadequate.

Chairman HUMPHREY. Over the past year?

Mr. ACKLEY. Well, the past year had two halves but certainly over the year as a whole very much so, and in the second half very distinctly so.

Chairman HUMPHREY. The next question to you: What is your view on the form of credit allocation or what kind of credit allocation could we have if Congress feels it necessary to go that route?

Mr. ACKLEY. It seems to me the problem of credit allocation is a problem which exists in periods of tight money only, and does not exist normally in the economy. I am quite prepared to recognize that, in past periods of tight money, certain sectors of the economy—particularly housing, perhaps small business, State and local governments—have been seriously discriminated against. Whatever measures might remedy that discrimination in any new period of tight money, I would support.

I think that some method of the sort that former Governor Brimmer of the Federal Reserve made, and I believe Representative Reuss suggested improvements to, might be very appropriate for such a period. That scheme would set reserve requirements against bank assets rather than bank liabilities, and would allow individual reserve ratios against each class of assets. I would be opposed to any allocation scheme which operated continuously in periods of easy money as well as tight money.

Chairman HUMPHREY. So what you are really saying, if the money supply is eased sufficiently there is much less need for any kind of credit allocation?

Mr. ACKLEY. Certainly in the period ahead, if the Federal Reserve does what it ought to do.

Chairman HUMPHREY. Mr. McCracken, what specific increase in the money supply would you recommend or what is your general view here as to what we ought to do with the money supply? I might add I should have asked how do you get the Federal Reserve System to cooperate with the rest of the Government? You know its sort of like they are separate members of the United Nations.

Can we have communication, since you have served in both, may I say?

Mr. McCRACKEN. Yes. Well, my experience in the Federal Reserve System, as a matter of fact, was in Minneapolis.

Chairman HUMPHREY. I know, that is why I feel you are such an expert on this matter.

Mr. McCRACKEN. That was several incarnations ago in my career. I probably, of the three panel members here, would attach the most significance to the pursuit of the right monetary policy.

I share Professor Ackley's concerns about laying out some procrustean figure of x percent per year and never depart from it. In the current economy the rate of expansion for monetary policy and again for M_1, the money supply, the currency in circulation and demand deposits, that figure ought to be in my judgment not less than 8 percent. I would not be unhappy with 10.

Chairman HUMPHREY. What is it presently?

Mr. McCRACKEN. During the last quarter, if I remember correctly, it was 3.1 percent, at an annual rate of 3.1 percent.

As Professor Ackley indicated, by the way, 1974 was two distinctly different periods. It was probably too rapid in the first part of the year and entirely too restrictive in the second half, and it really helped to set the stage for the current recession.

I would guess that something like an 8 percent rate ought to be pursued through the year, although once again this is not something where one can make a decision and then play golf for a year. It has to be watched.

The second question pertains to credit allocation. I really don't have very much to add to what Professor Ackley has indicated. I think we get into these binds because basic monetary policy gets off track because it is overly expansive. This lays the basis then for an overheated economy, and then we start to get these severe pressures in the money and capital markets. The weekly positioned claimants, heavy housing and others, get squeezed out. If we pursue the right basic policy I think the apparent need for allocation is much reduced. In 1975, and I suspect in 1976, I would not see these pressures so formidable that this would really be very important.

Chairman HUMPHREY. Mr. Schultze.

Mr. SCHULTZE. I would associate myself with the remarks of my two colleagues. I would add one other point, I think. Without getting into a long debate about the nature of monetary policy, I would say in the year ahead the Federal Reserve ought not to operate in terms of a target with respect to money supply but ought to operate in terms of having an interest rate objective and pursuing a money supply rate of growth sufficiently to ease interest rates somewhat further and not to let them climb during the first stages of recovery the Fed ought to operate, at least partly, in terms of interest rate objectives and do whatever is needed on the money supply to get there.

I am not suggesting that we always ought to do that—but that is what the Fed ought to do now.

The second point, what does the Congress do about this? The only suggestion is, somewhat facetiously, that my impression has always been that the members and Chairman of the Federal Reserve Board do read the political tea leaves and that I don't know——

Chairman HUMPHREY. Would you repeat that?

Mr. SCHULTZE. Political tea leaves. They do pay attention to what the President and what the Congress say monetary policy ought to be, if expressed firmly enough.

Chairman HUMPHREY. Thank you. My time is up.

Senator Taft.

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

May I say I appreciate very much the courtesy of permitting me to join you. I have not formally joined you yet, but I expect to do so very soon. I look forward to it with great pleasure.

Mr. McCracken, in your prepared statement you cite a measure for assessing the stimulative effect of Federal fiscal pressure: A rise in outlays plus the revenue decline—the rise in after-tax incomes—for many changes in tax rates.

Could you explain that more precisely? Does it mean that you have abandoned the full-employment budget concept as a means for measuring the stimulative effect of the budget? Is it not true when you were chairman of the Council of Economic Advisers, you suggested that changes in the full-employment budget surplus or deficit were the most unambiguous measure of the magnitude of the fiscal pressure?

Mr. McCRACKEN. Yes, sir. Let me comment on that, Senator Taft. I don't think the comments that I made in my prepared statement are inconsistent with my belief that looking at the full-employment surplus data is also important. The problem we get into in talking about whether the budget is expansive or restrictive is that this is sometimes discussed in terms of just the deficit. Well, we know that won't do because the deficit, as I indicated, may be producing an overly strong economy or it may be produced by an overly weak economy. Just looking at the deficit figures you don't know which it is.

And so in my own thinking it seems to me there is a role for something which is a little more parallel to the answer that we would give if we asked what is going to be the impact on the economy of plant and equipment spending, for example.

Our first inclination would be how much is the outlay on plant and equipment going to rise. Looking at that slice of the economy would be a first rough cut at what those outlays or that segment of the economy will be doing in terms of pushing the economy up or pushing it down.

Now, the thing that is most parallel to that in terms of fiscal policy is simply the projected rise in outlays which will directly be a demand for output or indirectly the revenue value of any reduction in tax rates which increases after tax income, and, therefore, indirectly it stimulates the economy.

That seems to me to be a useful and fairly unambiguous measure, although like any other measure we can discuss the refinements. At the same time, the full-employment concept is a very important one because particularly in a time as this if we are talking about tax reduction at a time when the budget is already in deficit, it is not amiss to ask ourselves, What is the kind of standard volume picture? In other words, if the economy gets back up to some more normal level, how would the current expenditure programs and revenues from the current tax structure compare?

Senator TAFT. Thank you, Mr. McCracken.

Mr. Schultze, you mentioned using the revenue sharing device and that immediately gave me pause. I was a proponent of revenue sharing. The principle, I think, is sound. However, I find serious problems with the distribution formula, particularly as related to heavily populated States in terms of per capita impact of the distribution formula.

Do you have some distribution formula changes in mind that would tie into any additional revenue sharing plan?

Mr. SCHULTZE. I do, but not precisely.

Let me first note that my emphasis here is on a revenue sharing program specifically aimed at relieving State and local governments from the burden of the recession, nothing more.

Senator TAFT. The formula should be related to recessionary factors?

Mr. SCHULTZE. The formula should incorporate various ways to do it. It has to be a shortcut, but some formula which in effect is based on the amount of revenue losses they have suffered because of the recession.

Now, you clearly cannot calculate that locality by locality. Hence what you must do is have a shortcut formula based on unemployment rates by labor markets and the overall reduction in State and local revenues, and obviously it has to be a shortcut. But it seems to me the distribution problems that go with the long term revenue sharing program are not the same as the kind of distribution problems which would, of course, arise if you tried to pass a——

Senator TAFT. Do you think we could ever get a formula of that type passed in the Finance Committee, or passed the floor of the Senate?

Mr. SCHULTZE. In my view the problems of recession, and avoiding State and local governments doing things they shouldn't have to be doing right now, are such that you could stand an awful lot of rough justice in order to get those funds out in a hurry. Of course, it would have to be rough justice.

Senator TAFT. One other question. In your statement, Mr. Schultze, you mentioned the possibility of selective wage and price intervention.

What particular industries are you thinking about in that connection?

Mr. SCHULTZE. Well, as a matter of fact, I am not thinking at the moment about any particular industry. I certainly don't have any answers, but I am convinced, even if I wasn't convinced as an economist, I would be convinced as an amateur politician that over the next decade, willy-nilly, that this economy is subject enough to inflationary pressures that we are going to be intervening at least sporadically with price and wage intervention and we had better be giving some thoughts to the long term mechanism to do it with the least damage. It will be damaging but in my view less damaging than the alternatives.

Second, I think we need to think about more imaginative means of dealing with wage-price problems.

For example, my colleague, Arthur Okun in Brookings, has suggested such devices as during a period in which you are trying to impose restraint on wages have the Federal Government in effect subsidize reductions in State and local government sales taxes, which reduce the consumer price index and, therefore, reduce the pressure on wages.

It seems to me we need to think in terms of designing tax reductions, where appropriate, to reinforce wage guidelines.

It seems to me we need to think in terms of a mechanism for selective intervention in particular industries where under particular circumstances it is clear that the price increase is unwarranted in some inflationary sense.

Don't get me wrong, I don't have a package of answers but I am convinced that this society has got to think them through because we cannot any longer choose either inflation at rapid rates or recession and I think we are going to have to do something else.

Senator TAFT. Thank you.

Chairman HUMPHREY. Thank you.

Congressman Bolling.

Representative BOLLING. Mr. Chairman, thank you.

I think this is probably the most remarkable trio of statements that I have heard in the years that I have been on this committee and I think it is a very auspicious beginning for your chairmanship, which I know will make a great contribution.

I have been on the committee since the days of the elder Senator Taft and O'Mahoney and Flanders and Douglas, of course, who was a junior member when I went on, and I have never heard three abler statements nor have I heard three statements which are more alike in their sense of urgency, not panic but urgency. They agree absolutely that we must act promptly, fiscally, and I think even more remarkable, considering the difference in the views of the authors of the statements, they agree so clearly on the need for a monetary policy which allows for a substantial increase in the growth of the money supply. It seems to me that the most important aspect of what has been said and what has been done today is that widely respected gentlemen with government experience at the highest level all concur that it is urgent that the Congress act promptly, virtually immediately, to turn the economy around, and that it act more judiciously and more slowly on a variety of very important other matters. And I find almost unique in my experience the total agreement on the need for monetary ease to accompany whatever else we do.

I have no questions, I just wanted to express my great pleasure at the opportunity to be here.

Chairman HUMPHREY. Well, I want to say that Congressman Bolling has surely stated my personal judgment. As I said just a moment ago to the staff director. this is unusually able and very brilliant testimony that we have had today and the sense of urgency is what I believe needs to go from this room. This committee has its one responsibility to advise and counsel and study and I hope that sense of urgency which has been emphasized here will get to the legislative committees of the Congress.

Senator Proxmire.

Senator PROXMIRE. There is indeed a highly welcome unanimity here, especially on monetary policy, and the Banking Committee of the Senate and House, as you know, has oversight responsibility with respect to the Federal Reserve and I expect to do my best to communicate that urgency to Chairman Burns and to other members of the Federal Reserve Board as vigorously as I can. The fact that three of the outstanding economists in the country have agreed, as you have in your views, and representing different political positions, I think, is most helpful and useful.

I would like to see if I can get the dimensions of that urgency a little bit by asking each of you if you can give me a figure on the assumption that the President's energy program is put into effect. No. 1, can you give, tell me, Mr. Ackley, what you think the inflation rate will be by the end of the year?

Mr. ACKLEY. One needs to make a number of other assumptions beside that one; but let me add for sure the important assumptions that there are no major crop failures, that we have the kind of crops that we ought to have this summer. In the absence of the energy program I would have said that the rate of overall inflation by the fourth quarter should be in the neighborhood of 6.5 or 6 percent, and declining.

The energy program as proposed seems to me to have a substantial, although very uncertain, impact in raising this estimate. One can't simply calculate the direct impact of the program on prices, in terms of its initial cost, and add that to the price increase that would otherwise occur.

In the first place, a program with a tax on crude oil dissipates the price raising effects throughout the entire economy, and will thus be much more inflationary than one confined to gasoline alone.

Senator PROXMIRE. We know what the President's proposal was, so on that assumption, as I understand it, it dissipates throughout the economy as a whole.

Mr. ACKLEY. There would certainly be markups on the cost increases, the price increase would be much greater than the direct cost increases; and these in turn would have repercussions on wage costs and on material costs, which would thus revive the spiral just when it was otherwise tending to die out. So I think it is very uncertain but I think it is substantial and unfortunate at this time.

Senator PROXMIRE. Would you say 9 to 11 percent, something like that?

Mr. ACKLEY. No; I would hesitate to give any number, but if I have to pick a number it wouldn't be that high.

Senator PROXMIRE. As you know, the administration has indicated about a 2-percent inflation impact. I understand that an eminent economist has estimated it would be about twice that, about 4 percent addition. So that is why I say 9 to 11 percent depending on whose estimate you take; 8.5 to 10.5 percent.

Mr. ACKLEY. It is highly uncertain.

Mr. MCCRACKEN. Well, I would certainly subscribe to all of the uncertainties which Mr. Ackley has indicated here.

I think there is one point. If we are focusing on what the rate of inflation might be by the end of the year, by which I presume you mean which would be the annualized rate during the fourth quarter?

Senator PROXMIRE. Yes.

Mr. MCCRACKEN. Then, of course, it is not only a question of what the ultimate magnitude of the impact of the program is on the CPI but the time shape of that through the year. It is conceivable that if the program were implemented almost immediately most of that impact would have occurred say in the middle of the year, and so it would have been in essence the price level moving to the higher price level, moving to a higher level, but with a rate of inflation by the fourth quarter not necessarily all that much higher, although, of course, the rate of inflation measured in terms of the fourth quarter of 1975 vis-a-vis the fourth quarter of 1974 would, of course, pick it up.

Senator PROXMIRE. On the basis of our experience of the skyrocketing of oil prices in late 1973, with an energy induced inflation that ensued throughout virtually all of 1974, it would seem to me, if we have another similar increase, that we might have a situation throughout 1975 in which we would have continuing increases.

Mr. McCRACKEN. You would certainly get some of that even in the fourth quarter and you would get some of it before that. The question is how that gets distributed.

As to the absolute magnitude, this is something that I think the committee itself ought to have subjected to rather exhaustive quantitative analysis, which I have not done. My impression would be that it is probably somewhere between two percentage points and the higher figure which I mentioned.

Senator PROXMIRE. How about the overall inflation rate?

Mr. McCRACKEN. The overall inflation rate I would guess is in the neighborhood of 7 percent, 6 to 7 percent by the fourth quarter.

Senator PROXMIRE. Including the energy?

Mr. McCRACKEN. Not including the energy program.

Senator PROXMIRE. So then it would be 8 to 9 percent?

Mr. McCRACKEN. Yes, 7 to 9 percent, something like that.

Senator PROXMIRE. Mr. Schultze.

Mr. SCHULTZE. First, I subscribe to the remarks of my two colleagues which are really remarkably similar. But let me throw a few other numbers in. If the President's energy program were enacted in full, the direct increase in the price of crude oil and natural gas passed on dollar-for-dollar only, is estimated at $30 billion. I would estimate nearer $33 billion, but that is certainly close. There would clearly be some sympathetic price increases for coal and intrastate natural gas, some sympathetic price increases, so the total increase would be probably somewhat larger than $33 billion passed through dollar-for-dollar.

Senator PROXMIRE. Also, wouldn't you get a reaction on the part of labor?

Mr. SCHULTZE. That is my next point. Even if there were no increases in markups on this, the critical point is how does this affect wage bargains? And I must say, I do not know. It clearly would have some impact but whether that would be only a modest part or a very large part of it I don't know, but you have to add something. So the 4-percent estimate you indicated seems to me to allow for a modest further impact on wages and prices.

Let me make one important additional point. Since you started your questioning with monetary policy, I want to relate to that.

Senator PROXMIRE. Would you give me a range on the inflation?

Mr. SCHULTZE. The impact of the President's program?

Senator PROXMIRE. The whole thing. What do you think the inflation rate will be at the end of the year?

Mr. SCHULTZE. If you force me to, I can find no reason to disagree with my colleagues that you would probably with good luck on food, and I just don't pretend to be able to predict food prices—with relatively good luck on food, perhaps a 7-percent rate of inflation by the end of the year.

Senator PROXMIRE. Then the energy.

Mr. SCHULTZE. Energy on top of that, including the timing? I don't know. I think Professor McCracken is right, you don't know the timing. It would not happen all at once, it would feed through, not evenly but gradually over the next year and a half as it affected other prices and labor. So you would have to add 4 percent but at what rate, I don't know. I think 2 percent is below any reasonable estimate.

I would add one point I think is important. If it should happen that a program something like the President's should pass, then I think it is very important that the Federal Reserve be sharply encouraged to ease money further. They should know this—but whatever rate of increase in the money supply would be appropriate without the energy program, a larger price increase is going to mean a larger need for funds in the economy to avoid pushing unemployment down if the price increase is larger because of oil. Therefore, I hope whatever is done on oil, if it does drive up prices, the Federal Reserve takes this into account, otherwise you could have a very bad effect on employment if it doesn't.

Senator PROXMIRE. I wanted to come back to the monetary policy maybe in a later turn. I would like you each to comment on what you think the rate of unemployment is likely to be with the program proposed.

I might say that I think we are going to be, as I may be able to indicate a little later, in a very difficult position to try to change the President's energy program. There are reasons why the President has a big advantage. It is going to be hard to pass a law changing the President's program over his veto, and we might be faced with the fact we will have to design economic policy around a fait accompli.

Mr. Ackley, can you give us an estimate of unemployment?

Mr. ACKLEY. Eight percent plus or minus three quarters of a percent.

Senator PROXMIRE. Mr. McCracken.

Mr. McCRACKEN. I agree. I don't see anything in the evidence to suggest any significantly different figure. I would just like to make one comment that even after economic activity resumes expansion, it usually is some time before you see significant improvement in unemployment. Possibly by the latter part of 1976 we ought to see, if history is any indication, 1 to 1½ percent below.

Senator PROXMIRE. By the latter part of 1976, almost 2 years from now. You say about the latter part of 1975?

Mr. McCRACKEN. Eight percent. Say by the end of 1976, about a year after the low point, 6½ to 7.

Senator PROXMIRE. My time is up. Could I ask Mr. Schultze to respond?

Mr. SCHULTZE. First, I think the unemployment rate will reach 8 percent plus before we turn around. Second, I think an economic—

Senator PROXMIRE. What do you mean by the plus? Are you talking about a quarter, a half, or are you talking about something maybe bigger than that?

Mr. SCHULTZE. No, I think a quarter or a half. I think the chances of it being significantly bigger than that, the chances are not zero, but they may be one to five, but they are not insignificant. It is the only way I can put it.

Second, I think that the net economic stimulus of $20 to $25 billion, and the right monetary policy, could get you to a point where you begin to knock unemployment down by something between 1 percent and 1.5 percent a year, but I don't quite know the timing.

I think I would agree with Professor McCracken that wouldn't begin until late in 1975.

Senator PROXMIRE. If the chairman will permit me, may I ask you what the effect, if any, do you think the President's energy program would have on unemployment? We know it would have a distinct effect on inflation. How about unemployment?

Mr. MCCRACKEN. I think I am going to answer your question in a meaningful way. I think one of the critical problems of trying to do what the President wants and bring imports down swiftly, is that we don't know the result. The President has suggested taking $30 billion out of the economy, and quite properly. If you are going to do as suggested—bringing $30 billion back in—I don't think the President and his advisers, or any economist can really give you a good answer. Since this is quite different from anything we have done, I think by trying to do it in a hurry you are taking awfully big chances that you might hinder the recovery. I think the chances that it would hurt rather than help are greater than zero but I must confess I think the real problem is uncertain. You are playing with a little dynamite. We don't know, it might work out all right, but it might not. It is too big too quick.

Chairman HUMPHREY. Thank you.

I have heard again here that you feel that the total cost of the President's energy program ranges between $30 and $33 billion. $30 billion is offset by rebates, tax reductions, et cetera. But isn't this only the direct cost?

For example, if you deregulate natural gas, take off the controls of domestic crude, add on the import taxes, levy the excise taxes that the President is talking about, and I think that Senator Proxmire made it very clear that the President really does have the upper hand here, the gun at our heads, so to speak, on it, the power of the veto—won't we see a sharp rise, for example in food and fertilizer?

Mr. SCHULTZE. Yes, sir.

Chairman HUMPHREY. After all, natural gas, petroleum is the feedstock. Won't you see a very sharp rise in all commodities, all across the board, because everything is touched by energy? There isn't any doubt, everything from medicinal up to textiles. So isn't this more than just a $30 to $33 billion increase in energy costs?

Mr. ACKLEY. I think the estimate of $30 to $33 billion is the direct impact in terms of additional energy costs. To that must be added the effects of the inflation which it helps generate. And this can affect, of course, not only prices but also income. And nobody really knows how to measure the cost of an inflation taking account both of its effects on incomes and on prices. But clearly it is an adverse additional effect which I should say needs to be considered as part of the judgment on the package.

Chairman HUMPHREY. What is really happening here is that the President's program would increase the cost of crude oil as much as it was increased after we had the oil embargo and after the international prices went up. It went from $4.50 average domestic price blending imports on domestic oil to $9 or $9.50. These new measures would take it up to $14, around the range of $14. So you have got a tremendous jump in energy costs not only in heating oil, in diesel fuel, in jet fuel, and in gasoline, but in electric utilities, for example. What do you think the electric companies are going to do when they have got to pay these rates not only for the oil that they use, but the oil companies own about two-thirds of the private resources of coal?

Does anybody really believe the oil companies aren't going to jump the price of coal?

I would be interested in any observations you want to make on energy costs.

Mr. McCRACKEN. There is no question but that the ultimate ramifications of this on the economy are going to be showing up in more ways than simply increases in tax bills. In a sense I suppose we ought to assume that if the program is working this is the way it should be because one of the aspects of the program is, of course, to try to encourage conservation of those things that are energy intensive.

Now, that leads me to make a comment that in trying to work through the secondary tertiary implications it is important to take account not only of the plus factors, that is the fact that crude oil costs more, utility rates will go up. We need to take account of the fact that in all kinds, millions of specific situations, in different markets, there will be a tendency to shift away from energy intensive products to those products that are less energy intensive.

I am certainly not an expert in that raw materials market but I think one of these would be a tendency to shift away from aluminum to whatever the substitute for aluminum may be that are not so energy intensive.

So it is a complicated thing and this is really what I had in mind in suggesting this is the kind of thing that ought to be subjected to very exhaustive quantitative analysis to try to take into account the secondary and tertiary ramifications, both plus and minus.

Chairman HUMPHREY. It is my personal judgment the administration did not think through the arithmetic of the economic impact of this energy program which on its face, looks like a $30 billion tradeoff, so to speak, and therefore it sounds like it is a salable item. I just have a very strong feeling that, as you have said here, it is extremely complex, it is the sort of thing that this committee and others ought to examine in meticulous detail, getting the best experts in that we can, because once you start down that path jacking up prices of energy another 50 percent, which is the raw material level at the crude oil level, you open up a Pandora's box of problems in a country that uses energy like we do in this country and not just the gasoline for our autos, which we will get to, but the whole subject matter. For example, you talk about food. Our agriculture is the most energy intensive agriculture in the world and if we do not have this energy; that is, in the form of the fertilizer that is required for intensive production that we need, we are going to be a food deficit nation rather than a food surplus nation or reserve nation. I don't think this has really soaked down yet to the average person that is studying the energy question.

Would you like to comment on this, Mr. Schultze?

Mr. SCHULTZE. I agree with the general statements and I would just probably take up time by agreeing.

Mr. McCRACKEN. Could I make one more comment?

Chairman HUMPHREY. Yes.

Mr. McCRACKEN. Mr. Schultze in his statement made an observation or made a point that ought not to get lost, one to which I would wholly subscribe and one which I think is particularly germane to this interface between energy and economic policy, particularly germane to this committee. And that is that we are going to have to try to find the right balance between a determined effort to make progress in the direction of energy policy but not adopt heavy-handed and sort of brute force constriction on energy availability, including imported oil, that starts to weaken the economy.

Mr. Schultze made this point in his statement but I think it is terribly important. There is a danger here that we will get locked to some kind of brute force in x million barrels of oil that imports must be down by a year from now, which is out of context with the shape of the adapting capability of the economy.

As you look at the economies around the world today, the thing that distinguishes economies that are in trouble with energy and oil and those that are not in trouble is not just the simplistic one of the ones that have oil and the ones that don't internally, the key difference here is the difference between those who have strong economies and those that have weak economies. Whether they have oil within their boundaries is secondary.

Obviously I do not denigrate the value of having internal sources of oil but here is the United Kingdom, apparently within 3 years of significant supplies of oil from the North Sea, in far more trouble than Germany. Germany has a strong economy.

Chairman HUMPHREY. I think that is a very relevant and very important point.

Mr. SCHULTZE. I would like to drive that home a little more if I could. Somehow I think there is a tendency to assume that the economic recovery and our economic problems all are bound up somehow with reducing the consumption of oil. I want to say they are not.

Let's ask what do we gain by reducing the consumption of oil rapidly in 1 year or 1½ years rather than spread over time. What do we gain, what are our objectives.

First, we want to reduce I think our vulnerability, political and otherwise, to blackmail, on the part of oil producers so we want to reduce our vulnerability. Second, it would be good in concert with other consumer nations to shrink the size of the world oil market to help, not to guarantee, but hopefully to help bring down the price of foreign oil. And, third, psychologically we want to demonstrate, bound up with this, a firm purpose and a firm commitment.

I would argue that we gain virtually nothing, or at most a little bit, by trying to do it all at once. Suppose we do reduce our imports of oil from 6.5 million barrels a day to a realistic estimate with this program of maybe 5.9 million barrels a day. I think that is generous. You are still vulnerable; you are still dependent. We are moving in the right direction. We have gained a little but is it so critical we have to do it overnight? Do you demonstrate determination as between doing something the President proposes and doing something equally as firm but spacing it over 5 years? I think you gain nothing. I think what is really important is to show that determination through legislation, but I think we just take a tremendous risk by trying to accomplish a longrun goal overnight.

Chairman HUMPHREY. Legislation on a phased basis?

Mr. SCHULTZE. That is correct.

Chairman HUMPHREY. With a composition of both conservation practices and price obviously; is that correct?

Mr. SCHULTZE. That is correct.

Chairman HUMPHREY. Just this question. I was interested in the figures that you were all talking about, particularly you, Mr. Ackley, on the necessity of expanding money supply enough to achieve real output increases of, I think you said, 7 or 8 percent. Then you indicated that if that were done, unemployment will not drop to 5 percent until 1978, or drop to 4 percent until 1980.

It has been brought to my attention, first of all, that it is very seldom that we have had that kind of gain in real output, and I think we have to ask how many times in our history have we achieved a real output growth of 7 or 8 percent over a 1- or 2-year period?

Mr. ACKLEY. Without some study I couldn't answer that question. I am sure there have been occasions where in recovery from recession where rates of growth of output of that magnitude have been sustained over a couple of years.

Chairman HUMPHREY. Well, it would be helpful to get that information. I think your statistical documentation was based upon that, relating to money supply.

Do you have any information, Mr. McCracken or Mr. Schultze?

Mr. MCCRACKEN. Well, Mr. Chairman, there is a chart on page 65 of Business Education Digest which does give the rates of expansion of GNP in constant dollars, and I think there are two points to make. It is not uncommon after a recession for the rates of gain in real output to reach the 8-percent zone and even up to approaching 10 percent.

Chairman HUMPHREY. Well, that is after a recession. Now we are in a recession and you have got the stimulus of a tax cut.

Mr. MCCRACKEN. This is my point. But there is another point, that the rates of gain in real GNP following a recession, though they frequently get up into that zone momentarily, have not normally held for 2 years. I think that is your point.

Chairman HUMPHREY. That is right.

Mr. MCCRACKEN. This would be an ambitious target, no question about that.

Chairman HUMPHREY. All right, my time is up.

Senator Proxmire.

Senator PROXMIRE. All you gentlemen talked about monetary policy and you have been somewhat vague. Even the most explicit statement by Mr. McCracken has left me up in the air a little bit as to what our monetary policy really ought to be. This may be because if you follow the monetary stimulus theory logically, your recommendations would have to be so shocking, the rate of money supply increase would have to be so great that we would be appalled and wouldn't be willing to accept it. I say that because as you, Mr. Ackley, described a neutral monetary policy in your prepared statement, you would have an expansion in line with growth of potential output in current prices. Here is the formula I end up with: about a 15-percent increase in the money supply. I say that because the potential growth which Mr. McCracken says is necessary to get us to a reasonable level of unemployment within 2 years is about 7 percent. The rise in prices is likely to be around 8 percent, might be a little less than that. You have said, 6, 7, and 8 percent. With the energy input I think 8 percent is pretty reasonable.

That adds up to 15 percent; 7 percent plus 8 percent is 15 percent. That would make it neutral.

If you want the monetary policy to stimulate the economy, then you add to the 15 percent, maybe another 5 percent, to make it 20 percent. Of course, this is outrageous and absurd, according to all of our previous experience, and I think almost anybody would automatically say that is highly inflationary, out of the question.

How can you tell us that you would have a monetary policy that would increase the money supply at 8 or 9 or 10 percent and argue this is going to really help under these circumstances?

Mr. Ackley. Let me correct the arithmetic as far as my numbers were concerned. I referred to the growth of potential output in current prices, during a period when the inflation rate was diminishing appreciably. The rate of growth of potential output is somewhere around 4 percent. I wasn't talking about the recovery of actual output toward potential but the rate of growth of potential. In current prices it would come within an 8- to 12-percent range, and I think that is the minimum which ought to be maintained through the period——

Senator Proxmire. Four percent. Let's take that 4 percent. I am not so sure that we can. Take the 4 percent, then add onto that the reasonable inflation rate. Nobody has said it would be less than 6 percent. Four and six is ten and the more realistic estimate in my view due to the likelihood of the energy program is about eight. That would make it 12 percent. That is neutral, isn't it, that would be a neutral policy.

Furthermore, in terms of the inflation that we have been having of 12 percent a year, we hope that goes down. That would decrease the real availability of money in real terms; right?

Mr. Ackley. Yes, indeed.

Senator Proxmire. So that I can understand your position, if you are not relying on monetary policy, don't want it to drag, you say it has to be around 10 to 12 percent of expansion of currency and demand deposits. If you want a stimulus from that it seems to me the logic would suggest it has to be greater.

Mr. Ackley. You are absolutely right; and I agree that the numbers we are talking about have to be large, and may turn out to be shocking to some people in the financial community.

Senator Proxmire. The reason I came to that, Mr. Schultze was saying forget about money supply, think about the target interest rate. We will do that, then you might end up with a money supply increase that would be in double digits.

Mr. ACKLEY. You might also end up with a money supply increase that would be lower than that.

Senator PROXMIRE. It doesn't seem logical on the basis of everything you and I have been discussing right now.

Mr. ACKLEY. I think the Federal Reserve has been in trouble before by using only an interest rate target, which was met only because the economy was very weak, and which resulted in no growth, or even in some cases a reduction of the money supply.

Senator PROXMIRE. Mr. McCracken.

Mr. MCCRACKEN. Well, I think the question you raised suggests trying to think through what policy ought to be. The first question is what a reasonable path that ought to be the target for economic policy, recognizing, of course, that one can't actually be all that precise, but it is worth while as a discipline to go through this. This is what I tried to do on the first question; namely, suppose in 2 years time we want a rate of gain in real output of 15 percent.

How would one arrive at this? If the economy rises at 3½ to 4 percent, if by then we are somewhere around 8 percent below the level of output, that would be consistent with say 5 percent unemployment. Then in 2 years' time we have to take account of the fact capacity to produce in an economy goes to 7 or 8 percent, we are about that much below in terms of the starting point.

So you have to add that and that gives you about 15 percent to get the 5-percent unemployment.

I want to emphasize that is 5-percent unemployment, not 4 percent.

Now, as best one can translate that into what it means for the rate of growth in the money supply, what would that mean? That would seem to me to mean a rate of expansion certainly not less than 8 percent for M_1, probably closer to 10 percent, because the economy generally will be rising a little more rapidly than the rate of gain.

Senator PROXMIRE. You say for the money supply currency plus demand deposits?

Mr. MCCRACKEN. Yes, for M_1. And now if it becomes the objective of public policy to crowd that process a little more rapidly it will take a more expansive money supply yet.

In any case it does seem to me that the managers of economic policy can reasonably be asked what ought we be thinking in terms of the path that economic policy ought to be trying to produce, then what does that mean for policy.

Senator PROXMIRE. Mr. Schultze, you apparently do not feel the kind of reluctance that I sense on the part of the Federal Reserve Board, that if you have a money supply increase of 9 or 10 percent, which might be necessary to get the target interest rate you want, you do not feel that that would necessarily mean a built-in inflation effect some years down the line?

Mr. SCHULTZE. No, sir, I do not.

In the first place, there is no magic relationship between the money supply and inflation. It is not magic.

Senator PROXMIRE. What do you mean by——

Mr. SCHULTZE. While the money supply operates on the economy and its real output and its price level in a lot of different ways, fundamentally the money supply is going to operate on output and prices by getting people to spend more. It gets people to spend more through a number of routes but as the money supply increases, depending on a lot of other events in the economy, it affects principally interest rates.

By reducing interest rates and other terms of credit, by making loans principally more available, a growing money supply tends to stimulate spending of various kinds and I am interested in stimulating spending.

Senator PROXMIRE. Let me zero in on one particular kind of spending where we have one of our biggest problems. Senator Humphrey mentioned last night, housing. That interest rate is very stiff—very hard to bring down—the mortgage rate. It is now still at 9 or 10 percent, very high.

What is your target rate for mortgage interest? Do you think realistically the money supply could be handled in such a way over the next 18 months or so to bring it down over that period?

Mr. SCHULTZE. First, I do not have a target rate. I simply have not gone through and tried to think through what a target rate would be except it should be significantly lower than it now is.

Second, the flow of funds in the saving and loan institutions is very sensitive to the difference between their deposit rate and the rate on Treasury bills and other short-term instruments and by bringing down those short-term rates you can induce large inflows into the savings and loans; in turn easing both the availability and reducing the terms under which you get money.

I do not have a target rate except that rates should be significantly lower than they are now. You have to be a man of reason on this. Particularly from month to month or quarter to quarter; you can get very large events happening in the economy, so what is happening to interest rates and what is happening to the money supply go in opposite directions and hence you have got to be reasonable about this and not go at this month by month.

I certainly would look at what is happening to the money supply and if it got to be 25 percent, I would begin to think about it.

If, on the other hand, I was getting interest rates down and money supply was only growing at 2 percent, I would begin to worry about that, too. But I am suggesting that during the next year the principal point ought to be a significant reduction, then holding——

Senator PROXMIRE. That is not a doctrinaire attitude. I certainly welcome that. I cannot wait to suggest to Mr. Burns that one of the most eminent economists in the country said if we got up to 25 percent annual rate he would not be particularly shocked.

I want to see the expression on his face when he hears that.

Mr. SCHULTZE. It may turn out in 1 month it might well be 25 percent. There is nothing magic about 25 percent in 1 month or 1 percent.

I would worry about it over a longer period, yes.

Senator PROXMIRE. My time is up but let me take 1 minute to point out why I think the President has a big advantage, and why I think it is going to be very hard for us to overcome.

The Energy Act which regulates prices does expire on August 31, as I understand. Meanwhile, under that Energy Act the President has complete discretion to let the price of oil go to whatever level he wishes.

As a matter of fact, when President Nixon had the price of old oil go to $5.25 a barrel we passed legislation reducing it, rolling it back. The President vetoed that. But he is free to take whatever action he wishes.

What can we do? We can pass new legislation, but I think he has made it clear he would veto that.

We have to pass it over his veto. We not only have the problem of trying to get partisan support, and we do have a big Democratic majority, but we have there a very difficult economic fact that many Democrats represent oil States and they have very strong convictions that the price of oil should be free and the price of oil should go higher, so you see we are in a position where we may very well have to live with this program which many of you think is a very bad one, but you think could be, as you said, dynamite.

Mr. SCHULTZE. Yes, sir.

Chairman HUMPHREY. I think your commentary is helpful and I hope our colleagues in the Congress will tune in and listen to what has been said here.

Mr. Ackley, your testimony on Federal deficits, I believe it was your testimony, let me be sure——

Mr. ACKLEY. I referred to them.

Chairman HUMPHREY [continuing]. Was, might I say, right unusual, compared with what you would call the currency of the time and the Congress of the United States and in the administration.

You said, for example, to the effect that the private borrowing was way down and, therefore, even though there was a substantial Federal deficit today as a reality and a larger one anticipated, that it would not put undue pressure upon the money market.

This is in contrast to what has been said by Secretary of the Treasury Simon and other spokesmen for the administration and indeed Members of Congress.

I don't find myself in basic disagreement with what you say but there surely needs to be a good deal of mass education.

If there is any one thing that frightens the American public it is when they hear about a larger deficit. They have become accustomed to certain levels of deficits. It is sort of like a tolerance of a certain amount of pain in their attitude. But have that threshold raised as large as currently being discussed and then to have the Secretary of the Treasury saying that it is almost a horror story, that Federal spending is outrageous, I think poses a very difficult problem for the Congress in dealing with the overall subject of economic stimulus.

I have got to be honest with you, I do not feel particularly frightened about it myself because of the explanations that you have given and others have given, but I do think it is a very serious public relations matter and in this country of ours what is possible is, in a large measure what is understandable and acceptable by the public and the public has not been able to get its arithmetic up to date. It is just incredible how little is understood. I'm sure that most people do not know that we have $1,500 billion economy. Most people at my age are thinking about when they had $100 billion economy. They haven't been able to move up. They just haven't been able to accept prices or wages or Federal figures or anything else.

The only reason they accept some wages, they have to under negotiations. The reason they have to accept prices, that is what is there. When it comes to governmental statistics they are really terribly upset about these large figures that they hear about.

I've gotten more mail already about the President's speech on what the deficit will be than anything else. They are frightened about it. You economists, if any of you agree on this, you've a job of education in this country, if what you say makes the sense that I think it does, and apparently is documented by certain facts.

What are you going to do about it, Mr. Ackley? How do we get this? I gather that there is somewhat of an agreement here that the pressure on the money market by Government borrowing under the current condition of the economy is not a horror story, so to speak, it is not as astonishing and frightening as has been portrayed by certain representatives of the Government in testimony before committees of Congress.

Now, having said that, there may be a little disagreement, what do you have to say, Mr. Ackley?

Mr. ACKLEY. Well, our mutual friend, Walter Heller, speaks of fiscal acrophobia, fearful people who are not used to very high numbers.

Chairman HUMPHREY. Could we just get Walter Heller to say something that the rest of us could understand in that line?

Acrophobia—what in the world is that? I don't think old Jack Eckhart who lives across the street from me in Waverly, and he has the vote, he has one just as good as Walter Heller's.

Mr. ACKLEY. What you are talking about is precisely the need for the education of the public, so that they recognize things in perspective. I have made some comments—which may have been impolite—about the administration's encouragement in recent years of unreasonable fears of Government spending and Government deficits.

Deficits can be dangerous, they can also be very healthy and nourishing to the economy, and that view has to be explained and not covered up by emotional rhetoric about deficits.

It is not surprising, perhaps, that the first reaction of the financial community, the New York investment community, was horror when they read these numbers. They hadn't thought about it very much.

Chairman HUMPHREY. There is a story——

Mr. ACKLEY. But, after thinking about it, they are now changing their tune. The more thoughtful members of the New York investment community are already beginning to tell their clients in their speeches and bank letters and so forth really not to worry about this; sums of this magnitude can be financed without difficulty.

Chairman HUMPHREY. I notice in the press this morning $28 billion financing of the Treasury, the largest single financial operation of the Treasury I believe since World War II. Is that about right or is it larger than we even had in World War II at any one time?

Mr. ACKLEY. I think it was reported as the largest in history for a 6-month period.

Chairman HUMPHREY. Now is this going to have an adverse effect upon the money markets? In other words, is this going to pop up interest rates? Is this going to tighten up the credit structure? What is going to happen?

Mr. ACKLEY. What effect it has on interest rates will depend entirely on what the Federal Reserve does and what it says and encourages members of the financial community to say. And I am very hopeful that the panic which arose from surprise at numbers which we are not used to is going to quiet down. But I think the Congress and the administration and the economics profession all have a substantial duty to perform to help educate the public.

Chairman HUMPHREY. With all due respect to the Federal Reserve System, and I surely do have a respect for it and its members and its Chairman and past members, to whom are they accountable? Here we have got the elected branch of the Government going off with general agreement at least on the necessity for some kind of tax reduction.

You can argue about its dimension, its details. There is agreement between the Congress and the President something ought to be done on this. Then there are arguments as to how much and the timeliness of it unless as has been said here so well, and I surely concur in it—unless there is some way to bring the Federal Reserve System into an immediate synchronization with this line of policy, I think that really it is like these old propeller planes that we had, we are going down to four engines, all at once one engine went in reverse prop. That used to tear them up.

What worries me, we have this four-engine jet going down the line called the United States economy, we are putting in a little more fancy fuel to get its rate up, its speed up, and to get to new heights, and all at once one of the engineers inside the plane, one of the men in the crew, says, "I think I am going to slow down the fourth engine on the right wing over here, engine no. 4, in fact, I think I will put it into reverse."

How do you get the Federal Reserve—this is really the whole question. I know Mr. Schultze, you said they read the political tea leaves. I'm not so sure.

I think that Senator Proxmire here has indicated very properly that some of the figures that you are talking about in terms of money supply, I realize that it is kind of like an accordion, there is no one set cruising speed, so to speak, but it averages out, and that is pretty important, what it is on a monthly basis and so on, at least a quarterly basis.

How do you get even the most thoughtful of the Federal Reserve Chairmen and Board members to sense or to coordinate with this expressed policy adjustment that is now being contemplated?

Mr. McCracken, you have been such a respected member of the Federal Reserve System and you have been in it and I have always felt that those that have tasted the wine are in better position to advocate the brand than those that are preaching temperance.

Would you mind giving us some indication?

Mr. McCracken. Well, I should perhaps state my disqualification. When I was there I was the most junior officer of the smallest of the 12 smallest Federal Reserve banks, so most of the system was between me and where the decisions were made.

Chairman Humphrey. That gave you a clear perception. You were not caught up with the big ones back East here.

Mr. McCracken. As a matter of fact, I felt that way at the time.

I would like to make a couple of comments briefly on two issues which you have raised here, I think very important ones, on this question of the deficit and what its significance is for the economy and can we handle it, and this whole related set of questions.

It is going to be very important for us, particularly at this juncture, to have a fruitful dialog or a fruitful debate, if one wants to put it this way, and here I would like to address a comment to my own profession and I do this as a person, by the way, who is a graduate student as a member of the fiscal policy seminar at Harvard which was in a sense one of the intellectual cradles of modern fiscal policy. But there is no question but what somehow or other the word deficit has almost been a pejorative word. It just as such seems to frighten people and that fact, I am sure, has been used whenever deficits have appeared by the opposition and so forth, and I suppose that is part of the game.

Now, as to how we can make rapid progress on this indeed needed education, I don't know. As an economist I have been at this for a good many years myself. I think we are making progress but it is slow. However, I do think at this particular juncture it is also important to listen to what those who do have real concern are saying on the other side, and I presume in your own committee deliberations you will be getting people who will be able to articulate these concerns.

We do need to recognize that we have been through a very difficult and unusual period in the financial market.

There is no question but what capital structures of companies have been strained, and a lot of financing is going to probably be required that in the normal context of this kind of economy probably would not occur.

This is why I emphasize in my own statement that it is a perfectly legitimate question to ask to what extent will the Treasury financing be preempting funds that otherwise private borrowers would acquire and put to use, because if it is, then we have to allow for that in terms of the impact on the economy.

Chairman Humphrey. This is the concern, as you know, that is expressed repeatly and I think it is necessary that we ventilate it and get a good deal of discussion on it.

Mr. McCracken. Exactly.

Now, in my own judgment I think these things can be worked out, once again providing that we have an appropriately expansive monetary policy.

Now you raised the larger question on monetary policy. I really do think that the question you are raising there is one that in the final analysis, somewhere down the pike, is going to have to be reexamined; namely, the position of decisionmaking about monetary policy in the structure of governments.

I must say I could argue this is a very difficult issue and there are strong statements to be made on either side, one of the three of us here could take the easy out, the Federal Reserve is the agent of the Congress so it is up to you. But it is not quite that simple.

Looked at from the other end of Pennsylvania Avenue, a President frequently finds himself being held responsible for the results of an economic policy at the same time being told that a major instrument is none of his business. I think we do have something here that at some stage is going to have to be given close attention.

Chairman HUMPHREY. Thank you very much. I surely am not dogmatic about it, I just raised the question because it bothers me and I think it is one we need to work on.

Senator PROXMIRE. I just have a couple more questions.

Chairman HUMPHREY. You wanted to comment on this?

Mr. SCHULTZE. A quick comment.

I had used the term earlier that the Federal Reserve does read the political tea leaves. My only point is sometimes you have to brew the tea fairly strong. We do a lot in this country by informal means and quite frankly by political and perfectly legitimate veiled political threats. The President can talk to the Chairman of the Federal Reserve, he is not without his powers in terms of appealing to public opinion; the Congress is not without its powers, partly through the oversight hearing process. Without suggesting anything specific, I am suggesting that perhaps a fairly strong cup of tea might have to be brewed.

Senator PROXMIRE. I will be as brief as I can. I know the hour is late. I would like to say, first, the point that the chairman has asked is one that has really troubled a lot of people in this country.

The independence of the Federal Reserve Board has been something that has, I think, been badly misunderstood. The Constitution is crystal clear.

As I understand it, it says Congress has the power to coin money and regulate the value thereof. That means we in the Congress have the money power; it is up to us to determine monetary policy.

Congress created the Federal Reserve Board, as its agent, as its creature in 1913, and the Federal Reserve Board has exercised most of the money power since then.

We have surrendered a lot of our power to them because they are more expert than us. Paul Douglas, when chairman of this committee, told William McChesney Martin, Governor of the Federal Reserve Board: "I want you to write on your mirror, so that you see it every morning when you shave, I am a creature of the Congress." So it is up to us in the Congress; it is our responsibility; if the interest rates are too high, monetary policies too tight, keeping us from moving out of recession, it is up to us to change it. If we want to we can abolish the Federal Reserve Board and recreate it. We can do whatever we wish. We can certainly have a far more profound effect than we have had. In the years I have been here in the Congress, the Federal Reserve has pretty much operated as a free agent. They won't tell us what their monetary policy is except several months after it has occurred, and I think we just have to exercise more responsibility.

Now, I just have this question I would like to pursue.

We have been talking on the assumption that the estimates by the administration are about right; that is, that we have about $35 or $36 billion deficit this year, maybe a $45 billion deficit in the year beginning July 1 on $80 billion over 2 years. If what you gentlemen have recommended on fiscal policy, at least Mr. Ackley and Mr. Schultze, works out, we could have a much deeper deficit than that perhaps, maybe not depending on how it works if you are recommending a much bigger tax cut you are recommending we do not stop new programs, we go along with providing more Federal spending.

Supposing we have a $100 million deficit over the 2-year period, what would be the effect of that monetary policy accommodating itself to something that big, maybe a little bigger than that. Mr. Ackley?

Mr. ACKLEY. I referred in my statement to annual deficits of $50 billion for each of the next 2 years. This does not disturb me. I was contemplating deficits at least that large.

Senator PROXMIRE. You feel that could be accommodated in the same way?

Mr. ACKLEY. I do, indeed.

Senator PROXMIRE. Do you agree with that?

Mr. MCCRACKEN. Paradoxically I think the size of the deficit is going to depend as much on monetary policy as it does on the budget; that is, if the monetary rate is set too tightly, you will then have a weak economy that cannot generate revenue. So within appropriate monetary policy, yes, I think this is the kind of thing that could be accommodated. I would reemphasize that it is always important to look at the other side together with all——

Senator PROXMIRE. You are saying even though Congress may reduce taxes further, or may spend somewhat more than the President has requested, if you have the proper kind of monetary policy, you might engender sufficient revenue and diminish some expenses like unemployment compensation, so you conceivably have no larger deficit; is that right?

Mr. MCCRACKEN. In other words, we need to remember this because the effect of the relationship is a two-way street and not a one-way.

Senator PROXMIRE. I would like to ask you other gentlemen, do we have any kind of empirical evidence that by letting the price of energy go up you do reduce consumption? The fact is we live in a mobile society; we live in a country which has to heat our homes whether we like it or not. We produce goods which take a fixed energy component. Over the years we can change these things But it seems to me we have, in the shortrun, an inelastic demand and if the price goes up by 10 or 15 percent or 20 percent, it is cruel and tough, especially in our sections of the country, but it may not reduce consumption very much.

What evidence do we have that President Ford's proposal will give us a million barrels a day reduction by the end of the year?

Mr. SCHULTZE. I think it is helpful to look at this by splitting it in parts. Three big uses for oil are gasoline, public utilities, and direct use for heating by industry and commercial establishments. There is some evidence that gasoline consumption does respond to higher prices, but not very quickly; it takes time.

There is, it seems to me, little reason to believe one should use the price system beyond what we are already doing to allocate oil to public utilities because most of those decisions, given the environmental impact, are going to be made by regulatory agencies anyway. So you are not going to gain much on raising the price of oil to public utilities. And finally, the shortrun response of industry and commercial establishments to increases in heating oil prices, is very small. Therefore, I would say that by spreading the oil price increase over all uses of oil rather than concentrating more of it on gasoline the President reduces the impact he is going to get. The elasticity is very low in the nongasoline areas in the short run, and therefore, I think he will not get as many barrels a day as he predicts, perhaps not even come close to it. Finally, I would again stress the point that the price system will work, people will respond, but they cannot respond, they won't respond in a hurry, and it is unfair to jack the price up sharply and rapidly on the assumption they will respond.

Senator PROXMIRE. So you would stretch out, you said, over a period of 5 years, meanwhile what you would do, as I understand it, is to provide that you could impose rationing, if you had to do it, if we had an embargo or another war in the Mideast which cut off our supply; we have the power to act; we have all kinds of fat in the economy; we have to provide oil for national defense; we could do it; we can do it very quickly by cutting that fat, if and when we have to do it.

The balance-of-payments problem, it seems to me, is a phony. You cannot argue that we have to do this because our balance of payments would otherwise get out of whack; is that correct?

Mr. SCHULTZE. I would agree. If anything our balance of payments does not have large enough deficits, given the deficits that the whole world is going to have to share with respect to oil. Our balance-of-trade deficit, in particular, is probably too small.

Senator PROXMIRE. What argument remains for this, Mr. McCracken, you have given the most sympathetic reaction. What argument, then, remains for the policy that the administration has recommended?

We don't have the national defense argument in my view with any force. Maybe you disagree. And you don't have the balance-of-payments argument to act this precipitously with this devastating effect on a sick economy.

Mr. MCCRACKEN. Well, the adminisitration spokesmen can speak for their program. I am not a spokesman.

On the other hand, I would make one or two comments here. I do think it is very important, as I indicated in my prepared statement, to keep firmly in mind the basic strategy of utilizing market forces in the pricing system to try to handle the adjustments in energy that we are going to have to make.

The second point would be that, if anything, I am impressed with the extent to which the economy has made more of the adjustments in the short run than I would have predicted a year ago. It is limited and has a long way to go and it takes time and we will get more as we allow time, but I am impressed, for example, with how many of the retailers have talked about setting their thermostats last summer

5 degrees higher. Why? Because energy costs more. And so it was a cost-saving device.

I think it is very interesting that our general impression is that people adapted their driving habits very much and apparently vehicle miles last year, in fact for the first time, fell below the years earlier, a practice that is an indication that the market system has a good way to go.

We get significant aggregate adjustments but, on the other hand, it is not so highly visible.

The final point I would make, however, is that, to underscore a point you were making at the end, that I think it is very important that we not set some kind of very near-term objective for our cutting back oil imports without regard to what the impact of that is going to be on the economy. If we have a self-imposed oil shortage there is no question but what this is driving people back to lines in the filling stations again. You won't get the support for the program and a year or two later we will find ourselves having to start over again on an energy program.

There is no doubt in my mind but what our balance-of-payments program certainly can handle the volume of imports that are necessary to maintain a strong economy and a strong economic expansion, but it is going to be important to us to keep making progress, of course, toward our ultimate goal.

Senator PROXMIRE. Thank you.

Chairman HUMPHREY. Senator Kennedy.

Senator KENNEDY. Thank you very much, Mr. Chairman. Even though it is a late hour, I want to say what a pleasure it is for me to have the opportunity to serve on this committee. The membership is a distinguished group of Congressmen and Senators and they have developed a well-deserved reputation for their constructive work in the whole area of the economy and it is a very great pleasure for me to have an opportunity to serve.

I want to apologize to our witnesses this morning. I heard Mr. Ackley's splendid statement, but I had to leave during your comments, Mr. McCracken. I have had a chance to talk with Mr. Schultze recently and to hear his views.

Just now, I went to the floor to introduce the resolution which Senator Jackson and I have proposed, deferring the action of the President on the $3 tariff on imported crude oil, and deferring any action on the deregulation of old oil.

Mr. Schultze has indicated his concern about what the President's action will mean in terms of reducing purchasing power in the economy, in terms of the recessionary problems facing us at this time. But I understand, Mr McCracken, that in your testimony you gave general support for the President's energy program. My question, and it is really just a single question, is a followup to what Senator Proxmire was asking. He asked what assurance we have that, as a result of the pricing mechanism, we are going to have sufficient conservation to achieve the President's objective.

I would be interested, given the concerns that have been expressed by Mr Schultze and others, what assurances you have, Mr.

McCracken, that the President's unilateral action on energy may not seriously jeopardize the whole recovery of our economy?

Mr. McCRACKEN. Well, Senator Kennedy, in the colloquy that we have had here after the statements, I did myself quite explicitly caution about any kind of explicit target of getting oil imports down *x* million barrels per day by the end of the year or something like this. I do not know whether the economy can tolerate this. I don't think anyone else knows.

Senator KENNEDY. Should we move ahead without trying to find out?

Mr. McCRACKEN. Yes, I think one can. There is a strategy by which we can make progress on our energy problem but I would caution——

Senator KENNEDY. My question was related specifically to the particular measures that have been advanced by the President. Can they have a dramatic adverse impact on the economy?

Should we find out more about what the implications of this kind of unilateral action by the President on the economy, before we take what is an extremely significant step?

Mr. McCRACKEN. Well, I was following up, I think, a slightly different point. If the point is, apparently your question is concerned with the impact of the magnitude of the tax, what the impact of that would be?

Senator KENNEDY. Exactly, particularly in light of the recessionary pressures that we are already feeling.

Mr. McCRACKEN. Well, in this case I would generally support the Administration's program, but of course, obviously if we are going to have additional energy taxes it is going to be essential to have the impact of those on the shortrun economic situation offset by other actions. They cannot stand by themselves or they will make the economy weaker.

Senator KENNEDY. I understand the President is signing the preliminary orders today. What reason do you have to believe that this is not going to jeopardize the recovery of the economy?

Mr. McCRACKEN. If we get the offsetting tax changes then the uncertainties about the residual, in other words, the extent to which these two might not quite offset quite acceptable risks, nobody knows for sure. We won't know 6 months from now.

Senator KENNEDY. Certainly as I understand the cost package against the figures by the Treasury, the $28 to $32 billion and the President announced it will be $30 million will be returned, that does not include the rippling effect. The economic best estimates I have seen are approximately $24 to $25 billion. In addition we are not going to take that: that amount is going to be out of the economy as well as I understand it.

Mr. McCRACKEN. I do not think it is out of the economy. It may have an impact on the price level. But, for example, if this goes, say, in terms of higher earnings to the public utilities or higher earnings to those who produce other products which are made out of oil, whatever these may be, these constitute income to the private economy. They produce displacement effect but that is different as I would see it from just a tax levy whose proceeds then go into the Treasury and out of the private income.

Senator KENNEDY. Well, this, as I understand it, can be questioned, I understand, by Congress, but I was interested should we be making this dramatic step before we have had the chance to consider the implications, both on the prospects of economic recovery, which is so important, and also on equity and fairness? Fifty Members of the Senate, and, I suspect, a majority of Members of the House believe we ought to consider the full implications of this action before the President moves ahead.

Thank you very much.

Chairman HUMPHREY. Thank you very much, Senator Kennedy.

Let me pin this down now because this record will be studied and read by other witnesses that come before our committee. We do have a very extensive series of hearings on the President's economic package, even before we get the report of the Council of Economic Advisers and before we receive the budget.

Let me ask, Mr Ackley, do you believe that it is desirable for the energy program that the President has outlined in terms of the imposition of import taxes to be withheld until the Congress has more time to study its implication?

Mr. ACKLEY. I wish strongly to be identified with Mr. Schultze's comments with respect to the importance of not letting this go through by default. There is great need for careful study and I think it is very unfortunate if it should go through without a chance to consider all of the aspects.

Chairman HUMPHREY. Do I understand that you also believe that the tax stimulus ought to be severed from the energy question? In other words, we should deal with the tax question on an urgent basis separately from the energy question?

Mr. ACKLEY. Very much so.

Chairman HUMPHREY. Mr. McCracken, I have listened to your comment to Senator Kennedy.

Let's get more specific.

Would you believe that it would be advantageous for the President of the United States, for example, to withhold for another 90 days, let us say, his proposal and to lay down import duties or import taxes upon imported crude oil until the Congress has a better opportunity to look through the ramifications or to study the ramifications of this complex energy package?

Mr. MCCRACKEN. No, I would not recommend that.

Chairman HUMPHREY. You think that he should proceed at once?

Mr. MCCRACKEN. Yes.

Chairman HUMPHREY. How do you repeal it once that you have set it in motion? I don't mean repeal the law, but I mean repeal the impact?

Mr. MCCRACKEN. Well, I would hope that significant aspect of the impact would not be repealed because this is an additional step in the direction of trying to move the economy in the direction of adjusting to less energy and more expensive energy and this is a fact of life.

Chairman HUMPHREY. Didn't I understand you to say you didn't really understand all of the implications or ramifications of what this energy program would do, yet you said we ought to go ahead with it?

Mr. McCRACKEN. I would regard the uncertainties here within the range quite acceptable. This is an area where no matter how much it is studied there are going to be large unanswered questions.

Senator KENNEDY. $32 billion worth?

Mr. McCRACKEN. What?

Senator KENNEDY. That is the estimate of the cost of the President's program, with all of the implications it would have in terms of our economy.

You are prepared to indicate the Congress ought to move ahead in a program that is going to take approximately $32 billion out of the purchasing power of consumers, with the uncertainties that you have expressed here and the reservations that others have stated? Do you think we still ought to go ahead?

Mr. McCRACKEN. I think it is very important for the Congress to take action to get that $32 billion back into the hands of the private economy.

Chairman HUMPHREY. Might I suggest that the $32 billion is a sure item and whether or not you can work out an acceptable tax refund program is more complicated, and the indirect costs people simply refuse to talk about. I think we have to recognize, and I think you have recognized it today, that the rippling effect—I do not think it is rippling, I think it is a tidal wave effect that takes place is evident and sure.

Let me go to Mr. Schultze.

You believe we should separate the energy package from the urgency of the tax cut?

Mr. McCRACKEN. Yes; I indicated in my prepared statement I think we need prompt action there on the tax stimulus package.

Chairman HUMPHREY. How can you separate the energy package from the tax cut if you have the energy package being implemented at the end of this week?

Mr. McCRACKEN. There are these two packages. There is the proposal for the two-stage one-shot tax rebate which I have indicated in my prepared statement I would prefer to have it be a permanent tax cut, but that is another issue.

I think it is very important to have prompt action there and within fairly broad limits, whatever package the Congress would find it possible to pass promptly, one that I would accept.

Now, when you come to the energy program, a part of that is of course a specific set of taxes on energy together with proposals for rebating those taxes back, and I think here it is important that we stay reasonably on schedule in terms of devising a program for these tax rebates so that the effect here is reasonably neutral, it doesn't have to be meshed within a matter of days or even weeks, but we wouldn't want these energy taxes to go on and then have no action out of the Congress for months and months on the other half.

It will be important to have prompt action.

Chairman HUMPHREY. Mr. Schultze.

Mr. SCHULTZE. Let me repeat what I said earlier, Mr. Chairman, I think whatever one thinks of the President's legislative program, whatever one thinks, it is unconscionable to put a gun to the Congress' head by taking unilateral actions to try to force congressional acceptance of that program without taking into account that the intervening effects of unilateral action will be to reduce the Nation's chances for economic recovery.

I think that is unconscionable and, therefore, at a minimum I think that any reasonable man, any reasonable man, would say that at least a 90-day delay to give the Congress a fair chance to look at this and not to preempt and not to run a big political risk and economic risk is the minimum one can ask.

Chairman HUMPHREY. This would be my final observation. I want to finalize this point.

Mr. McCracken says the President's cut is about the right size but it should be permanent. Mr. Ackley says we need a $25 to $30 billion tax cut. Mr. Schultze says a $12 billion rebate plus. Do I understand that all of you——

Mr. SCHULTZE. I would just add, I think it is an important part, a $6 billion additional counter-cyclical revenues.

Chairman HUMPHREY. That is another option or another point we had here that I would bring into this calculation.

Are all of the witnesses agreed that we need a permanent net individual tax reduction of at least $10 to $12 billion or in the $10 billion ballpark figure?

Mr. SCHULTZE. Yes.

Mr. MCCRACKEN. Yes.

Mr. ACKLEY. Yes.

Chairman HUMPHREY. Do I understand that is a point of agreement?

Mr. Ackley.

Mr. ACKLEY. Yes, I think that is a reasonable figure.

Chairman HUMPHREY. Mr. McCracken.

Mr. MCCRACKEN. Yes.

Chairman HUMPHREY. Mr. Schultze?

Mr. SCHULTZE. Yes.

Chairman HUMPHREY. And this, of course, was missing from the President's program. Do you think it is a sound recommendation for the appropriate legislative committees of the Congress?

Mr SCHULTZE. Yes, sir.

Mr. MCCRACKEN. Yes, sir.

Mr. ACKLEY. Yes, sir.

Chairman HUMPHREY. We thank you very, very much.

Senator KENNEDY. Just as a final question, may I ask Mr. Schultze, if Mr. McCracken is wrong about the downside risk for the economy, how bad could unemployment get if these uncertainties work out against us?

Mr. MCCRACKEN. Can I interject? I think the three of us generally agree on it. It is not just my view.

Senator KENNEDY. I was referring to the President's action on the oil duties. I think there was a difference between Mr. Ackley and Mr. Schultze and yourself about the need for immediate action on the plan. During the course of our exchange and in response to the chairman's questions, you felt that the program ought to be implemented because the risks are not sufficiently significant, given the magnitude of this problem, to delay action. My question to Mr. Schultze is, if the estimate of the risk is wrong, how bad do you think things could get?

Mr. SCHULTZE. I have to make a distinction in answering that question.

First, with respect to the President's legislative program, if that were all and he waited for Congress to enact the program, I have problems with that program but it takes 30 out and puts 30 back in. Whatever the problems are, the range of uncertainties there is one thing. I don't have to like the program and I think there are uncertainties but I think much more critical is the prior point of the President acting administratively and unilaterally on his own before the money is going back in. I haven't made an exact calculation, but, over the next 6 to 8 months between now and August if the President did that, it would remove from the economy a very substantial part, I don't think quite all, but a very substantial part of the stimulus the President is suggesting. Without quarreling with Mr. McCracken on the legislative program, I think its initial unilateral action which has the danger and has serious depressing economic——

Senator KENNEDY. What would you say in terms of unemployment? Are we talking about the difference between a recession and a depression? Is it of that magnitude?

Mr. SCHULTZE. I'm not really sure I can give you a responsive answer without doing some calculation. Let me put it another way. I think if the President went ahead and acted unilaterally and money was not pumped back into the economy, that it would be almost, not quite, but almost as if there had been no economic stimulus. My best estimate of what would then happen, subject to large uncertainty, is that the unemployment rate would continue up past 8 percent, the chances of recovery would not be zero, but would be quite low, and the recovery that you would get, even if you got it, would be very weak. We would then be subjected to a deep, long recession. But I really cannot give you a single unemployment number. But it would be a big number.

Chairman HUMPHREY. Thank you.

You have been most generous with your time and I must say I believe that this hearing has been exceedingly helpful to the members of this committee and I hope to the general public.

We express our appreciation for your willingness to come at some personal discomfort, I know, and you had to take time off and we really appreciate it.

May I announce that the committee will reconvene at 10 a.m. on Tuesday, January 28, in room 1318, to hear testimony from additional witnesses. We will be having witnesses that will discuss with us the energy problems. Hopefully we will have Hendrik Houthakker, of Harvard University, George Perry of Brookings, John Sawhill, former Administrator of FEA. We will have another panel of businessmen, Donald Regan, chairman of Merrill Lynch, Paul Ignatius, president of the Air Transport Association, and others. Our plan is to hear from the different segments of the economy as well as from the economists and then we will get to the governmental witnesses.

We thank you very much. The other witnesses will be noted to the press.

The committee is recessed.

[Whereupon, at 1:25 p.m., the committee recessed, to reconvene at 10 a.m., Tuesday, January 28, 1975.]

THE 1975 ECONOMIC REPORT OF THE PRESIDENT

TUESDAY, JANUARY 28, 1975

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

The committee met, pursuant to recess, at 10:10 a.m., in room 4221, Dirksen Senate Office Building, Hon. Hubert H. Humphrey (chairman of the committee) presiding.

Present: Senators Humphrey, Bentsen, and Kennedy; and Representatives Long, Brown of Ohio, Brown of Michigan, and Heckler.

Also present: John R. Stark, executive director; Loughlin F. McHugh and Courtenay M. Slater, senior economists; William A. Cox, Robert D. Hamrin, Jerry J. Jasinowski, and Carl V. Sears, professional staff members; Michael J. Runde, administrative assistant; and George D. Krumbhaar, Jr., minority counsel.

OPENING STATEMENT OF CHAIRMAN HUMPHREY

Chairman HUMPHREY. Gentlemen, we will call the hearing to order. I want first of all to welcome you all and thank you very much for your cooperation and your willingness to appear here today and to discuss matters with us.

Today the Joint Economic Committee continues its annual hearings with a panel of distinguished business leaders. During the course of our hearings this year we intend to obtain testimony from every major segment of the economy. On Friday we will be having a panel of State and local government officials. Later on we will have representatives of organized labor.

Such broad representation at our hearings is most important, because of the sweeping nature of the proposals already made by the President, and may I add of other proposals being made by Members of Congress. Some of the ramifications of these proposals are not yet released by the administration, by the Congress, or by the public. The only way that we can really begin to find out what all the effects of the President's proposals might be on the various sectors of the economy is to bring in a wide spectrum of witnesses and ask them to give their evaluation. We have had already a panel of three very distinguished economists. We will have more. But we feel, and I particularly feel, that it is very important to obtain testimony from the real world of production and management, finance, labor, and agriculture, so that we can hear from you as representatives of these respective areas of our economy, what is going on as you see it and what the impact will be of any proposal that may be advanced.

Among the many questions that we want to get into with our witnesses this morning are the following—and these are just some suggestions: What will happen to credit markets and to the stock market if the President's program is adopted?

Will funds be available at reasonable cost for Government borrowing, and for all the private borrowers who need funds?

Do the President's proposals, including the higher investment tax credit and the reduced corporate tax rate, affect large and small business equally?

How much will the President's energy tax proposal add to your business cost and thus ultimately to consumer costs?

Are the benefits of the President's energy conservation proposals really equal to the substantial costs in terms of added inflation and the possibility of increases in unemployment?

Can we find less costly ways to conserve—in other words, do you have any other suggestions or proposals? And might I add, in this area we surely will welcome any thoughts that you might have.

I would add that another question that comes to the forefront is, is it necessary to proceed with an immediate program within this year of a reduction of a million barrels of oil per day? What will be the impact on the economy of such a proposal?

These are only a few of the questions which lend themselves to discussion.

We have an excellent panel this morning. On behalf of the committee, I want to thank them for agreeing to appear on short notice.

Our first witness will be Mr. Don Crawford, president of the Edison Electric Institute. He is accompanied by Stanley Ragone, senior vice president of the Virginia Electric & Power Co.

Our second witness, I believe, will be Mr. Thomas Galligan, president of the Boston Edison Co.

The third panel member is Mr. Donald T. Regan, chairman of the board of Merrill Lynch.

The fourth panel member is Mr Milton Stewart, president of the National Small Business Association.

May I say I am glad to see an old friend here, Mr. Stewart.

It is a great pleasure to have each of you.

If there is no objection, we will hear a brief oral presentation by each panel member before beginning the questioning and discussion. Since there are four of you, it would be helpful if you could limit your oral statement to about 10 minutes or within some reasonable area.

I believe, Senator Kennedy, you had a comment you wanted to make at this time.

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

I just want to extend a warm word of welcome to Thomas Galligan, who will be testifying here, and introduce him to the committee. He has been with Boston Edison since 1953. With his testimony, along with the others, he will be able to present, to the committee, in an extremely effective way the economic implications of the President's program, in terms of the consumers of Boston and Massachusetts and throughout New England. He has been the director of the Associated Industries of Massachusetts, and so we will also have the benefit of his thinking on the impact that this program will have on other industries in Massachusetts and New England. And he has been active in a variety of different civic and other worthwhile undertakings in Boston. He is a very respected leader in our affairs.

I want to say personally what a pleasure it is to see him before the committee. I am sure the members of the committee will benefit from his testimony. I appreciate very much his willingness to come down here and talk with us.

I don't have to make a case here about the importance of this issue to New England. It is important throughout the country, but it has very special implications for us in New England. We couldn't have a finer spokesman to describe its impact on Boston and New England than Mr. Galligan. And I appreciate the committee's invitation.

Chairman HUMPHREY. Thank you very much, Senator Kennedy.

I am sure we join you in welcoming him.

May I say that we have another new member of our committee, recently assigned by the Speaker of the House of Representatives, Mr. Gillis Long, from the Eighth Congressional District of Louisiana. This is Mr. Long's second term in the House.

We welcome you, Gillis, to this committee.

With that, might I suggest, then, Mr. Crawford, that you proceed.

And the sequence I think you understand. After Mr. Crawford we will have Mr. Galligan.

STATEMENT OF DONALD CRAWFORD, PRESIDENT, EDISON ELECTRIC INSTITUTE, ACCOMPANIED BY STANLEY RAGONE, SENIOR VICE PRESIDENT, VIRGINIA ELECTRIC & POWER CO.

Mr. CRAWFORD. Thank you, Mr. Chairman and members of this committee.

Mr. Chairman, I was not informed of the hearing until 4 o'clock yesterday afternoon, and thus have not had an opportunity to prepare a prepared statement. What I have done is outline a number of points in which I think you might be interested, and I would like to go over these if I may.

The electric utility business was formerly thought to be a rather prosaic affair. Some of us in it would not agree with that assessment, but, certainly, today it is a far different business than it used to be. Today we face a broad array of serious, complex, and interrelated problems that challenge our very ability to meet the Nation's needs for electricity.

In our country there has been a long-term trend toward the greater use of electricity. In 1930, 10 percent of all the energy used in the United States was for the generation of electricity. At the present time 25 percent of all the energy goes into electricity. Our studies indicate that by the end of the century 50 percent of all the energy produced will go toward electricity generation.

There is very little question but that the Nation is going to require additional amounts of energy, and increasingly it will be electric energy. We believe that the rate of increase of total energy use should and probably will abate. But this is not true, in our view, about the increased use of electric energy.

The question is, How can electric utilities best provide the requirements that the Nation puts upon them?

I believe that there are four basic points to bear in mind: (1) Electric utilities must be financially strong to attract the investment funds needed to build the needed facilities; (2) we must be able to build the facilities that are needed and we must receive approvals for building utility facilities expeditiously; (3) we must have adequate supplies of fuel that we are permitted to turn; and (4) we must function with environmental regulations that also recognize the Nation's needs for electric energy.

Let me amplify each of those four points briefly. As far as the financial viability of the electric utility industry is concerned, there are two basic ways to approach the problem, and both of them are quite essential. First, we must streamline and improve our rate regulatory procedures. In his message, the President included a number of points along this line which would be very helpful.

The second basic way to help restore the industry's financial viability is through a number of tax-related pressures. The alternative that our industry feels would be most effective is to make dividends on common and preferred stock of utility companies tax exempt to the recipients. The President, as you know, has proposed that preferred stock dividends paid by utilities and others would be tax deductible to the payer, not to the payee. And that would be a useful provision to have. But we feel that even more useful would be a tax exemption to the recipient of these dividends.

We also favor strongly the increased investment tax credit. Utilities in the past have been discriminated against in this regard. We have had 3 percent and then 4 percent while the rest of industry has had 7 percent. We would favor going to either the 10 percent or the 12 percent, but with some additional changes being made. It would be more useful to have a longer period than that outlined in the President's message for 1 year for all industry and another 2 years for utilities, under certain conditions. A .more permanent provision for the investment tax credit would be appropriate.

It would also be helpful if the investment credit applied not to the plants put into operation in a particular year, but rather to construction expenditures during the year.

The idea that was previously enunciated by the administration—having the Treasury make payments back to individual companies after 3 years if they had not been able to take advantage of the investment credit—seemed to us to have a considerable merit. There are a number of utility companies that do not pay taxes because they do not have taxable income. They would have no way to take advantage of the investment credit. That administration proposal would permit such companies to benefit from the tax credit.

With respect to our ability to build utility facilities, the Nation must find a way to more effectively hear and grant approvals to proposed utility facilities. Whether the answers are yes or no, we need to have a more expeditious way of arriving at a conclusion. This is particularly true in the case of nuclear plants where, despite good efforts by the Atomic Energy Commission, about 10 years are required from the date of decision to the date of operation for a nuclear plant. In Japan, France, and other countries it takes much less time than this.

We believe that the fuels to meet our electric power requirements in the years and the decades ahead must be primarily coal and nuclear. It makes good sense to try to conserve our oil and gas resources for other uses for which they are uniquely qualified. But we must bear in mind that it is going to take some time for the change to be effected. The companies in the South and Southwest parts of our country, for example, which, consistent with our national policy, built their electric power systems on the basis of burning natural gas, require extensive periods of time to be able to convert those facilities to other fuels.

With regard to the President's proposal for increasing the tariff on imported oil and imposing an excise tax on domestic oil, while we can understand that approach, as a means of achieving energy independence and providing incentives to convert to other fuels, it seems to us that there should be exemptions from such tariffs and taxes for oil and natural gas used for electric utility purposes.

The companies that burn oil have very little ability to alter their furnaces to use other fuels. If companies in the Northeast, for example, were to try to burn coal, they would not be able to comply with the air quality regulations. They only recently converted some of these plants from coal to oil, and they now have a physical inability to revert to coal in a short period of time. Therefore they have little choice but to continue to burn the oil and to pay whatever tax is imposed upon it. That would further exacerbate the financial problems of some of the utilities which rely heavily on oil.

Finally, we feel that environmental regulators must recognize that there is another side of this coin—the Nation's need for electric energy. One principal concern is the Clean Air Act. We believe it must be amended to allow greater reliance on the Nation's coal resources. The way to do that is to permit industry, including utilities, to meet the so-called ambient or health standards in alternate ways, and not to require scrubbers to be installed, and not to require emission standards.

The act should also be amended to clarify the meaning of "significant deterioration."

Mr. Chairman, that is a very brief summary of some of the principal points that I wanted to cover.

Chairman HUMPHREY. Thank you very much, Mr. Crawford.

We will proceed according to our initial outline. Our next witness is Mr. Galligan, president of the Boston Edison Co.

STATEMENT OF THOMAS J. GALLIGAN, JR., PRESIDENT, BOSTON EDISON CO.

Mr. GALLIGAN. Thank you very much, Mr. Chairman, and gentlemen, and Congressmen, and Congresswoman Heckler.

I am very pleased to have the opportunity to speak to you today on subjects which affect everyone of us, young or old, rich or poor, black or white—the critical condition of the U.S. economy and, in particular, the energy crisis which has contributed significantly to our economic woes.

I plan to summarize my prepared statement which has been submitted for the record.

I appreciate the fact that over the years this committee has faced many serious problems in striving to develop constructive policies for the economy of this Nation but, in my opinion, we have never faced issues which are so complex and interrelated on an international basis and which have such severe implications not only for the present but for the long-range well-being of this Nation. As complex as these issues may be, they demand immediate and comprehensive response. As I observe the high quality of the membership of this committee, I am sure that it will lead the way for Congress to act constructively and promptly with equal misery for all.

President Ford has rendered a service by bringing the energy subject to the point where decisions must be made. We have already lost valuable time. It is our belief that a coordinated national energy policy now is absolutely essential if we are to become energy interdependent and remain economically sound.

However, I must take issue strongly with President Ford's tariff and energy tax positions, and protest most vigorously their adoption on the grounds that they are discriminatory in application and inflationary.

While my remarks refer to New England and to Boston Edison Co., it should be clearly understood that these problems affect most of the Atlantic seabord, Florida, southern California, and, to a lesser, extent, a number of other areas of the United States. It is not a provincial or regional problem but where it does exist it is critical.

Also, I want to emphasize that insofar as the price of oil is concerned, the beneficiaries of acts that you and Congress may take will be for the benefit of the general public, since savings are passed on directly to the consumer.

You may recall that Boston Edison, in January 1974, assumed a leadership role in appealing to the Federal Energy Administration to provide some form of financial credits or some other method of easing the fuel burden for the people of New England. Very frankly, the FEA has failed in its responsibility as charged by Congress in refined petroleum products at equitable prices among all regions and areas of the United States.

I feel obligated to also comment on the proposal to decontrol the price of old domestic oil. Not only will decontrol eliminate any possible economic relief to electric consumers in New England but its inflationary impact will be felt by all. I favor the imposition of a windfall profit tax on the oil companies but who is going to impose a windfall profit tax on the oil-producing nations?

In Boston, one can do little to provide consumers economic relief in the short term when we are paying over $13 a barrel for residual oil and foreign governments are pocketing $9 and more of that cost.

This Government has remained mute as it allows tens of millions of its citizens to suffer economic strangulation. We are faced with highway banditry of days gone by on an international scale.

The oil issue is such in New England that average fuel oil costs to Boston Edison rose from $4.61 a barrel to $12.91 a barrel in a little over 12 months. Fuel costs which amounted to approximately $36 million in 1970 rose to $154 million in 1974. A $1.80 per barrel increase in oil prices for New England will cost the region $800 million.

While some utilities in the Nation have been hit harder than Boston Edison in the economic crunch, the symptons are similar. Inflation, reduced consumption, increased interest expenses, regulatory lag, and additional common stock outstanding, all attributed to a 9.7-percent decrease in earnings per share in 1974. Earnings per share in 1973 decreased 18.8 percent.

Another matter which is of particular importance to a capital-intensive industry such as ours; namely, the cost impact of environmental control regulations should be considered. Air and water pollution control equipment is costly to install, to maintain, and to operate. It is in my opinion highly unfortunate that the imposition of such costs is often not justified by the accrual of appropriately balancing benefits. This is, therefore, and I want to emphasize, not an argument against necessary or reasonable environmental protection measures. It is rather a suggestion that some of the measures imposed are unnecessary, cost ineffective, or ineffcient in benefit/cost terms. They also place a significant added burden on the need to raise capital by utilities.

My recommendation, Mr. Chairman, is that the Congress reexamine environmental legislation to see to it that goals and objectives are not only still desirable in view of the Nation's economic condition but that they bring suitable benefits in view of the costs imposed. The Nation cannot afford inefficiency or unnecessary costs in this time of national crisis.

Many utilities in the Nation, including Boston Edison, would not be in the financial posture they find themselves today if State regulatory agencies had acted promptly on requests for rate relief. Our recent area of concern, the period of regulatory lag, which is 10 months in Massachusetts, must be reduced and we urge the Congress' support to bring State regulations within a reasonable 5-month guideline. Of course, it is essential that decisions be made within this time frame. We have one rate case that has been before the Federal Power Commission for almost 5 years.

Recommendations to increase the investment tax credit for utilities will be helpful. Certainly the existing discriminatory nature of only permitting a 4-percent investment tax credit rate for utilities and 7 percent for industry in general should be corrected. The overall rate should be increased to the President's recommended 12 percent for all industry. The limitations permitting the use of the investment tax credit of up to only 50 percent of the tax liability should also be permanently eliminated. The period of time that the investment tax credit can be carried forward or carried back for tax purposes should also be increased. Alternatively, to be helpful to all in stimulating investment with the related increase in jobs, a refund provision could be adopted which, in effect, would pay the investment tax credit immediately in cash to those companies who are not in a position to take advantage of the tax credit as they are in a net operating loss position.

Many utilities in the United States have been sustaining net operating losses for tax purposes for many years. Certainly, one way to improve their cash position is to extend the period of carry-backs to a minimum of 8 years and to extend the period of carry-forwards to a period of 10 years. This is but another way tax legislation can be utilized to help hard-pressed utilities.

The success of a sound national energy policy with "Project Independence" as the ultimate goal dictates the expansion of nuclear and coal and the primary energy sources for the generation of electricity. In 1974, nuclear energy accounted for 22.8 percent of the total electric energy supply in New England. When compared to current oil prices, it is anticipated that nuclear power could save for New England's consumers approximately $1 billion a year on their electric bills in the mid-1980's. But the attainment of these savings depends on our ability to finance and construct the necessary nuclear plants and we just cannot move ahead confidently in this direction if the leadtime to license and construct the units remains at the present 10-year level.

Mr. Chairman, as Congress reconvenes, it finds the most capital-intense industry in the Nation—the electric utilities, hard hit by inflation, conservation, stampeding environmental costs, deep recession, and international brinksmanship.

The viability of the electric utility industry and its capacity to continue its outstanding record of providing reliable capacity at reasonable cost is vital to the future growth of this Nation.

We need and will support a national energy policy which has as its basic premise economic equity for all citizens—a sharing of the national burden among all regions of the Nation.

We need to accelerate the development of our domestic energy resources such as coal and offshore oil.

We need help in speeding up the regulatory process in licensing nuclear powerplants and in rate proceedings before regulatory commissions.

We need tax relief that can be utilized in order to raise lower cost capital and also relieve the pressure of increasing electric rates on consumers.

And to be effective we need these actions now.

I promise you the support of Boston Edison in achieving these objectives.

Thank you, sir.

Chairman HUMPHREY. I am very grateful to you for your testimony.

I suggest that we include the entire text of your prepared statement submitted to this committee so that we can have the additional material that you bypassed in the interest of time.

[The prepared statement of Mr. Galligan follows:]

PREPARED STATEMENT OF THOMAS J. GALLIGAN, JR.

Mr. Chairman, I am pleased to have the opportunity to speak to you today on subjects which affect everyone of us, young or old, rich or poor, black or white—the critical condition of the United States' economy and, in particular, the energy crisis which has contributed significantly to our economic woes.

I appreciate the fact that over the years this Committee has faced many serious problems in striving to develop constructive policies for the economy of this Nation but, in my opinion, we have never faced issues which are so complex and interrelated on an international basis and which have such severe implications not only for the present but for the long-range well-being of this Nation. As complex as these issues may be, they demand immediate and comprehensive response. As I observe the high quality of the membership of this Committee, I am sure that it will lead the way for Congress to act constructively and promptly with equal misery for all.

President Ford has rendered a service by bringing the energy subject to the point where decisions must be made. We have already lost valuable time. It is our belief that a coordinated National energy policy now is absolutely essential if we are to become energy independent and remain economically sound.

It is because of this belief in the necessity for a sound National energy policy that as both a citizen and President of New England's largest single operating electric utility, Boston Edison Company, I must take issue strongly with President Ford's tariff and tax positions and protest most vigorously their adoption on the grounds that they are discriminatory in application and inflationary.

While my remarks refer to New England and to Boston Edison Company, it should be clearly understood that these problems affect most of the Atlantic seaboard, Florida, Southern California, and to a lesser extent, a number of other areas of the United States. It is not a provincial or regional problem but where it does exist it is critical.

EQUITABLE PRICES FOR OIL ESSENTIAL

You may recall that Boston Edison, in January 1974, assumed a leadership role in appealing to the Federal Energy Administration to provide some form of financial credits or some other method of easing the fuel burden for the people of New England. Very frankly, the FEA has failed in its responsibility as charged by Congress in its mandate of "equitable distribution of crude oil, residual oil, and refined petroleum products at equitable prices among all regions and areas of the United States."

After I testified at hearings in September, FEA's response to our plea was in the time-worn mold of 'too little, too late.' A credit of 60 to 80 cents per barrel was eventually adopted which would have amounted to a savings of about $12 million for Edison customers starting this February—a disappointing and inadequate amount.

Now comes a proposal from the White House which by February 1 would eliminate that small savings just handed down and by April 1 would mean an additional cost of $18 million in fuel prices to Boston Edison customers alone.

We seriously question the authority of the President to impose such a tariff and others are carrying this fight to the courts. The thrust of Boston Edison arguments under which we have been studying taking legal action is the incorrect administration of the "Emergency Petroleum Allocation Act of 1973" by the Federal Energy Administration. We still retain our option to take further legal action in this area.

That we must have a National energy policy is, as I said, essential to our progress as a Nation. But such a policy, instead of penalizing one region unfairly, must be dedicated to benefiting the whole Nation and all its people equitably.

NEW TARIFFS UNFAIR TO NEW ENGLAND

While the President's proposed tax relief program will fall equitably throughout the Nation, surely his energy program will not. In response to past National policies, New England is more dependent per capita on oil products than the rest of the Nation.

A $1.80 per barrel increase in oil prices for New England will cost the region $800 million annually. This is the impact of losing 60 cents under the old oil entitlement program and two additional 60 cent barrel increases planned in the import tariff in March and April.

This burden will fall heavily on those who rely on residual oil and home heating oil where conservation in New England is at a near maximum. We will pay the penalty even if we can't help the National objective of reduced oil imports.

I feel obligated to also comment on the proposal to decontrol the price of "old domestic oil." Not only will decontrol eliminate any possible economic relief to electric consumers in New England but its inflationary impact will be felt by all. I favor the imposition of a "windfall profit tax" on the oil companies but who is going to impose a "windfall profit tax" on the oil producing nations?

It is here where National policy must recognize the real villain in this drama—our National Government and its inability to deal effectively with OPEC.

In Boston, one can do little to provide consumers economic relief in the short term when we are paying over $13 a barrel for residual oil and foreign governments are pocketing $9 and more of that cost. This Government has remained mute as it allows tens of millions of its citizens to suffer economic strangulation. We are faced with highway banditry of days gone by on an international scale.

The oil issue is such in New England that average fuel oil costs to Boston Edison rose from $4.61 a barrel to $12.91 a barrel in a little over 12 months. Fuel costs which amounted to approximately $36 million in 1970 rose to $154 million in 1974. At the same time, a customer using 400 kilowatthours of electricity a month pays $22.10 for the same amount of electricity which cost him $13.40 in 1970. And the increase was due almost totally to the rise in fuel prices. As a matter of interest, our prices today, including fuel, are at the same level they were in 1921.

Some of you at some time must have been confronted by irate consumers frustrated with their increasing electric bills. They cannot understand that the Government would do this to them and we bear the brunt of their wrath even though fuel costs are the cause.

ADVERSE ECONOMIC IMPACT

While some utilities in the Nation have been hit harder than Boston Edison in the economic crunch, the symptoms are similar. Inflation, reduced consumption, increased interest expense, regulatory lag and additional common stock outstanding, all attributed to a 9.7 percent decrease in earnings per share in 1974. Earnings per share in 1973 decreased 18.8 percent.

We have watched not only our earnings decline but the rating agencies lower our bond ratings from AA to A to BBB. We are faced with a capital program of $760 million in the next five years, which has been reduced $480 million to reflect conservation efforts by our customers. We are concerned with our ability to finance that construction at reasonable interest costs. The construction is essential to maintain reliable service for our customers in the years ahead. We believe the Congress should act promptly to insure that we can meet our service responsibility.

ENERGY CONSERVATION IMPACT

There has been a National need for Americans to respond to energy conservation during this period. We must continue to find ways to reduce our overall use of energy. But energy conservation of itself is not a cure-all. In New England we have been leaders in conservation efforts which is reflected in the fact that energy sales at Boston Edison were down last year 6.3 percent from 1973 levels. The Congress in developing further conservation programs should recognize the leadership already shown by oil dependent regions of the Nation.

It is our firm belief that the need for electric energy will continue to grow. This means it is also essential that we have the Governmental regulatory machinery to permit that growth to take place in an orderly manner consistent with the objectives of "Project Independence."

Conservation of energy on Boston Edison's system has already caused a reduction in our capital spending program. As we have cut back our construction programs we have reduced our work force by over 600 people. Total announced industry cutbacks now amount to $21 billion as energy conservation and the financial crisis create uncertainties. This does not include the tens of thousands of jobs that will not be required because of these cutbacks.

While continuing conservation efforts, we must also maintain the vitality of our building programs to meet the longer-term needs of our customers. The achievement of energy independence, with the restoration of economic stability in the capital marketplace for electric utilities is a major problem that faces the Congress today.

ENVIRONMENTAL PROTECTION—AT WHAT COST?

I would like to comment on another matter which is of particular importance to a capital-intensive industry such as ours, namely, the cost impact of environmental control regulations. Air and water pollution control equipment is costly to install, to maintain, and to operate. It is in my opinion highly unfortunate that the imposition of such costs is often not justified by the accrual of appropriately balancing benefits. Boston Editon is one of the leaders in the industry in responding to the need and desire for improvement of air and water quality. That is, therefore, and I want to emphasize, not an argument against necessary or reasonable environmental protection measures. It is rather a suggestion some of the measures imposed are unnecessary, cost ineffective or inefficient in benefit/cost terms. They also place a significant added burden on the need to raise capital by utilities.

Let us consider the matter of water quality, especially the regulations of the United States Environmental Protection Agency to control thermal discharges. The Environmental Protection Agency has taken the position that under its legislaive mandate it cannot consider whether the installation of closed cycle cooling will have appropriate benefits, but they must impose stringent regulations within the limits of the practicality and availability of technology. This means, for instance, that unless a plant such as our Pilgrim Station Unit #2 can qualify for a strictly defined exemption, costs in excess of $60 million for cooling towers may have to be undertaken even though the Atomic Energy Commission has concluded in its Environmental Impact Statement on this plant a favorable benefit cost analysis of the proposed cooling water discharge system. These costs, I must point out, do not reflect the costs of delay, added interest costs, reduced plant capacity and recent inflationary trends. One has only to multiply the capital impact of this one plant by the number of similar plants in the country to obtain a glimmer of the serious financial implications arising from such regulations.

The regulatory interpretation under the Clean Air Act is also having serious financial consequences which can be avoided. I have in mind primarily the position of the Environmental Protection Agency that constant emission control is to be preferred to other measures such as intermittent or supplementary controls which meet air quality standards a far less costly way. The capital investment in scrubbers which may be necessary for constant emission control is substantial and ranges from $46 million to $80 million for power plants of 500 to 1,000 MW in size. The capital required for the alternate systems is relatively negligible since these systems depend on operational factors such as load reduction or fuel switching. The point I wish to emphasize is that these systems not only require less capital, but permit the use of other less costly fuels—both coal and oil—which cannot now be used. For example, fuel switching could save Boston Edison customers approximately $40 million annually without violating primary air standards.

My recommendation, Mr. Chairman, is that the Congress reexamine environmental legislation to see to it that goals and objectives are not only still desirable in view of the Nation's economic condition but that they bring suitable benefits in view of the costs imposed. The Nation cannot afford inefficiency or unnecessary costs in this time of National crisis

REDUCE REGULATORY LAG IN RATE PROCEEDINGS

There are two areas in electric rate setting where the Congress could be helpful. The Federal Power Commission is already working on one, the inclusion of construction work in progress in the rate base. This regulatory change would help to overcome regulatory lag by improving cash flow and would also improve the quality of Company earnings. We believe that the time has come when this principle should be adopted not only at the Federal level but, more importantly, by state regulatory agencies as well.

Many utilities in the Nation, including Boston Edison, would not be in the financial posture they find themselves today if state regulatory agencies had acted promptly on requests for rate relief. Our recent area of concern, the period of regulatory lag, which is ten months in Massachusetts, must be reduced and we urge the Congress' support to bring state regulation within a reasonable five-month guideline. Of course, it is essential that decisions be made within this time frame. We have one rate case that has been before the Federal Power Commission for almost five years.

INCREASE THE INVESTMENT TAX CREDIT AND PROVIDE IMMEDIATE REFUNDS

Recommendations to increase the investment tax credit for utilities will be helpful. Certainly the existing discriminatory nature of only permitting a 4 percent investment tax credit rate for utilities and a 7 percent for industry in general should be corrected. The overall rate should be increased to the President's recommended 12 percent for all industry. The limitations permitting the use of the investment tax credit of up to only 50 percent of the tax liability should also be permanently eliminated. The period of time that the investment tax credit can be carried forward or carried back for tax purposes should also be increased. Alternatively, to be helpful to all in stimulating investment with the related increase in jobs, a refund provision could be adopted which, in effect, would pay the investment tax credit immediately in cash to those companies who are not in a position to take advantage of the tax credit as they are in a net operating loss position.

INCREASE PERIOD OF OPERATING LOSS CARRY-BACKS AND CARRY FORWARDS FOR INCOME TAX PURPOSES

Many utilities in the United States have been sustaining net operating losses for tax purposes for many years. Certainly, one way to improve their cash position is to extend the period of carry-backs to a minimum of eight years and to extend the period of carry-forwards to a period of ten years. This is but another way tax legislation can be utilized to help hard-pressed utilities.

NUCLEAR POWER FOR NEW ENGLAND

The success of a sound National Energy Policy with "Project Independence" as the ultimate goal dictates the expansion of nuclear and coal as the primary energy sources for the generation of electricity. In 1974, nuclear energy accounted for 22.8 percent of the total electric energy supply in New England. As the mid-east threat and foreign oil prices stand as twin harbingers of gloom, nuclear energy stands out for this Nation as a citadel of hope.

The nuclear record in New England during 1974 gives credence to our conviction that clean safe nuclear power is the most practical source of energy for the consumers of New England. With natural gas supplies limited, hydroelectric sources utilized wherever practicable, coal burning limited by air pollution control regulations and imported oil prices continuing to skyrocket unbridled, nuclear power provides the least costly, most reliable source of power generation. With six operating nuclear power plants in New England and ten more planned, we are trying to move for fuel interdependence. When compared to current oil prices, it is anticipated that nuclear power could save for New England's base load consumers approximately $1 billion a year on their electric bills in the mid 1980's. But the attainment of these savings depends on our ability to finance and construct the necessary nuclear plants and we just cannot move ahead confidently in this direction if the lead time to license and construct the units remains at the present 10-year level.

In May of 1974, we testified before the Joint Committee on Atomic Energy concerning licensing difficulties we were experiencing at our Pilgrim Station in Plymouth, Massachusetts. I am sorry to report that although the Atomic Energy Commission (now the Nuclear Regulatory Commission) has made efforts to speed up the licensing process, no action has been taken on our recommendations. In fact, the situation has deteriorated markedly. If we are serious in our desire to achieve our energy goals, we must take positive action in the nuclear licensing area as well as provide an economic climate that will encourage the construction of nuclear plants. In their deliberations it is imperative that Congress fully understands the importance of nuclear power to our energy survival.

MORE RAPID DEVELOPMENT OF DOMESTIC NATURAL RESOURCES

I am sure we all agree that the ultimate attainment of fuel interdependence requires immediate and concerted attack on many fronts. To be sure, nuclear power plant expansion is a major step in that direction. But, by definition, energy interdependence dictates a more rapid development of our own natural resources. We should already be well on our way to developing these resources under National guidance. Offshore drilling must be explored, encouraged and brought to national reality; exploration and production of shale oil must be enhanced to bring domestic sources of petroleum to such a level as to neutralize reliance on imported oil. We have coal to be mined and new coal fields to be explored. But long-term contracts for coal as a product are required to fully realize the potential of this natural resource. The Clean Air Act may have to be amended so that those facilities able to burn coal may find it available and thus be encouraged to make use of it. We have not realized the potential of our own resources and now find ourselves dependent on others who technologically lag far behind this nation. Time has been lost already—we must not lose any more.

CLOSE

Mr. Chairman, as Congress reconvenes, it finds the most capital-intense industry in the Nation—the electric utilities—hard hit by inflation, conservation, stampeding environmental costs, deep recession and international brinksmanship.

We need and will support a National energy policy which has is its basic premise economic equity for all citizens—a sharing of the National burden among all regions of the Nation. . .

We need to accelerate the development of our domestic energy resources such as coal and off-shore oil. . .

We need help in speeding up the regulatory process in licensing nuclear power plants and in rate proceedings before regulatory commissions . . .

We need tax relief that can be utilized in order to raise lower-cost capital and also relieve the pressure of increasing electric rates on consumers.

. . . And to be effective we need these actions now.

I promise you the support of Boston Edison in achieving these objectives.

Chairman HUMPHREY. Our next witness is Mr. Donald T. Regan, chairman of the board of Merrill Lynch.

Do I understand, Mr. Regan, that you have a transportation deadline here?

Mr. REGAN. It is a bit of a time problem, but I will stay as long as I possibly can.

Chairman HUMPHREY. We will get to you in questioning. Go right ahead.

STATEMENT OF DONALD T. REGAN, CHAIRMAN OF THE BOARD, MERRILL LYNCH & CO., INC.

Mr. REGAN. For the record, my name is Donald T. Regan, I am chaiman of Merrill Lynch & Co., the investment company, and also chairman of Merrill Lynch, Pierce, Fenner and Smith, its operating investment banking subsidiary.

Although I do not represent it here today, I am vice chairman of the New York Stock Exchange.

I appreciate your invitation to appear here today before this important Joint Committee of the Congress. While I recognize your responsibility and interests range across the entire economic spectrum, I shall concentrate on the capital markets—the impact on them of proposed antirecession budget measures; the tasks they must perform; and, finally, some recommendations which would improve their ability to function, not only in helping a business turnaround but in promoting long-term growth of the economy.

Of course, the markets do not function in isolation but must be seen in the general economic setting. And we are all keenly aware of the unusual difficulties we face in trying to steer a proper economic course at this time. Probably never before was there so little maneuvering room between the twin shoals of recession and inflation, with the steep energy prices and uncertainties of future supplies compounding the problem.

Difficulties do not mean despair. We have tremendous strengths, in our physical wealth and in the stamina and resourcefulness of the American people. But we must be willing to face hard facts, even if that means deciding among some unpalatable choices.

In properly attempting now to combat recession and cushion unemployment, we must guard against rekindling virulent inflation. Pouring too much money into the economy could prove self-defeating if it leads to a still bigger inflationary rise during the next business expansion—and sows the seeds for a recession probably worse than this one.

Looking over the economic scene, we are already beginning to see some distinctly encouraging signs. The rate of inflation has slowed, and all indications are this trend will continue in the months ahead. The decline in money rates, which began last fall but stalled toward year's end, has resumed. And the consumer is apparently beginning to respond to price reductions on automobiles and in many retail stores. A similar reaction could come soon on the part of homebuyers, as both the availability and the cost of money improve. Aiding this trend is the fact that homebuilding costs have stabilized.

Meantime, our economists are trying to measure the impact of potential budget stimulants on the financial markets and their ability to handle resulting Treasury needs as well as those of local governments and private business. I am submitting a more detailed discussion of this subject, prepared by the economists at our subsidiaries, Lionel D. Edie & Co. and Merrill Lynch Government Securities.[1]

Let me just summarize some major points. While the official budget has not yet been submitted, our prelimniary estimates, factoring in expenditures on the scale of the latest administration proposals, project a deficit around $32 billion in the current fiscal year and a $45 billion deficit for fiscal 1976. Our Edie economists figure that such a Federal deficit—about $80 billion for the 2 years—can be handled without severe disruptions in the money and capital markets. Among their reasons are some recession-caused slack in private credit demand, especially during the earlier part of the period, probable inflow of OPEC money, and an expected policy of more aggressive ease by the Federal Reserve than it has demonstrated in the last two quarters.

However, if the Federal deficit goes much higher—heading toward as much as $60 billion for next year alone, atop the $30-plus billion for the year ending this June—then private financing needs would

[1] See memorandums, beginning on p. 118.

likely suffer from the excess government competition. This dislocation would become especially evident in early calendar 1976, because by then a business upswing should stimulate private demand while the deficit-generating Federal programs would be in full stride. Such a development could bring either new sky-high inflation or strangle the young recovery, especially in housing.

Thus, regardless of worthwhile projects, it would seem urgent to support the President's proposals for restrictions on expenditures and limits on the size of tax cuts—or else, to make equivalent adjustments elsewhere in the budget.

Our Merrill Lynch investment banking personnel also expects that, unless the deficit increases sharply over that based on the administration proposals, they foresee no overall difficulty in meeting the capital raising needs of industry and local government. But, and this is the disquieting aspect, that is the macro or overview. When they get down to the micro level, they conclude that, even with the 2-year Federal deficit kept to $80 billion, many lower quality borrowers will be hurt.

Industrial companies with a Moody's rating of "Baa" or medium grade will have difficulty attracting needed funds and, in the case of utilities, even somewhat higher rated companies may find the going rough. If these companies can get money at all, it will be at substantially higher cost. And getting long-term money, debt structure, will be most difficult and costliest of all. Incidentally, the same emphasis on quality, with increasing difficulties and costs for lower credit risks, will undoubtedly apply to municipal financing.

This would mean a sharp escalation of a trend already in evidence. As Business Week recently commented:

> In a period when demand for credit is high, the market begins to discriminate. Investors are placing tremendous emphasis on the 'quality' of investments they make. (Also) the supply of capital that investors are willing to commit long-term has slowed.

All this can hardly be considered surprising. When an investor has a choice, naturally he prefers top quality, and the uncertainties experienced by many companies and industries recently certainly fortify that preference. Similarly, the investor tends to place a premium on bonds maturing within, say, 7-to-10 years than over the more distant future. He feels there is less opportunity for something to go wrong; also he has learned that if inflation drives current interest rates up, the market value of outstanding long-term bonds goes to a much deeper discount than those with shorter maturities.

The preference for quality, of course, has always been there, but the increased emphasis on it is truly dramatic. For instance, in 1973 the average medium-grade Baa industrial bond yielded about three-quarters of 1 percentage point more than a highest-quality Aaa bond. By last year this spread had nearly doubled. Even more startling is the change in the utility sector, where the spread between high and medium grade more than tripled from 1973 to 1974—and what is more, the differential is now substantially wider among utilities than in the industrial group. Obviously, with utilities hit by huge cost increases and with slowed-down growth, relative quality has suddenly assumed momentous importance. Actually, the situation is such that no Baa utility has come to the long-term public market in the last 6 months.

Despite the difficulties in attracting investors faced by some companies and the high cost of borrowing faced by all, corporate bond offerings jumped to an alltime high of $27 billion last year and are expected to run at around a solid $23 billion or so in 1975. But that's simply a reflection of the tremendous needs for funds, a need which will continue throughout the foreseeable future.

A big reason is the need for capital expenditures. American business is conservatively expected to have to spend around $2 trillion, plus inflation allowance, between now and 1985, to expand and modernize, to provide jobs for roughly 1.4 million new workers a year, to satisfy ecological and safety rules, and to make at least a stab at easing our energy vulnerability. Other huge sums will be required for facilities by State and local governments and all types of public or quasi-public institutions.

The impact of the recession has sharply curtailed business expansion plans this year. With many cancellations, utilities will lag behind last year and other businesses may also fail to match the 1974 record in physical terms. But because of the steep rise in costs, total 1975 capital expenditures in dollars are still estimated a couple of percentage points above last year's $112 billion.

So this still leaves a hefty demand for business spending at a close to $10 billion a month rate. Lower profits and cash flow may also boost the financing need. Add to this the widely recognized need to upgrade balance sheets and it's plain that there's a big call for action in corporate financing for this year as well as for many years ahead.

As we know, for some time corporations have been pushed into depending on an unusually large proportion of debt rather than new equity, and, what's worse, a disproportionate amount of the borrowing has been short term.

One analyst has computed that 28 percent of the growth of manufacturing corporations between 1960 and 1972 was financed by "deterioration of the balance sheet," mostly through an increase in the debt-to-equity ratio plus some reduction in the working capital to sales ratio.

Another example of balance sheet deterioration: After increasing their relative equity position in the early sixties, nonfinancial corporations endured a sharp reversal of this trend. Since 1966, their borrowings have been $100 billion greater than the amount they were able to add to equity through new offerings plus retained earnings. Over half of this tilt toward debt came in the last 2 years. And compared with the early sixties, when short- and long-term borrowings were almost evenly balanced, short-term debt now has a 3 to 2 edge.

As for equities, new common stock offerings have disappeared almost completeley in recent months except for some utilities that had to sell well below book value and offer highly attractive yields. For industrial common stocks, the total 1974 offerings came to less than 3 percent of the corresponding bond value.

While speculative and untried companies would no doubt have a difficult time in marketing new issues, the dearth—indeed complete drought—of common offerings is not caused by just a lack of potential buyers. As we found out with several utility offerings, there is a lot of demand for equities of better companies with good dividend payments at today's bargain prices. But there is a "seller's strike" by many companies. Not that you can blame the reluctant companies. The very price which makes the stock a bargain for eager would-be-buyers tends to make it a "give-away" in the eyes of the company and its present stockholders. Often the corporation finds the return it could earn on the new money would be lower than what's earned on existing operations.

This is hardly a surprise. The average stock on the New York Stock Exchange lost 75 percent of its value between 1968 and 1974, which would seem enough to discount any number of recessions.

We may be beginning to see a new look, or rather a reappraisal, of basic values. There is a growing willingness to look at the total return concept—the sum of dividends plus long-term capital growth which can be expected from soundly based, well-managed companies.

Naturally, moves toward a sounder economy and a brighter outlook ahead should encourage the stock market, and strengthen the bond market as well, and thus facilitate the financing of all classes of business. That's another reason a balanced program to fight recession without locking us into policies which promote long-term inflation should pay rich dividends in healthy growth for the Nation.

But some other important steps to promote raising the capital we so greatly need would consist of measures to directly encourage investors to put their money to work. Three helpful moves in that direction would be fairer capital gains treatment; encouragement of portfolio investments from abroad by eliminating the special withholding tax on foreigners; some steps toward deductibility of double-taxed dividends. I might add that another wlecome improvement will be a more efficient marketplace; we have long believed in the advantages of a competitive market and we are glad to see that both houses of Congress will shortly consider legislation on making such a market more effective.

I am submitting separate memorandums outlining the desirability of relief in the capital gains and foreign withholding areas, so I will only summarize the highlights.[1]

I feel capital gains improvement should be granted not only for the social benefits to be derived from extra investment flow, but also to give a fair shake to the investor. The capital gains tax system deters people from cashing in on their theoretical gains, thus preventing them from switching to what they might now consider a more desirable investment—and while they sit with their old investment, the Treasury doesn't get its revenues.

An important avenue for us to obtain additional capital without putting the money up ourselves is to tap some of the wealth being accumulated abroad. One way to attract such potential investors is to eliminate withholding taxes on interest and dividends paid to foreign portfolio investors.

Serious consideration should also be given to the suggestion recently made by Chairman Garrett of the Securities and Exchange

[1] See memorandums, beginning on p. 118.

Commission to permit corporations to deduct dividends from taxable income, just as they now deduct interest paid on bonds. Since one problem in corporate financial structures these days is the top-heavy debt, such a step would make it easier for a company to issue stock instead, and thus strengthen its financial position. By encouraging higher dividend payments, taxable to holders, the Treasury would likely recoup a sizable amount of revenues, in addition to the general economic benefits from stronger growth.

Another key area where positive action can promote greater overall strength is helping business generate funds internally. So companies can better expand their job-creating activities, it is important to increase the investment tax credit and to make it permanent. This should be particularly helpful to the hard-pressed utilities.

It is easy when deciding on priorities to look at benefits for the individual and to leave the corporation to fend for itself. But we also need a strong business organization to help provide the jobs which are the basic source of individual income. The huge boost in energy costs has cut sharply into the normal consumer expectations of a rising living standard, and the only way we can get these expectations back on the track is to boost our overall productivity. Part of this can be accomplished when individuals pitch in and determine to achieve more. But we know that the principal effort must be by business providing the tools for such greater achievement. It must be in position to do so, if we are to continue to realize a better life for all.

Chairman HUMPHREY. Thank you. We will include the memorandums that you have prepared for the committee, to which you referred to in your statement, in the record at this point.

[The memorandums follow:]

THE IMPACT OF THE BUDGET DEFICITS [1]

FINANCING THE DEFICITS IN 1975

We are in the early stages of quantifying our own estimates of the federal budget deficits for the current and the coming fiscal year. A vital tool not yet available to us is the budget document itself which, as we understand it, will not be available until that first week in February. In the absence of this detail, and adjusting for the Administration's proposals, we have come up with preliminary projections of $32 billion and $45 billion deficits for the two fiscal years. These numbers are somewhat lower than official estimates, partly perhaps because of different assumptions about economic growth and inflation for the next year and a half. In any case, this is the first time that the *deficits* projected by our staff have actually been lower than the official ones.

Now the question is this: can such deficits be financed without undue pressure on money and capital markets and interest rates, and without undue upward pressure on monetary expansion and inflation? To help answer that question, we have begun to reexamine our estimates of Treasury cash needs in the context of other, mainly private demands on our money and capital markets and also in the light of prospective supplies of funds.

DEMAND FOR FUNDS

Our projections for the February-June period call for Treasury net cash borrowing of around $23 billion. This includes borrowing by the Federal Financing Bank. In the second half of the calendar year, Treasury borrowings could come close to averaging $5 billion a month. Of course, the ebb and flow of that bor-

[1] Memorandum presented to the Joint Economic Committee of the Congress by Donald T. Regan, chairman, Merrill Lynch & Co., Inc., on January 28, 1975.

rowing would depend upon Congressional action with regard to both taxation and spending, and seasonal factors. The average monthly cash need of the Treasury in the first half of calendar 1976 would be less than half of that amount. There may be some additional Treasury borrowing to help finance some agency cash needs.

Other demands for funds will vary in intensity. We see two major areas of heavy borrowing in the current year. In addition to the Treasury, *corporate financing* in the bond market should be very heavy as corporations seek to finance still rising capital spending and a restructuring of their balance sheets away from short-term debt in favor of long-term funding. A greater proportion of capital spending in 1975 will have to be financed externally owing to declining net retained cash flow. We, therefore, look for a continuing corporate bond calendar in 1975 averaging perhaps $2 billion-plus a month.

State and local financing may be somewhat higher in 1975 than in 1974, but below the record levels financed in 1971.

Agency cash needs should be substantially lower throughout 1975 as the Federal Home Loan Banks liquidate a large amount of debt in response to paydowns of their loans to savings and loan associations. That in turn would take place as savings flows to thrift institutions improve. Other sponsored agencies should continue to borrow but in smaller increments than was the case in 1974.

Mortgage credit demands are expected to be weak through most of 1975, with only a modest rise later this year, as the depressed housing market gradually recovers.

Consumer credit demands are expected to be weak. Some actual paydowns are possible in the early months of the year as consumers use what money they have left out of their monthly incomes after purchases of necessities and also a large part of their tax rebates to reduce their very high level of consumer debt.

Finally, *short-term business credit* demands should also be very weak as corporations liquidate inventories, restructure their balance sheets, pay down trade debt, etc. Therefore, bank loans and commercial paper demands should be very modest.

SUPPLY FACTORS

In contrast to the mixed picture on the demand side, all of the supplies of funds in 1975 should be rising fairly strongly. *Consumer savings* are expected to rise substantially owing to low confidence in the economy plus the expected tax rebates. A substantial part of those monies not used to pay down debt is likely to be saved at thrift institutions. Diminishing inflation could also surprise consumers, and leave them with slightly more money than expected at the end of each month. This is likely to be saved in the early part of the year, until consumers are satisfied that the real purchasing power of their savings has been restored and confidence starts to rebuild.

Life insurance companies have enjoyed strong sales, in part as policyholders seek to offset the erosion of inflation.

Thrift institutions should also benefit from a transfer of assets on the part of the public from money market instruments bought during the period of disintermediation of thrift accounts as those securities mature.

We continue to expect large amounts of money to flow in from abroad as *OPEC members* invest their surplus funds and other internationally mobile money seeks out investments here. One of the reasons for this should be a strengthening dollar; it is presently terribly depressed.

Finally, and most important, the Federal Reserve is likely to continue a policy of ease through most or all of 1975. Rates of growth of the key monetary aggregates have been way behind the Fed's target levels. It would seem, therefore, that the Fed has some catching up to do. In the face of weak loan demand, it may require a fairly aggressive policy of ease for the Fed to manage to accelerate the growth in money supply. In summary, it would appear that the supplies of funds should be adequate to meet the Treasury's cash needs without rationing out other legitimate private credit demands.

The supply and demand for funds suggests the manner in which the Treasury could finance its deficit. The investors likely to be most inclined to purchase Treasury securities are the banks, thrift institutions and foreigners. The banks are likely to take the lion's share of the Treasury offerings since loan demand will be weak while the Federal Reserve will be making funds available to them. Thrift institutions will also find investment monies available without the normal amount of mortgage credit demands to absorb these funds. Savings and loan associations especially may be expected to buy large amounts of Treasury securities. This is a natural vehicle for them. Mutual savings banks are likely to put large amounts of money into the corporate bond market where the demand for funds will be large. However, they, too, may be expected to take on significant amounts of Treasury securities. Life insurance companies are more likely to concentrate on the corporate bond market.

As indicated, foreigners, particularly OPEC members, are likely to buy a large amount of Treasury securities, considerably more than in 1974 since their surpluses are accumulating more rapidly now. The present total rate of accumulation of OPEC surpluses is around $5 billion a month. Close to $10 billion during 1975 should be invested in Treasury securities by them alone. All of this would suggest that the bulk of the Treasury borrowing will be done in the short-term market, especially Treasury bills, and in the intermediate market out to seven years. Some modest amounts are also likely to be raised in the long-term market, but this should not be enough to interfere with the corporate market.

IMPLICATIONS FOR INTEREST RATES

For the next several months we expect to see short-term rates decline, perhaps rather sharply, in response to continuing ease on the part of the Federal Reserve and to declining credit demands. Treasury cash needs will not become a major factor until March and again in May. The trough in short-term rates may come around mid-year. While after that the heavy volume of Treasury financing could put some upward pressure on Treasury bill rates, other money market rates, such as on commercial paper and certificates of deposit, are not likely to rise as much. Yield spreads should narrow.

Long-term rates may come down modestly over the next couple of months in sympathy with short-term rates, and the decline could continue into the summer as the news of a sustained abatement of inflation becomes available. The intermediate market out to seven years is likely more closely to reflect short-term rather than long-term rates because this maturity range will be heavily influenced by the Treasury.

In conclusion, financing these huge budget deficits during the remainder of 1975 does not seem to pose an insurmountable task for our money and capital markets. A deep recession is making room by reducing private demands for money while the Federal Reserve pushes hard on monetary expansion. Of course this conclusion was reached by using estimates of $32 and $45 billion for the two budget deficits in question. Should new policy directions or unexpected factors raise these deficit, we would then have to go back to the drawing board. Frankly, according to our analysis, it wouldn't take much more Treasury borrowing to produce truly destabilizing effects which could seriously undermine the recovery process. Certainly a budget deficit for fiscal 1976 as high as, say, $60 billion would pose such a threat.

LIMITING FEDERAL EXPENDITURES IN 1976–77

The greatest threat that federal deficits pose to our money and capital markets, and thus to our economic stability, is next year. By then, a recovery should be well underway. Private credit demands should begin to grow more rapidly. By mid-1976, as we enter the next fiscal period, there is likely to be far, far less room for federal dfiecit financing. As the recovery accelerates, so will the growth of Treasury revenues. and that will help to pull down the deficit. But that won't be enough. The problem of excessive growth of federal spending will have to be faced up to.

The growth in federal expenditures, after rising by only about 9 percent in fiscal 1974, is slated to rise, according to Administration estimates. by 17 percent in the current fiscal year and by another 11 percent in fiscal 1976. And these estimates include assumptions such as the 5 percent cap on federal pay increases and government cost-of-living escalators. no new federal spending programs, and a number of proposed cutbacks totaling $17.5 billion in fiscal 1976.

An explosive growth in federal nondefense spending has gone on for years. Such spending has been rising at a clip of about 15 percent per year, or higher. since the start of the decade, far outpacing inflation over this period. If that kind of trajectory is carried forward into next year and beyond, government deficits. and pressures for high monetary expansion could very well ignite another boom-bust cycle in the 1976–78 period.

CONCLUSION

We believe that it is possible to finance about $80 billion of federal budget deficits for fiscal 1975 and 1976 combined without severe disruptions in our money and capital markets. There is some room because this recession is limiting private demands for credit and because it calls for greater monetary expansion. However, a deficit that reaches toward the $60 billion mark for fiscal 1976 alone probably would crowd private borrowers by the end of this year. If that happens, a recovery, particularly in housing, could be in jeopardy.

By mid-1976, there will no longer be room for big federal deficits, in the light of prospectively higher private demands. This means holding a tight lid on federal spending beyond the sharp increases planned for fiscal 1975 and 1976. A desirable target for a maximum growth rate would be in a range of 5 to 10 percent per year. Congressional implementation of such a restriction would, in our judgment, have an enormous positive impact throughout this country on our long-run economic future.

THE U.S. WITHHOLDING TAX ON INTEREST AND DIVIDENDS PAID TO FOREIGNERS: A BLOCK TO NEEDED INVESTMENT FUNDS[1]

At a time when we must battle a three-pronged problem of recession, inflation and energy crunch, it is particularly important to tap all available capital sources in order to create employment opportunities, increase our energy capacity and ease interest rates. Conversely, this requires eliminating roadblocks which restrict the ability of the United States to attract investment funds.

One imporant roadblock is the withholding tax requirement imposed by the United States on interest and dividends paid to foreigners. It obstructs the free flow of foreign portfolio investment to the United States by severely limiting the cash return to foreigners on fixed income and yield-oriented U.S. securities. The taxes range up to a maximum of 30% depending on the foreigner's country of residence.

The elimination of these taxes could significantly stimulate increased flows of foreign long-term capital to the United States. It would:

Help to bring home substantial amounts of the over $100 billion held in private hands abroad;

Yield significant benefits to the U.S. balance of payments;

Increase the flow of foreign funds into the U.S. real estate and building industries by making mortgages and other income-yielding real estate investments attractive to foreigners;

Increase foreign investments in U.S. corporate bonds and yield-oriented common and preferred stocks such as those issued by U.S. utility companies;

Tend to reduce interest rates in the United States; and

Help to reestablish the United States as an international financial center by making U.S. investments competitive with the Eurodollar and Eurobond markets which are not subject to withholding taxes.

THE TAXES

Since the 1930's the United States has imposed taxes, withheld at the source, at a flat 30% rate on gross interest and dividend payments to foreigners. However, this 30% rate has been reduced or eliminated for residents of a number of industrialized countries with which the United States has double-taxation treaties. Attached is a list of such countries and the U.S. withholding tax rates applicable in their case; the average is bound 15% for residents of these countries.

But what is becoming increasingly important in view of the drastic shifts in economic status around the world. the U.S. does not have such tax-reducing treaties with the vast majority of countries. Among these nations are some which now represent very substantial source of funds for investment in the United States; for example, Hong Kong. and the countries of Latin America and the Middle East. In view of the history of unsuccessful attempts to negotiate treaties with many of these countries, it is doubtful that the withholding tax rates could be reduced in the foreseeable future through a negotiation of treaties with a significant number of additional countries.

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[1] Memorandum presented to the Joint Economic Committee of the Congress by Donald T. Regan, chairman, Merrill Lynch & Co., Inc., on January 28, 1975.

Further, many existing treaties are limited in their application. For instance, while the Swiss tax treaty calls for 15% withholding on dividends and 5% on interest, these rates apply only to Swiss residents. Thus, under the treaty, when an Arab or Latin American invests in the U.S. through his Swiss account, Switzerland withholds additional amounts and remits them to the United States in order to bring the tax paid by such investors to the 30% rate. It is important to note that the vast majority of funds available in Switzerland for investment in the United States is for the account of non-Swiss residents.

In many cases, foreign nationals can credit withholding taxes paid to the U.S. against their domestic tax bills. But the procedures involved are cumbersome and, therefore, do not facilitate the free flow of funds to the United States, particularly in the case of individual foreign investors.

THE EFFECTS OF ELIMINATION

While it is not possible to project an exact dollar figure for the increase in investment in the U.S. which would result from removal of the taxes, it could well amount to several billions of dollars over time. Foreigners already have a strong appetite for U.S. equities. Their net purchases of U.S. common stocks were $697 million in 1970, $836 million in 1971, $2.268 billion in 1972 and $2.797 billion in 1973. However, these stocks have generally been bought for their growth potential. There is no U.S. capital gains tax applicable to foreigners.

Removal of the withholding tax on dividends would greatly increase flows into U.S. equities as substantial numbers of foreigners are also yield-oriented. In particular, it would make several important markets attractive for foreign purchasers including utility common and preferred stocks and possibly also real estate investment trust shares or other housing-oriented securities. Thus, a foreign investment influx could assist two industries in dire need of new sources of funds, if their ever-increasing capital expenditures are to be financed at reasonable costs.

Investments by foreigners in interest-bearing debt securities have been minimal. While accurate statistics which would measure these flows are not available, the closest approximation indicates that net foreign purchases of U.S. bonds were $347 million in 1970 and $233 million in 1971. In 1972, net sales of $81 million were made, and there were net purchases of $47 million in 1973.[1] The low level of these purchases stems to a considerable degree from the U.S. withholding tax, since foreigners interested in fixed income dollar investments can buy Eurodollar bonds which carry no withholding tax. Dollar-denominated Eurobond sales in the past five years have averaged $2.4 billion and were $2.5 billion in 1973. Removal of the tax on interest would for the first time permit substantial purchases of regular U.S. debt securities, including corporate straight and convertible bonds as well as mortgages and government bonds. This will occur even if interest rates in the U.S. are somewhat lower than abroad, because there is a shortage of first-class, liquid investments outside the United States.

IMPLICATIONS FOR U.S. TAX POLICY

The effect on U.S. Treasury revenues of the removal of the taxes would be slight. Total income from these taxes was less than $200 million in 1969, the latest year for which data is available. Of this amount only about $20 million

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[1] These figures are from line 67, table 6, U.S. balance of payments article, Survey of Current Business, June 1973 and March 1974, U.S. Commerce Department. Both the Treasury and Federal Reserve Monthly bulletins give statistics which seem to show substantially higher foreign bond purchases. It is important to note that these latter statistics include purchases of Eurobonds issued by U.S. companies and U.S. bonds acquired by international organizations, neither of which are subject to U.S. withholding tax and, therefore, must be excluded for this purpose.

was attributable to the tax on interest payments, an indicator of the small size of foreign investment in interest bearing U.S. securities. Of the remainder, an estimated $100 million was due to inter-corporate payments by subsidiaries to their foreign parent companies, a tax which would not need to be removed to meet the objectives outlined herein. In addition, revenue losses from removal of the taxes should be more than offset through the income tax as greater income is generated in the U.S. economy from additional investment here.

Some have argued that removal of these taxes would discriminate against American citizens who would, of course, continue to be subject to U.S. income tax on their debt and equity investments. However, it is a principle of international taxation that individuals should be subject to tax in their country of residence and/or nationality. In any event, the benefits to be derived for the United States in this time of monetary crisis and high interest rates far outweight any such discrimination. Moreover, removal of the withholding tax would not be unprecedented since our tax treaties already reduce or eliminate the taxes for foreign residents in several countries. In a sense, this move would eliminate existing discrimination as between foreigners from different countries. In addition, it is important to note that the U.S. capital tax does not apply to foreigners. Finally, a significant group of industrialized countries with which we must compete for funds do not tax interest paid to nonresidents.

Others have argued that removal of the withholding tax would tend to stimulate tax evasion by Americans who would send their money abroad and reinvest it in the United States. It is highly doubtful that a 15 to 30% withholding tax can be much of an obstacle to tax evasion when compared with U.S. income tax rates ranging as high as 70%. Moreover, the real incentive already exists in that there is no capital gains tax on foreign investment in the United States. The way to prevent tax evasion, of course, is through continued and enhanced enforcement of the law in the United States, improved reporting requirements by U.S. citizens and through the exchange of information with tax authorities of other countries which is built into U.S. tax treaties. In addition, it sould be possible to draft the withholding tax elimination legislation in such a way so the taxes could be reapplied, at the discretion of the Secretary of the Treasury and after a reasonable period of time, to those countries which are unwilling to exchange tax information with the United States.

It is also argued that the United States would reduce its ability to negotiate future double taxation treaties because, if it unilaterally relinquished the right to withhold tax on interest and dividends, it would reduce its leverage to exact similar concessions from other countries. The United States already has treaties with most industrialized countries. Developing countries, with whom the U.S. generally does not have treaties, are unwilling for economic and political reasons to diminish their ability to tax dividends and interest paid to investors abroad, because this would lead to additional profits remitted abroad. In the face of this, the willingness of the United States to reduce taxes withheld from citizens of less developed countries does not seem to provide much leverage in any case.

Finally, there is the worry about "foreign takeover" of U.S. industries and businesses. It must be emphasized that such takeovers would not be facilitated by the proposed repeal of the withholding requirements. Relief would be granted for investments, exactly the kind of funds we wish to attract from abroad to stimulate our economy and aid the balance of payments. The exemptions would not apply to control purchases and direct business operations. More importantly, withholding taxes on dividends are not likely to be the determing factor in a business acquisition. In any case, the proposed repeal, as tentatively adopted by the House Ways & Means Committee last May, clearly specified that the relief applied only to portfolio investments.

TABLE OF TAX TREATIES: TAX TREATIES IN EFFECT BETWEEN THE UNITED STATES AND FOREIGN COUNTRIES

Country	Percentage rate of U.S. tax withholding at source: Dividends	Interest	Estate tax treaty	Gift tax treaty
Australia	15	30	Yes	Yes.
Austria (except mortgage interest)	15	0		
Barbados [1]	15	30		
Belgium	15	15		
Canada	15	15	Yes	
Congo, Republic of	15	15		
Denmark	15	0		
Finland	15	0	Yes	
France	15	10	Yes	
Germany, Federal Republic of	15	0		
Greece	30	0	Yes	
Ireland	15	0	Yes	
Italy	15	30	Yes	
Jamaica [1]	15	30		
Japan	15	10	Yes	Yes.
Luxembourg [2]	15	0		
Malawi [1]	15	0		
Netherlands	15	0		
Netherlands Antilles [2]	15	0		
New Zealand	15	30		
Nigeria [1]	15	30		
Norway	15	0	Yes	
Pakistan	30	30		
Rwanda	15	15		
Sierra Leone [1]	15	30		
South Africa, Union of	30	30	Yes	
Sweden	15	0		
Switzerland	15	5	Yes	
Trinidad and Tobago	25	30		
Zambia [1]	15	0		
United Kingdom [3]	15	0	Yes	
South Rhodesia (as United Kingdom colony)	15	0		
Other United Kingdom colonies [4]	15	30		

[1] Former colony of United Kingdom, now independent. The United Kingdom treaty as it was extended to this colony continues to apply.

[2] Payments to corporations in Netherlands Antilles and Luxembourg are subject to 30 percent tax unless special requirements contained in the treaties are met. The Netherlands Antilles includes Aruba, Bonaire, Curacao, Saba, St. Eustatius and the Netherlands part of St. Martin.

[3] United Kingdom includes only Great Britain (England, Scotland and Wales) and Northern Ireland, but excludes the Channel Islands and the Isle of Man.

[4] Aden, Antigua, British Honduras, Dominica, Falkland Islands, Gambia, Grenada, Montserrat (St. Christopher, Nevis and Anguilla Federation), St. Lucia, St. Vincent, Seychelles, United Kingdom, Virgin Islands.

NOTE.—Withholding at 30 percent is required on lump sum payments from qualified pension or annuity plans, except to residents of Canada, Germany, Sweden, and United Kingdom. For these countries, the treaty and regulations should be referred to for details.

Attitudes of Merrill Lynch Customers Toward Capital Gains Taxation [1]

INTRODUCTION

Merrill Lynch has a deep and abiding interest in the individual investor, and especially in the investor of modest means. Merrill Lynch welcomes and encourages participation by individual investors in the nation's securities markets. By offering effective and interested service, we have attempted to make the modest-income individual feel that there is a worthwhile role for him as an investor in American enterprise.

However, much also depends on the external investment environment and especially on the tax consequences which any investment entails. Revisions in the taxation of capital gains are particularly timely because of the great urgency to attract capital to meet the growing needs of America. It is estimated that, even before allowing for inflation, some $2 trillion in capital investment is needed by American business between now and 1985. To meet these mammoth requirements, we must make investment as attractive as possible for everyone—especially including the investor of moderate means.

Facilitating the investment capability of this type of investor should be an important concern of this Congress. I believe that some selective changes

[1] Memorandum submitted to the Joint Economic Committee of the Congress by Donald T. Regan, chairman of Merrill Lynch & Co., Inc., on January 28, 1975.

could be made in the taxation of capital gains which would not involve a drastic overhaul of the entire tax structure. Such changes would make significant contributions to our markets, and the opportunities for small investors to participate in a sounder way. Such changes, I believe, also are inherently sound as tax policy.

I recommend serious consideration of several avenues which appear well suited toward achieving this objective.

1. A deferral privilege which permits capital gains tax to be postponed at least up to a certain dollar amount, if the funds realized from the sale of securities are reinvested in other securities. This roll-over principle is the same as that which permits the homeowner to move from one house to another without incurring immediate capital gains liability.

2. A sliding scale of capital gains rates, with lower rates, the longer the security is held. To make such a system most effective, the scale should be reduced in small, gradual steps throughout the holding period, rather than in a few steep steps at long intervals.

3. Some reduction of over-all capital gains rates, at least as applied to the small investor, and elimination of the minimum holding period distinction in the case of normal securities investments.

4. Deducton of capital losses against dividend and interest income.

I believe that adoption of at least some of these proposals would be most helpful in stimulating needed investment, improving the financial stability of the hard-pressed investor of modest means, and promoting the general welfare of the economy. At the same time, there would be little revenue loss and, quite possibly, some net revenue gains to the Treasury. Thus the results should, in all respects, be most fruitful.

Our belief that changes in capital gains taxation would help to stimulate the capital markets was underscored by a survey Merrill Lynch conducted last summer. We believe this survey adds substantive evidence supporting many of our recommendations. The results clearly show that individual investors would increase their investment activity if changes in the tax treatment of their market gains and losses were enacted. This supports our view that billions of investor's dollars, vitally needed in our capital markets, can be unlocked.

Detailed results of that survey are attached.

The attitudes of these customers point the way to the adoption of proposals which could make significant contributions to our markets and promote the general welfare of the economy. Increased activity by individual investors in our markets is essential to provide the capital needed to assure healthy growth in the Ameican economy.

BACKGROUND

Because Merrill Lynch is inherently iterested in the welfare of the individual investor, the Company commissioned a marketing research study to determine investors' attitudes toward certain possible revisions in the current capital gains taxation laws. The provisions which were examined in the research study dealt with specific areas currently being reviewed by the House Ways & Means Committee as well as some which presented to the Committee by Donald Regan in a position paper on capital gains taxation.

While it is a fact that ratification by Congress of any of these provisions would provide tax benefits for individual investors, it was also felt that if there were significantly positive reactions from investors, that ratification might also stimulate the public to invest and thus help provide a much needed infusion of money into the capital markets.

OBJECTIVES

The specific objectives of this project were to: Determine the level of awareness of the House of Representatives work in the area of capital gains taxation; and measure investor reaction to the tax provisions included in the study, in terms of projected future investing activity.

METHOD

This study is very similar in nature to one conducted in 1969 on the same subject. The results of the earlier study were presented to the Senate Finance Committee by Donald Regan when he testified before the group.

Names and telephone numbers of Merrill Lynch customers were gathered from 31 Merrill Lynch offices located in a broad cross section of the country. Each office was required to supply a pre-determined number of names, equally distributed into three income categories, $10,000–$19,999, $20,000–$49,999, and $50,000 and over.

The lists were wired into New York and before they were delivered to the marketing research company, all indications that they emanated from Merrill Lynch were eradicated. Thus only Merrill Lynch and the research company knew the origin of the lists. This was done to preserve annonymity of our customers and to eliminate any type of bias which might be experienced if Merrill Lynch was identified as the sponsor of the study.

Six hundred and ten people were interviewed by telephone, between June 14,–June 18, 1974.

A table containing the cities and the number of completed interviews within each is found below.

DISTRIBUTION OF COMPLETED INTERVIEWS

City	Number of offices sampled	Total completed interviews	Income segments: $10,000–$19,999	$20,000–$49,999	$50,000 and over
Total	31	610	206	203	201
New York	8	150	50	50	50
Boston	2	42	14	14	14
New Haven	1	23	9	7	7
Philadelphia	1	21	7	7	7
Chicago	1	19	5	7	7
Fort Wayne	1	18	6	6	6
Louisville	1	18	6	6	6
Detroit	1	21	7	7	7
Saginaw	1	20	8	6	6
Cincinnati	1	21	7	7	7
Milwaukee	1	21	7	7	7
Kansas City	1	19	9	7	3
Memphis	1	23	7	7	9
Dallas	1	22	7	7	8
Fort Worth	1	21	7	7	7
Beverly Hills	1	18	6	6	6
Hollywood	1	18	6	6	6
Los Angeles	3	55	18	18	19
Pasadena	1	18	6	7	5
Oakland	1	21	7	7	7
Denver	1	21	7	7	7

Merrill Lynch's Marketing Research Unit of the Corporate Planning Department is responsible for the design of the study and questionnaire as well as for the analysis of the data.

Directions for Decision, Inc. an independent marketing research company under Merrill Lynch's supervision was responsible for the interviewing and tabulation of the data. A short biography of the company's principals follows.

DIRECTIONS FOR DECISIONS INC.

Directions For Decisions, an independent research company specializing in all phases of consumer research, was formed in June 1971 by Joseph Baldi and Linda Lurie.

Mr. Baldi, who is President of the Company, formerly was employed at Alfred Politz and Weller and Klein, two independent research companies, and at Ogilvy & Mather Advertising.

Miss Lurie, the Executive Vice President, formerly worked at Grey Advertising, J. Walter Thompson and Ogilvy & Mather Inc.

John Almash is a Vice-President of the Company and formerly was employed at Alfred Politz and Ogilvy & Mather Inc.

Some of the Company's clients include: General Foods; Johnson & Johnson; Lever Brothers; Pfizer Inc. (Leeming Pacquin Division); Merrill Lynch, Pierce, Fenner & Smith Inc.; Ogilvy & Mather Inc.; and J. Walter Thompson Inc.

THE INTERVIEW

Following are the areas covered in the interview:

Awareness of the Committee on Ways & Means work in the area of capital gains.

Allowing the first $1,000 of capital gains to be tax free.
Two types of declining tax rate over an extended period of time.
A deferral privilege in the taxation of capital gains.
A reduction from the current tax rate in the first $25,000 of capital gains in any one year.
A reduction in the amount of net long term losses allowed to be deducted.
Allowing capital losses to be deducted from dividends and bond interest.
Allowing retroactive application of capital losses against capital gains.
Attitude toward how long the holding period should be.
A questionnaire is appended.

CONCLUSIONS

1. As in the previous study, the Merrill Lynch customer appears to be well aware of the fact that work is being done in Congress which might affect capital gains taxation.
2. Regardless of the provisions, if any one were passed, it would help the capital markets by encouraging individual investment activity. If several were passed and adequately publicized, it appears that there might be an even greater incentive for investors to participate and thus, in addition, provide significant contributions to the market.
3. To many of these proposed revisions, the person of moderate means reacted as positively, in terms of projected future stock investment activity, as did those of more affluent means. This was especially true in the instances of the deferral privilege, increasing maximum net loss deduction, retroactive (3 years) application of capital losses against capital gains, a decreasing tax rate, and allowing the first $1,000 of capital gains to be tax free.
4. The provision which created the most impact on the investor is the deferral privilege similar to that afforded the home owner who sells his home and purchases another in the same year.
5. Also certain to encourage investor activity are several provisions geared to alleviating the burden of loss: (a) increasing the net loss deduction limit, (b) retroactive application of capital losses to offset capital gains, and (c) using capital losses to offset dividends and bond interest.
6. A reduction in capital gains taxation of the first $$25,000 of capital gains also would appear to stimulate investment activity.

PERCENTAGES OF INVESTORS "WHO WOULD INCREASE FUTURE STOCK INVESTMENT ACTIVITY" IF PROVISION WAS PASSED

	Would increase future stock investment activity			
	Total	$10,000–$19,999	$20,000–$49,999	$50,000 and over
1. Deferral privilege—Postponing capital gains tax up to $100,000 of funds if reinvested within 1-year	72	72	69	76
2. Increasing maximum net loss deduction in 1 year to:				
$2,000	52	53	51	51
$3,000	60	63	58	60
$4,000 (cumulative)	66	68	64	67
3. Allowing investors to be able to apply long term capital losses against capital gains for the previous 3 years	66	65	68	63
4. Reducing capital gains tax by a third on 1st $25,000 of capital gains in any 1 year	65	61	65	70
5. Allowing deduction of capital losses from dividends and bond interest	60	54	61	67
6. Decreasing the current tax rate by 20 percent over a holding period of 20 years:				
By allowing a tax rate deduction of 1/12 of 1 percent each month	47	45	44	52
By allowing a tax rate deduction of 5 percent after 5 years, 10 percent after 10 years, etc	43	41	42	47
Preference in response to direct question:				
1/12 of 1 percent	45	49	41	47
5 percent–5 years	34	32	37	34
7. Allowing the 1st $1,000 of capital gains to be tax free	43	47	44	39

DETAILED FINDINGS

1. Awareness of the House Ways and Means Committee's work on capital gains taxation

As a group, Merrill Lynch customers are very much aware of the fact that the Committee is working on possible revisions in the taxation of capital gains.

While all three income groups are aware, the percentage increase directionally with income.

[In percent]

	Total[1]	$10,000–$19,999	$20,000–$49,999	$50,000 and over
Aware of committee's work	77	72	76	83
Not aware of committee's work	23	27	24	17

[1] Summary tables in the text of this report do not add to 100 percent because the "no opinion" and "did not answer" factors are not included. See appendix for complete detailed tables.

2. Projected investment behavior if allowed deferral privilege—Postponing capital gains tax up to $100,000 if the funds are reinvested within one year

This provision generated the most positive reaction of all those considered with 72% of the total indicating that ratification would stimulate them to increase their future stock investment activity. Reaction was about equal across the groups.

[In percent]

Deferral capital gains tax up to $100,000	Total	$10,000–$19,000	$20,000–$49,000	$50,000 and over
Will increase future stock investment activity	72	72	69	76
Will decrease future stock investment activity	1	1	2	1
Will keep it about the same	23	23	26	20

3. Projected investment behavior if the maximum net loss reduction in 1 year is raised to $2,000—$3,000—$4,000

Increasing the amount of net losses allowed to be taken in any one year from $1,000 to $2,000 would stimulate 52% of the investors to increase their stock investment activity. Raising the level to $3,000 would increase this to 60%. increasing it to $4,000 would raise the overall total to 66%. At this level, it is one of the more highly regarded modifications of the present structure.

[In percent]

Increasing net loss deduction—	Total	$10,000–$19,999	$20,000–$49,999	$50,000 and over
From $1,000 to $2,000 will increase future stock investment activity	52	53	51	51
From $2,000 to $3,000 will increase future stock investment activity	[1] 60	[2] 63	[3] 58	[4] 60
From $3,000 to $4,000 will increase future stock investment activity	[5] 66	[6] 68	[5] 64	[3] 67

[1] Plus 8 points.
[2] Plus 10 points.
[3] Plus 7 points.
[4] Plus 9 points.
[5] Plus 6 points.
[6] Plus 7 points.

4. Project investment behavior if investors are allowed to apply long term capital losses against capital gains for previous 3 years

This provision also received very strong reaction from the investors with just about two-thirds indicating that they would increase their stock market activity if it was passed.

[In percent]

Applying long term capital losses against capital gains for previous 3 years	Total	$10,000–$19,999	$20,000–$49,999	$50,000 and over
Will increase future stock investment activity	66	65	68	63
Will decrease future stock investment activity	1		1	1
Will keep it about the same	30	30	26	32

5. Projected investment behavior if current capital gains tax reduced by a third on 1st $25,000 of capital gains in any 1 year

Overall, about two-thirds of all investors felt passage of this provision would stimulate their investment activity. The percentages increased from a low of 61% in the $10,000–$19,999 to a high of 70% in the $50,000 and over group.

[In percent]

Current tax reduced by a third—	Total	$10,000–$19,999	$20,000–$49,999	$50,000 and over
Will increase future stock investment activity	65	61	65	70
Will decrease future stock investment activity	7	4	8	10
Will keep it about the same	25	31	24	20

6. Projected investment behavior if capital losses were allowed to be deducted from bond interest and dividends

Three out of five investors would increase their stock investment activity if this provision was passed. However, while the percentage is relatively high in the low income group, the provision is much more favorably reacted to by upper income people whose portfolio would allow them to take greater advantage of the provision.

[In percent]

Capital losses deducted from bond interest and dividends	Total	$10,000–$19,999	$20,000–$49,999	$50,000 and over
Will increase future stock investment activity	60	54	61	67
Will decrease future stock investment activity	1	(1)	2	1
Will keep it about the same	34	40	33	30

[1] Less than 0.5 percent.

7. Projected investment behavior if current rate is decreased by 20 percent over a holding period of 20 years (1/12 of 1 percent each month)

The investors weren't as positive toward this provision as they had been to those mentioned earlier. Yet, almost half (47%) felt they would increase their investments in stocks. Reaction was somewhat higher among upper income people than among the lower income groups.

[In percent]

Decreasing current rate by 20 percent over holding period of 20 years (1/12 of 1 percent each month)	Total	$10,000–$19,999	$20,000–$49,999	$50,000 and over
Will increase future stock investment activity	47	45	44	52
Will decrease future stock investment activity	4	2	4	4
Will keep it about the same	44	48	45	39

8. Projected investment behavior if current rate is decreased by 20 percent over a holding period of 20 years (5 percent after 5 years, 10 percent after 10 years, etc.)

This provision, an alternative view of the 1/12 of 1 percent provision, produced a somewhat less favorable reaction with 43% feeling they would increase their investment activity if the provision was ratified. Reaction increased directionally with income.

[In percent]

Decreasing current rate by 20 percent over holding period of 20 years (5 percent per 5 years)	Total	$10,000–$19,999	$20,000–$49,999	$50,000 and over
Will increase future stock investment activity	43	41	42	47
Will decrease future stock investment activity	6	6	5	7
Will keep it about the same	45	49	48	39

9. Preference for alternatives of decreasing tax rate

In line with the results of the two previous sections, when asked which of the two decreasing tax provisions they would prefer, 45% chose the 1/12 of 1% and 34% the alternative.

[In percent]

Preference for alternatives	Total	$10,000–$19,999	$20,000–$49,999	$50,000 and over
5 percent after 5 years	34	32	37	34
1/12 of 1 percent	45	49	41	47
Neither	7	8	5	8

10. Projected investment behavior if the 1st $1,000 of capital gains each year is tax free

Passage of this provision would stimulate 43% of our customers to increase their investment activity. Its ratification would have a greater effect on the lower income customer whose portfolio is probably smaller than on the more affluent segments.

[In percent]

1st $1,000 of capital gains to be tax free	Total	$10,000–$19,999	$40,000–$49,999	$50,000 and over
Will increase future stock investment activity	43	47	44	39
Will decrease future stock investment activity	3	3	3	3
Will keep it about the same	50	47	49	54

11. Reaction to current holding period of 6 months

The investors were given specific alternatives (see table below) and asked what they felt the holding period should be. The answers indicate that the majority of investors felt it should be six months or less.

[In percent]

Feel the holding period should be—	Total	$10,000–$19,999	$10,000–$49,999	$50,000 and over
Eliminated completely	27	30	19	31
3 months	13	13	14	13
6 months	43	43	48	37
9 months	1	2		
12 months	10	8	11	9
Longer than 12 months	5	2	5	7

Chairman HUMPHREY. The final witness this morning is Mr. Stewart, on behalf of the National Small Business Association.

We welcome you, Mr. Stewart, and ask you to proceed. At the conclusion of Mr. Stewart's testimony the members of the committee will proceed with their questioning.

STATEMENT OF MILTON D. STEWART, PRESIDENT, NATIONAL SMALL BUSINESS ASSOCIATION

Mr. STEWART. Mr. Chairman, if I may, I would like to begin by expressing some cases of dismay at the effort to speak for any significant number of the 10 or 12 million independent entrepeneurs of the United States. Any man who presumes to do so is a fool. Even to try to speak for the many thousands of the people in our own organization is a difficult thing. Any time you get three small businessmen in America together you are likely to get not three but five or six opinions as to how business is and what to do about it.

May I also remark that after listening to the description of the difficulties of our big business cousins and brethren, we would urge them to take heart. We have lived with the kind of problems that now confront them all our lives—dried-up equity markets, high cost of money, maldistribution of credit—small businessmen in this country have survived this kind of problem, and fully intend to continue to do so. We have every confidence in the ability of the Government to come to grips with this problem. We are very concerned that it do so quickly.

Perhaps I ought to begin the matter of our recommendations by reminding you of some general propositions which I think most Americans share. First of all, the more diverse our economy is, the safer the values which most of us share, economic as well as political.

Second, the maintenance of diversity in our economy must be continually acknowledged as a national goal comparable or equal in piority with full employment, national security, efficiency in productivity, environmental and consumer protection, world trade, resource development, or anything else. If it continues as in our judgment it has been, to be subordinated to other needs or goals, it will wither along with the independent sector of the economy.

Third, Federal programs and policies which do big things for big business and small things for small business have the net effect of making big business relatively bigger and small business relatively smaller.

Fourth, any business revenue or regulatory or procurement measure which does not allocate the burdens and benefits by size of enterprise automatically discriminates against small business. We have understood this with respect to the personal income tax for over 50 years. And that is why it is cast in the progressive form it is cast in. But that is not yet the case with our business taxes.

Our specific recommendations today reflect our concern with the failure of the proposal of either the President or the congressional leaders to accommodate sufficiently yet to the special needs of small companies. And we are not even going to try to deal with energy until we know much more about alternative proposals.

We know you are going to have to make special provisions for the five or six industries within which the present stagflation centers—energy, the money market, the utilities, housing, and auto industry. They have special headaches. And the problem is to move quickly enough and hard enough to keep what has happened in those industries from continuing to fan out and to depress the rest of the economy.

I have, a little inelegantly perhaps, described our present trials as the first of the "Dinosaur Economy Capers," because it was so clearly not created in the competitive sector of the U.S. economy. It was created by administrative decisions of either the Federal Government or of big business executives in the industries I have mentioned. And I believe this is a major and significant change which this committee in particular must take note of. It needs to consider again whether our present economic decisionmaking structure is adequate. We do not believe that it is. We cannot live through the kind of ineptitude and fickleness which marked the energy situation and which marked the treatment of the capital markets in the last 3 years. We do not think the leaders of big business or big government have been sufficiently involved, alert, understanding, or aggressive in meeting these problems.

Back to our specific recommendations. What we think most about taxes is that the President's proposals are, as we have come to call them, "flat headed." A "flat headed", tax proposal is one which applies the same percentage to companies without regard to size. So that if you take 5 percent out of Joe's Machine Shop or General Motors, the presumption is that you are treating them equally. And if you reduce taxes 5 percent for each of them, the presumption is that you are treating them equaly. You are not, of course, as we learned with the individual income tax. What you are doing is leaving the small business with less disposable income to meet the same wide range of needs which both it and the big companies have to meet. And we have learned in dealing with individual income that the best way to do this is to allocate the broadest burden to the broadest back, and to give the biggest benefit to the most in need. But we have not yet done this with respect to our business taxes. And the President's proposals do not do it either.

We have, I think, carefully tailored a four-part tax package, which we urge as strongly as we know how the members of this committee to support and to use their good offices in the House Ways and Means Committee an dthe Senate Financial Committee to get us swift action on. It is tailored to help every kind of small company.

First, the largest small company which still can show profit and a return on investment. What we recommend here is that the corporate surtax exemption be increased from $25,000 to $100,000. This will put approximately $1.5 billion into 150,000 growth companies which can put it right to work.

Second, we recommend that the very smallest tax paying businesses be given relief by having the specific rate of corporate taxation on the first $25,000 of income cut from 22 percent to 10 percent. The President's proposal actually represents, from the stand point of those companies, a step backward, because the only reduction he proposes is from 26 to 20 percent on taxpayers above $25,000, without any upside limit. And therefore the bulk of the benefit—now, almost all the benefit—of the $6 billion, which according to Secretary Simon this represents, will go to large companies. We submit that a reduction to 10 percent in this first step of the corporate income tax will do more for helping the tiniest small companies than anything else he can do that we can think of.

Third, we would provide some direct help immediately to the companies with losses—and there are small businesses, many of them, which will show losses as a result of the recession. What we urge here is the enactment of a 10-year loss carry forward and carry back provision which, as I remember it, was approved in the House Ways and Means Committee last fall in connection with some legislation that did not pass.

Here again, a third large segment of small business would be materially helped.

And finally, we would improve the investment credit proposal in two ways, one of them an easy way, and one, perhaps, a more difficult one. First, small companies defined by present Small Business Administration regulations should get a 20 percent credit. Larger companies should be held to 10 percent. The need for equipment replacement where there are small companies that have it is just as grievious, if not more so, than it is in large businesses. And for the progressive tax reasons I have mentioned, the distinction would be well made. Again, this compares with the President's "flat headed" 12 percent for all companies.

Second, since so many small companies are not hardware companies and do not buy lots of machinery, we urge that you equalize the benefit by providing a minimal investment credit for a one time use for the purchase or creation of people power as well as machinery. Let small companies use the investment credit to create up to two jobs per company.

These suggestions, we believe, will go far to cushion the impact of the present stagflation on small companies.

May I respectfully remind the members of this committee that we have been through three recessions since World War II. In the case of each one of them, small business came out of it with a smaller share of the national economy than it went in with. We ask you to make this the first recession in which that does not happen.

Let me conclude with a number which I think will bear scrutiny; 14 years ago one of every four Americans was employed either by one of the 500 large industrial companies in this country or by government—one of four. Last year it was one of three. The independent sector of this society is shrinking approximately at the rate of 0.5 percent a year, the way we fiugre it. This stagflation will either accelerate that rate or with proper Federal policies, arrest it. The decision is up to Congress and the President.

Thank you.

Chairman HUMPHREY. Thank you very much, Mr. Stewart. We appreciate your forthrightness in bringing us some suggestions and proposals that surely merit very careful consideration. I do think it is important that this committee review not just the overall levels of taxation, but impact, and what the results will be as a result of these tax proposals.

[The prepared statement of Mr. Stewart follows:]

PREPARED STATEMENT OF MILTON D. STEWART [1]

To many small businessmen the present worsening and unprecedented stagflation looks more serious than any of the other post-World War II recessions. The structure of our economy seems to have changed as has its ability to recover quickly in cases of economic downturn. In terms of origin, this may turn out to be the first of the "Dinosaur Economy Capers"—the joint product of the inepti-

[1] Milton D. Stewart is a small businessman and lawyer; he serves as chairman of the board of a construction and real estate development company called Terra California, and practices law in New York. He is president of the National Small Business Association. He has been engaged in the venture capital business for 15 years. He is a former president of National Association of Small Business Investment Companies, served as special counsel to Governor Averill Harriman of New York and in a number of Federal and State positions.

tude of bigness in business and Government. The two precipitating shortages—capital and energy—are centered in industries which are supposed to be regulated in the public interest. Both are tied to foreign policy and world trade, the special preserve of the Federal Government and the playground of the multinationals. Both are managed by a combination of corporate managers and public officials who presumably know one another very well and talk frequently.

There is no time for it right now but at some point it would be instructive to see a coherent review of exactly how big Government and big business managed to blunder in their inability to anticipate the impact of both the energy and capital problems. Perhaps we need a major study by this Joint Economic Committee on the "Risks and Costs of Bigness in Business and Government". We need to really understand who did, or did not do, what to whom, when and how, to bring about the present situation. We need to really understand the significance of the spotty impact of this recession—the devastating situation in communities where a few big companies dominate the economy; the milder impact reported recently in the press from places like Richmond, Virginia, and Cedar Rapids and Muscatine, Iowa, where there is no excessive reliance on the "big business in town".

We need to see through and understand the meanings of a shutdown of a major national retailer of 125 stores after it lost $175 million in a single year. Would 125 single entrepreneurs, owning and managing those stores as separate businesses, all have gone broke at once? What is most distressing is the prospect that the relative shrinkage of the competitive section of the economy may be losing us the resilience and swift "recovery ability" that a diverse economy permits.

All of us are going to pay for those failures for a long, long time. Small business has been paying for them already—for the past 18 to 24 months.

It is clear that the machinery for managing the Federal side of the economy is not yet adequate to its mission. It is also clear that big business cannot make up for Federal management deficiencies and that its overseas financial and resource programs and activities are out of public policy control.

My reason for using the term "Dinosaur Economy Caper" is to emphasize three points about this downturn. First, our Government and big business seem not to have been able to forecast, plan for, adjust to, or manage change. Neither the capital crunch nor the energy crisis happened without warning. Although huge, dinosaurs were not very good at either contingency planning or anticipating crises.

Second, the "dinosaur" size of more and more units in our economy has introduced some new elements or made old ones more important, and we have not yet adjusted to the changes. "Structural inflation" is the other side of increasingly imperfect competition, market domination, conglomeration and size. There is no doubt about the ability of the Federal Reserve to choke credit and capital to small business very quickly and effectively. But it takes longer for results to show with multinational banks and multinational companies. But after a while the Fed's efforts directed at "dinosaurs" squeeze everybody else in the economic forest past the point of toleration.

And third, with corporate "dinosaurs" as in all of life—the bigger they are, the harder they fall. The collapse of a Lockheed or Penn Central or the next King Kong Konglomerate to go, brings down thousands of jobs, thousands of stockholders and many millions in asset value. At least when we fail in small business, and we fail plenty, the carnage of each failure is not so great.

The basic purpose of all of our recommendations is to help small business acquire the ability to survive two bad years in a row. It is that ability, rooted in greater stability of capital access and in tax policies that favor it unduly that give big business most of its real edge, as against its well-publicized self-glamorized edges. We want for small business those things that will help, not just small business owners and managers but their employees and the economy as a whole. In our judgment that takes a four-point immediate and permanent tax relief and stimulation package. We agree that prompt tax relief is needed: but to be equitable and effective that relief must be related to the size of the business affected. We have learned in the hardest possible way that "flatheaded" tax policies—whose benefits or burdens are applied "flatly" with the same percentage to all business regardless of size—discriminate against small business. *We urge the Congress to shape a recovery program which will make this the first recession which did not leave small business still further behind the growth of Government and big business as a result of inadequate Federal policies.*

There are two reasons for relating size to recovery support. First, the same logic and commonsense applies to the taxation of business which led us to progressive income tax on individuals. Simple equity demands that the broadest taxpayer carries the biggest burden, and the smallest gets the most relief when it is needed. Second, the same percentage of income taxed from a large and small company leaves the small company with far less ability to use its remaining income for its other needs. It has been demonstrated again and again that the effective tax rate on big companies is far less than that on small companies (see the recent data released by Congressman Vanik of Ohio). "Flathead" tax policies simply pyramid the pro-bigness bias already in the tax laws.

Our four-part small business tax package is designed to provide help to every single small company in the country regardless of its industry, regardless of its current profitability, and regardless of its size within the small business community. We need the fairest, widest-ranging direct stimulus throughout the small business sector and no one tax measure will give it to us.

First, the corporate surtax exemption should be increased from $25,000 to $100,000 (this is long overdue because of inflation anyway, $100,000 is little more in adjusted dollars than the $25,000 established in 1938). At our request and that of other small business groups, SBA has furnished us with data showing the economic impact of such a reduction. Based on 1970 tax data this change would leave about $1.5 billion to stimulate the small business sector. It would help about 150,000 corporations which pay normal tax and surtax and have incomes of more than $25,000. More than 90% of the relief would go to companies with less than $1 million in pre-tax income. No company would receive more than $20,000 in relief. This part of the package would give most help to the growing small business which is still able to show a reasonable net income.

Second, to help the smallest taxpaying businesses, we would modify sharply and progressively the President's corporate tax rate adjustment. His proposal in the traditional "flatheaded" manner makes no size distinctions. It would keep the tax on the first $25,000 at 22% and reduce the rate above $25,000 from the present 26% to 20%. That would make the total burden for both small and big companies 42% as against the present 48%. As to the companies with income under $25,000 (generally the smallest ones), this appears to be a step backwards. They get *no* relief. Since there is no limit on the amount of relief given, the bulk of this reduction's benefit, estimated by Secretary of Treasury Simon to be $6 billion, would go to larger companies. We leave to Congress the question of what reduction, if any, should be made in corporate surtax rates above $25,000. As to most larger and professional small businesses, our first proposal may be adequate. Our greatest concern in the second proposal is to provide a reduction in the initial 22% rate on the first $25,000. *A reduction here to 10% would truly relieve the smallest profit-making, taxpaying businesses the most.* If it is administratively feasible we would be content to see the reduction limited to companies which meet the SBA size definition of small businesses.

Third, we would provide some direct help to those small companies which show losses as a result of this recession or when their earnings are fluctuating wildly. We recommend that small business—defined by SBA standards or in any reasonable way satisfactory to IRS—be given a 10-year loss carryforward and carryback. To keep from encouraging practical big business mergers and acquisitions for tax avoidance purposes, we would limit transferability of this special tax relief to *one* subsequent merger or acquisition and *only* with or by another company which also meets the small business definition.

Fourth, we would improve the investment credit proposal in two ways, one of which is easy and one more difficult. First, small companies defined by present SBA regulations should get a 20% credit, larger companies should be held to 10%. This comparies with the President's "flatheaded" 12% for all companies. Second, small companies should be given the alternative of using part or all of the credit for buying "people power" as well as machinery. The credit should be useable for the one-time creation during the next taxable year of up to two new jobs by any one business. We know this is difficult of administration but it is important enough to try to learn how to make it work. Otherwise, the vast majority of businesses will not be able to use the tax credit at all in a meaningful way. In one recent year, slightly more than half the benefits went to a grand total of some 350 companies! The benefit of this credit, if it is to help the economy as a whole, must be more broadly and fairly available.

On the energy crisis we are really not ready with specific recommendations. A spot-check of a dozen small business leaders and operating managers in 12

States persuades me that while they are somewhat concerned about the economic impact of the energy crisis, they are far more worried about their Government's ability to understand and deal with it quickly, effectively, and fairly. Several expressed surprise that "it has taken them so long in Washington", others fear that "we may be in for some bloody Watergate battle between the President and Congress, this time about energy". They are less concerned about the precise steps to be taken than that their national leaders do not upset the country or take too long in agreeing on action. They know Democrats and Republicans will not agree about some measures. They know the President and Congress will not always see things the same way. But their strongest view may be summarized as a hope that there will be an early moratorium on elbowing for political advantage on energy.

"Wait till next year as they used to say in Brooklyn" as one small manager put it "there will be plenty of time to begin politicking then. We cannot afford a nasty and divisive rhubarb about energy between regions, we cannot have an ugly squabble about whose scheme for equality of inconvenience is better. Those people on the unemployment lines are out of patience and so are we. The President and Congress will get together; they might as well do it quickly."

We believe strongly that the Congress must be an equal partner with the President in making those choices. Perhaps one reason we believe that as strongly as we do is that under seven Presidents now, four of one party and three of the other, we have seen the Congress take the lead again and again on small business issues. Without exception every small business policy advance has originated in the Congress. We hope more will come soon. We have emphasized here our immediate need for tax changes as part of the recovery program. We will be making other recommendations on energy and other economic policy in the near future.

Chairman HUMPHREY. By the way, we have two new members that have not been introduced. We have Mrs. Heckler from Massachusetts and Congressman Garry Brown from Michigan.

What we will do, we have a 10-minute rule for each of the members of the committee to ask the questions. We will go just on the basis of how they arrived. So following the chairman, Mr. Gillis Long will ask questions and then Mr. Brown, of Ohio, and we will proceed back and forth, if that is agreeable.

I would like to put the one basic question to each of you—it is a broad question—and get your judgment, the same question that was asked of witnesses in our most recent hearing.

Viewed as an antirecession program, and now looking primarily at the economy as being afflicted with recession, of course, as well as inflation, in your judgment do the President's proposals go far enough? Will they be sufficient to turn the economy around and restore what in your judgment is a healthy rate of growth and reduce unemployment?

Simply put, starting with Mr. Crawford, do you believe the proposals provided by the President, the tax proposals, investment tax credit, tax refunds, and the energy proposals, comprise an adequate antirecession program?

Mr. CRAWFORD. I would like it better if I were the fourth or fifth man on this panel, I would have a little more time to think about it.

Chairman HUMPHREY. May I just help you out a little bit.

Mr. CRAWFORD. I wish you would.

Chairman HUMPHREY. We are just getting your point of view. All of us are going to learn hopefully a great deal as we go through these hearings. What is your general impression? Don't hesitate to give it. We are always subject to change. I do meet myself at least twice a week.

Mr. CRAWFORD. Senator, I think it is a very difficult question to answer, on balance, because there are some countervailing forces in each direction. From the standpoint of the electric utility industry it seems to me that the President has proposed a number of things that would be very helpful to us. I think it reflects an understanding on the part of the administration of the financial difficulties our industry is in. And his initiatives, his moves in the direction of financial assistance, toward coal, and toward expediting nuclear plants, we think would all be very helpful.

On the other side is the question of the proposed increase in taxes and tariffs. And as I indicated in my direct statement, it seems to us that that would be quite harmful to the electric utility industry.

Now, which way this comes out on balance, I think is very difficult to say, because it depends so much on the situation of individual companies. A company such as that headed by Mr. Galligan, or the companies in New York tha tdepend so heavily on fuel oil, the companies in Texas and Louisiana that depend so heavily on natural gas, their situations, I would think, would be harmed much more than others that depend heavily on nuclear plants.

I think my judgment on balance would be that it would be helpful to the utility industry, but there are certainly some aspects of it that we would like to see modified.

Chairman HUMPHREY. I gather that your concern is primarily in the energy area that the President described in his message.

Mr. CRAWFORD. Yes, it is.

Chairman HUMPHREY. But on balance, you find the tax proposals of the President on the plus side?

Mr. CRAWFORD. Yes, sir.

Chairman HUMPHREY. Very good.

We will just go right down the line.

Mr. Regan, what do you have to say.

Mr. REGAN. Senator, there is an old, old expression, that all roads lead to Rome. I think every one has a road to lead us out of the depression, and on to the goal of a healthy economy again. Which road you choose depends upon how you see the thing.

The President's proposal might take us to our goal. But if I had my "druthers," I think there is another road that I would prefer to go on. For example, I think that the energy proposal may be self-defeating with the tax proposal. On the one hand you are giving, and on the other hand you are taking more away. In addition, our economists on a preliminary look—and this is subject to review, because we haven't been able to study it too long—would indicate that the energy proposals of the President's plan would probably add 2.5 to 3 percent to the inflation rate later this year. Now, we are trying to get out of inflation. And it seems to be on the downward grade. But if we are going to come out with, let's say, 4.5 to 5 percent inflation rate in the final quarter of 1975, and if the President's proposal were to be put in, ou restimate is that the rate of inflation would be 7.5 or 8 percent, which again is an intolerable amount. So we think there are other ways to solve it. The tax cut, the initial boost to the consumer, with the accent on the middle- and low-income brackets, we applaud. We think that one is necessary.

We do think that there are other things that should be done to help the unemployed. We think the investment tax credit is good.

And as far as the deficits that might come from this, we dispute the figures arrived at by the administration in the size, not in the direction, but the size. And we further dispute the fact——

Chairman HUMPHREY. You think they will be larger, do you?

Mr. REGAN. We think they will be less.

Chairman HUMPHREY. You think they will be less?

Mr. REGAN. Yes. The Secretary of the Treasury seems to be saying $100 billion. We don't see where he gets that. Of course, we haven't seen the budget yet or the economic message, so we don't know about it as they do. But according to the facts and figures we have now, we see a deficit of from $32 billion plus, to $45 billion, as I said in my opening remarks, which call, in round figures, for around $80 billion. We don't see where the $100 billion comes in.

The final thing is that the Secretary of the Treasury implies that there will be grave disruptions to the capital market if the Government has to go in for $100 billion over the next 2 years. On the basis of $80 billion we don't see that interruption and we are confident that we can finance it.

Chairman HUMPHREY. That is pretty much what Mr. McCracken and Mr. Schultze and Mr. Gardner Ackley came down on. We would appreciate, Mr. Regan, just quickly, when the budget message does come down, and the Council of Economic Advisers report, if you and your excellent organization would take a good hard look at it and give us another evaluation of it.

Mr. REGAN. I would be glad to do it.

Chairman HUMPHREY. We are glad to hear from the business community. We hear an awful lot from economists, and I have great respect for them, and government offices. But I like to have people out there who meet the customers and go into the market and handle the commodities and perform the services. For some reason they seem to have a little different point of view.

I serve on the Senate Committee on Agriculture, and I find the Government estimates very, very unreliable as compared, let's say, to Leslie's report out of Chicago, people who have to live by the market. For some reason you take a greater interest when you have to live by what is going on.

Mr. Galligan.

Mr. GALLIGAN. I share Mr. Regan's concern that the tax relief is offset by the energy taxes and tariffs that the President is proposing. But I do feel very strongly that we need a comprehensive energy program and policy, or we are just going to get into more and more trouble. Right now the tax program on a net basis will only provide about $4 billion into the economy, because the balance is taken out through tariffs. In New England, as a matter of fact, we find that the tax cut will provide about $76.92 on the average, and the oil cost increase will take away $73.55 per capita. On a national basis, there is at least a net income to the consumer, the individual, of $18, in favor of the consumer. But in New England it is just about a break-even point, they take away as much as they give.

We do think that the tax moves that the President has proposed in relation to investment, and particularly in relation to utilities, are very important. It will allow us to get a grasp on the line at a lower cost to the consumer, which, I think, we are all striving for.

In that connection it will provide more jobs. As a result of our financial position and the cutback in use from conservation, we still have a 5-year budget of $760 million. But we have eliminated $480 million that was previously in there. So if we can get plants built, it means jobs and a healthy economy.

In this connection, I would like to comment on Mr. Stewart's remarks about the relationship to big business and small business. I would like to emphasize very much that by helping the utilities we are helping the consumer, we are helping small business, and we are helping those businesses that are essential to economic vitality in the community. So that, I think, the utilities themselves need help and do provide an opportunity to help the consumer. This is embodied in the President's program. So it is unfortunate that the energy part of it takes away. If we were just looking toward putting in new moneys into the economy, it would be nice if we could get along without taxation. I don't believe that we can, but if taxation is needed, we urge that it be done on an equitable basis across the country, and not as it has been done in a way discriminatory toward certain areas of the country.

Chairman HUMPHREY. In other words, you are saying that you see a kind of tradeoff in the energy program with the tax rebates on the one hand, as compared to the direct costs of energy.

Mr. GALLIGAN. That is right. It is about a $4 billion differential. So when we measure what is being done, I think we should look at it on a net basis. Now, this can be helped by eliminating the application of these tariffs to products, or perhaps more specifically to residual oil, which is a big import area. That does soften the impact, and on top of that, base equality throughout this Nation, which we think is important.

Chairman HUMPHREY. We will come back to these respective positions.

But finally, Mr. Stewart, in response to the general question I put, and then we will turn to Mr. Long here.

Mr. STEWART. Mr. Chairman, I think it is our view, and it is implied in what we have said, that the President's proposals are not adequate as antirecession programs, neither for the economy as a whole or, more particularly, for the small business sector. We give him full marks for decisiveness, and I think many small businessmen are very pleased that he took the strong lead he has. They are most concerned with how long it will take for him and the Congress to come to an agreement.

I share many of the views that have been expressed here, and perhaps I should concentrate on where we may differ a little. Investor confidence in this country is not in very great shape. The new issues market, for example, which was a source of capital for small businessmen, died not 6 months ago, but 30 months ago. You are not going to get that back without some very precise fine-tuning tax legislation along the lines that Senator Bentsen was talking about a year and a half ago—changes having to do with the capital gains tax. We might go much further than we would in terms of stimulating investment in the long-term risky small businessmen take. Because if I call Merrill Lynch and buy 100 shares of General Motors and sell it in 6 months and 1 day, I get exactly the same treatment as I would if I were a farmer or small businessman in Maine, and worked my guts out for 20 years and then sold my farm or small business. My gain or loss treatment is identical. I must tell you, that is insane. Because if there is one thing that investors understand, it is how to balance the advantages and disadvantages of various forms of risk.

So I think we have to go much, much further. At a time like this, that kind of inequity, if you will, is exaggerated tremendously: small business will be kept out of the equity market just indefinitely, unless we take very strong affirmative action, and the kind of taxation we suggest.

Chairman HUMPHREY. Thank you very much, Mr. Stewart.

Congressman Long.

Representative LONG. Thank you very much.

I would like the views particularly of Mr. Galligan and Mr. Crawford, and I will ask them in this order. Turn about is fair play, if that would suit you better, Mr. Crawford.

With respect to the whole energy problem, and because of the business you two gentlemen are in, you naturally emphasize the energy aspect of this economy problem more than any one else. All of us recognize that it is a single part of a complicated economic situation in which we find ourselves at the present time.

Political columnists, economic writers, economists, and energy people, all are talking about the more unusual alternate sources of energy. Yet while you two gentlemen recognize the importance of it, and the seriousness of the energy chortage to the economic problem, which cuts across all American industry, neither of you even discussed in any way these possible alternative sources of energy. Is this really something that could be seriously considered, or is it merely as a matter of science fiction.

Mr. GALLIGAN. I don't think so, Congressman Long. We deliberately did not include it in these remarks, because we were looking at the immediate situation.

I would like to emphasize that in the long range there are things that should be developed, and on which research money should be spent. I include among them, solar energy, fusion, the breeder, which is a little closer than some of the others. I could name a number of other alternate sources.

Representative LONG. Would you advocate that we give serious consideration to the development of a crash program in this regard similar to what was done in the space program, and that perhaps this should be done by the Government rather than by private industry?

Mr. GALLIGAN. I think you will find, in talking with responsible research people, that for a comprehensive program in a specific time scale, there is only so much money that can be put into these research programs. Even with the type of program that you are talking about, we are talking about 15, 20, maybe 30 or 40 years on some of these. Fusion is that long, and solar maybe as close, in a meaningful way as close as 15 years. We fully endorse moneys being spent. We are doing it as an individual company, and we are doing it through support of the Electrical Power Research Institute, and we publicly subscribe to a number of these things. We are involved in some solar of windmills, which will be done on an experimental basis. Yes, we subjects. We are involved, as a matter of fact, in a proposed project subscribe to this.

But the danger is that people will address themselves to these proposals—which should be addressed—but they will look on them as substitutes for decisions today. If we don't get the decisions today to get more coal plants on the line, to get more nuclear plants on the line, then we are really stealing from the next generation that is coming and depriving them of the type of living that we have been used to, and that is necessary for economic development in this Nation.

So the only caveat I would put on it—and I think we have been one of the leading companies in supporting research for the future—but the caveat I would put on it is, let's not substitute those programs for action now. I think there is room for both.

Representative LONG. The psychological danger there of looking long range and the reliance on that in your opinion poses a real problem?

Mr. GALLIGAN. It is very dangerous in my opinion. I have been at meetings where somebody gets up and seriously says, let's stop everything and move on fusion. Fusion might well be the answer for the industry. But there is research ongoing in Texas, MIT, and other places. But when we talk about fusion, we are talking about the year 2000 and beyond.

Representative LONG. Mr. Crawford.

Mr. CRAWFORD. I agree with what Mr. Galligan has said, but I might characterize my response even more strongly. I believe that it is a disservice to the American people for proponents of such processes to hold them out as being able to replace reliance on our present methods of producing energy. We should research and develop all those ways of producing energy, but when someone says that if we just had a crash program for solar power or geothermal, or whatever, we could forget about building nuclear powerplants, I feel that is a disservice to the country because it cannot be done. None of these ways to produce power will contribute any significant part of our electric power requirements in the next 20 years.

Representative LONG. I think it is a very real danger that both of you have expressed in that regard.

One of the things that has concerned me, as people from my area and the people I represent come to see me, is the delays that have been occasioned, particularly with respect to the atomic energy move, and the permits that are required by local governments, by State governments, and the Federal Government. Again this being the area in which you two gentlemen are interested in, I would appreciate the experiences that you have had in that regard, if you would.

Mr. GALLIGAN. Those are very serious, sir. In my prepared statement I covered this in more detail but as Mr. Crawford pointed out, it takes at least 10 years to build a nuclear plant in the United States and you can build the same plant in Japan and/or France in probably 7 or 8 years, with the same protection. We are hung up in a really bureaucratic jacket.

I think what has taken place in the separation of the AEC into a research organization and a regulatory organization is very good in the long run. But in the short run, we have been faced with a period of transition. It will be over a year of indecision as the transition takes place.

Representative LONG. But, say, what would be the result of cutting a year off of this period that is now required to get an atomic energy plant into operation—how long is that period now, 10 years?

Mr. GALLIGAN. The period right now is 10 years or more to get it done. We should be able to do it in 8 years. What is implied by this is, for a 1,000-megawatt nuclear plant we are talking about the replacement of 10 million barrels of oil per year.

Representative LONG. How much of that reduction from 10 years to 8 years would you say could be accomplished by a reduction in the amount of bureaucratic trouble that you have in getting the necessary permit?

Mr. GALLIGAN. I think it can be all accomplished in that area. The actual construction period is about 60 months, or 5 years. The rest goes into planning and preparation.

Representative LONG. Would you agree with that, Mr. Crawford?

Mr. CRAWFORD. I believe something between 1 and 2 years probably could be reduced from the construction time of the nuclear plants through changes in bureaucratic procedures.

Representative LONG. And then it could make a very substantial difference just by administrative action, or less administrative action, lets say, than we presently have.

Mr. GALLIGAN. And without sacrificing the protection.

If I could make one other point on this also, cutting down the leadtime is worth about $100 million per year on the cost of that plant.

And the other thing is, we had a very discouraging——

Representative LONG. Would you say that again?

Mr. GALLIGAN. Cutting down the time of construction for a nuclear plant, a large nuclear plant, is worth $100 million per year on the cost of the plant, through escalation, through interest carrying costs, and those related types of cost.

Representative LONG. But when you add that to the point you made before about getting the additional energy and the amount that it would save at the end of the period when the plant went on the line, your cost factors really become most substantial; do they not?

Mr. GALLIGAN. We are talking about a very critical part of the U.S. economy, and it involves our energy interdependence.

Just one example, if I may, that happened to us. We have a nuclear plant that is a very successful one. In 1974, it was shut down for some repairs and for refueling. In 1973, it produced 33 percent of all our power. It had an 88-percent availability during that year. In 1974, it was shut down for 3 months for what would have been necessary refueling. One individual intervened on putting that plant back, because we were putting fuel in, which was a more conservative fuel, and which was in operation in three other plants in the United States. And that plant sat there ready to go into operation for 4 months. We got a clean bill of health from the AEC, but it cost our customers $40 million.

Representative LONG. Mr. Regan, in your statement you said all you had projected was the possible budget deficit—recognizing that you do not yet have the President's budget and the information you might need, and subject to changing your opinion on this matter—that they could handle without severe disruptions in the money and capital markets. And you gave a number of reasons for that. And one of them was the probable inflow of some money from the OPEC nations.

Mr. REGAN. Yes, sir.

Representative LONG. Have you seen any occasions of that? How do you see that? Do you see that as really perhaps being substantial?

Mr. REGAN. At the present moment, Congressman, the money coming from OPEC nations, particularly Arab money, has been invested in very short-term government securities, usually purchased by the Fed on behalf of customers, as they say, knowing that the customer has to be an OPEC nation at this moment. Perhaps $10 billion has been invested so far in this. I think that the financial press has exaggerated the amount of takeover that has been experienced by American industry from Arab money. The few cases on record have been grossly exaggerated. And there has been much more takeover of plants by Englishmen or by Canadians in recent years than there has been by Arabs. We are looking forward, now, to where OPEC money will go longer term. Right now, due to the potential difficulties, they won't put their money into the long term. But if there is a solution to the Middle East crisis—and we certainly hope that the President and the Secretary of State are able to accomplish this—then we do look forward to longer term investment by OPEC countries.

Chairman HUMPHREY. Just a comment on the latter exchange. It seems to me that our danger is not that the Arab nations are going to buy Wall Street, but that they might buy the U.S. Government. And frankly, that is their choice, perhaps, given some of the problems we have.

Mr. REGAN. Do we have a choice?

Chairman HUMPHREY. Congressman Brown of Ohio.

Representative BROWN of Ohio. I would like to ask Mr. Galligan: Years ago we had legislation called the powerplant siting legislation which never survived the Interstate and Foreign Commerce Committee. I served on the Communications and Power Subcommittee at that time, and we were split on the Interstate and Foreign Commerce Committee, as I recall, about a third, a third, a third. A third of the folks thought it was too restrictive on the utility industry, a third of them thought it was not protective enough in the interest of the environment, and the other third of us were trying to get legislation passed because we recognized that a serious problem existed.

Mr. GALLIGAN. Yes, I do, sir.

Representative BROWN of Ohio. Was it supported generally by the New England power interests?

Mr. GALLIGAN. We supported the concept that this was something that would best be done through State rules and regulations.

Representative BROWN of Ohio. In other words, you did not support the Federal legislation at that time?

Mr. GALLIGAN. That is right.

Representative BROWN of Ohio. It might have been helpful if we had gotten it through.

Mr. GALLIGAN. Well, the problems I am alluding to are not related to siting per se. I do not think they would have gotten around to the problems we are facing. As far as siting itself, we have not had any serious problems on that. We do have a Massachusetts Siting Commission. The problems we get into are ratcheting with the AEC, and now the NRC is ratcheting requirements after plans have been developed, and sometimes after the plants have been built.

Representative BROWN of Ohio. This would have encompassed final siting as you know, and it would have had one-stop service at both the Federal and the State level.

Mr. GALLIGAN. Yes. As I remember the legislation, sir, it had one-stop service. That part certainly was favorable. But it did not give real assurance that the process would be expedited.

Representative BROWN of Ohio. What did you propose or what would you propose now as an alternative? I do not think it can be resolved by the administrative process alone, because you indicated in your comments to Congressman Long that it was not an administrative lack that showed up this completed atomic energy plant, but apparently it was a private citizen.

Mr. GALLIGAN. But he used the administrative processes of the AEC——

Representative BROWN of Ohio. The administrative processes of the AEC are mandated by law, are they not?

Mr. GALLIGAN. To the extent they are, and they allow this travesty of justice, they should be changed.

Representative BROWN of Ohio. Yes, indeed. And that is what was attempted in the Power Plant Siting Act.

Mr. GALLIGAN. Well, this can be done without the whole siting process. This could have been done by an administrative decision. But it was not. But to the extent it needs to be, and direction should be given to NRC, we know that Congress can make a consideration in this area.

Representative BROWN of Ohio. You think there ought to be a substantially revised law in this field?

Mr. GALLIGAN. Very much so.

Representative BROWN of Ohio. Why did the utilities in the South and in New England switch to natural gas and fuel oil if we were anticipating such a problem?

Mr. GALLIGAN. Well, we get this question often. Our point of view—without speaking for the Southern utilities, but I think their thinking applies the same way—is that we, at the time we went to oil back in 1949, and more emphatically in 1953—

Representative BROWN of Ohio. Why did you make that decision?

Mr. GALLIGAN. We were responding to national policy, which said that you should, in fact, produce your electric power at the lowest possible cost. At that time oil was a much cleaner fuel. And we were paying more for coal, in fact we were paying more in freight than we were for the product itself.

Representative BROWN of Ohio. And so you went to domestic oil?

Mr. GALLIGAN. The answer there is there is not enough domestic oil, residual oil, produced in the United States to provide the needs of the utilities, because it is more profitable for the oil companies to get the better products out of the refinery. They made a decision that—good business decision—they would get the most profitable products out of the crude oil. So that we have in our refineries what they call sweet refineries, only 7 or 8 percent residual coming out of those refineries. On top of that, at that time oil was being discovered on an international basis, so that there was in fact a glut of oil throughout the world. The oil companies had investment in those refineries overseas and in the wells, in the entire oil process. There was very strong competition for selling this product. They came to us—and I was quite proud, as a matter of fact, that is something I hasten to say today—we got the price of oil in our community down to $1.67 a barrel.

Representative BROWN of Ohio. So you made an economic decision to go to foreign oil as the source of producing power, is that correct?

Mr. GALLIGAN. Based upon what was then the national policy to the extent it existed.

Representative BROWN of Ohio. Now, since it has become national policy that we do not want to be dependent upon foreign oil, what vehicle do you think could be used to discourage dependence on foreign oil?

Mr. GALLIGAN. To encourage the use of nuclear and coal.

Representative BROWN of Ohio. How should that be done?

Mr. GALLIGAN. It should be done through some of the tax recognitions and investment credits that have been mentioned. It should be done by expediting the administrative process. It should be done by eliminating ratcheting.

Representative BROWN of Ohio. But it should not be in an economic way, it should not be done by raising the price of foreign oil?

Mr. GALLIGAN. Well, we feel this way, sir. We feel our Government has completely abdicated their responsibility in the price of foreign oil.

Representative BROWN of Ohio. I see that you said in your prepared statement: "We are faced with highway banditry from days gone by on an international scale." What did you think should be done to change that?

Mr. GALLIGAN. Let me give you the situation we have.

Basically, residual oil is a byproduct. Historically, it sold lower, significantly lower, whether domestic or foreign than crude. Venezuela is where our product comes from. They have priced their product through a process of royalties and taxation, so that the price of crude today worldwide is about $10.25 per barrel. The price that we get the oil, in part because it is half-of-1-percent oil, which is very low sulfur—we think that can be changed too—but the price of that is about $13.50 a barrel. It is done directly through tax contrivance on the part of the Venezuelan Government. We think for our Government to sit here and allow that to take place indicates that they have abdicated their responsibility.

Representative BROWN of Ohio. But Venezuela is not one of the 50 States. How would you act to deal with that problem? That is my question.

Mr. GALLIGAN. I think that we have the capacity of talking with the Venezuelans, the recognizing our common mutual interests. I am a firm believer in encouraging South America, and the economy development of South America. But I think this has been allowed to develop through a laissez-faire policy over 4 or 5 years.

Representative BROWN of Ohio. And you would talk them out of it; you would talk them into lowering the prices the way we have talked the Arabs into lowering prices?

Mr. GALLIGAN. I am not a Mr. Kissinger, and I am not expert in that area. But I have a firm feeling that a more aggressive stand on the part of the U.S. Government could in fact do something about that.

Representative BROWN of Ohio. By more aggressive, what do you mean?

Mr. GALLIGAN. I am not talking war, if that is what is being hinted at.

Representative BROWN of Ohio. I understand the feeling that we ought to do something specific to force the Venezuelans, or persuade them, to lower the price of oil. I am curious what that is.

Mr. GALLIGAN. We taught them how to increase it in the first place.

Representative BROWN of Ohio. Some of them went to Harvard Business School, I suppose. But how do we get them to lower the prices?

Mr. GALLIGAN. Let me go to the point of how we taught them.

We specifically, in this country, moved to low-sulfur oil requirements before the capacity of the refineries existed to produce low-sulfur oil, so that when New England, New York, Philadelphia, and New Jersey moved to a very, very low sulfur requirement, there was only one place in the world where you could get significant quantities of that kind of oil. And that was Libya.

Representative BROWN of Ohio. Before you get into that, why did we do that; why did we go to the low sulfur?

Mr. GALLIGAN. It was because of a desire for improvement of our environmental quality which we subscribe to. But we think it was done precipitously. It was not done as part of a national program where you would say that this is our objective, this is the time scale that we should establish to reach that objective, and this is how we will go about doing it.

If I could get back to Libya, which is where the source of this low-sulfur oil was. Mr. Khadafi did not have respect for the U.S. Government, or I guess for much else Western. He discovered or realized that he was in a sellers market, and he doubled the price of oil, and nothing happened. Then he doubled the price of oil again, and nothing happened. As a result, in general, the OPEC nations, who never really had the courage to move up the price of oil, discovered that they now were in a position where they could do it and get away with it.

Representative BROWN of Ohio. So the Venezuelans learned the same thing?

Mr. GALLIGAN. Sure.

Representative BROWN of Ohio. I know some of this history, so I don't think there is a need to put it on the record. I think some of the rest of us know it. But you suggested that instead of in any way discouraging the importation of foreign oil, that we would encourage the switch to nuclear power and clean coal and to other kinds of resolutions of the energy source problem.

Mr. GALLIGAN. I did not quite say that, or if I did, I did not intend to. I say that the long-range answer to our energy problem is the encouragement of the development of nuclear energy and our coal resources. I do believe that we should endeavor to cut back on importation of oil. I believe that the only way we can do that in an even-handed way across this Nation is through the gasoline, whether it be through a price process or a rationing process. It is unfair, a disproportionate burden on residual oil, when you are affecting selected parts of this Nation; you are hurting the consumer and the small homeowner; you are hurting the small business; and you are hurting the economic development of those parts of the country that are affected in relation to the rest of the country.

Representative BROWN of Ohio. My time is up, Mr. Galligan. I represent a district which does not have the advantages of Boston's mass transit system. Therefore if you raise the price of gasoline—and I also have had farmers who raise food with gasoline in their tractors—a disappropriate burden falls upon my district.

So with all due respect to my colleague sitting to my right, and my colleague, Senator Kennedy, sitting to my left, if a disappropriate burden is going to fall on someone, my thoughts is that it might as well fall on New England as on the Seventh District in Ohio.

Mr. GALLIGAN. I understand that. But at the same time I think there has been proposed, in answer to that problem, that to the extent that people are particularly hurt, that there be special credits and considerations for that. So that I think we can work around that if we can work toward an objective.

Chairman HUMPHREY. You will hear from other districts. That is one of the problems that we have in Congress. But it is one that we can resolve.

Mr. RAGONE. Mr. Chairman, could I respond to the question for the South a little bit.

New England has a little different problem from the southern district. I am with Virginia Electric Power Co. I have been involved with the power and fuel responsibility of the company for a number of years. We went from coal to oil, and we had 17 units that were capable of going from coal to oil relatively easily. At the time the Environmental Act was passed it was necessary, because only two, or possibly three, of those could meet the standards without major investment. We found out that the price of oil in competitive bidding was lower than the price of coal at that time, and it was an economic choice that was made.

We have been working with the FEA, and I have been involved with the FEA's task force reviewing the million barrels a day savings associated with the utility industry. I believe when that report comes out you will find out that there is no way that a million barrels of oil can come from the utility industry even by the year 1980. It is probably going to be in the range of 1985.

The reason for that is that the present consumption of oil by the utility industry is 1.5 million barrels a day, estimated to get to 2.25 or 2.5 million by 1985.

So when you are looking to reduce by a million barrels a day, which is roughly 250,000 tons of coal a day, you will find that you have a major problem.

Representative BROWN of Ohio. In other words, this switch to nuclear and clean coal and so forth is not a realistic solution in the short-term sense?

Mr. RAGONE. Not in a year's time. In other words, we can convert two, possibly three units, which would save on the order of 20,000 barrels a day of oil. It will take a year to do this even on those units, because we have maintained the coal facilities, but you can't get coal. We went out to 42 suppliers a year ago to get coal with the price level left blank in the specification just for these units or any portion of these units. We got 17 noes and 25 didn't respond. We plan to go out again, because we understand that maybe the coal market has improved a little bit.

But you cannot look at investment of hundreds of millions of dollars for the conversion of the remaining units here—I am talking about 14 other units that we have a possibility of converting—because we are committed to a nuclear power program, and we have two units already in service providing 20 percent of our energy needs, roughly the same as New England. Those same units will provide 30 percent this year.

By the way, that 10-percent increase is worth 10 million barrels in 1 year's time. But by 1977 we plan to have two more nuclear units in service, which will increase our nuclear generation to 50 percent of the total, and a corresponding reduction in oil or coal depending upon what the alternatives are.

The major impact, therefore, will have to come over a period of time from nuclear and coal facilities.

To further burden investment in these fossil-fired facilities—and I will be short—to further burden investment in these coal conversion facilities at the expense of the nuclear units—which we have already postponed because of financial problems a year or so—really means another major impact, and could affect the reduction in oil consumption materially.

So I agree that we need to improve the nuclear licensing. Also—and that may not be a bad thing—the AEC or the new organization, the Nuclear Regulatory Commission, has improved the scheduling over the past. I think they are on the road to recovery a little bit. And this will help.

You have one major problem if you solve the licensing process, that if you also require construction in all of these major energy facilities, coal burning, other refineries and so on, you are also burdening the construction labor market. It is one area where qualified personnel are extremely scarce. There may be some need for this Nation to contribute into a learning program or some way of getting the labor market qualified in the proper construction fields. We have spent over a million dollars, VEPCO alone, in qualifying welders for nuclear welding in the past 2 years.

Chairman HUMPHREY. Thank you, Mr. Ragone.

I know that Senator Bentsen has to leave. I want to turn the questioning over to him.

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

First, let me congratulate you for calling these hearings. This is a matter of great concern to everyone in this Nation of ours. You have assembled some highly qualified witnesses to testify before us.

Let me ask about the President's energy policy. There are those amongst us who for many years have been pointing out the dangers of reliance on the Middle East countries' petroleum, and the need for self-sufficiency. One of the problems we run into in our country is that we go from crisis to crisis in our planning, and we do not do enough long-term planning. Perhaps one of the reasons for this is that politicians seldom get credit for long-term planning. They are more interested in results that show up at the next election. We are paying for that today. But by the same token, there is a tendency, I think, to overreact once the crisis is there. I look at the situation where we paid in 1972 about $4.2 billion for oil that we imported, and in 1974, we don't have the figures, but we know it is somewhere in the area of $25 billion. That is a massive hemorrhaging of funds, but it seems to me that we ought to put it in perspective. It is a serious problem. But I don't think it is a disastrous problem, except in the long run. I think that we can moderate it and live with it a while. We are looking at an economy of $1.4 trillion. With a 5-percent increase of the GNP, we are talking about $70 billion dollars. If we don't increase the GNP we have lost that $70 billion.

What I am getting to is the impact of a million barrels a day cut in oil consumption undertaken in a relatively short period of time; of changing the price of petroleum from $8 on the average to $14 on the average, give or take a dollar, an increase in the cost, ranging from the President's figures of $30 billion to the Library of Congress' figures of $50 billion.

My concern is the timeframe within which we would bring this about and what it does to an economy, an economy that is already beginning to dampen inflation. I am talking about now adding 3 or maybe 4 percent to the inflation factor, however counterproductive it may be, and whether or not we should not try to extend this price increase out over a more lengthy period of time as we bring this country out of a serious recession.

Is there anyone in this distinguished group that can aid me and come forth in this viewpoint?

Mr. Crawford.

Mr. CRAWFORD. It seems to me, Senator, that while we can talk about the payments made for imported oil as not being all that significant in the context of the GNP—I guess that would be true if you look at it on a national basis—still it has had very serious effect on a local and regional basis. I think that that is the important thing, in terms of the way we should look at it, not only on a national basis—what it does to New England, what it does to the west coast and such areas as that. It seems to me—and this further responds to an earlier question—that we really do not have to rely on increasing the price of oil to discourage its use. The way to discourage its use by electric utilities is to permit us to burn coal. We have hundreds of years of availability of coal in the United States. All the incentive we need in the utilities business to stop bringing in oil is to let us use coal. There are several things that have to be done. There is the Clean Air Act, the stripmining bill, and improving the financial health of the utilities to provide funds for conversion to coal.

Senator BENTSEN. Mr. Crawford, I am all for moving toward coal and accelerating the conversion to it. But I really want to get to the question of the overall balancing of the impact on our economy—recession and inflation.

I notice Mr. Regan has some very sophisticated econometric models that he uses in his firm. And I would like his comment.

Mr. REGAN. Senator, on balance here I do suggest that we are overreacting. I think that for us to try this \$3 a barrel surcharge levy on oil coming into the country, as well as permitting domestic oil to go to that price of itself is so inflationary as to be very dangerous for the economy. I would suggest that there are other ways of getting at that for the short term, until such things as these gentlemen are talking of can come about. For example, if each motorist in this country saved 2½ gallons per week—not an unusual amount, and even in Congressman Brown's Ohio district I am sure that the average carowner there could save 2½ gallons—that is a million barrels a day. These figures do not come from me, they come from the American Automobile Association. To get at 2½ gallons merely means that we cut down on pleasure driving. It does not ruin the economy. I am sure that \$3 a barrel tax on imported oil might if accompanied by some other severe methods.

As far as the recycling of that money, there is another way that we can do it. If we make it advantageous for these foreigners to bring that money in or borrow that money from them, we in turn will be using our own money in a bootstrapping type of operation. But so far we have roadblocks in that particular system. I think that the recycling is a phase that could well take place in 1975 with a political solution there. I am talking about the international political situation now.

As far as other things that can be done, if you consider that—this is a very startling thing—all of us are for a tax cut. We have been asking merely the question of dimension of both the Congress and the executive branch. A cut of 2 percent in the rate of inflation is more advantageous to the average citizen than the tax cut that we have been talking about. A 2-percent cut in inflation puts into the pocketbooks of U.S. citizens over \$30 billion a year. So I suggest that the main goal would be the cutting of the inflationary rate, not necessarily the tax goal, if you are looking to give the consumer more in his pay check.

Senator BENTSEN. Let me ask the question as to how you bring about a reduction, other than the 2½ gallons a week.

In visiting with Giscard D'estaing a couple of months ago, and in talks with his Economic Minister, Poincare, I asked them what was most effective in France. They said what had been the most effective was to put in an allocation system. They did not speak of the possibility you are talking about; they are concerned about their political problems. They did say, however, that what they had been able to bring about politically, that had worked, was most effective, was to put an allocation system in and whereby the energy that you have used that goes through your meter, whether it be industry or commercial enterprises or the home—and there you run into political problems again, I recognize—that you get something based on last year's allocation, whether it be 90 or 95 percent, and that above that you would pay, say, a substantial tax on any overage to the Federal Government.

I would like to ask some of the gentlemen in the utilities, because that put a particulai burden on them, I understand that, I know everybody in the utility industry would like to put it on the automobile. Then I talk to people in Detroit, and they say, let's put it on the utilities industry. Let me get a reaction on that.

Mr. GALLIGAN. We do not really want to put it on the automobiles. What Mr. Regan said, I think, should be considered. I believe the response to your first question is a more gradual system, and is I indicated, the problem today is whatever we give back in a tax cut we are going to take away on this energy tax. I guess if we accomplish that. Congressman Brown of Ohio and I would be both on the same side.

But on conservation, Senator, we probably have more of a reduction, and therefore conservation in our particular territory than any other major utility in the United States, with the possible exception of the Los Angeles municipal system.

We know certain things can be done through allocation and through conservation, and we just plead that it be evenhanded across this Nation and not in one area or the other.

So that we think that there are ways to address ourserves to the problem, and programs to go into this on a gradual basis, rather than throw the whole burden all at once, and really shock the economy of this country.

The one thing I would urge, though, is that if we go to a gradual system, that it be part of an established policy today, and that this is not just one piece, that we do not address ourselves to the other problems, such as nuclear and coal and things like that. If it is part of a total policy, yes, I think this is the way to do it.

Senator BENTSEN. Let me ask you another one, then. If you are talking about coal gasification—and I get all kinds of numbers, $1.50 or $2 per Mcf a day—you are looking at a plant that can run all the way from $500 million to a billion dollars. Then you talk to a corporation about making that kind of a capital investment, and they say, now what happened to us? What if we can do this at $2 an Mcf, and then all of a sudden the OPEC countries say, we are going to break that kind of a situation, and for a short time we are going to drop the price of oil, so that it is no longer economically feasible to sell that particular gas taken out of coal at that price? So some of these companies are concerned about making that kind of a capital investment, because it is a very substantial one as related to their net equity or their capital. Would it be feasible for the Government in that kind of a situation to say, alright, you take the top 30 percent of that risk venture, and the Government will maybe guarantee the loan on the plant, on the bottom 70 percent or some other such number, where you still leave it very much in the free enterprise system, but you limit some of the risks in trying to do this in the national interest?

Mr. GALLIGAN. I think we have to do something like that, because you have got to protect business and this country against the whims of the outsiders. This is what the Venezuelans were doing in the 1960's, they were bidding low to try to stop nuclear plants from getting built, and they were doing it deliberately. I think oil shale companies now are pulling away and backing off from that because they are running scared of the very point that you are making. That has got to be part of the policies that are developed.

Mr. CRAWFORD. Senator Bentsen, before you leave, may I come into the question you asked Mr. Galligan? I think it would be a disaster, frankly speaking, if a tax were put on increased consumption of electric energy. The concept has been floating around for sometime that you cut it back to, say, 90 percent, or 85 percent of what you used last year, and then put a tax on excess consumption. It seems to me that if you look at the present problems we have had, where we have reduced consumption, reduced kilowatt hours and reduced revenues, but the loads stay about the same, and we have to put the capacity to to carry those, it just erodes the utilities financial conditions further. And I am afraid if we went that step it would really have a very dire effect.

Senator BENTSEN. I am not talking about that. I think that gets into you structure. I am telling you what they said worked in France, the most effective thing they have done. I think you would have to have consideration in your rate structure for that. But I am afraid you would not get it.

Mr. CRAWFORD. That is the problem.

Chairman HUMPHREY. Thank you very much, Senator.

Congresswoman Heckler.

Representative HECKLER. At the outset I would like to direct my first question to Mr. Regan.

You alluded to an old expression in one of your answers, and I would like to test out an expression that I have heard in the Boston financial community which I would like to have you evaluate it as to its validity. It is that the market traditionally is 6 months ahead of the economy. How would you interpret the rally yesterday in terms of the economy? Is the economy actually getting better, only we just don't know it?

Mr. REGAN. I think perhaps I am a good guide for you, Congresswoman. You know I am a native of Cambridge, Mass. So I do understand a little bit about that Boston financial district.

The market usually predicts in advance, but it is not a precise one, and not a perfect one. You have heard the expression, no doubt, that the market has predicted seven out of the next four recessions. It constantly swings one way one time and one way another time and goes much too far in each direction. As a result, it is imprecise. What the market, I think, is telling us now is that the American public, both individuals and institutions, are bargain hunting, because when Chrysler gave a bargain of $200 or $300 per car, their sales immediately went up.

You have to remember that the stock market in December of 1974 was at a 12-year low. Many good bargains were around. I think people started bargain hunting. We have had very much of an increase in participation by the public. during January. For the first time—this maybe of interest to you—individuals in the marketplace have been of common stock on balance at the bottom of the market. It has been about 15 or 20 years since they have done this. The public has been sellers on balance, and now they are buyers. We have to believe from interviews from our costomers, and so forth, that it is bargain hunting.

Representative HECKLER. Does not this tell us something also about the question of the confidence of business, in the Government and the economy? If they are buying——

Mr. REGAN. I do not know who it is that they have confidence in, but they do have confidence in our Government.

Representative HECKLER. If that yardstick of 6 months is to be considered somewhat valid, then would you say that the economy itself would show an up turn, barring the impact of the President's economic and energy message?

Mr. REGAN. Those are our projections.

Representative HECKLER. From June of this year——

Mr. REGAN. Yes, those are our projections that we made last year. And I think they were shared by most people in Wall Street. The economy would still be on the downgrade in the first quarter of 1975, flattening out in the second quarter, and probably maybe slightly on the plus side in the third quarter, and definitely on the plus side in the fourth quarter.

Now, this is before the President's message and the like.

Representative HECKLER. I am happy to hear you comment although it does not concern me as much as the grim reality of today.

And turning to that aspect of my concerns, I would like to say for my colleagues' benefit that while the impact of the President's message on New England is of primary concern to me, as Mr. Galligan mentions in his own comments, my point of view is not based on provincial considerations exclusively, but is one that is shared in many areas; certainly in Florida and in Southern California.

Chairman HUMPHREY. No one has mentioned here that Canadian oil is a dollar a barrel higher than all the other oil you get. And that happens to come to the upper Midwest. We are not covered by the New York Times and the Wall Street Journal and all the rest, we are sort of out there in the wilderness. But we do have people that get cold.

Representative HECKLER. To return to the problems of New England, I might very well address the same questions to the representative of VEPCO, as one of his customers as well. At this point I would like to state for the record that these questions are shared by Senator Kennedy, who unfortunately had to leave. Mr. Galligan, in your prepared statement you have indicated that the substantial increases in the average cost of electricity in Boston over the past few years were related directly to increased fuel costs. I am wondering what your estimate will be in the percentage increase in the electricity bills of residents as a result of the President's energy program.

Mr. GALLIGAN. As we look at it, including the credits that he had provided that come out in trickles, it represents an 11 percent increase in the cost to the consumer.

Representative HECKLER. An 11 percent increase? As I understand it, the President's program has been estimated to increase cost by 6 percent nationally.

Mr. GALLIGAN. Nationally, yes. I think is the point that I made earlier, that nationally on a per capita basis there is a net credit to the consumer of the individual of about $18. It is practically zero in New England.

Representative HECKLER. Obviously the ramifications in New England will reach beyond the cost to the consumer and will certainly have an impact on the competitive capacity of our industries, and on jobs. Have your experts done any computation of the impact in terms of industrial growth or curtailment or unemployment as a result of the President's energy program?

Mr. GALLIGAN. As you know, the unemployment in our area is perhaps the highest in the Nation. Our concern is because this affects the consumer directly, whether it is industry or the individual. Our concern is the impact it will have on the economy of our area. Already for industrial users the fuel charge is in excess of 50 percent of their bill. And where our concern is most serious is that it will either force some industries out of the area to another area that is not impacted the same way, or it will cause decisions to be made to locate in other areas of the country. So this is a real consideration. It involves jobs. The chances are that if the President's program goes through that unemployment will increase perhaps in excess of 10 percent as a direct result of this program.

Representative HECKLER. In my district, Fall River, Massachusetts, the unemployment rate is already 9.9 percent.

I am confused by some of the statements which I heard on the subject of the impact in New England, and how it can be redressed. Secretary Morton has commented on this and has actually said at a meeting of Senators that New England will come out ahead. And Mr. Zarb made the same statement at a meeting of House Members just a few days ago. Can you understand how New England would come out ahead in this program, or suggest a way in which New England might perhaps just share the misery equally?

Mr. GALLIGAN. I am afraid that I can not understand them when they say we are not going to come out ahead. What they are really saying is that we are not going to come out as bad as we thought we were. My figures are based on the proposals as I understand them. What they are talking about is a $3 tariff imposed over a 3-month period. In the first month it is a dollar tariff, and they will give you a dollar credit. In the second month it is a dollar tariff and they give us a 40-cent credit. And in the third month there is a dollar tariff and a 40-cent credit, which amounts to a net of $1.20 extra cost. And the costs I have used are based on that, plus, after fighting for a year with the help of not only our New England congressional caucus, but a number of other people in Congress throughout the country, we did get FEA in a small way to recognize their responsibilities for equality. And they did come up with a 60-cent entitlement program. But with the lifting of the limits on old oil, that entitlement program is completely wiped out. So the best we can figure is, we are losing $1.80 a barrel as far as residual oil is concerned. So when they say we will come out ahead, I really think they are just saying that we are not going to come out as bad as we thought.

Representative HECKLER. Obviously you are as aware as I am that New England has been criticized for not permitting construction of a refinery. You do not allude to that factor in your statement. Do you think that our lack of refinery capacity a major drawback in terms of meeting our energy requirements in New England?

Mr. GALLIGAN. I just think that this is a sort of a ghost that they hang up there, and is not addressing itself to the problem. In my detailed remarks, I do say that nationally we should expedite and encourage offshore drilling, especially on Georges Banks and other areas, and we should encourage construction of refineries. But the facts are that there was a proposal by Occidental to build a large refinery which was capable of taking the very large tankers. This was frankly killed as the result of the lobbying of the big oil companies which were not involved in that particular incident. That was one that was really, could have been built, and would have been in operation today if it had not been blocked. To be sure, Onassis was turned down in New Hampshire. But it is my considered opinion that if there is a viable proposal to build a refinery in New England, or perhaps two or three refineries, which we should have, that those can be built, and will be built.

People asked for environmental protection but we have people in connection with the Siting Commission of the Massachusetts Legislature who have visited refineries in Florida, have visited refineries in Washington and California, and even the environmentalists recognize that refineries can be built that are environmentally compatible with the area.

So to say that this is the cause of our problems is really just a ghost that is being thrown up, and it is not true.

Representative HECKLER. I share your opinion. I have questioned my own constituents on the subject, and found that 80 percent of my constituents favor the location of a refinery in this district. Now, they were not tested on the question of the location of such refinery, which is a much more difficult issue. But I do think that we are receptive to this.

Chairman HUMPHREY. Thank you very much.

We will proceed now with our next committee member, Congressman Brown of Michigan.

Representative BROWN of Michigan. Thank you, Mr. Chairman.

Mr. Regan, when you were talking about capital availability, and so on, you talked about the problem of the flow of OPEC money. I think that in answer to a subsequent question you said so far there has been $10 billion, is that correct?

Mr. REGAN. Yes, Congressman.

Representative BROWN of Michigan. And this has gone primarily into government securities?

Mr. REGAN. Yes, short term.

Representative BROWN of Michigan. To what extent or what percentage of the investment of OPEC money has come into this country?

Mr. REGAN. Approximately a third. These are very hazy figures. They are not compiled with any degree of certainty. But as close as we can come, it is about a third.

Representative BROWN of Michigan. About a third of all of it invested. Where has most of the rest of it gone?

Mr. REGAN. Western Europe, sir, has taken about 40 to 50 percent in the form of Eurodollar loans and things of that nature. As a matter of fact, one of the smart aleck cracks that is being made is that the OPEC countries are keeping the British Government afloat with their loans. The remainder of the money has gone usually from one Arab country to another Arab country, or from one of the OPEC nations to one of the underdeveloped nations of the world in the form of loans or grants.

Representative BROWN of Michigan. Do you have any idea of what part of the $25 billion net flow to OPEC countries will be coming back to this country?

Mr. REGAN. There is no way of telling, sir. The governments in question actually prefer to keep the amounts of their funds secret. They don't reveal it too visibly to the rest of the world.

We do have here in the United States a peculiar situation, where if we got this type of money—this is alluded to in my statement—we do have a withholding tax on dividends and interest, in the case of an individual citizen of the OPEC nations, we would withhold 30 percent of their dividends or interest in taxes. And they don't like this. It is an impediment. I know that the House Ways and Means Committee looked favorably upon doing away with this particular tax in 1974. But in the shuffle of the last Congress, that particular amendment was lost.

I do think it is something that you should again consider this year.

Representative BROWN of Michigan. We have been speaking of the investment of OPEC money in this country as though it was kind of a monolithic thing. As I understand it—and correct me if I am wrong—is not quite that nice and clean. The individual sheiks try to do their own thing, don't they?

Mr. REGAN. Naturally each country has their own fish to fry, so to speak. Smaller nations such as Kuwait and even smaller nations such as Abu Dhabi, which has $3 or $4 extra billion a year to invest, have an entirely different outlook than the Shah of Iran, with say, $6 or $8 billion of revenue.

Representative BROWN of Michigan. Looking in your crystal ball, do you see that there is any problem? Or what is the future impact of the outflow in our current accounts of returns on OPEC investments in this country?

Mr. REGAN. It depends upon how it is invested here in the United States. The remittance of earnings back to the OPEC nations could be in our favor. If we are to take that money and be able to use it for expansion of our own plant—as a matter of fact—these gentlemen are looking for ways to finance their nuclear plants or shale or something of that nature, and to be able to use that money for these very purposes would be a very neat trick, and give them a just return on their money.

Representative BROWN of Michigan. This brings me to another point, because in your discussion, your recommendations, and so on, I did not hear you suggest Federal guarantee of utility obligations.

Mr. REGAN. No, sir, I did not.

Representative BROWN of Michigan. You know it has been suggested, of course.

Mr. REGAN. Yes, sir.

Representative BROWN of Michigan. What is your comment on that? It is a regulated industry. Why is that not better than a Lockheed loan, an 80-percent guarantee to farmers who face economic distress—and so forth?

Mr. REGAN. Perhaps I should turn that question over to the gentlemen on each side of me. But as far as I am concerned, the utilities of the Nation are not distressed companies. Lockheed was certainly a distressed company which is vital to our national defense.

I am not one to advocate going around with Federal money, plopping here and there, because some people can't cut the mustard. I think in the capitalist system companies do fail. That is the way we get more efficiency in this country. The utilities have a national monopoly, and they do have methods whereby they can raise money. One of the more well-known cases of near failure has been Con Ed when it had to cut its dividends. But Con Ed recovered and is doing very nicely now. So I do not think the Federal Government has to run around supporting the utilities until such time as they get in a distressed condition, which I hope is never.

Representative BROWN of Michigan. They are not distressed companies, but I think most utility companies would say that they are in a distressed position from the standpoint of developing capital. That is why there have been a lot of cancellations, deferments, et cetera. That is, their posture as a borrower is significantly inferior today than it was yesterday.

Mr. REGAN. Yes, but this is the marketplace. If the country wants and needs extra utility companies, or extra expansion on the part of utilities, funds will be made available for this. If not, we are not going to have that kind of expansion in the country.

Representative BROWN of Michigan. Let me go back to your saying that possibly the remission of profits, et cetera, by the OPEC countries, might be to our advantage because they could be invested in shale. I was approached sometime back by a broker representing a sheik, saying, if you can get the Federal Government to guarantee utility loans, they will invest in significant amounts in utility loans. Now, why is not that a beautiful transfer?

Mr. REGAN. Well, I have heard this expressed in the Middle East—they are privately worried about expropriations here in the United States in the event of an war or an outbreak of war. That is why they want the guarantee. I don't think we have to give them that guarantee.

Representative BROWN of Michigan. In the course of your analysis of the President's energy proposal, I think you said that there was general agreement, that it would add 2 to 3 percent to the inflationary rate, thereby, in effect, offsetting the tax rebate. Were your computations based on current level energy utilization, or reduced energy use prompted by the higher prices? I ask this because I think you would agree that an increase in price on a smaller base will have a less significant overall impact on inflation, on the inflation rate, and on the net reduction of purchasing power when the price increase is compared with the tax rebate.

Mr. REGAN. I am not positive, but I think we base it on less utilization, that the President's plan would accomplish his goal of saving a million barrels per day.

Representative BROWN of Michigan. Let me ask as a general question, more academic than anything else, to all of you; should upward movement in prices to parity, that is, those prices that are basically depressed prices, price items, be considered inflationary to the same extent as price movements upward in nondepressed prices? Let us talk about farm prices. We consider that farm prices are 75 percent of parity here.

Mr. REGAN. I would say—and I know this is politically kind of a hot one—and being from New York, I do not represent a farm district, but yet we are large commodity brokers at Merrill Lynch—I would say this, that the parity concept is a good one, and should be kept. But I am not one that feels that the farmer should be unduly babied in these situations. In the last several years the amount of the income that has gone to the farmer has increased. True, in the sixties he was getting less than his share. Now he is getting more.

Chairman HUMPHREY. The last 2 years?

Mr. REGAN. 1973 and 1974.

Representative BROWN of Michigan. But, Mr. Regan, do you consider getting farm prices up to parity, where they should be, inflationary? Do we not get down to saying, our inflationary index is merely a comparison of today's prices to a previous period of time.

Mr. REGAN. What it does, when you bring those up to that level, take a look at what their share is, and they demand more, and you get the cost-push type of inflation coming through.

Representative BROWN of Michigan. But in any kind of a norm you have an item, whether it be labor, or shoes, or what have you, that is overpriced at the present time under any kind of a norm, if those things go up, is not that much more inflationary than if you have farm prices which are below normal achieve parity?

Mr. REGAN. What are they, 2 percent of the total cost? To the extent that they do go up, yes.

Chairman HUMPHREY. Food prices account for 17 percent. Food prices are different from farm prices. Eggs in Minnesota are 31 cents-a-dozen even today, that is on the farm where I live. They are 92 cents in Washington.

Mr. REGAN. I understand the distance, Senator Humphrey.

Chairman HUMPHREY. I do not know what happens, who processes those eggs after they leave the hens, but something happens.

Representative BROWN of Michigan. My time has expired, but one final thing, Mr. Regan, and I don't mean to pick on you, but Mr. Stewart alluded to capital gains treatment. Is he not right, that we give the same special tax treatment to transfers of capital within the market that we do to new infusion of capital?

Mr. REGAN. Yes, that is true. The solution, of course was the one that Senator Bentsen did suggest last year. I would hope at a subsequent time, when the Congress is considering tax reform—I am talking about immediate tax cuts—later tax reforms, when they come to the capital gains tax, that they would also change the holding period, and the longer the particular thing is held, be it a house, or a security, or anything else, the less the capital gains tax.

Representative BROWN of Michigan. And that is as it should be; is it a logical result?

Mr. REGAN. Purely logical.

Representative BROWN of Michigan. The only reason we have a special treatment for capital investment is because we want an influx of capital. When you are merely switching it around from one issue to another, you may get millions of dollars of tax benefits, but not one new dollar of capital.

Mr. REGAN. That is correct.

Mr. STEWART. Congressman Brown, of course we were, in addition to providing an incentive based on length of holding, and also in terms of additional risk. The easiest way to do that is to provide more incentives for investment in smaller companies.

Mr. GALLIGAN. Congressman Brown, on one question you asked Mr. Regan, I think it is important to make a point on construction of refineries. When you are talking about the Middle East money, there is something going on in this Nation that everybody should be fully aware of, that refineries that should be built here in this country are now being built in the Middle East nations, and in other nations which are holding some of oil produced as capital, and they say, if you want our oil you are going to build the refineries here. And it is two factors, one is the captive type of approach and the other is, the companies are not building in the United States because there is absolute—it cannot be absolute, but there is complete uncertainty as to what is going to happen, and they are not prepared to invest their money in the refineries. And we will wake up, if we do not get a national energy policy, without our own refineries, not only captive to the OPEC nations insofar as the product is concerned, but captive as far as the processing procedures are concerned. And this, I think, is the development that is extremely serious, and we should address ourselves to this.

Representative BROWN of Michigan. I think you can go around the world and you can see tremendous new modern refineries everywhere except here.

Mr. GALLIGAN. One of the major contractors has said that there was a flurry about 2 years ago. But this thing has gone dead in the last year and a half, and these are the reasons for it.

Representative BROWN of Michigan. Thank you very much.

Chairman HUMPHREY. We are not going to keep you much longer, but we have a few other questions.

I want to get back to one point we explored on Thursday last week. The witnesses before us stressed the importance of a monetary policy designed as to promote economic recovery. One of the voids or limitations in the President's presentation to the Congress was his failure to deal at all with monetary policy; that is, the growth of the money supply, the interest rate question, which is of course very vital to any balanced type of economic recovery program. Each of you on the panel this morning is in a position to know something about monetary policy and how it is actually working in practice: Is credit available now for these who need it? Will it continue to be available in the near future in your best judgment? And then the final question: Has the Federal Reserve moved far enough toward easing monetary policy; that is, making available a larger growth of the money supply? If not, what more do you think the Federal Reserve should do? Do you think the present situation on credit is detrimental to an economic recovery, or is it adequate? Do you think the Federal Reserve System ought to be encouraged to do a better job of easing money?

Mr. Stewart, I would like to have your comments as quickly as you could.

Mr. STEWART. Mr. Chairman, there is a problem that I have lived with for many years. Before I go to my grave I hope I see sitting on the Board of every Federal Reserve bank in the United States, including the Board here, a representative of small business. That is an indirect way of answering your question. I do not think the Federal Reserve yet knows how to fine tune its policies to distinguish between small and large companies. We have been stymied, there are no two ways about it. You cannot loosen up easily enough on small companies the way they do business now, without easing up on large users of credit. They are not going to do it until small business is represented directly on the boards of those banks.

Chairman HUMPHREY. Very good.

Mr. Galligan.

Mr. GALLIGAN. I have concerns with the policy as it has existed. And as you said, it is not addressed in the President's message. And the problem is, our policy has been to just let the interest rates go high and reach a limit. The facts are, they kept going up and they kept going up. As far as utilities were concerned—and it is merely the root cause of many of our problems we had to build in any case. So you had to go out and get the market, as Mr. Regan says, we had to get it on the open market at what the price was. Those prices, as you know, went up for some people 12, 13, and even 14 percent. And that is out and out inflationary when you are looking at the fact that the largest investor of capital in the country has to continue building to carry out their mandate to serve the public. And those costs get built in and get escalated, and interest on top.

So I think that the policy as it was developed was a disservice. I would favor a policy that I think works—others may disagree with me—that existed in the late sixties when we had a similar situation. At that time it was voluntary, but it worked, on the part of the banks and others, whereby they exercised credit controls, and really in a way made a voluntary credit allocation. It kept that interest rate from going up to unacceptable levels, which not only affected us, but affected small business and the entire Nation.

So I think there is room for improvement and reconsideration. Rates are going down now.

Chairman HUMPHREY. That is, prime rates are going down.

Mr. GALLIGAN. Yes.

Chairman HUMPHREY. But no rate is going down to the folks.

Mr. GALLIGAN. But small business rates never kept up with the rates of large business through this whole period. There has been a two-tier system whereby in effect, at least on the part of the large banks, the small business rate was being subsidized.

Mr. STEWART. I have to say, on behalf of my colleagues in New England, that there was at one time a three-point spread between prime for large and small companies. That has not been there for many months.

Chairman HUMPHREY. The thing that I noticed, it is sort of like beef prices. My wife came home the other day and she was complaining to me about the price of beef. And I just blew my stack, because I had had just a delegation of Minnesota farmers here who were complaining about what is happening to them on beef. Once the price gets up—unless you watch and occasionally I get one of those sales, if you are available on Thursday afternoon, but everybody is not available on Thursday afternoon—even though the producer's price goes down, it does not have much effect in between.

Let me relate this to interest rates, because I have some interest in this thing. If you get the prime rate up, that brings everything up. But when the prime rate starts to go down, on the other hand, other rates do not come down very fast; that is, not for the folks that really need the money.

I have two companies in my State that employ 550 people. They were laying them all off this last week. They could not get loans. They are very good companies, and they have been in business for years. They relate to housing. Because of the temporary problems of housing, we are going to have 550 families on either welfare or unemployment compensation.

The Small Business Administration stands there like it is paralyzed. It is about as useful as—I had better be careful of my language here—it is totally useless insofar as rescuing anybody. They say, we have got to talk to the banks. What do we need a Small Business Administration for if it has got to talk to the local bank? The purpose of the Small Business Administration is to bail out people that are reasonably good risks, but that a private bank under the circumstances can not take care of.

Anyway, we have got 550 people who are going to be unemployed, and the President comes up with a big message and says that we have got to get the economy revved up and do things to help people, and within the same week I get the message that 550 people are down the tube.

They cannot get credit, and if they get it, they cannot pay the interest rate. There is just no way. Of course, I have felt for a long time that one of the largest single factors in inflation has been high interest, because it is built right into the costs. Anybody that runs a business and does not build his interest rates into the cost of his item is a nut. He ought not to handle other people's money at least. If he wants to waste his own, that is his privilege, but he surely should not have any fiduciary responsibility.

I have my little prejudices on this. The reason I like you men is, you live out there in the practical world, and so do I. I have men to see me everyday, and I was born in a family of business people, and I live in a community that is interested in the business enterprise, and I say all this gobbledegook that we are talking about here, and it just does not get down to the folks, down to where people need a loan.

I see 3,800 farm families went out of business in the dairy business. If that happened in Honeywell in Minneapolis, 3,800 people laid off, the Minneapolis Tribune would have a headline bigger than the sinking of the *Titanic* or the resignation of Nixon. But you look around, and it is not even on the back page of the want ad section. They say a reporter would not know a farm family when he saw one. So we have all these people turned down the economic sewer. Nobody pays any attention to it, except one day they wake up and find out that the bank out there—that little State bank that has loaned the money—starts to get up against the wall; and if you get enough of those, something happens.

It always reminds me of the time of kidnaping. We had a lot of kidnaping, and then they started kidnaping the wrong people, and they made it a Federal crime. When you get up with the big ones, then it becomes a very serious matter. When they kidnaped one of the Hamm children in St. Paul, it became a serious matter in our city. Until then the others were getting knocked off, and they said, things happen like this, boys will be boys. But finally we had something go wrong.

Now I will go to Mr. Regan, because my prejudices ought not to take up all this time.

Mr. REGAN. I admire what you have just said, and I sympathize with it. But on balance I would have to say that the Federal Reserve has done a reasonably good job in conducting our monetary policy.

The reason I say that is if you go back just 4 months ago, I was one of those invited to that so-called summit; 800 people representing labor, management, big business, and small business were asked to put in papers as to how we were going to solve the problem of inflation.

Chairman HUMPHREY. Not me, and I summarized as a participant in it. I said the economic problem was twofold, the problem of inflation and recession, and recession was the big brother.

Mr. REGAN. But you were a lone voice in the wilderness at that particular time.

Chairman HUMPHREY. I know. And I was right.

Mr. REGAN. Yes.

Now, what I am getting at is that the Fed was the only instrument that we were using to fight the battle of inflation. We were not doing it in fiscal policy, because very obviously our budgets were out of whack. We had the combined problem of the terrible blunder on foreign purchases of grains, plus the oil situation. That was the battle we were then fighting. If you will notice in published reports the Fed did reverse its policy later and increased the supply of money. Since that time, in October until now, the prime rate is down about 3.5 points, and long-term rates are down about 1 point.

I think the situation is going to continue in this particular way. The Fed has its foot on the accelerator, and I certainly hope to God it does not push it down too fast, because they tried it once before in 1970, and the first thing we knew, in August of 1971 we were back under controls. I would hope that they would have a gentle foot on the accelerator, but I think the direction in which they are going now is the correct one.

Chairman HUMPHREY. I agree with you that we expected the Fed to be almost a total control mechanism. We have always put too much pressure on the banking structure, and I think that is a very serious mistake. Mr. Burns said to me in the hearings in October after the summit conference—I asked him if he was going to increase the money supply over there, and he said, "Yes," and I said, "How much?" and he said, "I do not know if I can answer that." I said, "Well, why do you not just strain a little here and see if you can not give us an answer." And he said, "Significantly."

Now, significantly is still rather modest. The general impression that we get is that it has been running at about an average of 3 percent lately, the money supply growth. It varies, of course.

Mr. REGAN. It is actually less than that over a 6-month period.

Chairman HUMPHREY. It needs to go up considerably beyond that, if you are going to get any economic takeoff here.

You know this tax reduction—I was impressed by what you said about inflation control, because inflation is a tax, a cruel tax across the board, it misses no one. If you can reduce that, you will get a greater impact on the economy than almost anything.

The total amount of the tax proposed in the President's program to have the stimulus effect is about 1 percent of the GNP, $16 billion. We have got about a $1.5 trillion GNP. So that you have got about a 1 percent lift. That is not too much of a stimulus if you do not have that packaged with some easing of the money supply. Increasing the supply of money in turn has a tendency to lower the interest rates for the actual borrower, it actually has if you moderate it carefully, if you watch it carefully, it does not have an inflationary impact, it could have a deflationary impact, in the sense that you get your interest rates down, you can increase production.

Recession is the greatest incentive to lower productivity of anything you can get. It raises unit cost, and it decreases productivity.

Mr. Crawford, do you want to comment?

Mr. CRAWFORD. Just one comment, Senator.

Some of us have had concern about the availability of capital for the energy industries. It almost appeared last summer as though there were a boycott of some type against investment in utility securities at a time when utility companies were having great difficulty raising capital. I really believe it is not a function of availability of capital as much as it is our ability to make our security attractive to the investor. Unless we are able to attract the investor's dollar, of course it is not going to be forthcoming.

There are those, looking at this situation, who feel that perhaps we should have some kind of compulsory allocation of capital. It has been said to me that in Israel a certain part of the investment funds of the insurance companies is required to be invested in utility securities each year to be sure that enough capital is available to meet the electric power requirements.

It seems to me that you ask for a lot of trouble when you go that route. We can make a strong case, I believe, that we should have priority, but I suspect that other major industries could make the same kind of case. I continue to think that we should not have compulsory allocation of capital, but continue to rely on the market mechanism.

Chairman HUMPHREY. I just received from the staff the annual rate of change in the money stock.

It was running in July at a 1.6 percent rate, in August, 1.7; in September, 1.9; in October, 1.9; and in November, 0.6 of 1 percent. It was up to 4.1 in January of 1974. Then it went down in April to 2.9, about 3 percent. So you have had a decreasing money supply all the way. I think it is one of the real problems as to the availability, for example, of credit in the American money market.

Do you have another 10 or 15 minutes? I have some questions that I want to ask utility people in particular.

The electric utility suffered a squeeze from skyrocketing fuel costs in the last year or year and a half combined with investment programs at exceedingly high interest rates that you have talked about. Under those conditions there surely was no particular surprise that many utilities were financially very hard pressed. Since then, however, expansion programs have been considerably curtailed, and interest rates are declining, and I don't know how much they have declined to you as a natural borrower. I asked the question, were not last year's problems exceptional, and will not the stretched out schedule for borrowing and reduction of capital costs greatly ease the utilities' financial difficulties?

Mr. Galligan.

Mr. GALLIGAN. Last year it was exceptional. I expect that some of those will continue this year. The cutback in construction on some utilities was done as a result of reduction in loads. But that will be felt over a 4- or 5-year period, and only a small part of it will be felt immediately. I think we should be very concerned, and especially for those utilities who cut back because of their inability to raise capital, because that has serious implications, as does the availability of electricity in those particular areas. We don't think that we should just say that the situation is passed and nothing needs to be done.

Unless some of these measures that have been considered in the House Ways and Means Committee which have been proposed by the President are carried on and brought into law, we are going to continue to have those problems. And the one thing that I think all of us would reemphasize—I had in my prepared statement that the attitude toward rate relief has to change in this country, both at the Federal, and more importantly, at the State level. The philosophy is to give as little as you absolutely have to, and to give it as late as you possibly can. I submit that a more considerate program would lead to lower costs on the part of utilities, and therefore would benefit the consumer in the long run.

So I would disagree heartily with the philosophy that all those problems are behind us and we can all relax. They are with us. If you are going to get nuclear plants built, if you are going to be able to provide the services that I think our public expects, we have to address ourselves to these problems.

I would just like to quickly touch on something Mr. Regan talked about that was suggested by Chairman Garett of the SEC. It has the deductibility of dividends on the part of the payor. I think that has merit and should be seriously considered, because the basic policy of most utilities is raising their equity capital and maintaining a sound balance between equity and net. This would enable them to do it at a lower cost. In this day of consumer pressures, inflationary pressures, some consumers are really desperate on all the costs that they are facing. This would enable us to raise this equity and find some of the programs and resolve the problems of a number of utilities at a lower cost to the consumer. I would respectfully ask that this committee and others in Congress seriously consider that proposal by Chairman Garrett.

Chairman HUMPHREY. I think it should be looked at very seriously. The ability to have capital accumulation in industry today is a very serious problem. I think it has to be studied. I hope that we will be able to be fair about it and come up with some proposals.

Mr. Crawford, do you want to comment on that? Let's get in another one to speed it up. All of these cutbacks that we have in the expansion plans—and there have been a number of cutbacks—and other investments abandoned simply because they could not be financed under current conditions and so cut back due to conservation and recession. What probability do you foresee that we will face serious power shortages within the next 5 years because of the cutbacks that have taken place?

Mr. CRAWFORD. Yes, I would like to comment. Let me start by commenting on your first question as to whether last year was an exceptional year. I think it was, because we saw great increases in three cost categories. One was inflation generally. Another was the great increase in money cost. The third was the great increase in fuel cost. The question really is whether the ensuing years are going to be exceptional too. I think there is good reason to hope that the money costs will be coming down so that we won't have to contend with that. Hopefully the fuel costs will either stay where they are, or maybe go down, so that we don't have to contend with that. If we can get a handle on inflation generally, then indeed we will be much better off than last year.

On the question of delays, the basic reason in most cases why the plants were stretched out was the unavailability of capital. Some component of the deferrals was the result of reduced loads and reduced expectations of sales in the future, but primarily it was lack of capital. Since the nuclear plants require longer to build and are the costliest from a capital investment point of view, they were the natural targets to cut back. Unfortunately, in the final analysis, the result is to put more dependence on oil and gas, the very fuels we should be trying to get away from. What may happen—and we are beginning to see signs of this already—is that we may have a respite of only about a year in the usual increase in kilowatt hours. In 1974 there was only about 1 percent increase over 1973; however, late in December we began to see a resumption of the normal trend. We will have to watch the figures closely, but if the historic trend is returning, the increasing loads will have to be met. The question will be whether the nuclear plants can be restored to their schedules. If they cannot be—and I think there is concern about this because of the financial problems—then we have to add capacity quickly to carry the load. This means gas turbines or other types of generation that depend on oil and gas. Our studies indicate that the shortages will not be until after 1979, because most of the cutbacks are for the longer range nuclear plants. But beginning in the early 1980's, unless the schedules can be restored, we may very well have serious problems meeting our power requirements.

Chairman HUMPHREY. Mr. Regan.

Mr. REGAN. One other item that I think is important. There has been quite an emphasis that the electric utilities will probably pick up a greater portion of energy growth than the other parts of the energy complex. A good illustration of that, I think, is if the housing picks up, the likelihood of obtaining gas is presently remote, especially in our area, the Norfolk area, the Richmond area, and the Washington area, where gas is limited as far as new customers are concerned. People can put in oil for heat and hot water. But it is very unlikely that they are going to have an oil cookstove and the rest of the appliances oil fired. So the appliances in new homes are almost all going to be electric, other than the hot water and the heat. This will have a major impact, not necessarily on peakloads, but it could over a period of time. It does concern us in these forecasts, since lack of energy can affect business. I will agree with Don Crawford that the 1980's are going to be our critical years, if a load forecast even approaches the minimal we see.

Chairman HUMPHREY. Mr. Jack Bridges, of the Georgetown University International Center for Strategic Studies, has been before the Consumer Economics Subcommittee of the Joint Economic Committee. He has made a presentation in many parts of the country on energy availability and the projection of the use of energy in this country. Those projections, in the light of availability of refinery capacity, and of production, of usable oil products, or petroleum products, are really very frightening. This goes back to what was said a moment ago about the refinery capacity in the country looking down the road, making ourselves so totally dependent upon foreign refinery facilities, and not being able to build—or not being willing, for whatever reason—to build the refineries that we will need in this country for our purposes. We not only have ourselves in the hands of the others for crude, but we have ourselves more significantly in their hands for processed products. I think this is a very dangerous thing.

The other point that I gather has been agreed upon here—and I mention this so that you can disagree if you feel to the contrary—is that the attempt to cut back on oil imports by 1 million barrels a day within this calendar year appears to be presumptuous, and could have adverse consequences upon the economy.

Now, have I stated it improperly or inadequately, Mr. Regan?

Mr. REGAN. Sir, I would suggest that my view of that would be that we could cut back, but the method that the President has selected of the dollar, $2 or $3 surcharge, is not the most precise method as far as I am concerned. I think we can save a million barrels of oil per day in this country during this calendar year if we get on it and get on it very quickly.

Chairman HUMPHREY. At least during the fiscal year.

Mr. REGAN. During the fiscal year it would be an impossibility.

Chairman HUMPHREY. The next fiscal year?

Mr. REGAN. Yes, I think it could be done.

Chairman HUMPHREY. You mention using the conservation method?

Mr. REGAN. Conservation plus perhaps some other type of method which has not come up here this morning might not be appropriate. But the gasoline tax, for example, has not been mentioned. Gasoline is 40 to 50 percent of all oil consumption.

Chairman HUMPHREY. It is better than that, actually.

Mr. REGAN. If you take a tax on gasoline, that might be the way to achieve it more quickly, and in a more desirable fashion, than passing it through the entire economy in the form of additional taxes on all kinds of petroleum chemicals and everything else.

Chairman HUMPHREY. Why do not we have some kind of incentive for people to use small cars that give better consumption? You know all this nonsense about this gas business that we are getting, everybody advertises that you get 18 miles or 20 miles except when you drive the car. It must be some trained driver that they have under ideal conditions, because it just does not happen.

Representative LONG. All downhill.

Chairman HUMPHREY. All downhill in the glide pattern.

But there are cars, the smaller cars, that are a drag on the market now, many of them. I imagine there are hundreds of thousands of them in inventory, or maybe more. If there was some kind of an incentive, either on a tax rebate or tax credit, to get people to buy them. I read the statistics the other day of a study that if you could have 5 million small cars purchased this year instead of the large cars, we would save 600,000 barrels of crude oil per day, just by buying 5 million small cars, just the difference between the consumption of what I call the luxury cars and the small cars.

Now, it seems to me that we have to bite the bullet somewhere along the line in the gasoline area. There may be many ways that you can mention, like you mentioned the tax. There may be other ways to do it if we can get the automobile industry to cooperate.

I see this morning that General Motors is planning very substantial retooling efforts over the next few years. But what about right now?

We had small cars, we were buying them when we were on allocation, people were all buying small cars. The minute we got back to where we could get all kinds of gasoline and all kinds of petroleum products, our imports have gone way up from where they were 2 years ago. Two years ago we were importing between 20 and 25 percent. Now we are importing 45 percent, which really means that the oil companies have just decided that they are not going to produce much domestic oil, and we have been importing the foreign oil. There is a glut of oil, petroleum products, there is no shortage of petroleum products worldwide, they are all over the place, you could float the earth in them probably right now, there is a tremendous amount of petroleum, no shortage whatsoever. But here we sit with the big cars. Then I just wonder if you had any ideas about—you said we ought to abandon some of the leisure driving. I will never forget what President Johnson once said: "You can tell a man to go to the hot place, but it is hard to get him there," and you can tell a person to conserve, but is there not a better way to get him to conserve, to buy a car that will get 18 to 20 miles a gallon?

Mr. REGAN. I think my own cursory analysis indicates that what Detroit is trying to do in giving rebates on small cars is helping to move them.

Chairman HUMPHREY. Chrysler is giving them on the big ones too.

Mr. REGAN. I think perhaps the Government should give encouragement to these rebates.

Chairman HUMPHREY. You will pardon me for getting concerned about this. I grew up in the merchandise field. When we had excess inventory, we always had sales. The automobile industry is making you think that it is something unusual. Why shouldn't they have cut prices? But they don't just cut the prices, they call it a rebate, because they are afraid they will get price controls, and they want to keep the prices up in case they get price controls. But if you are out there in the rural parts of America, and you produce more than you can sell at 60 cents a dozen, you sell them for 30 cents. That is the capitalist system. These characters talk about the capitalist system. They don't believe in it at all. They believe in fixed prices. Now when they do come around and decide to give you a rebate, they don't say they are cutting the prices, they call it a rebate, as if it were something unusual.

I never heard of anybody that didn't have inventory liquidations, every department store in this city after Christmas has a sale. They don't call it a rebate, they are just honest, to use the proper word. They say, we have too many shirts, lets clean them out, and ties of the wrong kind, clean them out, and we find that certain types of clothing are not selling at the prices, so we put a sale on them. But not the automobile industry. They stood right there like it was un-American to talk about cutting the prices.

What is wrong with cutting prices? I have been in that business all my life. We have a store that we have run since 1903. We used to have sales all the time. We had a clearance sale on gifts on things we didn't sell at Christmas. We sold them for 40 percent of what they were before. We don't call our customers in and say, you buy this Hamilton wristwatch for $140 and you come back and see us next week and we will give you a rebate. We don't do it. We sell it for $69 and get rid of it.

What is wrong with American enterprise that they are trying to play these con games with us? Why don't we get in there and have competition.

Mr. REGAN. I suggest that they do in most industries, except in the automobile industry.

Mr. STEWART. What about aluminum and steel? A lot of people in this country have chosen to cut production instead of prices, a lot of basic industry.

Mr. REGAN. Wholesale prices are one their way down. They have been receding since November. It looks as though the consumers price index has finally stopped going up. My own guess would be that it will be down in January.

Chairman HUMPHREY. The only reason that it is is because of food prices.

Mr. REGAN. Certain industrial prices are coming down.

Chairman HUMPHREY. Industrial raw material prices are generally lower, I grant you that.

I just can't understand for example, why the oil industry of this country is willing to cooperate overseas, knowing that it is going to be expropriated, they are going to kick them all out of this. In the meantime, in order to stay a little longer, they are building the refineries over there instead of over here. We have been trying to get a refinery in my State. But they would rather build it in Saudi Arabia. Or a steelplant.

We think we are pretty good. We have got one of the best economies in the country. But we have real trouble. They would rather go over there and put a plant over in Chad or Nigeria or someplace else rather than come back to Minnesota and put up a plant. We still count the same kind of money, and believe in hard work; 70 percent of our people are homeowners, and we would like to have 90 percent of them homeowners. We work long hours, and have high productivity. But you can't make a buck as fast over here, because we tax people.

Why doesn't the American industrial community face up to some of these things? I wish you gentlemen would tell me. Because you have a big stake in this, you have got more to lose than somebody else. Some poor Joe on the unemployment line has got nothing to lose. He is already down there.

Mr. GALLIGAN. The only thing I would like to say on that is that we have a lot of trouble in this country, and there are a lot of areas that we will probably cover here today where things can be improved. But I don't think we should lose the sight of the fact that we do have the greatest producer of goods and services for the people at the lowest cost of any nation in the world.

Chairman HUMPHREY. On some items, many on food items, not on some of the processed items, I say, Mr. Galligan. The Federal Republic of Germany out competes us, they pay higher wages, lower inflation, and less unemployment.

Mr. GALLIGAN. They have better tax rules.

Chairman HUMPHREY. They tax them pretty heavily. The Swedes have got low unemployment, and they have got taxes that make ours look like a Sunday afternoon picnic.

Mr. GALLIGAN. But as a electric utility industry, we produce more electricity than the next five nations in the world. We do it at a much higher level of reliability, and we do it at a higher cost. That came out of this capital system.

Chairman HUMPHREY. There are reasons for it. We have a bigger market than anybody else, and second, a higher standard of living. We had more resources up into the 1960s, we were absolutely fuel independent, lets face it.

Mr. GALLIGAN. But Russia has many of those things.

Chairman HUMPHREY. I don't want to compare the United States to Russia. That would be like comparing Humphrey's Drug Store to the Chase Manhattan Bank. There is no comparison. They are technically behind us and they don't have the marketing system. I am proud of our system. I am so proud that I want it to work. But what worries me is the reluctance I feel on the part of business leaders to come to grips with some of the real problems in the free enterprise system. They talk free enterprise and they talk competitive price.

I am not talking about your utilities. Those are regulated. You have got your own problems as a particular kind of regulated industry. But that automobile industry really gets me. I will tell you, I just couldn't believe it. I have grown up in a family—I have uncles that are big business people, and there has never been anything in our family but farmers and business people. I never could understand why somebody wasn't willing to liquidate an inventory if they are over priced and couldn't sell.

Representative LONG. I would suggest, Mr. Chairman, that the parallel you drew with respect to kidnaping might be very pertinent and very apt here. Perhaps what has happened, if you look at both the political end of it and the politics having to shape up—with which I completely agree—and you talk about American economy in industry having to shape up—with which I agree—perhaps it is like your remarks relative to kidnaping, some of the big ones finally got caught, so it is going all the way down the line and many others are now getting caught.

Chairman HUMPHREY. I think you are right.

I notice in my own county—I try to stay familiar with where I live—I notice that Northern State Power on the Perry Island Nuclear Plant, which was considered a very good, modern one, gets 24 percent efficiency, on the line about 24 percent of the time.

The reliability of nuclear power in VEPCO—maybe I should ask you this, because my facts may be wrong. VEPCO's Surry I unit is 52 percent since it opened in 1972?

Mr. RAGONE. That is correct. Surry II a little bit better.

Chairman HUMPHREY. 45 percent on Surry II since 1973.

Mr. RAGONE. I think there has to be an explanation. The nuclear units, up until the time they are first refueled, are going through a maturing period. We did not anticipate better than 60 percent up through the first refueling. We have too many startup and related problems, and these units were duplicates to save money. But fortunately, when you have one that has a problem that is possibly safety related, it must be cured in both of them immediately. We have no quarrels with that. Even though the way they did operate—and this is what you have to take into account—in 1974, these units had a capacity factor less than that 52 percent, roughly in the range of 50 percent. But they saved VEPCO's customers over $40 million in electric bills, taking into account the greater investment and operating costs associated with nuclear units. Also the two Surry units only have to operate at a 15 percent capacity factor to offset extra nuclear investment at current fossil fuel costs.

Chairman HUMPHREY. That is very interesting.

Before closing and without objection, I hereby ask that the record include a statement of Mr. Brophy, president of General Telephone & Electronics Corp., on behalf of the United States Independent Telephone Association.

[The statement follows:]

STATEMENT OF THEODORE F. BROPHY, PRESIDENT, GENERAL TELEPHONE & ELECTRONICS CORP., ON BEHALF OF THE UNITED STATES INDEPENDENT TELEPHONE ASSOCIATION [1]

The financial plight of the utilities—both telephones and electrics—threatens to undermine the basic infrastructure of our economy. A combination of factors, including record inflation, high interest rates, inadequate depreciation to fund replacement of obsolescent plant and equipment, and strained debt capacity has produced serious doubt as to the ability of the utilities to finance adequately their required construction programs.

Perhaps the most dramatic manifestation of this fundamental problem came a year ago when Consolidated Edison passed its quarterly dividend. Because of similar underlying problems, other electric and telephone utilities have announced drastic cutbacks in their construction programs. In 1975, for the first time in twenty-seven years, the budget for new construction of the Independent telephone industry will be less for the previous year. While the industry has shown an annual average construction growth of 12.2 percent over the last decade, the forecast for 1975 indicates a decline of close to 7 percent, thereby making the decline close to 20 percent below normal growth. Taking inflation into account, the cutbacks are much greater in real terms. In terms of dollars, the cutbacks in 1975 construction amount to around $400 million for the Independent telephone industry. In terms of jobs, a $400 million cutback in construction would result in a direct loss of 12,000 jobs further aggravating the recession.[2] Unless this trend can be reversed, it will inevitably lead to degradation of service, serious damage to our economy, and jeopardy to the public's safety and welfare.

These construction cutbacks reflect the continuing difficulty the utilities have experienced during the past several years in raising funds externally. Recently, there have been further (i) downgradings of utility bond ratings, (ii) cutbacks in the size of security offerings, and (iii) sales of common stock below book value. As an example of sales below book, GTE—the largest Independent—recently sold 6,000,000 shares at a net of $15.55 per share, although GTE's book value was $21.71 per share.

The current scarcity and high cost of capital have a peculiarly adverse impact on the utilities. The utility business inherently requires large amounts of capital relative to revenues (Exhibit 1). U. S. Department of Commerce figures show that total expenditures for plant and equipment have been rising more rapidly in the utility area than in the economy in general (Exhibit 2). His-

[1] The United States Independent Telephone Association (USITA) represents the independent (non-Bell) segment of the telephone industry in the United States. The independent telephone industry consists of 1,697 operating telephone companies serving over 25 million telephones through 11,100 exchanges in over one-half of the served geographical area of the nation. These companies, together with the operating companies of the Bell System, provide exchange and interexchange telecommunications services through the integrated facilities of the telephone network.

[2] The 12,000 figure is an extrapolation from our estimate for the GTE domestic telephone operating companies that a $100 million cutback in construction would cause a direct loss of 3,000 jobs. This figure would be substantially increased by the addition of indirect job losses.

torically, the construction expenditures by the telephone utilities are almost as large as those of the electric utliities, and they have been increasing about as fast (Exhibit 3). These utilities compete directly with each other and with all others for the limited amount of available capital.

The ability of telephone and electric utilities to fund their necessary construction programs adequately is seriously impaired. First, the ability to issue additional debt is practically foreclosed by high debt-equity ratios (Exhibit 4) and inadequate interest coverages. The average interest coverage of the electric and Independent (non-Bell) telephone utilities is estimated to be below 3.0 times in 1974 (Exhibit 5), and individual companies were close to the 2.0 ratio below which point they would be foreclosed by indenture limitations from issuing additional long-term debt.

Secondly, the ability to shore up the sagging capital structures with the sale of additional common stock equity is sharply limited by marketability and the spectra of dilution.[3] The average return on equity of the utilities barely exceeds the average of Moody's "A" utility bond interest rates (Exhibit 6). Many utilities have bond ratings below the single-"A" rating. The depressed market prices of utility stocks reflect their relatively poor earnings. A comparison of the ratio of market-to-book values and return on equity (ROE) for 106 utilities listed on the New York Stock Exchange shows that all but eight are selling below book value (Exhibit 7). Thus, common equity can be raised by the utilities only by introducing the degenerative spiral of dilution.[4,5]

Because of limitations on sales of debt and the unfavorable common equity market, many telephone and electric utilities have attempted to sell preferred stock. However, the market for preferred in its present form is extremely thin and consequently has not provided a large source of equity capital.

Capital conservation programs based on construction cutbacks and stretch-outs are not a satisfactory solution. These programs threaten the ability of American industry to move forward with the assurance of the availability of adequate, basic utility services. If the utilities are to be able to meet the demands for additional service and to replace obsolescent plant, the availability of funds to them must be promptly increased.

The flow of funds can be increased (i) internally, through inproving cash flow, and (ii) externally, through the sale of securities. Tax relief, if promptly enacted, will promote restoration of financial health and will help provide the funds necessary for the utilities' construction programs in the near term. But fundamental regulatory reforms are needed as well.

I. THE CONGRESS SHOULD PROMPTLY INCREASE THE INVESTMENT TAX CREDIT AND FACILITATE THE RISING OF PREFERRED AND COMMON EQUITY

To alleviate the serious and immediate problems facing all utilities and to stimulate the economy and encourage full employment, the Congress should immediately adopt the following three tax proposals:

(1) Permanently increase the investment tax credit (ITC) to 12 percent, equalizing the non-utility and utility ITC rates, and remove the 50 percent limitation;

(2) Allow a corporate tax deduction by the issuer at its option for dividends paid on designated new issues of preferred stock; and

(3) Allow tax deferral for shareholders' automatic reinvestment of corporate dividends, or reinstate the *Citizens Utilities* ruling.

These proposals offer significant benefits not only to the utilities but to the economy as a whole. The major immediate benefit to the economy is that they are anti-recessionary and will provide jobs. These proposals will help the

[3] Dilution occurs when there is an increase in the number of shares of stock outstanding without a corresponding increase in assets and earning power.

[4] Dilution is an unsound financial policy for any company which must go to the equity market for financing. Repeated sales of equity below book value eventually result in a situation where equity cannot be sold at any price. See Roseman, "Utility Financing Problems and National Energy Policy", 94 Public Utilities Fortnightly, No. 6, Page 19 (September 12, 1974).

Dilution is particularly pernicious for utilities which are subject to governmental limitations on potential return. Utility shareholders earn only on the utility's investment (rate base). Thus, dilution results in a division of the investment among a greater number of stockholders—a dilution of the very earning power of the stock itself.

[5] The dilution problem is not confined to the utilities. Other capital intensive industries, such as banks, also face the same problem (Exhibit 8).

utilities finance the basic services that are needed for a growing, prosperous, and efficient economy. Moreover, investment as a percent of Gross National Product in the United States is less than in the rest of the world,[6] and these proposals will provide needed capital to help correct this imbalance. The resulting increased investment will also help to increase productivity and thereby make domestic products more competitive in world markets.

(1) Increased investment tax credit

In the past, the investment tax credit has proven to be an effective tool for fighting recession, unemployment and inflation. Without an increase in this credit, we foresee continued widespread construction cutbacks in the telephone and electric utility industries which will result in increased unemployment, higher costs and degradation of vital utility services which are so necessary for a healthy economy. A permanent 12 percent investment tax credit will immediately provide corporations, including the telephone and electric utilities, with needed cash flow strengthening their capital structures and improving their return on common equity and interest coverage. In addition, the proposal will reduce the external demand for funds, thus relieving the strained capital markets. Furthermore, it will help to restore business and investor confidence.

Congress should eliminate anomalous discrimination in the investment tax rate which currently favors industrial corporations (7%) over public utilities (4%). Congress should also eliminate the 50 percent limitation on the use of the credit.[7] This arbitrary limitation deprives those capital intensive companies with the poorest earnings—the ones which need help the most—of the full benefits of the investment tax credit.

(2) Optional deductibility by the issuer for tax purposes of dividends paid on new issues of preferred stock[8]

Enactment of the proposal to allow a corporate tax deduction by the issuer (if the issuer so elects) for dividends paid on new issues of preferred stock would make an important and substantial contribution to the ability of the financial markets to meet the capital needs of the economy. Most importantly, the adoption of the proposal will help combat recession by supporting capital spending programs, which will bolster the economy in general and employment in particular. In addition, the proposal will reduce the net cost of capital to issuing corporations and thereby help to retard the rising cost of utility and other services to the public.

Implementation of the proposal would immediately broaden the market for preferred stock, because the issuer would be enabled to pay a higher dividend rate on the new type of preferred stock than in currently available on most income securities of similar quality without adversely impacting internally generated funds. Whereas the attractiveness of traditional preferred stock has been largely limited to corporate investors, such as fire and casualty companies and savings banks which can utilize the 85 percent dividend-received deduction (IRC § 243), the new preferred will be attractive to pension funds and other tax-exempt institutions, and mutual funds, as well as individuals. The new market thus created will particularly benefit the companies having limited or strained debt capacity. It will afford American industry a means of reducing debt ratios, broadening financial bases, and supporting or restoring bond and other credit ratings. The use of the new preferred will improve net earnings, cash flow, and return on common equity, and thereby help to restore and preserve capital investment programs and jobs.

A company not electing the new alternative because it cannot utilize the tax deduction, or for any other reason, could continue to sell, with reduced competition, traditional preferred stock to institutional investors who would continue to utilize the 85 percent dividend-received deduction (IRC § 243). Indeed, some companies may offer both types of preferred stock.

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[6] Statement of the Honorable William E. Simon, Secretary of the Treasury, before the House Committee on Ways and Means, Washington, D.C., January 23, 1975; Table No. 7.

[7] Currently, the investment tax credit is limited to 50% of the tax liability of the corporation.

[8] Under this proposal, dividends paid on qualified preferred stock would be allowed as a tax deduction to the payor corporation. The deduction would only be available for cash dividends paid on new preferred stock issued after December 31, 1974, for cash or pre-existing bona fide debt of the issuing corporation. The provision of the IRS Code providing for exclusions for dividends received by corporations would not be applicable to these dividends.

In addition to this indirect benefit, it is expected that utilities which do not currently pay taxes, ultimately will improve their earnings sufficiently to enable them to obtain the direct benefits outlined above.

(3) Deferred taxation of reinvested dividends

Deferral of taxation of dividends on common stock of all corporations reinvested by stockholders[9] will materially contribute to the solution of the fundamental, long-term problem of inadequate savings and capital formation. The proposal will create a new and significant source of needed equity funds for all corporations issuing new stock under these programs. The increased cash flow will support capital expenditures and related jobs and will reduce the strain on the capital markets as well as improving investor confidence. It will help cashstarved utilities maintain existing dividend levels and thus forestall further shocks to the capital markets such as followed the omission of a quarterly dividend by Consolidated Edison in 1947.

Deferral of taxation on reinvested dividends will materially increase stockholder participation in existing automatic dividend reinvestment plans and will also encourage other companies to establish such plans for their shareholders.

Further, the deferral of taxation will equalize the tax treatment of investors in high-growth, low-payout and low-growth, high-payout companies, thereby permitting the utilities to broaden their investor groups. The broadened market and the increase in the effective return on the shareholder's investment will facilitate the sale of additional securities on improved terms. The equity generated will thereby strengthen the capital structure of American industry and stimulate increased employment.

II. THE REGULATORY PROCESS MUST RESPOND TO CHANGING ECONOMIC CONDITIONS

Fundamental to the long run financial health and stability of the utilities are adequate earnings. Without adequate earnings, a utility can neither raise needed equity capital nor float long-term debt at reasonable cost. Since nearly half of the utilities' construction budgets are funded through external financing continued adequate earnings are necessary to sustain new construction and to avoid deterioration of service quality. Without adequate earnings, telephone and electric utilities will not be able to raise the capital necessary to provide adequate utility service to the public.

The existing regulatory process has largely failed to respond adequately to changing economic conditions. More specifically, it has failed to respond adequately to the inflation we are experiencing (Exhibit 9). While inflation has forced utility bond interest rates up sharply (Exhibit 10), the regulatory commissions have not allowed the earnings of the utilities to keep pace. The "spread" between bond interest rates and return on equity has narrowed practically to extinction (Exhibit 6).

Too often rate increases have been too little and too late. Substantial delays between the filing of requests for rate increases and commission disposition are, unfortunately, not uncommon.[10] Furthermore, the rate allowed is seldom earned (see appendix). To the extent such results reflect attempts by the regulators to "fight inflation" by holding down telephone rates, they are misguided. For the telephone companies are not the cause of inflation (Exhibit 12) ; they are the victims.

The primary thrust of regulatory reform must be to obtain a substantially higher return on equity. The restoration of a reasonable differential between return on equity and long-term interest rates that will compensate for the added risk element in equity investment is necessary to attract investors.

In addition to making it possible for the utility industry to earn a reasonable return on equity, it is imperative that steps be taken immediately to eliminate the excessive regulatory lag. There are a number of different mechanisms which might accomplish this objective.

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[9] Under this proposal, dividends on common stock which are directly reinvested under automatic dividend reinvestment programs by stockholders in the same company paying the dividend would be exempt from taxation until disposition of the shares so acquired. Normal capital gains tax treatment would apply where the stock was ultimately sold. In effect, the stockholder would be taxed as though he had received a stock dividend as under the IRS' 1956 *Citizens Utilities* ruling.

[10] Exhibit 11 shows the regulatory lags experienced by the domestic GTE telephone operating companies.

(A) Rate increases should be authorized to go into effect immediately upon the filing of new rates, with a refund bond to protect the customer. Such increases could be limited to a maximum of 15 percent (for example) of existing rates in any twelve-month period.

(B) Utilities should be permitted to use a forecasted test period in filing rate applications. Presently, in most jurisdictions, rates are based upon a company's revenue needs as determined by historical operating or earning results. Consequently, by the time rates are approved and made effective, the effects of inflation have further eroded earnings and the utility fails to earn the rate of return on equity determined to be fair by the regulatory authority. (The lag and attrition problems are discussed in detail in an appendix to this statement.) The use of forecasted test period results would facilitate the determination of revenue requirements more in line with current costs of providing service.

(C) Regulatory authorities should be required to issue final decisions with regard to applications for rate adjustments within a reasonable, finite period of time after the applicant files an application. This would greatly assist companies in their short and long-range financing plans, which must be geared to meet demands for service.

(D) A comprehensive program of automatic rate adjustment procedures should be adopted. Automatic rate adjustment provisions will eliminate delay and unnecessary expense both on the part of the utility and the commission with respect to clearly defined items that really require no hearings and are based on undisputed and indisputable facts.

Automatic rate adjustment clauses not only permit the utilities to obtain justifiable rate increases without attrition and lag but could serve to unburden the regulatory commissions from the tremendous load occasioned by the almost unbroken chain of rate cases which utilities must file in order to keep pace with inflation. This, in turn, would permit commissions to devote their valuable time and expertise to those important issues which would not be subject to the automatic rate adjustment clauses.

Some steps are being taken in certain states to implement these reforms. These efforts must be expanded as soon as possible in order to counteract the damaging effects of inflation and to help the industry procure badly needed capital. The deleterious effects of regulatory lag have been recognized by many, including Dr. Arthur Burns in his testimony before your Committee on October 10, 1974 when he urged the Administration to move quickly in urging regulators to speed up decisions on rate increase applications.

In addition to regulatory reform including the elimination of regulatory lag, certain accounting reforms to offset inflationary pressures, such as liberalization of depreciation rates and inclusion of construction work in progress in the rate base, should be adopted by the regulators.

Many of these regulatory reforms are incorporated in Title VII of H.R. 2633 and in S. 594—but limited to electric utilities. The regulatory problem should be treated on a unified basis, with the telephones included.

CONCLUSION

The utility financing problem is a serious one. It has a direct impact on the economy as a whole and threatens to undermine the basic infrastructure on which the health and growth of American industry depends. Moreover, the utilities, through their large capital expenditures for required construction programs, directly employ a significant portion of the American labor force. The utilities, through their large purchases of capital goods, indirectly support jobs in the manufacturing and service sectors as well.

The utility financing problem affects all utilities—not just the electrics. The pertinent financial ratios of the electric and telephone utilities demonstrate that the financing problems of both are acute.[11] Therefore, any solution to the "utility" problem must include the telephone utilities.

Solutions to the utility problem must embrace tax relief, making the regulatory process more responsive to changing economic conditions, and necessary accounting reforms.

Tax relief should include: (1) permanent increase and liberalization of the investment tax credit, (2) optional deductibility of dividends on designated

[11] See Exhibits 1, 3–7, and 10.

new issues of preferred stock, and (3) tax deferral of automatically reinvested dividends.

Reform of the rate making process is equally essential to a long-term solution of the utility financing problem. Congress has a direct and immediate responsibility to see that the Federal regulatory agencies employ sound rate making policies and procedures. Congress has an indirect and equally urgent responsibility to foster—and require, where necessary and appropriate—sound rate making procedures by the state regulatory commissions.

Accounting reform should include liberalization of depreciation rates and inclusion of construction work in progress in the rate base.

The proposals discussed above would not only help to alleviate the critical financial problems of the capital intensive utility industry, but would provide a much needed stimulus to the economy in general and employment in particular.

The entire utility industry, *including the telephone sector,* is committed to providing required public service. We share with the Congress this responsibility to the American public. We need the Joint Economic Committee's enthusiastic endorsement and active support to accomplish the essential reforms discussed in this statement.

Appendix

REGULATORY LAG AND ATTRITION

An important part of the problem is regulatory lag and attrition. In GTE telephone operations we have averaged, over a three-year period, nine months' delay for a rate case from the time of filing to the grant of rate relief. One case settled in January 1975 required over two years to receive an order and we still have one case which has been on file for over three years. Another case, settled in 1973, was decided in three months, but we were allowed no increase.

The following hypothetical example illustrates the impact of lag and attrition (Exhibit 13, 14, and 15).

It is assumed that the utility has 60 percent debt and 40 percent equity; that it has a 6 percent embedder interest rate; that depreciation represents 20 percent of operating costs and that the remaining operating costs increase at the rate of inflation. It is also assumed that the inflation rate is 8 percent and will remain steady for the three-year period to be discussed; that the income tax rate is 50 percent; and that it is necessary to wait twelve months from the date of application for the rate increase to the date of the award.

Exhibit 15 shows the back-up figures for Exhibit 14. Exhibit 14 is a schematic diagram of the effect of lag and attrition. Lag is defined as the impact of the delay between the time of filing and the time of granting of the rate increase, assuming no impact from inflation. Attrition is defined as the effect of inflation on return on equity. In the example, it is assumed that the utility was earning a 10.5 percent return on equity and needed a 15 percent return on equity. It filed a rate case asking for sufficient revenue to give it that 15 percent rate of return.

At the end of one year, immediately prior to the granting of the rate award, the return on equity, because of attrition, had declined to 9 percent. Assuming that the entire amount of revenue requested was awarded, on the date of the award, because of attrition, the return on equity realized would only be 13.5 percent. A year later, because of continued attrition, the return on equity would be 12 percent. Two years after the award, the return on equity would be 10.4 percent, actually lower than the return on equity at the time the original rate case was filed.

For each $1,000 of equity investment, the utility actually required $180 in net income in order to earn the required 15 percent return on equity. Because of lag, it lost all the earnings indicated in the rectangle on the left side of Exhibit 14. Because of attrition, it lost all the earnings indicated by the scalloped segment of the diagram with the result that its actual total earnings for the three-year period were only $135. The other $45 required was lost forever. In other words, the utility fell 25 percent short of achieving earnings necessary to meet the financial integrity of the utility and to attract equity money from the marketplace at a price in excess of book value.

EXHIBIT 1

An Asset - Intensive Business

Assets Required to Generate One Dollar of Sales Revenue

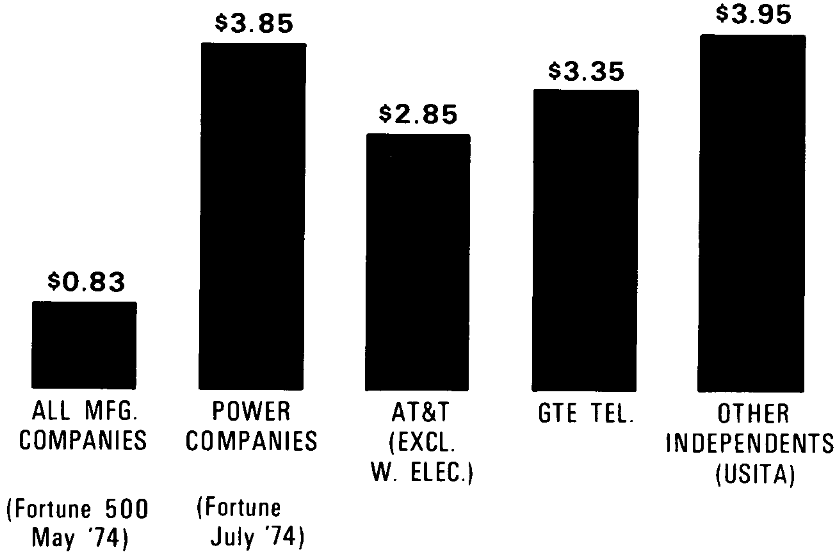


EXHIBIT 2

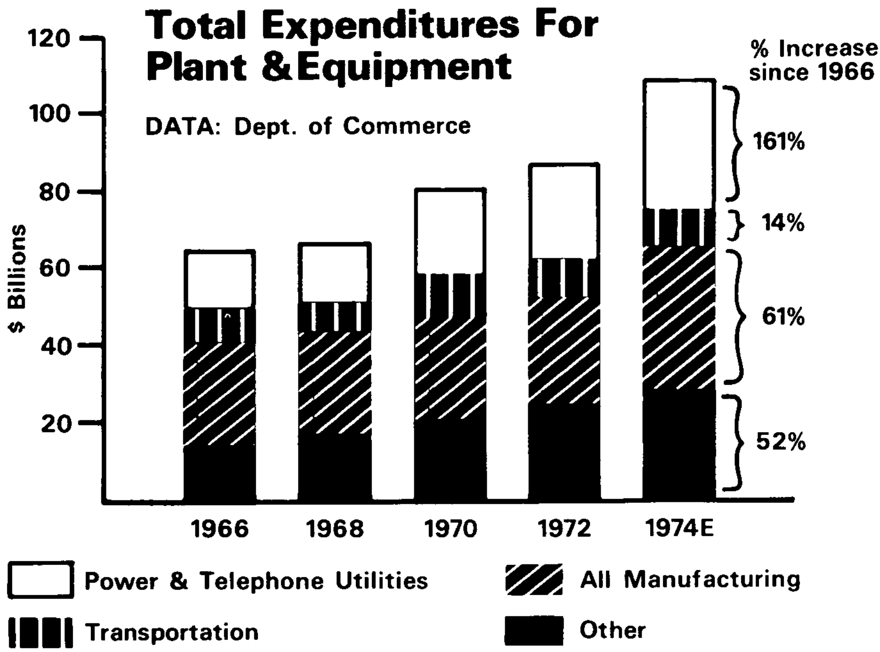

Total Expenditures For
Plant & Equipment
DATA: Dept. of Commerce
% Increase
since 1966
161%
14%
61%
52%
$ Billions
120
100
80
60
40
20
1966
1968
1970
1972
1974E
Power & Telephone Utilities
All Manufacturing
Transportation
Other

EXHIBIT 3

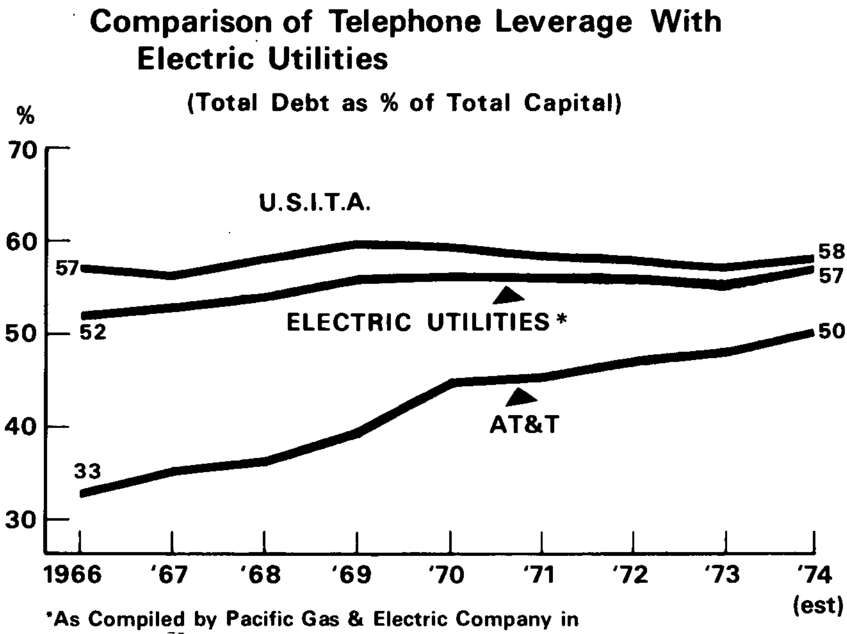
CONSTRUCTION EXPENDITURES

[Dollars in millions]

Year	Electrics [1]	Telephone industry [2]
1974 (estimated)	$14,300	$12,600
1973	14,600	11,587
1972	13,385	10,314
1971	11,894	9,438
1970	10,145	8,737
1969	8,294	7,213
1968	7,140	6,033
1967	6,120	5,469
1966	4,932	5,237
1965	4,027	4,769
1964	3,551	4,231
1963	3,319	3,759
1962	3,154	3,557
1961	3,256	3,221
1960	3,331	3,168
Total	111,448	99,333
Average annual growth rates (percent):		
1968–74	12.3	13.1
1960–68	10.0	8.4

[1] Investor-owned electrics: Smith, Barney & Co., Inc. (using Edison Electric Institute figures).
[2] Includes companies reporting to the United States Independent Telephone Association (USITA) and A.T. & T.

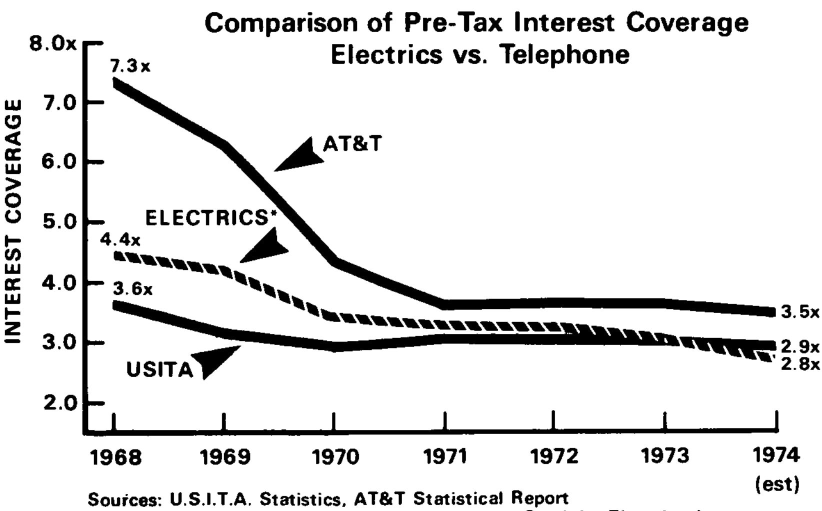
EXHIBIT 4



*As Compiled by Pacific Gas & Electric Company in Comparative Financial Data: Fifty Largest Utility Companies

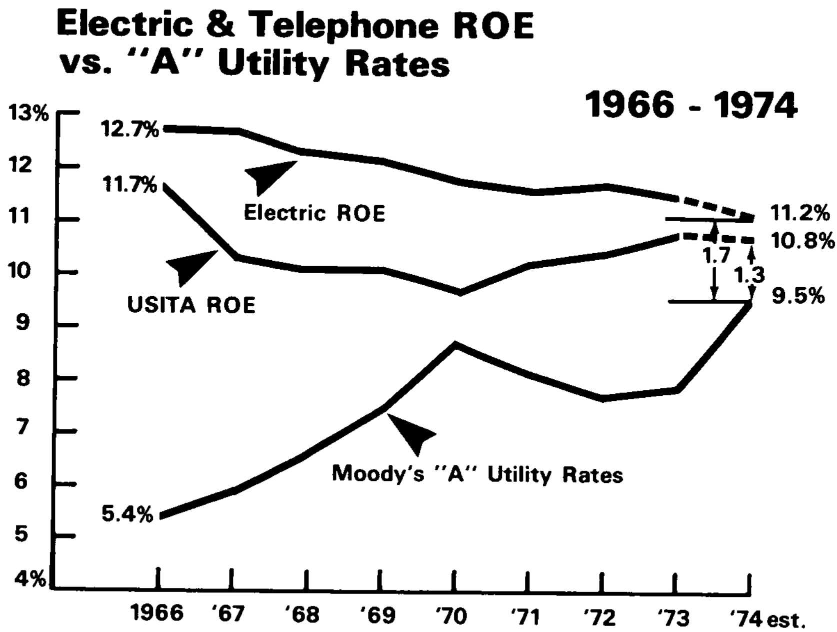
Source: As Above: AT&T Statistical Report, and U.S.I.T.A. Statistics

EXHIBIT 5



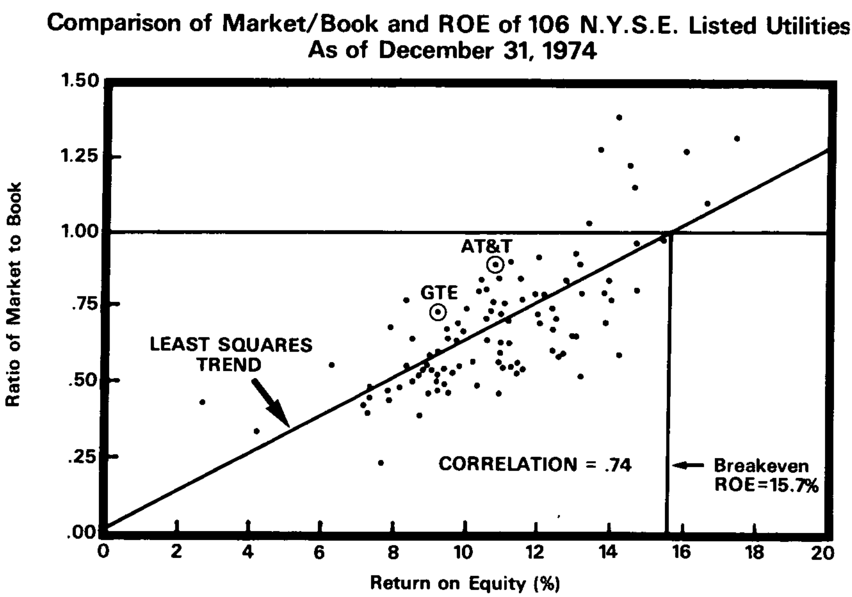
Sources: U.S.I.T.A. Statistics, AT&T Statistical Report
*Pacific Gas & Electric's 29 Largest Straight Electrics in Comparative Financial Data: Fifty Largest Utility Companies

EXHIBIT 6



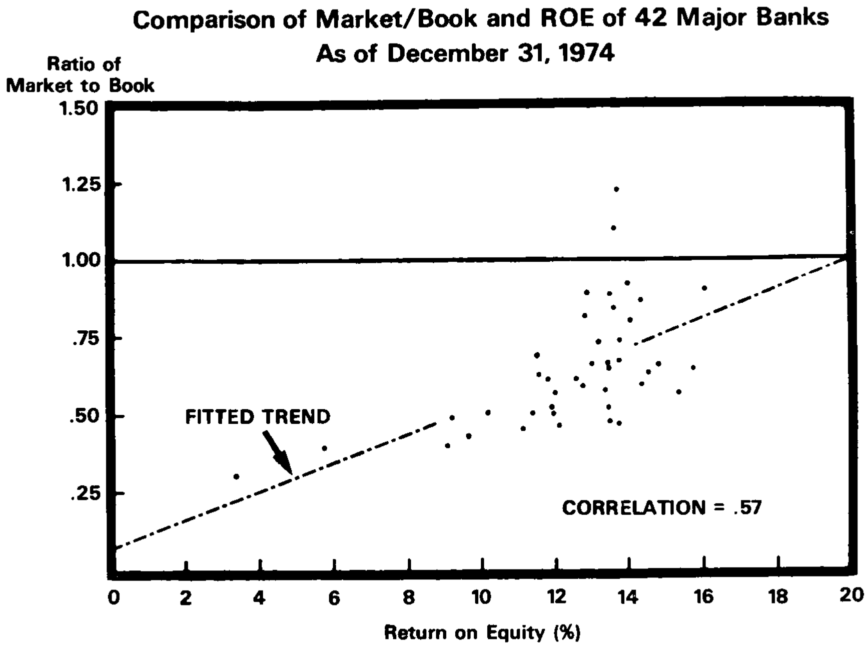
SOURCES: Edison Electric Institute Statistical Yearbook
USITA Statistics, Vol. 1
Moody's Investors Service

EXHIBIT 7



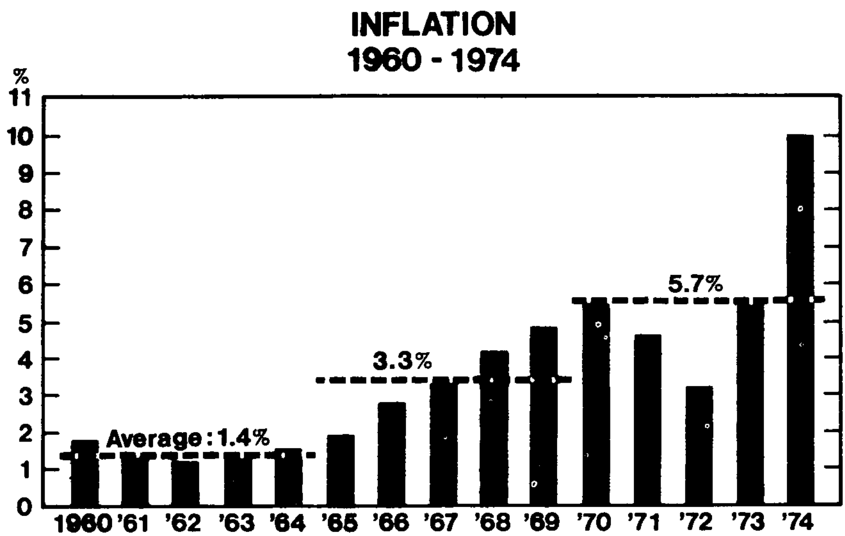
SOURCES: Media General Financial Weekly
Time Sharing Resources

EXHIBIT 8



SOURCES: Standard & Poor's Stock Guide
Time Sharing Resources

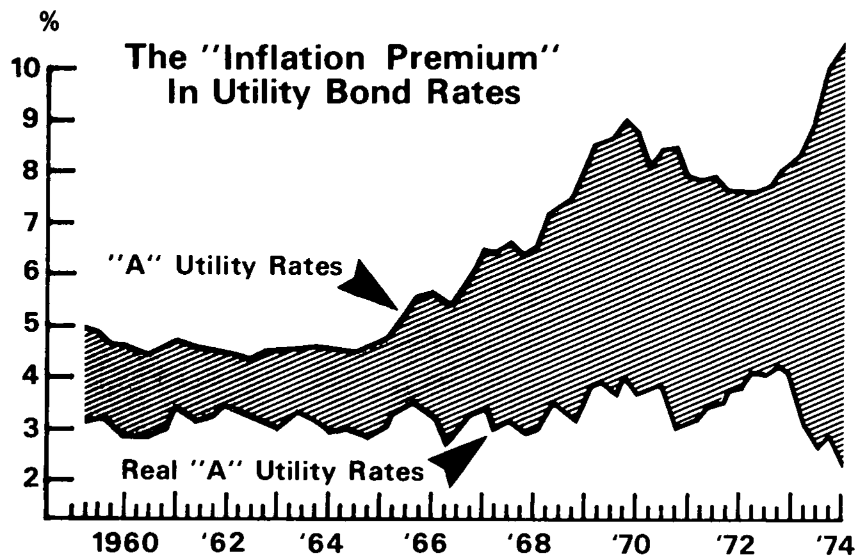
EXHIBIT 9



Source: GNP Deflator, Department of Commerce

EXHIBIT 10

"Inflation Premium"



Basic Source: Moody's Investors Service and U.S. Dept. of Commerce

EXHIBIT 11

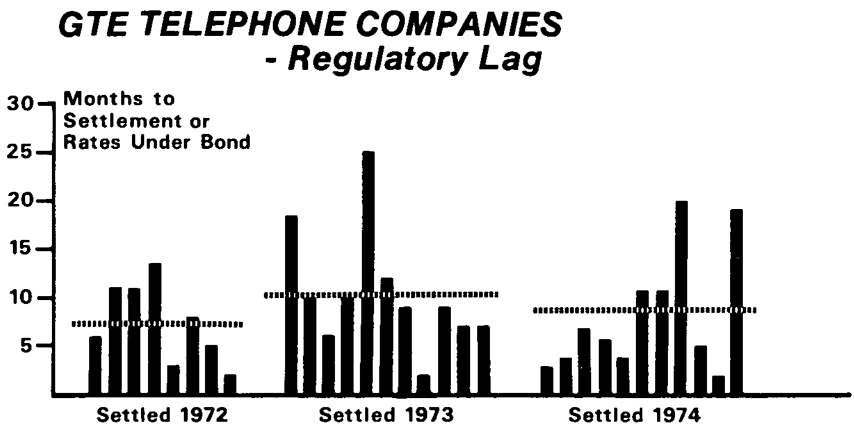
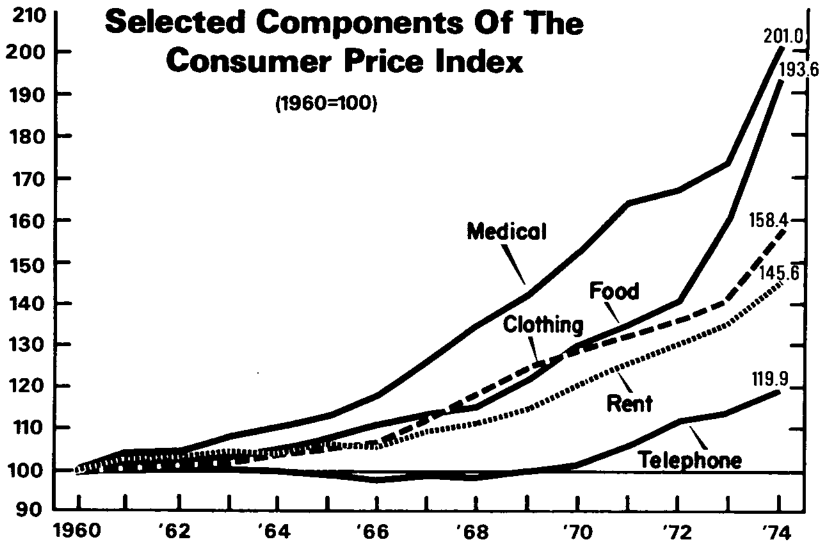


EXHIBIT 12



SOURCE: Bureau of Labor Statistics

EXHIBIT 13

ILLUSTRATION OF LAG/ATTRITION EFFECTS

Assumptions:

60/40 Debt/Equity—Remains Constant Through Period.
6% Embedded Interest Rate—Remains Constant Through Period.
Depreciation, 20% of Operating Costs—Remains Constant Through Period.
Other Operating Costs Increase at Inflation Rate.
8% Inflation Rate—Remains Constant Through Period.
50% Income Tax Rate—Remains Constant Through Period.
12 Month Period Between Rate Filing and Rate Award.

EXHIBIT 14

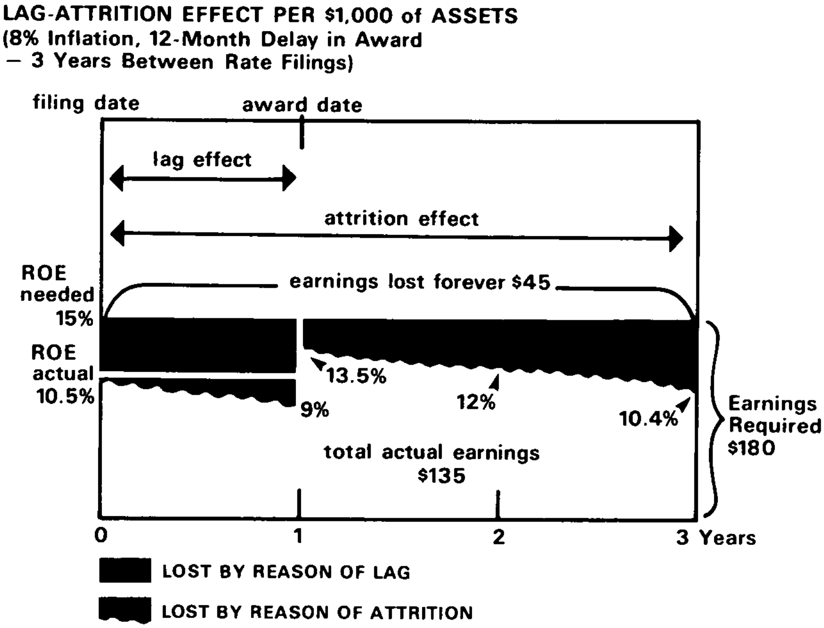


EXHIBIT 15

LAG-ATTRITION EFFECT: 8% INFLATION, 12 MONTH DELAY IN AWARD

[Per $1,000 assets]

	Filing date		1 year later (Before award)	1 year later (After award)	2 years later	3 years later
	Actual	Requested				
Revenue	300	336	300	336	336	336
Operating cost	180	180	192	192	204	217
Income tax	42	60	36	54	48	41.5
Net operating increase	78	96	72	90	84	77.5
Interest	36	36	36	36	36	36
Net profit	42	60	36	54	48	41.5
ROE (percent)	10.5	15	9	13.5	12	10.4
Cumulative earnings loss				(21)	(30)	(45.2)
Cumulative actual earnings				39	90	134.8

Chairman HUMPHREY. The committee stands recessed until tomorrow morning at 10:30.

[Whereupon, at 1:15 p.m., the committee recessed, to reconvene at 10:30 a.m., Wednesday, January 29, 1975.]

THE 1975 ECONOMIC REPORT OF THE PRESIDENT

WEDNESDAY, JANUARY 29, 1975

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

The committee met, pursuant to recess, at 10:35 a.m., in room 1318, Dirksen Senate Office Building, Hon. Hubert H. Humphrey (chairman of the committee) presiding.

Present: Senators Humphrey, Bentsen, Javits, and Fannin; and Representatives Bolling, Long, and Brown of Ohio.

Also present: John R. Stark, executive director; Loughlin F. McHugh and Courtenay M. Slater, senior economists; Richard F. Kaufman, general counsel; William A. Cox, Lucy A. Falcone, Robert D. Hamrin, Sarah Jackson, Jerry J. Jasinowski, Carl V. Sears, George R. Tyler, and Larry Yuspeh, professional staff members; Michael J. Runde, administrative assistant; Leslie J. Bander, minority economist; and George D. Krumbhaar, Jr., minority counsel.

OPENING STATEMENT OF CHAIRMAN HUMPHREY

Chairman HUMPHREY. The meeting of the Joint Economic Committee will come to order. Welcome to our witnesses today.

Today's hearing will examine the President's proposed economic program with emphasis on his energy proposals. May I say that in the more recent hearings we have been giving a good deal of attention to the energy proposals in the hopes that we can elicit some better suggestions. I could not help but think that the Ford Motor Co. had the better idea, and that is really what we are looking for here, so we will listen with great attention.

We shall hear testimony from three witnesses who are very well qualified to discuss this matter: First, Professor Hendrik Houthakker of Harvard University, who has worked extensively on energy economics in recent years in addition to his well-known previous work in the general field of taxation and fiscal policy; second, George Perry of the Brookings Institute, who has testified before this committee previously on these questions, and for whose ability as an economic forecaster we have the greatest respect; and third, John Sawhill, who probably knows more than anyone else of the background and the details of current energy policy and the difficulties of implementing a fair and comprehensive national policy in this thorny area.

Congress and the President agree at last in diagnosing the basic ailment of the Nation's economy: Both now recognize that we have a serious recession and that a sizable tax cut is needed to reverse it. But many Members of Congress—probably a majority—dissent emphatically from the President's prescriptions for energy policy. I, myself, am baffled by his recommendations in this field.

To me, the President's plan for higher prices and heavy new taxes on energy commodities seems to promise a renewal of the past year's inflation combined with this year's recession to give us the worst of both worlds. The proposed tax rebate clearly would not cover the full-price impact of Mr. Ford's energy package, so his measures would bring about another decline in the real income of most consumers. This income loss to the consumers would appear to go largely to energy producers. Even if Congress supplements the President's unilateral action on tariffs by passing the requested domestic taxes on oil and gas, his proposals would leave unconscionable new windfalls for gas and coal producers. How, I ask you, could the President overlook these consequences of his program, especially after the large windfall profits going to these industries in the year just past? On top of these major defects in the Ford program, no one has shown convincingly to my knowledge just how this package would achieve the energy conservation objectives that have been laid down. Yet President Ford intends to impose this plan upon the country with haste but without examination, debate, or the necessary accompanying legislation.

Today we must address the basic question of the justification for the announced conservation goals for 1975. This is fundamental! Is it really necessary to turn the economy on its head to save 1 million barrels of oil per day this year? If attainment of this goal is vital, then how can we reach it without so much disruption as the President's plan threatens to create? May I say that there is, of course, honest legitimate argument over this. There are a number of witnesses who believe that the plan is too much of a blow at one time. If so, what goals are appropriate? Most important, which steps should we undertake now to give us the savings attainable in the short run plus a really effective conservation effort over a long period, during which basic changes can be made in equipment design and pattern of transportation, production, and residential construction?

We will hear statements from each witness before turning to questioning. It will help us if each of you will limit your oral statement to 15 minutes and as I said, we would like to go through the three statements so we have some continuity of authority here and then we would open up for questions.

Mr. Houthakker, would you begin the testimony to be followed by Mr. Sawhill and then Mr. Perry.

STATEMENT OF HENDRIK S. HOUTHAKKER, PROFESSOR OF ECONOMICS, HARVARD UNIVERSITY

Mr. HOUTHAKKER. Thank you, Mr. Chairman.

Mr. Chairman, allow me to start by congratulating you on assuming the leadership of this committee and by thanking you for the opportunity to appear before it. I realize that energy is supposed to be the main topic of discussion this morning, but with your permission I would first like to say something about more important matters. As I will explain later the best thing we can do in the energy area is to cease and desist from the foolishness in which we are now engulfed and let market forces bring about new equilibrium. This does not mean I am unconcerned about present and future developments in the energy area, but I am much more alarmed about the general economy.

The economy is now going through a decline of terrifying steepness. From the third quarter to the fourth quarter of 1974, real GNP fell at the highest rate recorded since quarterly data started in 1974. The increase in unemployment is also without precedent in recent decades. Unlike most previous post-war recessions, moreover, the present one is not dominated by inventory adjustments, but appears to have a more deep-seated character, although superficial explanations in terms of energy shortages do not appear to hold water.

What has already happened in the current recession is bad enough, but my concern is further increased by looking at recent monetary policy. According to the weekly figures, which admittedly are somewhat inadequate for analytical purposes, the money supply has been falling for several weeks, and is now no higher than it was 3 months ago. It is true that interest rates have declined somewhat but this should not be interpreted as indicating a less restrictive monetary policy. The fall in interest rates appears to be due not to easier monetary policy but to a decline in the demand for money, which is normal in a deep recession. There is much evidence that a sustained fall in money supply will lead to a fall in money GNP, and hence to an even steeper fall in real GNP when prices are rising. Since the apparent reduction in the money supply is only a few weeks old, and may be due primarily to international factors, I do not want to make too much of it. Nevertheless, it would not be amiss to remember what Friedman and Schwartz had to say about the effects of perverse monetary policy on the early development of the great depression.

There is widespread agreement among economists that the economy needs stimulation without further delay. Getting monetary policy back on a track of moderate expansion is the first order of business, but tax cuts are also necessary. I have reservations about some details of the President's fiscal program, yet I hope that a prolonged legislative debate can be avoided and some fiscal stimulus applied during the next few months. The idea of rebating a part of the 1974 income tax is an ingenious one which should be implemented without interminable discussions about equity. The proposed permanent reduction in the individual income tax is also necessary and should certainly not be made conditional on passage of the energy tax proposals, whose merits I will discuss in a moment. My most serious reservation concerning these permanent reductions relates to the corporate income tax, which in view of the deterioration in the capital markets needs a more drastic restructuring than is currently under consideration. However, today's hearing may not be the right occasion to expand on this point.

Another defect of the President's program is that it appears to be based on a simple dichotomy between inflation and recession. What we have had for the last year or two is stagflation, a phenomenon that calls for a more sophisticated approach. There are now many signs that inflation is receding, but we have to keep the next recovery in mind and try to make it less inflationary than the preceding one. This can be done by a policy aimed at greater efficiency by removal of obsolete Government restrictions on competition—often known as the "sacred cows". More active competition in the product, labor and capital markets will at the same time increase real GNP and lower prices. It is sometimes dismissed as a longrun approach, but we have to recognize that the longrun is upon us.

Let me now turn to energy by first saying a few words about the economic nature of recent developments. What we have seen in the world petroleum market during the last few years is not nearly as much influenced by politica factors as is commonly believed. During the 1960's the real price of petroleum and other energy resources declined because of large discoveries, and these declining prices in turn led to an accelerated growth in energy consumption. As was true in virtually every other raw materials market, the worldwide boom of the early 1970's further intensified petroleum demand. As a result, inventories had to be drawn down and the stage was set for a price increase, which happened to come after the Arab-Israeli war of October 1973, although it would probably have come earlier and more gradually if there had been a central market in petroleum. The higher price was proclaimed by a cartel, but so far the cartel has not really had to inconvene to make the higher price stick some of its members have reduced production unilaterally. The normal reactions of the market have already led to a worldwide reduction in demand for petroleum products, which was probably of the order of 4 percent in 1974. At the same time crude oil output increased by about 2 percent in the non-Communist world. Thus inventories are being rebuilt, and this will in due course put pressure on the price. In the long run further relief will come from new exploration, which is now proceeding at a feverish pace and has already led to considerable success, contrary to the popular notion that we are close to the limits of the world's energy supply.

To emphasize this point let me give some figures from the "Oil and Gas Journal." These figures are reflected in much greater detail in a table attached to my statement.[1] At the beginning of 1974 oil reserves in the non-Communist world were about 525 billion barrels; 1 year later they are 604 billion barrels, an increase of 15 percent in 1 year; this is about double the growth rate of reserves experienced since World War II. Gas reserves in the non-Communist world increased even more spectacularly, from 1,298 trillion cubic feet at the beginning of 1974 to 1,709 trillion cubic feet a year later, an increase of 31 percent. There were also large increases in the Communist countries, some of which will be available for export. It is true that much of the increase in the reserves, especially in gas, occurred in the OPEC countries, but there have also been considerable increase in non-OPEC reserves, and even the OPEC reserves are not likely to remain undeveloped. Instead of the ever-tightening scarcity of energy that we hear so much about, the statistics suggest that there may well be a glut once the new discoveries come into production.

Even in the United States during 1974 more oil was found than was consumed, although not really large finds have been made so far. Oil reserves showed a small increase, but there is much more we could do and should do if we are serious about becoming less vulnerable to supply interruptions. Naval Petroleum Reserve No. 4 in Alaska, for instance, is believed to contain at least as much oil as the neighboring

[1] See table, p. 193.

Prudhoe Bay Field and the President's bill to permit development of this reserve is a matter of the highest priority. There will probably be no market for this oil on the west coast and to ship it to the east coast would be inefficient, but selling this oil on the world market would have a salutary effect on the global price structure.

Perhaps even more important is exploration in the Atlantic and the Pacific. The oil industry is sufficiently confident of finding oil there to be prepared to bid large amounts for leases. It goes without saying that exploration in these areas has to be accompanied by proper environmental safeguards, but it would be irresponsible to retard exploration merely because of the unfounded fears of summer residents about beach pollution. After the Alaska Pipeline had been delayed for some precious years by legal maneuvers, Congress wisely decided that enough is enough; it should be the same thing with respect to Atlantic and Pacific leasing. The opposition of some of the coastal states, especially my own area of the Northeast, is all the more questionable because these same States are the first to complain about the high cost of imported oil and about the threat to their economic viability. Rather than establish price-equalization schemes, which weaken our conservation efforts, these States should be told that the solution to high energy prices and to a weakening economy is in their own hands. An element of realism could be introduced by linking continuation of price relief for the Northeastern States to their own efforts at increasing energy supplies.

I have probably said enough to indicate that I see the solution of the energy problem in terms of domestic output, augmented by reduction in demand consequent upon higher prices. I support these parts of the President's proposal that go in this direction, including particularly the deregulation of old oil. Although there is not yet much evidence on this point, it seems likely that the price ceiling of old oil is reducing production from existing fields by providing an incentive to withhold recovery or to drill unnecessary new wells. The distinction between old oil and new oil is far from tight, and we should have learned by now that price controls lead to artificial shortages. An increase in the price of old oil to the level of new oil would probably add 8 tor 10 cents to the price of gasoline, with further beneficial effects on conservation. There may be a case for capturing the resulting windfalls by a special tax, but the windfall profits tax proposed by the President does not appear to be well-conceived. In fact it is not a windfall profits tax at all but a separate tax on the profits of the oil companies, levied indiscriminantly on old and new oil. This proposal has to go back to the drawing board.

The other tax measures proposed by the President are even more questionable. Our principal problem is that the price of imported oil is already too high from a longrun point of view, so on the face of it it appears strange to put another duty on top of it, or to impose additional excise taxes on domestic oil and gas. These proposals are especially inappropriate in the present economic context because they would raise prices and absorb purchasing power, just the opposite of what we need. While higher taxes might lead to some further reduction in consumption, there is a danger of overkill; if we let prices find their market level by decontrolling old oil, we will probably get all the conservation we need for the long run. The notion that energy conservation is somehow good for its own sake is difficult to take seriously. As regards reactions abroad—and especially in OPEC—it would seem that a decision on our part to accelerate the development of massive new reserves will have more impact than a relatively minor reduction in imports in 1975.

What we should avoid above all is a piling of new distortions on top of old distortions, such as the price ceiling on old oil and the price-equalization program. The President's energy tax proposals threaten to resurrect something like the sugar program, now fortunately defunct, for oil and gas. Just as the Sugar Act was unable to prevent staggering price increases, so the import duties and excise taxes are unlikely to bring imported oil prices down. Compared to the proposed crazy quilt of taxes and regulations, the workings of the market have the merit of simplicity and proven effectiveness.

Let me finally say a few words about the international financial aspects of the petroleum problem. We have heard so many alarms on this subject that it is hard to get excited again. After the embargo many people believed that the money received by the oil countries would somehow disappear from circulation. When the fallacy of this argument became evident it was argued that while the money would indeed go into the Eurodollar market, it would all go the short end where there was no demand. Somehow this particular calamity also evaporated and now we are told that the major banks of the world are unable to accept any more deposits, so that disaster is once more at hand. Conceivably there are transitional problems because the Arabs tend to favor a relatively small number of banks, but if these banks really were to turn down the deposits that are offered to them the owners would no doubt find outlets in other banks. Moreover, the banks that complain most about unwanted deposits could improve their capital structure by issuing new equities; both Morgan Guarantee and First National City Bank, for instance, have price earnings ratios of 13 which would make new issues quite attractive. While I think, therefore, that most of the financial apprehension is exaggerated, I do support Secretary Kissinger's proposals for a safety net and expended recycling facilities. I also have much sympathy for the idea advanced by Richard Gardner to establish new investment funds in which the Arabs could invest their money.

Finally, I wish to restate the main message of my testimony: Let us save our attention for essentials; namely, the turning around of the recession and the control of future inflation. In a commodity problem, such as we have in energy, the Government can do most good by letting the market do its job.

Thank you.

Chairman HUMPHREY. Thank you very much, Mr. Houthakker. I must say this is a no-nonsense statement for which we are most grateful. There is no doubt about where you stand. We will get back to you in a little while.

[The table attached to Mr. Houthakker's statement follows:]

OIL AND GAS RESERVES

[Oil in billions of barrels, gas in trillions of cubic feet]

	Jan. 1 1974		Jan. 1 1975	
	Oil	Gas	Oil	Gas
Asia-Pacific	15.6	114.2	21.0	115.9
Indonesia	10.5	15.0	15.0	15.0
Australia	2.3	37.7	2.3	38.0
Europe	16.0	193.8	25.8	202.8
Netherlands	.3	92.0	.3	94.8
Norway	4.0	23.0	7.3	24.7
United Kingdom	10.0	50.0	15.7	50.0
Middle East	350.2	413.3	403.9	672.7
Abu Dhabi	21.5	12.5	30.0	200.0
Iran	60.0	270.0	66.0	330.0
Iraq	31.5	22.0	35.0	27.5
Kuwait	64.0	32.5	72.8	32.0
Saudi Arabia	132.0	50.9	164.5	55.0
Africa	67.3	187.7	68.3	315.0
Algeria	7.6	105.9	7.7	229.0
Libya	25.5	27.0	26.6	26.5
Nigeria	20.0	40.0	20.9	45.0
Western Hemisphere	75.8	388.9	85.3	402.7
Mexico	3.6	11.0	13.6	15.0
Venezuela	[1] 14.0	42.0	[1] 15.0	43.0
United States	34.7	257.3	35.3	250.0
Canada	9.4	[2] 40.3	9.4	[2] 52.5
Total non-communist	524.9	1,298.0	604.3	1,709.1
Communist	103.0	735.4	111.4	846.6
Total World	627.9	2,033.4	715.7	2,555.1

[1] Does not include Orinoco heavy oil.
[2] Does not include Arctic gas.

Source: Oil and Gas Journal, last issue of year.

Chairman HUMPHREY. Please proceed, Mr. Sawhill.

STATEMENT OF JOHN C. SAWHILL, FORMER ADMINISTRATOR, FEDERAL ENERGY ADMINISTRATION

Mr. SAWHILL. Thank you very much, Mr. Chairman.

I appreciate this opportunity to appear before you to discuss and evaluate government actions to deal with the Nation's energy problems. During the year that has elapsed since the oil embargo, we have become a far more energy conscious Nation; but we are not yet an energywise Nation. We still do not have a coherent, effective national energy policy.

The President has presented a comprehensive and extremely complex program for dealing with the energy situation. Congress, on the other hand, thus far has come forward with only a fragmented response. Some members favor rationing of gasoline; others call for quotas on imported oil; others want to decontrol all prices immediately; and still others support a variety of different measures. Given the scope and intricacy of the President's program—the fact that it would in numerous ways affect virtually every American—perhaps such a fragmented response was to be expected. But it is inadequate.

Consequently, I hope that our comments today will contribute to a more united congressional—and national—response and, hence, ultimately, to the more rapid solution of our problems. The time has passed for investigations, reports, and debates. The time has arrived, not simply for the formulation of a national energy policy, but, more urgently, for the implementation of such a policy.

At the outset of my statement, I would like to place the dual problems of economic recession and energy dependence in perspective. The economy is spiraling downward into the worst recession since the Great Depression. This situation is intolerable. The costs in human and social terms of continued unemployment at such levels are profoundly disturbing. Congress must move quickly to reverse these trends. It must do so not only to salvage our economy here at home but, also, to provide much-needed stimulus to the economies of many of our traditional friends and trading partners overseas, some of whom are teetering on the brink of bankruptcy. The most important single thing that we can do to help them finance their oil deficits, which are far more disruptive than ours, is to provide a growing market for their exports, and this growth will not take place until we have turned the American economy around. This is why I feel that we must make the revitalization of our economy our No. 1 priority.

I have spent some time dwelling on the economy because I am convinced that—important as our energy problems are—at this time our economic difficulties must come first. A balanced energy budget is an important national goal, but not if it comes as a result of economic dislocations that would largely obliterate its benefits. And this, I fear, might be the case if the President's energy program were to be implemented exactly as presented.

I go on to review our current situation and some of the facts that lead up to our current situation and talk about the gap between supply and demand, noting that the gap between demand and domestic supply has created a number of unfortunate consequences. First, we were in no position to deal effectively with the quadrupling of prices over the past 18 months, and that increase, coupled with the increased volume of imports, has undermined our balance-of-payments position. Second, the rising cost of oil has had serious impact on the economy, contributing perhaps one-third to our high inflation rate, and forcing some other nations to the brink of disaster. And, third, increasing imports means increasing vulnerability to another embargo and to further price increases.

Regarding this final point, I might note that since the embargo our imports have become more and more concentrated in Africa and the Middle East.

Of course, this has implications as well.

It has been said that 1974 was the year the Arabs discovered money and the year we discovered the Arabs. That observation reflects the dismay that has swept the industrialized, non-Communist world over the past year as the oil deficits of the consuming nations skyrocketed and the oil surpluses of the producing nations multiplied. The financial implications of this growing imbalance are staggering. According to our best estimates, the surpluses of the members of the Organization of Petroleum Exporting Countries—OPEC—that is, what they have left after they have paid for their imports and domestic development—are currently piling up at a rate of about $60 billion a year, or $7 million an hour, or $115,000 a second.

The respected London-based journal, the Economist, has assessed the economic potential of these accumulations in dramatic fashion: It notes that 8 hours' worth of surplus OPEC cash can buy on Lockheed C–5A; 10 days' worth can buy the Bank of America; 79 days, the Exxon Corp.; 143 days, IBM; 1.8 years, all America's direct investments outside the United States; 9.2 years, the New York Stock Exchange; and 15.6 years' worth of surplus OPEC cash can buy all the companies on all the world's major stock markets.

Secretaries Kissinger and Simon and representatives of other major consuming nations made progress in their recent meetings to provide a financial cushion for those countries that are most hard-pressed. But with a few nations acquiring such surpluses—and the power that goes with the wealth, more must be done. Given the magnitude of the problem, further cooperation among the governments of the consuming nations must be forthcoming. To accomplish our country's part in these cooperative endeavors, the U.S. Government must play a more active role in international petroleum matters in the future. We must support the proposed meeting of producing and consuming nations and we must be prepared to discuss the demands of producers for indexing and special trading relationships.

But, I think we must do more than merely participate in programs designed to avert the bankruptcy of the most vulnerable countries; we must also assume far greater responsibilities in direct negotiations with the oil producers, perhaps, as suggested by Prof. Morris Adelman of MIT, by requiring exporters to bid for access to U.S. markets. Over the past 5 years, we have seen the control of the international oil system shift from the oil industry to the governments of producing countries. I believe, therefore, that the governments of consuming nations—including our own—must now become more deeply involved in oil negotiations. We can no longer leave such a vital national interest exclusively in the hands of private enterprise.

Beyond these international considerations, the Government's most important function is to develop a comprehensive program to increase domestic energy supplies, to stockpile supplies as a precaution against possible future supply interruptions, and to curtail energy demand. In short, the Government must take steps to make this Nation more self-sufficient—not only in petroleum, but in all forms of energy.

The critical question that this poses—indeed, the crux of the current debate on energy—is simply this: In striving to attain our goal of energy self-sufficiency, while at the same time working toward our other national goals and meeting our other national needs, how fast can we afford to go? How many economic and environmental trade-offs are we prepared to make to expedite energy self-sufficiency?

Clearly, we will have failed to answer these questions correctly if, a decade from now, we are a people sitting atop a vast mountain of strip-mined coal or awash in the coastal spillages of a domestic oil surplus—even though those surpluses might have bought us self-sufficiency. And, clearly, we will have failed to answer them if, 2 or 3 years hence, we are still struggling to climb out of the current recession.

The correct answers require that we keep all of our needs and aspirations in perspective.

At this point, and in the time remaining, I would like to discuss what we can and what we should do to advance toward our energy goals, while maintaining that perspective.

To begin with, we should all recognize that, even if all other economic, environmental, or social goals were subordinated to that of energy, we would be unable to depend immediately or exclusively upon increased domestic supply.

In my prepared statement, I indicate how long it takes to develop additional energy supplies.

In light of these and other difficulties already of great concern to the members of this committee, we should all recognize that we do indeed have few short-range options for expanding domestic energy supply. But we must begin now to take those steps available to us to assure domestic energy production increases in the future.

We must develop the Elk Hills Naval Petroleum Reserve in California.

As you know, the Senate voted 13 months ago to allow development of the Elk Hills Naval Petroleum, but the House did not.

I hope that the new Congress recognizes the gravity of the situation and makes provision for development of Elk Hills.

We must also explore and develop Naval Petroleum Reserve No. 4 in Alaska. While the payoff from NPR No. 4 will be years in coming, if we do not take the necessary beginning steps now, we will get no benefits from the resource until after 1985. We cannot allow a decade to pass for the sake—or as the result—of inaction now.

We must, through congressional mandate, agree upon and implement a method by which we increase the price of natural gas. Only by taking some steps in that direction will we bring an end to the uncertainty of the current regulatory climate, and, thereby, assure increased production of our cleanest, most efficient fuel.

It is also important to begin Outer Continental Shelf exploration and development in the so-called frontier areas of the Gulf of Alaska and the Atlantic. I recognize that this is an emotionally charged issue, but that does not detract from the necessity of getting started. I would suggest that we put first priority on exploration. We need to know what our OCS reserves are so that we can assess how heavily we need to rely on other sources of energy and how much to cut back on energy demand. Furthermore, once we have drilled exploratory wells and know where the reserves are located, we will be in a better position to determine how to develop these reserves in the most environmentally appropriate way. As part of this program, it may be necessary for the Federal Government to contract for or, in some other way, carefully supervise exploratory drilling on the OCS. In that way, our resources, the environment and the interests of all of our citizens will be protected through a greater-than-usual degree of Federal involvement.

While this Nation takes these exploration and development steps, the Congress and the administration must agree upon, and implement the following measures so that other, equally important energy projects can be undertaken:

First, a tough, clear bill to regulate strip-mining activities and to bring about the restoration of previously destroyed lands.

Second, amendments to the Clean Air Act and to the Energy Supply and Environmental Coordination Act. These amendments should give EPA greater discretion in delaying the implementation of certain State plans—they should not change the basic environmental standards. I also feel we should take a hard look at—and perhaps change—the automobile emission standards, but I do not favor the 5-year moratorium on auto emission standards suggested by the President.

Both the strip-mining bill and the Clean Air Act amendments must become law to enable us to use the coal we have in such prodigious quantities. And we must be able to use the coal if we are to solve the energy problems we now face.

In my prepared statement I go on to discuss the energy research and development priorities we must enact—and quickly—and finally I turn to conservation.

But having said that all those things are necessary, I must also say that they are insufficient. We must also take a number of other steps that only now, more than 1 year after the embargo, seem finally to be gaining wide acceptance. The only way to make ourselves more self-sufficient in the immediate future is to restrain energy consumption. And the only way that consumption can be restrained is by mandatory, or institutionalized, conservation measures. The President's program recognizes this fact, and it includes a number of steps to move us along this path—tax incentives to save fuel in homes and thermal efficiency standards for new buildings, for example. But it also has certain defects.

First, and this returns to my major point at the beginning, it could severely aggravate our economic difficulties, which are already as acute as any we have experienced in decades. The proposed taxes and tariffs on crude oil would raise prices on the entire range of petroleum products, from gasoline to plastics, from home heating oil to synthetic fibers. The program would result in higher costs for other fuels, such as coal. It would require an additional tax on natural gas that could, for example, translate into increased fertilizer costs of $4 or more per acre of cultivated land and, ultimately, into further escalation of food prices.

In short, the ripple effect of these proposals would eventually work its way through the entire economy—transportation, industry, agriculture, utilities, would all be affected. The administration projects an increase in the consumer price index of approximately 2 percent—probably enough to assure continuation of double-digit inflation—but given the scope and magnitude of these ripple effects, that figure remains at best uncertain.

Second. such undiscriminating increases would penalize those people who can least afford them. Poor people and people living on fixed incomes, along with the rest of us, would have to pay those higher prices to heat their homes and feed their families. They would not have the option of closing the cottage in the mountains or postponing the vacation on the West Coast.

Third, people living in certain regions, such as New England and the upper Midwest, could be forced to carry a disproportionate share of the burden.

Fourth, there is no guarantee that the proposals would work: That the Arabs would not simply view this as an invitation to hike their prices again and that a nation faced with increased costs across the board would not simply find itself, a year from now, sending even more dollars to the Middle East.

What I have just done, of course, is to give some comfort to critics of certain aspects of the President's program. I should go on to say, however, that I feel that the arguments against rationing are as numerous and as serious for citizens and for the economy as many of those against the President's program.

Advocates of rationing either do not realize or do not explain, that their proposal to cut gasoline usage is not one that replaces higher gasoline prices; it merely adds an administrative and bureaucratic layer onto those higher prices.

Then I indicate in my prepared statement some examples compiled by the FEA showing this point.

Above that 40-gallon point, every gallon would cost nearly three times more for the driver under a rationing system than under the President's proposal.

And, of course, the cost of the 15,000–20,000-man bureaucracy, the inconvenience of the lines at Post Offices for coupons and at gasoline pumps for fuel, cannot be forgotten. Nor can the income-transfer effect of a "white-market" which would work in such a way that East Coast residents would be the ones with the surplus coupons to sell to the citizens of the larger, more rural States where people drive nearly twice as much.

I don't think I need dwell on this further. The simple fact is that while the President's program may be inequitable for our citizens and bad for the economy—rationing is equally bad or worse.

I am convinced, however, that there is another way to reduce oil imports and curtail consumption at home, and to do so without imposing inequities or further disruption to an already shaken economy. The way to achieve this is not to try to meet a conservation goal of 1 million barrels of oil per day by the end of this year, or 2 million barrels a day by the end of 1977. Our economy simply cannot afford it. We must set some lower target for this year, but make sure that we meet that target—and successively higher ones for the next several years. Only in this way, through a more gradual approach, can we hope to return our economy to health as rapidly as is necessary for our own national welfare as well as that of our allies.

Beyond setting the lower, graduated goals—and I am in a somewhat unfamiliar role now calling for less haste in energy conservation—we must take a different approach to achieving those goals. We should not raise all petroleum-related prices, for that would do little to reorder personal, industrial or national spending priorities. Rather we must raise the prices of those products that we, as a people, can most afford to do without.

First, instead of pointing a shotgun at the field, we should aim a rifle at the rabbit. The rabbit, in this case, of course, is gasoline, which should be the target for increased prices, because it is the petroleum product with which we are the most wasteful.

Second, a moderate but gradually increasing gasoline tax—accompanied by refunds to those who would otherwise suffer undue hardships; that is, those whose livelihoods are dependent upon it, and by investment in mass transit—is the best means of achieving the necessary targeted reduction in oil consumption. It could be set at 10 cents the first year, and increased by perhaps 5-cent increments over the next 4 to 5 years. This would bring about some gasoline savings immediately, but would also signal a future of gradually higher prices. Consumers and auto manufacturers would plan and act accordingly. The transition to a more efficient auto fleet would be steady, and rapid. This type of energy/tax program is one that the American people can understand and are willing to buy. And, in the long run, with a public increasingly well-educated in energy affairs, it is a far more politically palatable remedy than a program with a rippled increase in costs to the consumer that might reach $30 billion—or perhaps exceed $50 billion.

Third, to reduce the inflow of Arab oil and the outflow of dollars, we should set quotas rather than impose a tariff that, by its very nature, would result in inflationary price increases. At the same time, we should involve the Government more directly in negotiations with oil exporters—perhaps, as I mentioned earlier, by having it require exporters to big for access to U.S. markets. But, we must first take steps to curb demand before quotas and a sealed bid approach can be effective.

Then I go on to discuss the needs for standards for mandatory efficiency standards for automobiles. I support the President's proposals for mandatory efficiency standards for new buildings and a tax credit for those who represent existing buildings with insulation and storm windows, although suggesting this might be increased slightly, and finally suggest Congress might enact legislation that would require FEA to monitor conservation in industry, particularly among the large industrial users.

With a new, lower set of goals, and a tough, targeted program to bring about the desired results, we will have an energy program that will work to the benefit of our economy at a time when such a benefit is sorely needed. Conservation is important if we are to achieve self-sufficiency. But we must not sacrifice economic recovery to energy conservation.

These are steps that I believe can lead to a solution of our immediate energy problem. And perhaps they, or some variants of them, will ultimately be taken as Congress and the administration put together a national energy policy. Hopefully, that policy will—indeed, it must—emerge rapidly in the weeks ahead.

Thank you.

Chairman HUMPHREY. Thank you very much, Mr. Sawhill. We appreciate your very constructive and thoughtful statement. It is exceedingly helpful.

[The prepared statement of Mr. Sawhill follows:]

PREPARED STATEMENT OF JOHN C. SAWHILL

I appreciate this opportunity to appear before you to discuss and evaluate government actions to deal with the Nation's energy problems. During the year that has elapsed since the oil embargo, we have become a far more energy-conscious Nation; but we are not yet an energy-wise Nation. We still do not have a coherent, effective nation energy policy.

The President has presented a comprehensive and extremely complex program for dealing with the energy situation. Congress, on the other hand, thus far has come forward with only a fragmented response. Some members favor rationing of gasoline; others call for quotas on imported oil; others want to decontrol all prices immediately; and still others support a variety of different measures. Given the scope and intricacy of the President's program—the fact that it would in numerous ways affect virtually every American—perhaps such a fragmented response was to be expected. But it is inadequate.

Consequently, I hope that my comments today will contribute to a more united Congressional—and national—response and, hence, ultimately, to the more rapid solution of our problems. The time has passed for investigations, reports and debates. The time has arrived, not simply for the formulation of a national energy policy, but, more urgently, for the implementation of such a policy.

At the outset of my statement, I would like to place the dual problems of economic recession and energy dependence in perspective. The economy is spiraling downwards into the worst recession since the Great Depression. Unemployment jumped from 5.5% in the third quarter of 1974 to 6.5% in the fourth quarter. It will, quite likely, reach 7.5% during the current quarter. Most economists believe that unemployment will climb to 8.5% and average at least 8% this year. Industrial production, which had remained relatively flat through most of 1974, actually declined sharply in November and December. Other economic indicators are equally discouraging, i.e., productivity, housing starts, plant and equipment spending, corporate profits, etc.

This situation is intolerable. The costs in human and social terms of continued unemployment at such levels are profoundly disturbing. Congress must move quickly to reverse these trends. It must do so not only to salvage our economy here at home but, also, to provide much-needed stimulus to the economies of many of our traditional friends and trading partners overseas, some of whom are teetering on the brink of bankruptcy. The most important single thing that we can do to help them finance their oil deficits, which are far more disruptive than ours, it to provide a growing market for their exports, and this growth will not take place until we have turned the American economy around. This is why I feel that we must make the revitalization of our economy our number one priority.

I have spent some time dwelling on the economy because I am convinced that—important as our energy problems are—at this time our economic difficulties must come first. A balanced energy budget is an important national goal, but not if it comes as a result of economic dislocation that would largely obliterate its benefits. And this, I fear, might be the case if the President's energy program were to be implemented exactly as presented. I will come back to this point later.

Now, I would like to turn specifically to energy. Before outlining some of the steps that I regard as appropriate in solving our energy problems, I will briefly describe our energy situation. Energy consumption in this country has been growing at a rate of 4-5% since the mid-1960's, while domestic energy supply has been expanding less rapidly. Coal production has been stagnant since the 1930's, and we now are using natural gas faster than we find new supplies. Oil production has actually been declining since 1970. The result, of course, has been sharp increases in petroleum imports in recent years. Petroleum imports in recent years. Petroleum exporters less than a decade ago, we now find ourselves relying on foreign sources for 37% of our oil consumption. And, if the present trends continue, this figure could rise to more than 50% by 1980. The reason for such projected increases in imports—in the absence of government action to curtail demand—is that domestic oil production will continue to decline at least through 1977 and perhaps longer. Current heightened domestic drilling actually is simply not sufficient to offset the declining rate of production from existing fields prior to the time that Alaskan oil begins to flow.

This gap between demand and domestic supply creates a number of unfortunate consequences. First, we were in no position to deal effectively with the quadrupling of prices over the past eighteen months, and that increase, coupled with the increased volume of imports, has undermined our balance of payments position. Second, the rising cost of oil has had serious impact on the economy, contributing perhaps one-third to our high inflation rate, and forcing some other nations to the brink of disaster. And, third, increasing imports means increasing vulnerability to another embargo and to further price increases.

Regarding this final point, I might note that since the embargo our imports have become more and more concentrated in Africa and the Middle East. We are, therefore, more vulnarable now than ever before since, today more than half of all the oil we import comes from the Middle East and Africa—areas that, in the past, have been referred to as "insecure." We rely more and more on those sources because other nations have begun to cut back on production and exports. Those nations, including Canada and Venezuela, to name two of our greatest suppliers, are reducing their exports because of the fear of overproduction or the eventual loss of their own self-sufficiency. But whatever the reason, we are becoming more reliant than ever on the Middle East.

It has been said that 1974 was the year the Arabs discovered money and the year we discovered the Arabs. That observation reflects the dismay that has swept the industrialized, non-Communist world over the past year as the oil deficits of the consuming nations skyrocketed and the oil surpluses of the producing nations multiplied. The financial implications of this growing imbalance are staggering. According to our best estimates, the surpluses of the members of the Organization of Petroleum Exporting Countries (OPEC)—that is, what they have left after they have paid for their imports and domestic development—are currently piling up at a rate of about $60 billion a year, or $7 million an hour, or $115,000 a second.

The respected London-based journal, *The Economist*, has assessed the economic potential of these accumulations in dramatic fashion: it notes that 8 hours worth of surplus OPEC cash can buy one Lockheed C–5A; ten days worth can buy the Bank of America; seventy-nine days, the EXXON Corporation; 143 days, IBM; 1.8 years, all America's direct investments outside the U.S.; 9.2 years, the New York Stock Exchange; and 15.6 years worth of surplus OPEC cash can buy all the companies on all the world's major stock markets.

Secretaries Kissinger and Simon and representatives of other major consuming nations made progress in their recent meetings to provide a financial cushion for those countries that are most hard-pressed. But with a few nations acquiring such surpluses—and the power that goes with the wealth, more must be done. Given the magnitude of the problem, further cooperation among the governments of the consuming nations must be forthcoming. And to accomplish our country's part in these cooperative endeavors, the U.S. government must play a more active role in international petroleum matters in the future. We must support the proposed meeting of producing and consuming nations and we must be prepared to discuss the demands of producers for indexing and special trading relationships.

But, we must do more than merely participate in programs designed to avert the bankruptcy of the most vulnarable countries, we must also assume far greater responsibilities in direct negotiations with the oil producers, perhaps, as suggested by Professor Morris Adelman of M.I.T., by requiring exporters to bid for access to U.S. markets. Over the past 5 years, we have seen the control of the international oil system shift from the oil industry to the governments of producing countries. I believe, therefore, that the governments of consuming nations—including our own—must now become more deeply involved in oil negotiations. We can no longer leave such a vital national interest exclusively in the hands of private enterprise.

Beyond these international considerations, the government's most important function is to develop a comprehensive program to increase domestic energy supplies, to stockpile supplies as a precaution against possible future supply interruptions and to curtail energy demand. In short, the government must take steps to make this Nation more self-sufficient—not only in petroleum, but in all forms of energy.

The critical question that this poses—indeed, the crux of the current debate on energy—is simply this: in striving to attain our goal of energy self-sufficiency, while at the same time working toward our other national goals and meeting our other national needs, how fast can we afford to go? How many economic and environmental trade-offs are we prepared to make to expedite energy self-sufficiency?

Clearly, we will have failed to answer these questions correctly if, a decade from now, we are a people sitting atop a vast mountain of strip-mined coal or awash with the coastal spillages of a domestic oil surplus—even though those surpluses might have bought us self-sufficiency. And, clearly, we will have failed to answer them if, two or three years hence, we are still struggling to climb out of the current recession.

The correct answers required that we keep *all* of our needs and aspirations in perspective.

At this point, and in the time remaining, I would like to discuss what we can and what we should do to advance toward our energy goals, while maintaining that perspective.

To begin with, we should all recognize that, even if all other economic, environmental or social goals were subordinated to that of energy, we would be unable to depend immediately or exclusively upon increased domestic supply. It takes 3-5 years to open a new coal mine, to develop an oil or gas field, to build a major refinery. And it takes 8-10 years to bring a nuclear power plant on line. And those numbers are conservative when we must first find the new oil or gas fields, when we must decide how and where we will allow refineries and power plants to be built, and when we must decide where, when and how much of the various kinds of exploration and development can be done in our coal-rich lands, or in the promising areas for oil and gas in the Gulf of Alaska or the Atlantic Outer Continental Shelf.

In light of these and other difficulties already of great concern to the Members of this Committee, we should all recognize that we do indeed have few short-range options for expanding domestic energy supply. But we must begin now to take those steps available to us to assure domestic energy production increases in the future.

We must develop the Elk Hills Naval Petroleum Reserve in California. This could mean 160,000 barrels per day by the end of 1975, and about 300,000 by the end of 1977. As you know, Mr. Chairman, the Senate voted thirteen months ago to allow development of Elk Hills, but the House did not. I hope that the new Congress recognizes the gravity of the situation and makes provision for development of Elk Hills.

We must also explore and develop Naval Petroleum Reserve #4 in Alaska. While the payoff from NPR 4 will be years in coming, if we do not take the necessary beginning steps now, we will get no benefits from that resource until after 1985. We cannot allow a decade to pass for the sake—or as the result—of inaction now.

We must, through Congressional mandate, agree upon and implement a method by which we increase the price of natural gas. Only by taking some steps in that direction will we bring an end to the uncertainty of the current regulatory climate, and, thereby, assure increased production of our cleanest, most efficient fuel.

It is also important to begin Outer Continental Shelf exploration and development in the so-called "frontier" areas of the Gulf of Alaska and the Atlantic. I recognize that this is an emotionally charged issue, but that does not detract from the necessity of getting started. I would suggest that we put first priority on exploration. We need to know what our OCS reserves are so that we can assess how heavily we need to rely on other sources of energy and how much to cut back on energy demand. Furthermore, once we have drilled exploratory wells and know where the reserves are located, we will be in a better position to determine how to develop these reserves in the most environmentally appropriate way. As part of this program, it may be necessary for the Federal government to contract for or, in some other way, carefully supervise exploratory drilling on the OCS. In that way, our resources, the environment and the interests of all of our citizens will be protected through a greater-than-usual degree of Federal involvement.

While the nation takes these exploration and development steps, the Congress and the Administration must agree upon, and implement the following measures so that other, equally important energy projects can be undertaken:

1. A tough, clear bill to regulate strip-mining activities and to bring about the restoration of previously destroyed lands.

2. Amendments to the Clean Air Act and to the Energy Supply and Environmental Coordination Act. These Amendments should give EPA greater

discretion in delaying the implementation of certain State plans—they should not change the basic environmental standards. I also feel we should take a hard look at—and perhaps change—the automobile emission standards, but I do not favor the 5-year moratorium on auto emission standards suggested by the President.

Both the strip-mining bill and the Clean Air Act amendments must become law to enable us to use the coal we have in such prodigious quantities. And we must be able to use the coal if we are to solve the energy problems we now face. Further, we need to find ways, administratively or legislatively, to facilitate nuclear licensing and siting and to expand research and development—particularly, but not exclusively, in nuclear safety and waste management programs. And we must have continued expansion in energy R&D programs to give special emphasis to coal conversion; shale development, particularly in situ processing; environmental effects; solar and geothermal energy; alternative breeder reactors, fusion and MHD. In short, we must continue to fund, or to foster through other special arrangements, public and private research and development. Only through a broad, flexible and imaginative R&D program will we go beyond the mere point of manageable self-sufficiency to restoration of a long-term position of leadership.

But having said that all those things are necessary, I must also say that they are insufficient. We must also take a number of other steps that only now, more than a year after the embargo, seem finally to be gaining wide acceptance. The only way to make ourselves more self-sufficient in the immediate future is to restrain energy consumption. And the only way the consumption can be restrained is by mandatory, or institutionalized, conservation measures. The President's program recognizes this fact, and it includes a number of steps to move us along this path—tax incentives to save fuel in homes and thermal efficiency standards for new buildings, for example. But it also has certain defects.

1. First, and this returns to my major point at the beginning, it could severely aggravate our economic difficulties, which are already as acute as any we have experienced in decades. The proposed taxes and tariffs on crude oil would raise prices on the entire range of petroleum products, from gasoline to plastics, from home heating oil to synthetic fabrics. The program would result in higher costs for other fuels, such as coal. It would require an additional tax on natural gas that could, for example, translate into increased fertilizer costs of $4 or more per acre of cultivated land and, ultimately, into further escalation of food prices.

In short, the "ripple" effect of these proposals would eventually work its way through the entire economy—transportation, industry, agriculture, utilities, would all be affected. The Administration projects an increase in the consumer price index of approximately two percent—probably enough to assure continuation of double-digit inflation—but given the scope and magnitude of these "ripple" effects, that figure remains at best uncertain.

2. Second, such undiscriminating increases would penalize those people who can least afford them. Poor people and people living on fixed incomes, along with the rest of us, would have to pay those higher prices to heat their homes and feed their families. They would not have the option of closing the cottage in the mountains or postponing the vacation on the West Coast.

3. Similarly, people living in certain regions, such as New England and the Upper Midwest, could be forced to carry a disproportionate share of the burden.

4. Finally, there is no guarantee that the proposals would work: that the Arabs would not simply view this as an invitation to hike their prices again and that a Nation faced with increased costs across the board would not simply find itself, a year from now, sending even more dollars to the Middle East. They did not choose to do so at their meeting over the weekend, but that is no guarantee that they will not do so at some future time.

What I have just done, of course, is to give some comfort to critics of certain aspects of the President's program. I should go on to say, however, that I feel that the arguments against rationing are as numerous and as serious for citizens and for the economy as many of those against the President's program.

Advocates of rationing either do not realize or do not explain, that their proposal to cut gasoline useage is not one that *replaces* higher gasoline prices;

it merely adds an administrative and bureaucratic layer onto those higher prices. As a matter of fact, according to FEA's estimates, a person who used 40 gallons under the President's proposal ($40 \times 65 = 26.00$) would pay less than someone who used the same amount under the rationing system ($36 \times 55 = 19.80$) $+ (4 \times 1.75 = 7.00) = 26.80$. Above that 40-gallon point, every gallon would cost nearly three times more for the driver under a rationing system than under the President's proposal.

And of course the cost of the 15,000-20,000-man bureaucracy, the inconvenience of the lines at Post Offices for coupons and at gasoline pumps for fuel, cannot be forgotten. Nor can the income-transfer effect of a "white-market" which would work in such a way that East Coast residents would be the ones with the surplus coupons to sell to the citizens of the larger, more rural states where people drive nearly twice as much.

I don't think I need dwell on this further. The simple fact is that while the President's program may be inequitable for our citizens and bad for the economy—rationing is equally bad or worse.

I am convinced, however, that there is another way to reduce oil imports and curtail consumption at home, *and* to do so without imposing inequities or adding further disruption to an already shaken economy. The way to achieve this is not to try to meet a conservation goal of a million barrels of oil per day by the end of this year, or 2 million barrels a day by the end of 1977. Our economy simply cannot afford it. We must set some lower target for this year, but make sure that we meet that target—and successively higher ones for the next several years. Only in this way, through a more gradual approach, can be hope to return our economy to health as rapidly as is necessary for our national welfare and that of our allies.

Beyond setting the lower, graduated goals—and I am in a somewhat unfamiliar role now calling for less haste in energy conservation—we must take a different approach to achieving those goals. We should not raise all petroleum-related prices, for that would do little to reorder personal, industrial or national spending priorities. Rather we must raise the prices of those products that we, as a people, can most afford to do without.

1. Instead of pointing a shotgun at the field, we should aid a rifle at the rabbit. The rabbit, in this case, of course, is gasoline, which should be the target for increased prices, because it is the petroleum product with which we are the most wasteful.

2. A moderate but gradually increasing gasoline tax—accompanied by refunds to those who would otherwise suffer undue hardships, i.e., those whose livelihoods are dependent upon it, and by investment in mass transit—is the best means of achieving the necessary targeted reduction in oil consumption. It could be set at 10¢ the first year, and increased by perhaps 5¢ increments over the next 4-5 years. This would bring about some gasoline savings immediately, but would also signal a future of gradually higher prices. Consumers and auto manufacturers would plan and act accordingly. The transition to a more efficient auto fleet would be steady, and rapid. This type of energy/tax program is one that the American people can understand and are willing to buy. And, in the long run, with a public increasingly well-educated in energy affairs, it is a far more politically palatable remedy than a program with a "rippled" increase in costs to the consumer that might reach 30—or perhaps exceed 50 billion dollars—according to various estimates.

3. To reduce the inflow of Arab oil and the outflow of dollars, we should set quotas rather than impose a tariff that, by its very nature, would result in inflationary price increases. At the same time, we should involve the government more directly in negotiations with oil exporters—perhaps, as I mentioned earlier, by having it require exporters to bid for access to U.S. markets. But, we must first take steps to curb demand before quotas and a "sealed bid" approach can be effective.

4. In addition, instead of taking a voluntary approach toward development of more energy-efficient automobiles, as the President's program suggests, we should use some of the tax funds for public transportation and we should proceed to set mandatory efficiency standards which would require companies to make more efficient cars. After all, automobile manufacturers have, over the years, demonstrated two things: that they are resilient in responding to market demand that they are resistent to accommodation of the public interest—as in decreasing pollution or increasing efficiency in their automobiles—until they feel compelled to be otherwise.

5. Further, I think the Congress should quickly—and favorably—consider the President's proposals for mandatory efficiency standards for new buildings, a tax credit to those who retrofit existing buildings with insulation and storm windows and subsidies to low income families to make their homes more energy efficient. The only change I would suggest in these proposals would be to increase the tax credit from 15 to 25 or 30 percent.

6. Finally, I would suggest that the Congress enact legislation requiring the FEA to develop conservation goals and programs for the largest industrial consumers of energy—i.e., steel, aluminum, cement, pulp and paper, petroleum refining, chemicals and food—and report annually on the progress achieved.

With a new, lower set of goals, and a tough, targeted program to bring about the desired results, we will have an energy program that will work to the benefit of our economy at a time when such a benefit is sorely needed. Conservation is important if we are to achieve self-sufficiency. But we must not sacrifice economic recovery to energy conservation.

These are steps that I believe can lead to a solution of our immediate energy problem. And perhaps they, or some variants of them, will ultimately be taken as Congress and the Administration put together a national energy policy. Hopefully, that policy will—indeed, it must—emerge rapidly in the weeks ahead.

Thank you.

Chairman HUMPHREY. Mr. Perry, we welcome you and thank you for your attendance here today. Please proceed.

STATEMENT OF GEORGE L. PERRY, SENIOR FELLOW, THE BROOKINGS INSTITUTION[1]

Mr. PERRY. Thank you, Mr. Chairman.

Four basic propositions shape my recommendations for economic and energy policy at this time: First, the economy is in a fast-deepening recession, easily the worst since the 1930's. The outlook for production and unemployment is grave. Strongly expansionary monetary and fiscal policies are urgently needed.

Second, the underlying forces of inflation are waning. Without another increase in energy prices, the inflation rate will soon be only half of recent rates and should continue to slow even if monetary and fiscal policies now reverse the economic downturn.

Third, a substantial rise in the price of oil will add a huge new burden depressing the economy and will undo most of the expected improvement in the inflation rate. It is doubtful that policies would be implemented to offset either the depressing effect or the inflationary effect of the price increases that would come from the administration's energy proposals.

Fourth, while bringing down the international price of oil is a very desirable goal, increasing energy prices in the United States is an extremely costly and unpromising way of trying to achieve it.

FIGHTING RECESSION

The only thing falling faster than forecasts of the economy has been the economy itself. Unemployment rose from 5.4 percent to 7.1 percent during the last 4 months of 1974. It is likely to go above 8 percent this spring. Unless prompt policy actions are taken to reverse the decline and generate a strong expansion, it is likely to continue rising throughout the year. The economy needs a substantial expan-

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

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sion of purchasing power and investment incentives together with a sharp and sustained decline in the interest rates.

The President's proposal of a $12 billion tax rebate on 1974 personal tax liabilities is needed, and as soon as possible. It should be paid in a single installment and it would be desirable if it could be available in time to reduce final tax settlements due in April. The economy could use a larger rebate than the President proposed. And Congress may want to modify its form. But every day of delay in providing this rebate will cost jobs and output to the economy.

The President's proposal of an increase in the investment credit is a timely incentive to business spending. Business investment plans are being cut sharply and growing weakness in this sector of demand is one of the major danger signals in the present economic outlook.

Prompt passage of these measures are urgently needed to help arrest the present decline in the economy. But the economy will need a permanent lift from further fiscal stimulus to promote a sustained economic expansion. By this summer, the Nation's total output will be some $150 billion below the level that would accompany 5 percent unemployment. The economy is burdened by the effects of past inflation on private purchasing power. Making an allowance for the need to keep interest rates down, $20 billion of permanent tax reductions should be enacted to lift this burden and provide a good chance at sustained recovery. These should include raising the investment credit to 10 percent on a permanent basis and tax reductions aimed particularly at helping middle and lower income consumers who have been hardest hit by recent inflation. Such tax reductions should not be delayed. If possible, they should take effect by this summer so as to sustain the momentum of the spring tax rebates.

FEEDING THE RECESSION

In view of the state of the economy and the need for massive measures to reverse its decline, it is alarming that the administration has proposed adding the burden of sharply higher fuel prices. The President's proposals would add more than $30 billion to the Nation's bill for fuel and other petrochemical products, most of it to be paid by consumers: Releasing "old" oil prices would add $12 billion and the $2 excise tax on oil and gas, $20 billion more. If one believed coal prices would rise in response to oil prices, or that industry unit margins would expand in response to any decline in volume that would accompany higher prices, the total bill would rise even further.

At a time when a major shift in fiscal and monetary policies is needed just to undo the effects of past price increases and reverse the recession in the economy, it would be particularly difficult to offset the burden of these new price increases. The offsets proposed by the President are insufficient.

First, in order to offset the purchasing power loss we would need a $25 billion reduction in tax bills of consumers, including payments to those whose incomes are too low to pay income taxes. These would have to come on top of the $12 billion tax rebate that the economy needs immediately to stop the present downturn, and the $20 billion tax cut that the economy needs on a permanent basis if a healthy expansion is to be sustained.

Second, in order to accommodate the higher transactions demand for money that would accompany higher oil prices, the Federal Reserve would have to expand the money supply by an additional 3 to 4 percent. It would have to do this at a time when the economy already requires aggressive monetary easing just to bring interest rates down and to keep them down in order to support recovery and expansion.

Third, in order to offset the inflationary spiral effect of prices pushing up wages, we would either have to intercede directly in the wage-setting process, which nobody is seriously considering at this time, or else take most of the needed overall tax reduction in the form of reduced excise taxes or payroll taxes that show up directly in the price level. This form of tax reduction would be highly desirable today, since it would restore purchasing power by reducing prices and thus simultaneously fight both inflation and recession. But it is a complicated and novel form of tax change to start considering at a time when tax reduction is needed promptly.

IF NOT OIL TAXES, THEN WHAT?

Before putting the American economy through the wringer of another massive price increase for energy, it is vitally important to explore the alternatives available to us and ask what it is we are trying to accomplish. Oil today, at present prices, is plentiful on world markets. Were it not for the possibility that reducing U.S. imports could contribute materially to bringing down the cartel-controlled world price, a proposal to self-inflict on ourselves a further price increase would seem totally bizarre.

However, it is extremely doubtful that a rise in the price of U.S. petroleum products would be decisive in bringing down world oil prices. Assume for the moment that any reduction in U.S. consumption would result in a corresponding drop in our imports. The guess that a $30 billion increase in our petroleum bill would reduce consumption by 1 million barrels a day is highly uncertain but not unreasonable. Yet that amounts to only one-third of a billion barrels a year or about 3 percent of OPEC exports to the world. It would be hard to justify the huge costs and risks to our economy that are involved on the chance that this last 3 percent would bring down the cartel and with it the price of world oil.

But the case is even weaker than that, for the easy assumption that any reduction in domestic use would show up as a corresponding reduction is imports is itself questionable. During 1974, our oil imports grew steadily once the embargo ended while domestic production declined month by month. It is often argued that the decline in domestic production reflected the disincentive of the present pricing system which has frozen the price of "old" oil at $5.25 a barrel. But production of old oil has risen during the course of the year, while production of new and released oil, where price incentives are great, has declined. In these categories, production in the August-October period—the latest months for which I have such data—was 30 percent below its level in the embargo months of the first quarter. One can only speculate about the reasons for this peculiar development. But a plausible explanation for these figures is that imports are not the residual source of supply for the United States, filling the gap between our demand and our maximum domestic output. With the same companies involved in importing and producing domestic oil, they are free to choose to import or expand their domestic output according to their own considerations of profitability or political strategy rather than according to any national desire to minimize the level of our imports. I believe the reasons for the decline in domestic oil production last year deserve serious investigation. And until we are assured that domestic output is as large as possible, I do not believe that we can assume that a reduction in total domestic demand would achieve a corresponding reduction in our petroleum imports.

There are far more direct and promising ways to put economic pressure on world oil cartel prices. If we want to limit imports, we should use import quotas, and take bids from world market sources for filling those quotas. This would have two important advantages. First, with quotas, we would know how much we were going to import. We would eliminate both the uncertainty of guessing how much demand will fall in response to a particular price increase; and more importantly, would eliminate the uncertainty about how much of a drop in demand would show up as a drop in imports. Second, with competitive bidding to fill those quotas, we might add a potentially divisive element to the cartel's operation. We cannot directly break the cartel; but we can at least molest it.

Of course, by limiting imports through quotas, we make the market-clearing price of petroleum in the United States uncertain. It will depend on the import level set by the quotas, on the level of domestic production, and on the success of nonprice conservation measures that are adopted. It should be our aim to leave little or no gap between total demand and total supply to be closed by price increases or other means, such as some form of rationing. To do this, top priority should be assigned to producing all that we can domestically. It is hard to believe that we maximized our output in 1974. I have just mentioned the need to find out why new oil production has declined since the embargo's end and to see to it that no potential production is being withheld. In addition, we can relax existing State restrictions on production that may have been economically desirable in the oil market of several years ago but are no longer desirable today. And we can start producing from the naval petroleum reserve at Elk Hills.

This still leaves the hard question of what level of imports to aim for. I can see no justification for choosing a low level that would create shortages at current prices despite our best efforts to expand domestic output. The world's productive capacity for oil exceeds world demand today. Competitive bidding for the right to import to the Unted States should have its effect, whether big or small, quite independent of exactly how much we are willing to take in. And it makes no sense to tell American consumers that there is oil available at prices they are willing to pay, but the Government will not let them have it.

This leads me to the final issue of what to do if we do not want to do any of the above. Then, I believe, the answer is do nothing. If an embargo comes, it will be time enough to ask for sacrifice, rationing, gas lines, excise taxes or whatever; and there will be time enough to choose our response and implement it before the first ship doesn't arrive.

For the longer run, both demand and supply will respond increasingly to the price increases that have already occurred. Even prices well below those on today's world market—together with measures to encourage leasing, exploration and development of new fields—will assure the expansion of domestic supply. This may or may not lead to self-sufficiency. But we should not pursue self-sufficiency if the cost is a protected domestic energy industry with prices well above those available to other countries in world markets. In the meanwhile, we should avoid crusades to deliberately reduce the amount of oil available to our country or needlessly to raise its price. Such policies can only worsen our economic problems.

Thank you.

Chairman HUMPHREY. Thank you very much.

I am very grateful to all of the witnesses.

Might I say that as I sense the temperature in this room, we have obviously forgotten anything about energy conservation. There was, you know, a year ago, Mr. Sawhill, a great to do about cutting back on the thermostats and conserving some fuel. I think the fact that this temperature is about 77 or 78 degrees here indicates the engineer that is responsible for heating in the Congress has decided that it is better to do nothing. He is not for the President's program. He is obviously not for anybody else's.

I make the point because I think that the efforts nationwide on conservation have literally evaporated. There does not seem to be any moral force. We do not hear much about that on television or radio any longer, Governors or mayors or Presidents saying anything about it. All we hear is we are arguing about the President's program or the program of some Senator is the one we ought to have.

Having said that, I want to come to one or two observations. All three witnesses believe it is absolutely essential there should be prompt action on tax relief.

Mr. HOUTHAKKER. Very definitely. I would hope that action could be taken within the next month or two.

Chairman HUMPHREY. Mr. Sawhill.

Mr. SAWHILL. I would think Mr. Perry has made a pretty good suggestion that tax relief be made available in time for people to use it for their April tax payment. Every day we wait the economy spirals downwards.

Chairman HUMPHREY. Mr. Perry, I think your statement is very clear, but is it your judgment we need prompt relief first of all in the tax rebate? Do I gather that all three of you believe there are some permanent improvements needed in the tax law?

Mr. PERRY. Yes, we need the rebate and as quickly as possible. And we must not confuse that issue with the need for permanent tax reduction and substitute one for the other or some how delay the one for the other.

Mr. SAWHILL. I think economics has shown us that a temporary relief can't do the job. Unless it is permanent we won't get the sustained relief we need.

Chairman HUMPHREY. Mr. Houthakker, is that your view?

Mr. HOUTHAKKER. Yes, sir, Mr. Chairman. I think we need permanent tax reduction.

At the risk of introducing a new element, we might learn something from Canada, which has indexed tax rates which eliminates the need for frequent revision of tax schedules. In the meantime, I believe we should proceed as soon as possible.

Chairman HUMPHREY. I would like to make note that every witness we have had before this committee since the President's message has advocated prompt tax action. I believe the duty of the Congress is to get off the dime and get some prompt tax action and get with it. I hope that that message goes from this committee, which is, of course, a consultative and advisory committee to the other committees of both Houses of the Congress.

By the way, some of us have introduced legislation that relates to both of these features, the rebate, as the President has, and also some of the permanent modifications in the tax structure, including a tax credit to partly offset social security taxes on incomes of $14,000 a year or less; some increase in personal exemptions; some increase in standard deductions—those are some of the proposals that have been mentioned so that increased take-home pay week after week continues to be a factor in workers' incomes. Then the investment tax credit, do I gather there is a general agreement here—let's go down the line—on the investment tax credit—what is the view of the tax credit, including percentage?

Mr. Houthakker.

Mr. HOUTHAKKER. I have some reservations on a tax credit as a permanent feature of our legislation. I believe we could have more benefit from an overhaul of the corporate income tax.

But again, I view the need for speed as such that I am not suggesting we should strive for perfection at this moment.

Chairman HUMPHREY. You would support some prompt action now on the tax credit?

Mr. HOUTHAKKER. Provided it is not made permanent.

Chairman HUMPHREY. What would you suggest, 1, 2, 3 years, or what?

Mr. HOUTHAKKER. Two years I would say as a minimum to be effective.

Chairman HUMPHREY. Mr. Sawhill.

Mr. SAWHILL. I would support a permanent increase to 10 percent.

Chairman HUMPHREY. For all——

Mr. SAWHILL. For all, including the utilities. I think it is very important we increase the credit for utilities.

Mr. PERRY. I would support an increase. If it were temporary, it would maximize the amount of investment in the short run, and if the temporary change was about to expire, we would find ourselves making it permanent so as to avoid the air pocket at the other end. So we can propose a temporary increase if we like. We will get a permanent increase.

Chairman HUMPHREY. Now, just some questions. We are going to abide by a 10-minute rule with each of us so we get active participation.

As an antirecession program are the President's proposals enough, Mr. Houthakker?

Mr. HOUTHAKKER. I believe that very much depends on monetary policy. As fiscal policies go, the proposal may well be enough, and I would not suggest anything bigger than that at the moment. I think it is important that some assurance be obtained from the Federal Reserve.

Chairman HUMPHREY. The President did not address himself to monetary policy in his message.

Mr. HOUTHAKKER. I don't believe he did.

Chairman HUMPHREY. Do you consider that a vital part of the antirecession program?

Mr. HOUTHAKKER. I believe it is the most vital part.

Chairman HUMPHREY. What would you suggest as a guide to a monetary policy, what kind of easing of money supply and credit?

Mr. HOUTHAKKER. To go to a 5-percent growth rate in money supply and stick to it would be a great help compared to the performance we have apparently had during the last few months.

Chairman HUMPHREY. Mr. Sawhill, what is your view? Is the President's antirecession program adequate?

Mr. SAWHILL. No, I think the tax decrease should be more, that we should be shooting for something in the range of $20 to $25 billion, more equitable and permanent as we said before.

I think one thing we are all agreed on in our statements was that the energy tax he proposed is really counterproductive to an antirecession program, and therefore it should be substantially changed.

I believe that the ceiling on spending is not appropriate at this time.

Chairman HUMPHREY. Mr. Perry.

Mr. PERRY. The President's program as a whole is nowhere near sufficient. If you take the energy part along with the tax part, I don't believe it represents a net stimulus of any importance at all. If we strip away the increase in energy prices but keep all the tax deductions the President proposed, we have a program of roughly the right magnitude.

I would also join Professor Houthakker in saying monetary policy is very important and much too tight a policy has helped bring us to our present condition.

I am not a monetarist, so I have less confidence in putting precise numbers on how rapidly the money supply should grow. But 5 percent strikes me as inadequate; we have reached our present condition with an average growth rate of a little over 4 percent for the past 12 months. However, 5 percent is much better than what we have gotten recently, which has been no growth at all in the money supply. That is a terrible monetary policy at a time like this.

Chairman HUMPHREY. Mr. McCracken was with us last week. He suggested 8 to 10 percent monetary growth, I believe, in that range. He felt monetary policy has to have some flexibility. It is a very fine tuned instrument and you have to watch it very, very carefully.

Let me toss out a suggestion. I was up with a group of about 800 people, workers, and my observation is that here is a group of people that would ordinarily be quite politically active, but they are rather discouraged and distressed with the Congress and the President over the handling we are giving these matters. They are worried about tax relief, feeling it is very necessary. We have a bitter argument going on, if not bitter, at least serious and sincere argument over the President's proposals.

I happen to be one who believes the time is at hand for a little statesmanship and less partisanship. I regret that the Democratic majority did not prepare an alternate program and be ready to negotiate with the President. We have a policy, we have a majority in the Congress, we have a responsibility. It did not happen—I wanted it to happen in December and ready to take it out in January. I think now it is pretty important we have some kind of legislative task force in energy that sits down and tries to negotiate our program that has some sense in timing and has some realistic appraisal of what the economic impact will be and gives us a long-term schedule. I don't want to fill in the details because we would have some disagreements, and there have been many suggestions made.

What is your judgment? How do you think we can best approach it? Here today we have several different views on the energy problem. How do we count this out on the final bill so that we get a policy rather than just fragmentation, as Mr. Sawhill said, that we have a fragmented program? I will just toss this out, and that is my last question here. I will toss it out individually. What do you think, Mr. Houthakker?

Mr. HOUTHAKKER. Well, I certainly agree with you that the time for partisan debate is up. We have to take action very soon.

I believe that the elements for an action program are there. When I said that the President's program in the fiscal area is sufficient, I was making the assumptions which George Perry made explicit; namely, that it would not include the energy taxes. I believe that the income tax proposals made by the President probably are sufficient to pull us out of the present recession provided monetary policy is appropriate.

Now, as regards the energy program, the idea of a task force is certainly one that merits consideration. What worries me is that it may take quite some time because there are still very different views to be straightened out.

I don't have the impression there is not much disagreement on energy at the moment, if we disregard the energy tax measure, which as far as we can see do not have an awful lot of public support.

The other items in the program are more debatable. There are committees of Congress which are particularly concerned with this, and I would hope that the various elements having been suggested could be reconciled within the next 3 or 4 months without setting up new organizations that would take some time to get started.

Chairman HUMPHREY. Mr. Sawhill.

Mr. SAWHILL. My response to that would be this. I think the Congress ought to get on immediately with the tax reduction proposals and the other proposal to stimulate the economy and not put those in a task force.

But on the energy side, from my experience in dealing with Congress, and I testified over a hundred times last year so I have had some experience recently, I found the problem was there was too much fragmentation in the Congress. There is some fragmentation in the executive branch, too, but by and large the energy policymaking and decisionmaking is pretty well focused. I think the problem is in the Congress, and I think it incumbent upon the Congress to try to organize some focus for energy decisionmaking within the Congress and then there can be an effective relationship between the administration and the Congress.

So I would argue mainly rather than setting up a congressional task force that the Congress first sets itself up some kind of a task force or a joint committee or a temporary group that could focus in on the energy problem and come out with some kind of alternative to the President's program so that we could get on with the job, although I would think in the meantime we would not proceed with the energy taxes, because we have all agreed it would be a detrimental effect on the economy.

Chairman HUMPHREY. We ought to have an ad hoc committee of the House and Senate and bring together these fragmented parts.

Senator JAVITS. Mr. Chairman, may I have 1 minute?

Chairman HUMPHREY. Yes.

Senator JAVITS. I do want to comment on this, and I yield my time.

I would like you to address yourself to the mixed task force idea with this point of view. A number of bills I have been engaged in have been worked out by a task force, where they met in a Senators home or his little cubby hole at the Capitol, and that is what Senator Humphrey is talking about. We are talking about a mixed task force. What do you say to that?

Mr. SAWHILL. If a mixed task force would provide some focus for congressional decisionmaking I think it would be all to the good.

Senator JAVITS. Thank you.

I yield my time.

Chairman HUMPHREY. Thank you.

Mr. PERRY. I don't have any suggestions on precisely how you organize this kind of effort. Let me just cite a few principles that I think we could get very wide agreement on and against which specific proposals could be viewed.

One, pursue the nonprice conservation schemes that John Sawhill has outlined very well. I think we could get a good deal of agreement on most of those.

Two, be very wary of any price increases. Proposals that involve big new price increases should only be accepted if they remove obvious restraints on new development, such as in the case of natural gas.

Three, examine the questions of our domestic petroleum industry carefully to try to assure that we are maximizing our production. In that same line, try to assure that we have competition, particularly in the importing business.

Four, don't start down any roads that commit us to a protected, high-cost energy industry for this country in the long run.

I think these principles would get very widespread support among specialists and they would narrow the range of discussion of alternatives.

Chairman HUMPHREY. Thank you.

I want to yield to Senator Fannin.

May I welcome you as a new member of the committee. We are pleased and honored to have you.

Senator FANNIN. Mr. Chairman, I certainly appreciate the privilege of serving on the committee.

I want to commend the chairman for immediately getting the meeting started, the hearings started and going forward very rapidly. Of course, I do feel that with what has happened we are a little bit overheated in this room, and the Congress has gotten a little bit overheated about the President's program and they are getting pretty cold treatment down at the White House. They seem to be doing quite well as far as heating is in the White House.

But very seriously, I think we must realize, and I think all of the witnesses will agree—the old story of getting the attention of the Congress—but the attention of the American people by the mood he has made, and I think we have to take that into consideration.

I would like to ask the panel, and of course this is mainly to Mr. Sawhill. That has been mentioned before, but in the spring of 1971 we very generously approved S.J. Res. 45. I know that very well, the fuel and energy study to bring all these great rules in a short time. As Mr. Sawhill testified, we had hundreds of hours of testimony. We had been working on this supposedly for these 4 years and we have had members from seven committees that have been working when you talk about the programs concerned and what have we done. There has not been one recommendation.

I will ask Mr. Sawhill if he knows of one recommendation that has come out of Congress that has resulted in legislation.

Mr. SAWHILL. None that I recall, no.

Senator FANNIN. Do any of the other witnesses know of anything that has come out of this effort? Now we are talking about another program, to do all these studies and do that, and what is going to be the result. You have stated, all of you stated that you did not agree with the move the President made, but have you carefully evaluated what is involved?

I ask Mr. Sawhill, you realize in the New England States that nothing goes into effect immediately?

Mr. SAWHILL. Yes, I do recognize that.

Senator FANNIN. In March, the first 60 cents goes in, but this is all I think we could say, not in a negotiating way, but in a cooperative way being done to try to best accommodate the situation facing us today.

Mr. SAWHILL. I don't think the concern is so much that there is differential effects because we already have those in existence right now. New England is disadvantaged.

I think the real concern is the impact these higher energy prices would have on the economy, which is already in a very serious recession.

So the issue is, shouldn't we try to do everything to try to recover from this recession rather than tackle our energy problem, which I think is somewhat secondary to the economic problem?

Senator FANNIN. We are all in agreement that it is not only the situation here in the United States, but the world monetary situation is involved, it is what is going to happen as far as the value of the dollar is concerned. How would you think that—I ask you each individually—we can meet this situation, this drastic situation in 1973? We had imports of $19 billion, which included crude oil of $4.2 billion. Then chemicals, $2 billion, which is also involved in iron and steel, which we are not discussing much here today, but very important from the standpoint of what we are going to try to accomplish and what the President was trying to achieve in taking this action.

Now we go to imports of, even beyond the estimate that we had, and we find that we had imports of approximately $42 billion in 1974.

So, jumping from $19 billion to $42 billion, what is the procedure that we can follow, if it is not by the price mechanism, as you have said, it would be by quota as an all, that could be put into effect immediately. This is something the President has authorized to do. Now, what could he have done instead of taking that action?

Mr. HOUTHAKKER. Well, Senator, my feeling is that the course of events in the world petroleum market is going to be determined by market forces and in particular by increases in supply for which the United States is one of the most promising areas in the long run.

I happen to disagree with some of the pessimistic views expressed by some of the domestic petroleum producers. Certainly one can get very pessimistic views from the majors, but when you talk to the independents you get a different picture. They feel there is a great deal more they can produce, and otherwise the most important thing we can do to stimulate domestic production within reason, using what is in our power; namely, petroleum reserves and the offshore leasing.

On international aspects, perhaps you will allow me to make one further point. We are now looking forward to a meeting between the producing and the consuming states. I have great doubts about the wisdom of this course of action. It might well be that this particular conference, if held within the next few months, is more likely to be another Munich than anything else. The only thing there is agreement on could be capitulation by the importing countries. I believe we should not go into such a meeting until we are in a stronger position, and it will be at least another year until there are some results we can point to.

Mr. SAWHILL. Senator Fannin, I do not know of any other action that the President could have taken alone, by executive action without the approval of Congress. So I don't believe there was any other action he could have taken. That does not mean I agree with it.

I guess my concerns about the program are, one, I think the tax increases are too large in view of the economic situation, I don't believe they focus on the fuel we use most wastefully, which is gasoline, but spread across all fuels. I certainly agree we need to do everything we can to bring oil prices down by creating a surplus, which means some conservation and then the device of opening up our market to solid bids which could be an appropriate way to, as Mr. Perry has said, to molest the cartel, if not break it up.

Senator FANNIN. Mr. Perry.

Mr. PERRY. I believe we should see what we could do to get competition in the importing business, and what we could do to expand domestic supply to its maximum. Having done all that, going ahead and paying the resulting import bill is better than the alternatives.

The fact that we are importing a good deal of oil simply says that we value that product and that consumers, while they would like to pay less, are quite willing to pay the present price until something happens to bring it down.

So the issue isn't, I think, that we absolutely must reduce that import bill at all costs. The issue is what is the cost of reducing it as compared to going along with it.

Senator FANNIN. My 10 minutes has expired.

Representative BOLLING. We will give you some additional time as a new member.

Senator FANNIN. Thank you kindly. I don't mean to interfere with the time.

The maximizing of our production is a very important factor. Evidently you don't feel that the State regulatory agencies are performing the service which they are obligated to perform?

Mr. PERRY. It is my impression that the maximum efficiency rate of production has some engineering and some economic justification. But the same rate that was appropriate a few years ago at a much lower price of oil, when there was no great urgency to maximize production, would not be appropriate today. The much higher price ought to alter that.

Senator FANNIN. Mr. Perry, I know that we have made investigations as to what is involved in some of the States. I would just say that I have heard, for instance, in Texas, that the regulation, for instance we talked about regulations, EPA, when somebody is trying to develop a well, which requires having to dispose of the grime, and you know that often occurs, especially when they are going into secondary recovery, even tertiary recovery, that they do need to dispose of what results. Some of this is a very serious problem, even in the wells which are classified as strippers.

Here we have requirements that are restricting the ability of these producers to go forward with their programs. Don't you think it is absolutely essential if we are going to encourage them to produce—and I will give you an example. One producer had to dispose of three barrels of grime for every barrel of oil. Do you not think that something must be done to accommodate the necessity for changes that would help bring about increased production?

Mr. PERRY. I am not familiar with the process you are describing, but from your description I would agree.

Senator FANNIN. A super well, and Mr. Sawhill, I think would agree, because I have discussed this with him many times and had absolutely marvelous cooperation, and I praise him for the work he did in that regard and his attempts to try to bring about this, and we have all talked about the tremendous delay in the Outer Continental Shelf drilling.

My whole point is that we here in the Congress have not taken action and that is why I feel we are moving now—I hope we are moving—but if we delay the President's action and take passage of the, say, Kennedy-Jackson resolution we are perhaps delaying the Congress going forward.

We must penalize the user that is negligent. I think that we have all said that whatever can be done to bring about more efficient utilization of fuel, that we must have a program, and I agree with the panelists, that will not detrimentally affect the economy, will not make it necessary to cut back on jobs and the competitive position would be restricted.

So I agree at the same time—do you not feel if we go ahead and start with the President's recommendations and go forward writing legislation that we can work the will of the Congress on his recommendations, because he did not send a bill to us? He sent recommendations. He did take this one action, and the first action that has actually benefited in getting the attention of the Congress and getting some action of the Congress, I hope.

Mr. PERRY. I believe there are many parts of the President's bill that one could go along with, but I see no reason why you could not act on the President's bill and reject those parts that involve sharply raising consumer prices.

Senator FANNIN. That is my point. In other words, we can work—and I know that the President, for instance, has stated to members that he wants to cooperate; this is a joint venture. But if we take the initiative away from the President then what results? Would you like to comment? What do you think will happen if we rescind his program?

Mr. SAWHILL. Judging by past results, Senator Fannin, nothing will happen. We only had three pieces of legislation, the Alaskan pipeline, in setting up the two agencies, the FEA and ERIA, but not a great deal of legislation passed.

I agree with you the President should be commended for coming forth with a comprehensive program and confronting Congress with an action and saying, let's get on with the job. That I believe is important.

Senator FANNIN. I would just like to put it in this perspective. The President's program goes in effect in stages. The President has already laid it on to the public that if Congress acts he does not expect to go to the third figure. The figure he has called for as far as legislation is concerned is $2. We have the time if we get busy to formulate legislation, perhaps acceptable to the President, that might take the place of what he is now doing. I do not know, but I would think this is always a possibility. But if we take the action that is contemplated now, if we take the past record, then we have defeated the very objective that we have to try to meet the great energy crisis facing us and the tremendous problems we have in our economy.

I just feel that when we realize that we went from $19 billion on imports to $42 billion on imports the President was forced to move. Now, do you agree with that?

Mr. HOUTHAKKER. Well, Senator, I do not think I can agree with it entirely.

Let me say, Senator, I view the prospect of congressional inaction with a little more equanimity than perhaps the other panelists. I believe the market will lead to a solution, too. In a way we have done too much in the past and to let some of these things run out is not necessarily a step backward.

For instance, I believe the bill requiring price controls on old oil should be allowed to expire July 1, and as far as I am concerned, it could expire earlier. There are other actions which I believe may be needed.

You raised the question of rescission of the import fees which the President is already imposing under existing authority. I think that rescission might well be in order, maybe not in general but with respect to this particular action.

I also feel that there should be legislation concerning States. In particular, I believe that the two laws which have been on the books for a long time are overdue for repeal. One is the Connolly Hot Oil Act which gives Federal backing to State regulation, and the other the Interstate Compact Act which has a somewhat similar effect, although less important. In a free market we certainly do not need those bills.

The States may have a role in preventing pollution. This, I think, is not in dispute. But in the past some of the States have certainly, in my opinion, abused the possibility of imposing regulations on production in their States.

Senator FANNIN. Thank you. We have tried to make an investigation of just what States are doing, whether or not they are complying, and the data that I have received is that they are going forward with their programs.

But I do appreciate very much the comments that you have made, all three panelists, and certainly contributed a great deal to the efforts of trying to get the information.

Thank you.

Representative BOLLING. Mr. Chairman, the distinguished Senator from Arizona has consumed my 10 minutes as well as his own at my suggestion.

I would only like to take long enough to make a comment on his suggestion that if we in any way try to prevent the President's initial steps of the program from going into effect we might be condemning the country to no action. I think it concerns a great many of us that the President's program as a whole as we perceive it to be in the energy field, is very destructive to the other part of the bill that deals with the economy. In the one section of the President's program that he himself can put into effect, the dollar increase, he has in effect indulged in a preempted strike because we have no opportunity to approve or disapprove that. It goes into effect before we can act.

I think some of us are suggesting that the reason we need to move in the direction of a task force, a joint committee or what have you, is that we need very badly to see to it that that preemptive part of the President's program does not go into effect because we think it would have a pernicious effect on the country. I think that draws the line very clearly perhaps between the view of the Congress and the view of the President.

I should add, so that the Senator will know that I am the author of the unanimous committee report in the Congress last year, I was chairman of the select committee which dealt with putting all the jurisdiction of energy in one place, so I share his views on the failure of Congress to organize itself properly, but I do not think we should allow ourselves to get into a position where perhaps an unwise act would impair economic recovery.

Thank you, Mr. Chairman.

Chairman HUMPHREY. All right. Congressman Long, you have your time now.

Representative LONG. Thank you, Mr. Chairman.

The points I would like to discuss are very closely related to what Senator Fannin and Representative Bolling are talking about. It seems to me in listening and following your statements that all three of you agree that the overriding condition at the present time is the spiraling downward, as one of you used the term, of the economy and perhaps resulting in the worst recession since the Great Depression of the 1930's.

Is it an oversimplification to say that if we add the $1, $2, $3 that the President is advocating—in 63 days or 64 days as it works out—and that increased cost passed on to the American consumer, plus the deregulation to occur within that same next 63 days, because as I recall it that would become effective after the imposition of the third dollar—is it an oversimplification for me to say that this is really adding fuel to the fire? That the spiraling downward of the economy might become kindled to a degree that it could become catastrophic. I would appreciate each of your views on it.

Mr. Perry.

Mr. PERRY. I think you have put it very well. The economy is in a serious downward spiral. None of us can assure this committee that it is not going to get very substantially worse, and the measures you have just described would contribute to pushing it downward.

Mr. SAWHILL. I think, Congressman, you have summed up the view we have tried to express here this morning quite well.

I think what we are concerned about, by raising these prices we are sopping up consumer purchasing power, which, instead of for oil and energy, should be going for fiber and other things to get people back to work. That is what we are concerned about.

Mr. HOUTHAKKER. I fully agree with you.

Representative LONG. I would like to address this to you, Mr. Sawhill. Being from Louisiana makes me automatically suspect of oil companies. I have had my differences with them over the years. I have seen them drill in Louisiana and not take protection with respect to environmental matters and ruin parts of whole forests. They did not pay property taxes on many refineries along the Mississippi River. I did not think it was fair for the people of the State of Louisiana.

Also, I have recently been in a rather dogged fight with them with respect to who ought to build the deepwater ports off the shores of the United States, if they are to be built. My belief dictates this should be in the hands of the public and not the oil companies, primarily because of the experience we had with the railroads.

I have done a great deal of fishing off the coast of Louisiana for the last 8 or 10 years, every time I get an opportunity, and I have found fishing off of Louisiana during the last 8 or 10 years better than it has ever been. I have been in the middle of a fishing boat where you can stand and look in all directions and you cannot see anything but oil derricks, and I have caught three times as many fish there as I used to catch. I could see very little environmental harm.

I have seen economic harm to the State of Louisiana because I did not think the oil companies were fair and that if the oil was more than 3 miles offshore we did not even get a sales tax on the equipment used; yet we were providing all the services for the people that worked there.

Back to this environmental question: with respect to offshore production, particularly the east coast and the west coast, and I know the unfortunate experience on the west coast, frankly, I think there is a middle ground that can be reached on this matter and that perhaps both sides are overreacting to this particular question.

In your official capacity do you all go into that very deeply, and what kind of conclusion did you reach?

Mr. SAWHILL. We tried to study the impact of Outer Continental Shelf drilling and a quite extensive report was prepared by the Ford Foundation. While I have not had the experience of fishing off of Louisiana, I do feel that environmental problems have probably been exaggerated, but it is a very emotional issue and very political. So in my testimony I suggested we first do the exploratory drilling and find out whether the reserves are there. You know as well as I do that we have the best geological picture in this country in the Destin Anticline area where Exxon has drilled four dry holes. You can't tell from seismic data whether the oil is there.

Representative LONG. All you can tell is, the structure is there that might contain oil.

Mr. SAWHILL. I am sure you have and I have looked at a lot of pretty structures that end up as dry holes.

I think it is important we determine what we have on the Outer Continental Shelf and provide incentives for getting drilling done.

Because this is such an emotional issue I would suggest we have the Government somehow more involved in this process than it normally gets. Maybe the Government should contract for exploratory drilling on the Outer Continental Shelf and then let the companies develop the field once they are found, because once we know what is there we have a better assessment of what our U.S. reserves are and a better understanding of what the environmental problems are in developing these fields. It may be they are actually discovered in areas where they cannot be harmful to the public beaches and the emotional problem will go away. Maybe it will prove to be a problem, but let us find out first and get the Government involved so that we do not go through the interminable delay that was created by the Alaskan pipeline.

Representative LONG. Thank you very much.

Chairman HUMPHREY. Thank you very much, Congressman. They were mighty good questions.

I have a couple of questions.

First, Mr. Perry, in your statement you say that reasons for decline in domestic oil production last year deserves serious investigation. Apparently you do not believe that the oil companies are doing all that they can to increase oil supplies, that is domestic oil supplies.

Could you elaborate on why we need an investigation of the oil industry or what you had in mind here?

Mr. PERRY. As you know, we have a two price system on domestic oil produced in this country. I find it very peculiar that in the first quarter of the year, when there was an embargo, we had one level of high priced oil production and by the most recent 3 months for which I have the data, that level had dropped sharply. I have people tell me the data is not reliable. If that is the case, someone is reporting dishonestly to the FEA. But I think we ought to take the data on face value and inquire what is happening.

One plausible explanation stems from the fact that the same companies are involved in making the decision of whether to expand production out of a new field or import oil. They may have reasons of their own, whatever they may be, for meeting their sales needs in this country through imports rather than by expanding their domestic production as much as they might. This is a conjecture. But somebody in a position to look closely at the figures that companies have on production from specific fields could find out if there are fields whose production has been deliberately reduced.

Chairman HUMPHREY. We apparently do not have any way in the Government of ascertaining that.

Mr. SAWHILL. I can probably answer that, Senator.

We are developing ways of ascertaining that. We put this two-price system into effect about 1 year ago, and frankly we had an auditing force in the FEA, and we directed most of these auditors toward the companies in auditing refining problems. We did have little auditing of actual refining of oil because we thought refiners themselves would explain to us if they felt too much new oil was being created.

Chairman HUMPHREY. By the way, Mr. Sawhill, you commented about the same way except in a little different direction. You said we can no longer leave such a vital national interest exclusively in the hands of private enterprise.

Mr. SAWHILL. Yes. I was thinking particularly there of negotiations for oil from abroad, because I just think it is terribly important that the Government become more involved in the negotiating process because the companies are no longer in a position to negotiate on an equal basis with governments. If the consumer does not get involved, we will have an unequal kind of negotiation.

Chairman HUMPHREY. Is it not true, as you have heard before, that the Government has had very inaccurate, limited records on oil companies in terms of their distribution system and so forth?

Mr. SAWHILL. Until we had the FEA we had nothing.

Chairman HUMPHREY. They had much more information about MacDonald's hamburgers than the oil industry. The oil industry was going willy-nilly.

Mr. SAWHILL. Well, I think George Perry has brought up a good point and one that deserves exploring. I am not quite as confident as he is that there has been a holdback in production. Remember under our two-price system an old barrel is $5.25, a new barrel at $11 or $12. When you discover a new barrel, you have the opportunity of releasing an old barrel. You not only get $12 but an additional $6 for that old-released barrel, so in effect you are getting $18 for a new barrel of oil produced. I would think there would be an awful lot of incentive to producing these new barrels than importing.

His statement may be right and certainly deserves investigation, but because of the tremendous incentive under the new barrel price, I am doubtful—I think we will find statistical error rather than holding back on new barrel production.

Chairman HUMPHREY. Mr. Perry, what have you got to say?

By the way, I am just reminded about the number of taxes and royalties that the oil-producing country is placing on the imported oil. So that also is a factor.

Mr. SAWHILL. Yes, there would be a tax incentive on importing.

Mr. PERRY. Mr. Sawhill's calculation of the profitability of new oil is really what makes these data on production so paradoxical. I am not a lawyer, and do not know what the legal situation is. But I think somebody could subpena information on production of specific fields.

Mr. SAWHILL. FEA has the authority to do that.

Chairman HUMPHREY. We will have the FEA people up here. Mr. Zarb will be coming up here. We will pursue, Mr. Sawhill, the same line of questioning we did with you. I would say I was running out of patience about the collection of data necessary for our proper study. I am sure much of that has been accomplished.

Mr. SAWHILL. Although, of course, Senator, many of the things you were impatient about was the equalization program which became effective a little later.

Chairman HUMPHREY. Mr. Perry and Mr. Houthakker could also keep this in mind. You, Mr. Perry, have a pretty good track record on some of your forecasts, and I do not mean to exclusively direct this to you. The National City Bank of Minneapolis newsletter of January 15, 1975, contains a forecast by you and Mr. Heller. I will place this in the record. I want that included in our testimony.

[The newsletter referred to follows:]

[From the National City Bank of Minneapolis Newsletter, Jan. 15, 1975]

THE U.S. ECONOMIC OUTLOOK FOR 1975

(By Walter W. Heller and George L. Perry)

This will be a year of very bad news and some good news for the U.S. economy. The bad news is that policymakers have once again overstayed both monetary and fiscal restraint and have indeed plunged us into "the worst downturn since World War II," as projected in our fall bank letter. The good news is that the shock waves of the 1973–74 inflation are subsiding and that, absent new policy blunders or crop failures, we can enter 1976 with prospects of solid economic recovery and inflation rates below 5%.

In appraising the outlook for 1975 and the policy turnabout it demands, one must bear in mind the hammer blows that have pounded the economy into its present state of submission:

In economic terms, the federal budget has undergone one of the sharpest swings from expansion to restriction in modern history. In terms of full employment—defined pragmatically as the situation prevailing in early 1973—the federal budget has shifted from a $7 billion deficit, at annual rates, in the second quarter of 1973 to a $27 billion surplus in the third quarter of 1974. Even after subtracting $10 billion of corporate tax receipts attributable to non-recurring inventory profits, one is left with a huge swing of $24 billion toward restriction in 15 months.

Although we are now entering the second year of the current recession, the Federal Reserve System is only grudgingly relaxing its stranglehold on the economy.

Quadrupled oil prices are already siphoning some $30 billion of consumer purchasing power into the hands of oil producers and royalty collectors, with very little offset to date in the form of rising exports to OPEC or net increases in capital spending (that is, when expansion in oil and gas industry investment is balanced against cutbacks by electric utilities). Another $20 billion or so would be plucked from consumers' pockets if the Ford Administration were to carry through its reported intention of freeing the price of "old" domestic oil ($10 billion) and imposing, say, a $2-per-barrel excise duty and tax on oil (another $10 billion). Since this method of cutting back oil consumption would boost prices, undercut consumer buying power, and prolong recession, one can only hope that this exercise in economic sadism will be aborted.

Policy has already waited too long to avoid the deepest recession since the Great Depression. Still at stake, however, is the margin by which the current recession earns that dubious award; the timing of the turn from recession to recovery; and how many years it will take us to get back within striking distance of reasonably full employment (say, 5% unemployment). It is worth noting that even if recovery started next fall and proceeded at a sustained 6% annual growth rate in real GNP, it would not bring us back even to 6% unemployment before late 1978.

Clearly, since monetary, budgetary, and energy policies play such a critical role in the 1975 outlook, a prediction of such policies is a prerequisite for any GNP forecast, especially for the second half of the year. For forecasting purposes, we are assuming a $12 billion personal tax reduction and some relaxation of expenditure targets in the budget, with a sizeable new drag on consumer demand of $10 billion added to the cost of petroleum products by federal policy changes. We expect a continued decline of interest rates this winter and spring within the context of continued modest growth targets for monetary aggregates; thus, we assume that the Fed will take its foot off the brakes but provide only a modest stimulus to demand in 1975. In short, we expect much talk of a policy turnaround but fear an overly modest response to our sickening slide into recession. To the extent that the White House, the Federal Reserve and, more likely, the Congress respond with more stimulative measures than we now project, the outlook would be correspondingly brightened.

GNP IN 1975

For the second year in a row, real GNP will shrink in 1975—the first back-to-back declines since the 1940's. Following a 2% year-over-year drop in 1974, real GNP will fall another 3% this year. From a peak of $846 billion (annual rates, 1958 prices) in the fourth quarter of 1973, real GNP will fall to about $795 billion in mid-1975, a 6% drop, half again as large as any previous drop since World War II (though far from the 35% drop in the Great Depression). We expect the GNP deflator to rise 9½% year-over-year, but at a sharply decelerating rate later in the year. Nominal GNP would rise to $1484 billion in 1975, $86 billion above 1974.

As the year wears on, the weakness that now pervades all sectors of the economy—consumption, investment, and government—will be less widespread. However, with the too-late, too-little policy responses we now anticipate, we see no marked turnaround in the economy in the second half of 1975 and expect unemployment to continue rising throughout the year. A sector-by-sector analysis of the weakness in the economic outlook follows.

CONSUMPTION

The precipitous decline in automobile sales dominated the consumer spending picture in the last part of 1974. From an annual sales rate of over 10 million units in the first three quarters of 1973, domestic car sales dropped to 8 million units in the following three quarters. After a brief anticipatory buying surge in the summer months following announced price increases for the 1975 models, the rate plummeted to less than 6 million units in the final quarter of 1974. Although sales have probably hit bottom, the decline that has already taken place will depress GNP further in early 1975 as production is again cut back to work off excess dealer inventories. Automobile output levels should recover somewhat after this winter, and sales will gradually revive from their unsustainably low rate of recent months. But with real income continuing to fall as recession deepens, no big rebound is now in the cards. Domestic sales for all of 1975 are destined to fall below 7 million units.

While the depression in autos has dominated the retail sales picture, consumer spending has been weak in other areas as well. Beset with declines in real compensation per manhour and real disposable incomes throughout 1973 and 1974, consumers have been holding back the volume of their purchases to keep up with rising prices. Buying power reserves have in large part been depleted, leaving little prospect that a surge in consumer spending will lead to an upturn in the economy. Large and prompt tax reductions could brighten this picture considerably, at the same time redressing some of the inequities that both inflation and recession have inflicted on the lower income groups.

In the first half, unusually large refunds and small final settlements on 1974 income tax liabilities, added to the modest tax reduction we are forecasting, will bolster disposable income. This will help halt the slide in purchases of autos and other durable goods. But food price increases are expected to continue during the first part of the year, and policies to cut imports threaten a new surge in the cost of petroleum products. The net result will be little improvement in the position of consumers and continued sluggish prospects for retail sales. Unless the Congress boosts consumer purchasing power with a larger tax cut than we now foresee, consumer spending during the course of 1975 will not be strong enough to reverse the weakness in other sectors of the economy.

INVESTMENT SECTORS

In the face of contracting economic activity and reduced inflationary pressures, market interest rates will fall during 1975, and more funds will become available for mortgage loans and support of the housing industry. A small improvement in the foreign trade balance will also provide a minor cushion to the decline in total GNP. But a fall-off in business investment, both in plant and equipment and in inventories, will more than offset these plus factors.

Business fixed investment

For several quarters, the business fixed investment picture has been full of cross currents. Cyclical weakness in many industries has co-existed with growing investment in a few others characterized by pressing long-run needs for expanded capacity. But the depth and duration of the present economic downturn is tipping the overall balance increasingly towards a decline in this most important sector. After remaining on a plateau the previous three quarters, real business fixed investment declined in the third quarter of 1974, and further declines can be expected over the 1975 forecasting horizon.

Investment plans as reflected in Commerce-SEC surveys of capital spending intentions were already eroding in the second half of 1974, although more gradually than the history of past economic downturns would have predicted. The same optimism that caused businesses to hold on to their work force in the first half of last year, leading to a sharp decline in productivity, may have contributed to the relative durability of plant and equipment spending plans thus far. But the most recent survey plans, calling for a 4.8% rise in current dollar spending between the third quarter of 1974 and the second quarter of 1975, are likely to be revised sharply downward. We expect investment outlays to decline in current dollars throughout 1975, and to fall substantially in real terms. For the year as a whole, the dollar level of business fixed investment outlays will be little changed from 1974, but the real volume of business investment will decline for the first time in over a decade.

Inventory investment

Although the rate of business inventory accumulation slowed throughout the first three quarters of 1974, the ratio of total inventories to sales continued to rise. So 1974 ended with a substantial overhang of excess stocks in the hands of business, most conspicuously in the auto sector. A period of overall liquidation of inventories during 1975 seems unavoidable. Declining production for inventory will be a major factor in the drop in real GNP this year.

Residential construction

The housing industry has suffered by all odds the biggest decline of any major sector of the economy during the past two years. The rate of housing starts dropping from 2.5 million units at the beginning of 1973 to just under 1 million units by November 1974. Lending institutions have been painfully illiquid, and monetary policy has been slow in pulling market interest rates back to levels that will encourage large shifts of funds back to the thrift institutions. Housing starts are expected to fall still further this winter before a mild recovery gets underway in the second quarter of the year. Not until the second half of the year will residential construction provide a significant counter-cyclical offset to the general weakness in the economy. For the year as a whole, housing starts will total only 1¼ million units, not enough to prevent a substantial year-over-year drop in real construction activity.

OTHER ASPECTS OF THE OUTLOOK

Government

Since the fourth quarter of 1973, real purchases at both federal and state and local levels of government have risen only marginally. At the federal level this represented a levelling off after many quarters of decline. For state and local governments, it reflects a growing squeeze as price increases overtake revenue increases. The deepening recession will loosen the federal purse strings somewhat in 1975, and part of the rise in purchases, notably, the outlays under the Public Service Employment Program, will flow through state and local budgets. For the year as a whole, purchases in current dollars are expected to rise by $7½ billion at the federal level and by $22 billion at the state-local level. This would represent some growth in real demand in the government sector, a modest offset to the recessionary forces in the private sector.

Employment

The recession in output will drive the unemployment rate above 8% within the next six months. Even though real GNP may level off after sharp declines in the last quarter of 1974 and the first quarter of 1975, the policies we now foresee would not generate enough recovery to reverse the unemployment decline during the year. Thus the unemployment rate is expected to rise in every quarter of 1975, exceeding 8% at the peak, and averaging 7.9% for the year as a whole.

Profits

As recession deepens and inflation abates, corporate profits will be hit by the triple blow of declining volume, weak productivity, and sharply lower capital gains on inventories. During 1973 and 1974, underlying profit margins—that is, margins that would prevail at a constant utilization rate—improved substantially in most industries. But in 1975, profits excluding inventory gains will be down 10%. After-tax book profits, which had been temporarily swollen by gains on inventories, will decline by some 22% for the year.

Inflation

While 1975 will hardly see the end of inflation, it does offer the pleasing prospect of substantial and progressive relief from the traumatic price pressures of 1973–74. For the year as a whole, it is true that our predicted rise of 9.5% in the overall GNP deflator will be only slightly smaller than the 10.2% rise now estimated for 1974. But this conceals a marked slowdown in inflation as the year progresses. The "private nonfarm deflator," an important index of basic inflationary trends, was rising at rates of 13% to 15% in the first three quarters of 1974. By the second half of 1975, the ebbing of inflationary forces should slow it down dramatically, to near a 5% rate of increase.

Raw materials prices are falling world-wide. With the whole world economy in recession, they should continue to soften throughout the year. Weak U.S. product markets also make it unlikely that we will get a repeat of the widening of profit margins that contributed noticeably to 1974's inflation. Most importantly, we expect that the weak labor market of 1975, with layoffs and unemployment rising sharply, will hold down the rate of wage increase and moderate the rise in standard unit labor costs. Weak labor markets offer some insurance against prices passing into wages—albeit at an excessive cost—but they are of course no *guarantee* of moderation.

Special factors have upset inflation forecasts with regularity in the past two years, and could upset our 1975 outlook as well. Two big unknowns in the 1975 price picture are the prices of food and petroleum products. In our forecast, we have factored in (1) a $10 billion rise in the prices of petroleum products and (2) a levelling or even a drop in food prices in the second half of the year after a 15% annual rate of advance in the first half. The drive to cut oil imports and consumption via excise taxes and decontrol could be so single-minded as to raise oil prices even more than we expect. And a third successive year of crop failures would keep food prices rising in the second half of the year. This, in turn, would make wage moderation less likely. Nevertheless; the basic forces now at work point to a marked slowdown of inflation in 1975 and, given the large continuing slack in the economy, a further improvement in 1976.

POLICY FOR 1975

Against this background of receding inflationary pressures, a sagging economy, and continued downdrafts from fiscal-monetary and energy policies, the case for easier Federal Reserve policies and a prompt and bold tax cut is overwhelming. Not only do we need to restore the health of the U.S. economy for its own sake, but also, as we slide ever deeper into recession, we undermine the ability of our trading partners to cope with their oil-cum-recession crises and dangerously increase economic pressures on the Third World.

A well structured tax cut of $20 to $25 billion would now be the right medicine for recession and unemployment without triggering unwanted side effects on inflation. Ideally, the tax cut should be structured (a) to restore consumer confidence and buying power, (b) to provide relief to the victims of inflation and recession, (c) to be part of a social contract for moderation in wage and price increases, and (d) to provide stimulus for needed investment.

A tax cut to meet these specifications might include (1) a refundable tax credit of 2% of earned income up to $14,100 (the present dividing line for Social Security payroll taxes), (2) an increase in personal exemptions, low-income allowances, and standard deductions to compensate for the inroads of inflation, and (3) an increase in the investment credit to 10% for all industries.

Perhaps the greatest enemy of a tax cut of this size today is what one might call "fiscal acrophobia," an unwarranted fear of fiscal heights. A $20 to $25 billion tax cut sounds high until one puts it into today's rather than yesterday's fiscal and economic perspectives:

It would be only 1½% of the projected GNP for 1975.

It would do no more than offset the "inflation drag," that is, the automatic increase in effective federal income tax rates "legislated" by inflation in 1973–75.

It would offset only about half of the prospective 1975 "oil drag," the combination of quadrupled crude oil prices plus the price effects of new oil policies now foreshadowed.

It would equal less than two-thirds of a year's automatic growth in federal tax revenues which, at present tax rates, runs close to $35 billion a year.

It would fall short of the 1964 federal income tax cut translated into today's terms. That $11 billion cut would be $26 billion today. Yet, that reduction was enacted when GNP was running 7% below the U.S. economic potential calculated at 4% unemployment, while GNP in 1975 will soon be running 10% below our economic potential calculated at 5% unemployment.

It is not an exaggeration to say that the biggest danger to the economy in 1975 is that we will think too small. Given what is now at stake in both economic and human terms, in both domestic and international terms—and given that inflation forces are ebbing, excess demand is years away, and tax cuts offer means of reducing cost-push pressures—our policymakers cannot afford *not* to think big.

Chairman HUMPHREY. At that time you forecast a rather sharp decline in the gross national product in 1975. This forecast was made before we knew the disastrous 9.1 rate of decline of GNP in the fourth quarter. Now that the fourth quarter data is available, do you feel that the 1975 outlook is even more gloomy than you forecast?

Mr. PERRY. It depends so much on the policy actions that are taken, and taken promptly, that I have to give a conditional answer. In the forecast I did not assume the oil price increases that the President proposed. I assumed a very modest increase in the price of energy products. I also assumed an immediate $12 billion tax reduction.

So all things considered, I would revise down in view of what we saw in the fourth quarter. I think that would suggest an even weaker economy than I had before me at the time the forecast was made. And I would revise down even more if the President's program were enacted.

Chairman HUMPHREY. So you feel the condition is worse?

Mr. PERRY. Yes.

Chairman HUMPHREY. I know these are guesstimates. What about unemployment?

Mr. PERRY. I would now guess unemployment would reach 8 percent very quickly, rather than by summertime. I had expected the rate of inventory adjustment might be rather gradual. But in view of the size of the unintended buildup of inventories that we got in the fourth quarter, I would now expect a sharper decline which will lead to more layoffs and move unemployment up much more quickly. We are talking about a situation where we are looking at 8 percent unemployment very soon and a continued rise in unemployment after that unless we take very strong actions to reverse it.

Chairman HUMPHREY. What you are really trying to do first is to stop the downhill slide. That is a major job. Then, after you do that, you hopefully will level off and climb up the walls of the economic canyon which is rather hazardous and time consuming.

May I get to Mr. Houthakker? You speak of an economic decline of terrifying steepness, that is your language, "terrifying steepness." Would you like to define that to us just a little bit more?

Mr. HOUTHAKKER. Well, I had in mind partly the fact which we referred to, the decline in GNP in the fourth quarter with a very steep percentage rate. It becomes even worse when you try to analyze this into the various components. Rather than GNP, perhaps a more meaningful trigger to look at is domestic final sales in real terms, because that is a better measure of demand.

So in those terms it looks even worse. I don't have the exact figures, but it declined nearly 12 percent a year, or 13 percent.

Chairman HUMPHREY. 12 or 13 percent?

Mr. HOUTHAKKER. I can supply it for the record, but between 12 and 13 percent.

Chairman HUMPHREY. Between what period of time?

Mr. HOUTHAKKER. Between the third and fourth quarter.

Chairman HUMPHREY. What is the index that you use? I mean what—final sales.

Mr. HOUTHAKKER. Domestic final sales in real terms. You exclude the change in inventories and the trade surplus.

Chairman HUMPHREY. I see. That is a terrifying decline, is it not?

Mr. HOUTHAKKER. It is, indeed.

Chairman HUMPHREY. Do you find yourself in agreement with Mr. Perry on the rate of unemployment?

Mr. HOUTHAKKER. I am afraid there is a lot to what he says. We will undoubtedly have a further substantial increase.

Let me, however, if I may, mention two things on the favorable side.

Chairman HUMPHREY. Please, we could use a little of that.

Mr. HOUTHAKKER. This is of deep concern. There are two things which may provide some balance.

In the first place, inflation is definitely slowing down very rapidly now. The weekly commodity price index, which is a very sensitive one, at last report was 6.5 percent below a year ago, so that is definite progress.

Also we will get some benefit, but not enough to pull us out from the foreign side because the very steep decline of the dollar will stimulate our exports and curtail our imports.

Chairman HUMPHREY. Yes. I mentioned in my discussion with you, earlier, that the President's state of the Union message did not include any reference, as I recollected, to the matter of monetary policy, particularly the easing of monetary conditions. I was in error on that. The back up material that the President included along with his message states: "The recession is deeper and more wide spread than expected earlier, but the tax reduction together with the easing of monetary conditions that has already taken place will support a healthy economic recovery."

My point here is that the President felt in his message that the easing of the monetary policy that has already taken place is adequate; do you agree with that?

Mr. HOUTHAKKER. No, I do not believe there has been easing at all. It depends on what you look at. Interest rates have come down some.

Chairman HUMPHREY. The prime rate.

Mr. HOUTHAKKER. The prime rate and the Federal funds rate, the dollar rate, all have come down some.

Chairman HUMPHREY. But most of the rates that the average individual borrower gets, those have not come down?

Mr. HOUTHAKKER. I believe the mortgage rate has declined a little.

Chairman HUMPHREY. Very little. And the amount of money you can get is very limited.

Mr. HOUTHAKKER. But my point is it is very misleading to look at interest rates in regard to monetary policy, because they reflect both demand and supply. In a recession demands for money tend to fall and that in itself will bring interest rates down. With an expansive monetary policy the supply would have to increase, too. The statistics which we have at the moment suggest that supply has gone down, therefore, I believe it is misleading to talk about an easing of monetary policy. We just have not had it yet.

Chairman HUMPHREY. Last month, the month of December, I believe it was, the rate of increase of money supply was about six-tenths of 1 percent, and the previous month it was about 1 percent. Now, that is a very limited easing of monetary restraints.

How do we get the Federal Reserve Board, gentlemen, to cooperate in this matter?

On the one hand, let's say that the Congress just snaps into action, which will be the news of the year, and then we finally get this tax bill through in 30 days, which I think ought to be a maximum period of time. We don't need over 30 days, everybody knows what we ought to do. It is just a question of buckling down and doing it. Let's say we get the tax bill through, that that we will not get hung up on all the little peripheral arguments, just get the tax bill through, then the Federal Reserve Board decides the money rate should be leveled off at about 2 percent. What will happen?

Mr. HOUTHAKKER. I mentioned the figure of 5 percent. Some people may come up with something more. The main reason I think 5 percent is enough is in part that inflation is slowing down and I don't think we want to lose too much on that front if we can help it.

As regards the Federal Reserve, I believe the real problem is there is a gap between the decisions taken by the Federal Open Market Committee and execution of the policy of the Federal Bank of New York. I remember Dean Acheson saying: "I don't mind who makes the policy as long as I can do the negotiating." The New York Fed people don't seem to care about the monetary policy as long as they can carry out the open market operations.

Chairman HUMPHREY. Do you have any suggestions as to how you might deal with the Fed up in New York?

Mr. HOUTHAKKER. Well, the situation is such that if I am right in thinking the execution of the monetary policy is at fault there would have to be personnel changes, because this has been a longstanding problem, and I believe that the Federal Reserve has not been able to carry out its stated intentions.

Chairman HUMPHREY. You know the Fed has been sort of a sacred cow, with the exception of our dear friend Wright Patman who, for some reason or other, had some difficulties here. He has been the No. 1 counterpuncher, so to speak, on the Federal Reserve.

I am really very serious about this because I believe this is a major problem in the overall national economic problem, how you synthesize or coordinate the fiscal policy on the one hand that may be formulated by the Executive and the Congress and then what do you do about the monetary policy that is almost totally in the hands of the Federal Reserve system that has apparently begun to feel it does not have any accountability to the Congress, the Congress that created it. The Federal Reserve—I believe it was you, Congressman Bolling, who said the Federal Reserve system was created by the Congress, the instrument of the Congress, but it said goodby to us along time ago, and denies that we have any paternity.

Mr. HOUTHAKKER. I believe when Senator Proxmire was chairman of this committee he had an agreement with Chairman Burns about a quarterly report.

Chairman HUMPHREY. We are having Mr. Burns. We always enjoy his testimony.

Mr. HOUTHAKKER. His quarterly report could be made an explanation on the part of the Federal Reserve Board, whose intentions are usually quite laudible.

Chairman HUMPHREY. We would appreciate it if you could help neophite like the chairman to ask proper questions. I find in order to get answers which are meaningful you have to have good questions.

I would appreciate it if you could give us a little memorandum in a probing exercise, because I think this is very important.

Mr. HOUTHAKKER. I will be very happy to help whenever I can.

Representative BOLLING. I would make one comment. I think one of Congressman Patman's problems with the Fed is that sometimes he did not have the right questions.

Chairman HUMPHREY. I think that may be our problem here today, too.

Mr. Sawhill, how did we ever get that million barrels a day figure? Where did that pop from? Once somebody makes a suggestion all at once somebody grabs it up, the print press and the electronic press and the whole world says a million barrels a day, and if you do not say a million barrels a day you look like you are stupid.

Who concocted that idea?

Mr. SAWHILL. I do not know where that million barrels a day came from. I do remember once myself asking Sheik Yamani on a television show that he and I were on together, I asked him what would happen if we cut by a million barrels a day and the rest of the world did likewise. He said he thought the price would probably come down. I doubt if that was the source of the million barrels. I do not know why the President fixed on that particular goal, and that might be something to explore.

Chairman HUMPHREY. Our committee and friends decided they do not mind if you cut a million barrels a day, and I say this with great respect. I am out there in the Midwest and they just say go ahead and play your little arithmetical games and we will tell you what the price is and you will pay it unless you want to freeze.

They seem to think if we signal something to the world everybody will snap to attention. I do not see any reason at all that the OPEC countries should respond.

Mr. SAWHILL. I think this is one of the critical things, that there is nothing magic about a million or 2 million barrels a day. Once you set the goal, sure, you need these price increases or other mandatory measures to achieve it. What we have tried to convince you this morning is there is nothing sacrosanct about the goal. Let's question that goal. Can we really afford to cut that much in view of the economic circumstances in which we find ourselves, and I think your witnesses have said no, we cannot afford it.

Chairman HUMPHREY. The only thing is in the balance of payments——

Mr. SAWHILL. I am not really sure of that. Is it all that important that the United States have a positive balance of payments, particularly in the next year or two when our trading partners will have a severe deficit? Perhaps what the United States could do is to define the kinds of oil deficits that they are going to have.

Chairman HUMPHREY. I understand the logic of what you are saying, and I don't disagree with you at all. But you try to sell that to the general public. The minute they hear "deficit" you hear somebody say well, I can't run my house that way. We equate the grocery account with the whole economic system.

Mr. SAWHILL. I think Mr. Perry could probably elaborate on this point better than I can, but you have to look at the United States as part of the world. The whole world has to be in balance, but no one country will ever be in balance as far as its trading accounts are concerned. That is why we will sometimes run a surplus and sometimes a deficit, but right now it is more appropriate for us to be in a deficit position.

Part of the problem Mr. Perry said to an audience is that the press makes a big headline when a deficit occurs as if it were bad.

Chairman HUMPHREY. It is like saying sex.

Mr. SAWHILL. That is not bad.

Chairman HUMPHREY. "Deep Throat" or something like that.

Representative BOLLING. The question I have is, based on what I think has happened this morning, it seems to me that very clearly the witnesses have joined all the other witnesses we have had in saying the really urgent matter before the Congress is not to make a mistake on energy at the same time we are doing the right thing on the economy. It seems to me that that has been established so firmly. And the reason I don't have other questions is that we want to leave that as the thought that there is great unanimity, that we must act on the economy at once.

I happen to agree with the 30-day deadline that you set, Senator Humphrey, and we don't need to act on energy and the probability would be better if we did not have the President's first dollar of increased cost in terms of getting the economy turned around.

The other things we would elicit from the witnesses on energy really have to do with longer range policy. It seems to me that there is some advantage to not limiting ourselves thoughtfully, but limiting ourselves in terms of action to a step at a time. I think we can suffer disaster if we let the President's program go into effect, even if we do a rather good job on the economy.

I just wonder if what I have said represents in the short term the view of the three witnesses. I think it is. I think it has what they have been saying, that it is essential that we act on the economy, that we not do energy in such a way that it impairs on the economy in summary.

Mr. SAWHILL. I think it is a good summary.

Mr. PERRY. That is a good summary.

Mr. HOUTHAKKER. My only qualifications is there are some good things in the President's proposal, too.

Chairman HUMPHREY. How do you get the President to stop putting on this $3 a barrel tariff? We have had a great deal of discussion, he is over in the White House and I am here, we have a vote in the House of Representatives. You do not have a vote until the next election. Now what do you do? Do you know who sold the President on this Rube Goldberg special?

Mr. HOUTHAKKER. I believe you will have Secretary Simon here. I am not in a position to say who pushed what, but there is a preponderance of opinion right now, and not just here, but all the witnesses of different congressional committees on this $3 import duty and on the excise taxes.

Now, the administration is going to be very hard put to defend those.

When it comes to the point Congress may have to go farther and rescind the import fees which will take special legislation——

Chairman HUMPHREY. Once you get that injection, the first one goes into effect February 1, that is a dollar right off the bat, and you can rest assured that will trigger something all the way through the entire petroleum economy. Congress does not have the swiftness of the rabbit. As a matter of fact, occasionally it makes the turtle look like a super jet when we move on these things. I say this with both humor and sincerity, because I am worried about the fact that the Congress of the United States does not yet fully understand the severity of this recession as you gentlemen have outlined in here today. I still believe there is a little politics to this, and I personally think that the politics are a disaster for it. The people I meet are so fed up with us here in Congress that they are not sure what they ought to do.

I am just trying to find a way to get a handle on this.

I happen to like the President, and I am going to see him about another matter, and I am going to tell him, as I have before, what my views are. He is getting advice from people that he obviously trusts, and I would not impute any ill motives to him. I am grateful that he has at least made us bite the bullet. But, why don't you top men in the economic field get kind of a general national letter to the President and say stop, look, and listen before you increase prices on crude oil which touches everything from an aspirin tablet up to fertilizer. It is unbelievable. It is not targeting in on just gasoline. We have a lot of things we could do about the automobile industry that would be helpful, and gasoline, and I agree with that. But my God, if you are going to add 28 percent to the fuel costs out in Minnesota—we had 8 inches more snow today. You talk about Boston and New York. We live, too. I realize the need covers the eastern seaboard.

How do we get this message to the President that he is on a disaster course? I think it is major economic disaster.

Mr. SAWHILL. I think the President wants to put into place measures to reduce energy consumption, and I would support him on that.

Perhaps what you can do is develop some compromise where he would not put this tariff into place and the Congress would come forward and say we will enact major pieces of your program such as the tax credit for insulation, mandatory efficiency standards for automobiles.

Chairman HUMPHREY. He doesn't have any mandatory standards. The voluntary program has literally disintegrated. You get on the highway and you go 55 miles an hour and you will think you are parked. People are going by you like crazy. It is unbelievable.

Mr. HOUTHAKKER. Senator, you raised the question of why 1 million barrels. My impression was this was the result of an international agreement which the administration was firmly committed to. Maybe that is a question that needs to be further explored, and I see Mr. Sawhill shaking his head in denial. My understanding is there was an agreement by which we would cut imports by 1 million barrels a day and Europe and Japan by 2 million barrels a day and this would have some effect on the world petroleum market.

Mr. SAWHILL. I don't think there was ever any formal agreement to that effect.

Mr. HOUTHAKKER. This is the way the administration sees the international energy program operating and that is why they are casting about for ways for making the United States fulfill this commitment, apparently.

Chairman HUMPHREY. Well, if it makes the recession worse I can't imagine anybody in Europe or elsewhere would want us to enter that kind of a program.

Mr. HOUTHAKKER. I agree with you. It is not a treaty or anything. It is not part of the law of the land, but I believe it is an explanation for this particular figure.

Mr. SAWHILL. If that is true perhaps the administration will gain some comfort by the recent report by the Morgan Guaranty Co. of New York in which they attempt to adjust some of their earlier estimates. The size of the deficit itself has not been quite the problem we once thought it was.

Chairman HUMPHREY. Now, this final part here. Mr. Houthakker you said something about the windfall profits tax that you said ought to go back to the drawing board. I note, maybe I am in error, but you help me if I am, isn't it true that coal and natural gas producers are not subject to the windfall profits tax but would stand to gain substantially from the increase in the price of oil because they are alternate or competing fuels, and if you take all controls off they tend to balance out, which is understandable?

I would like to get two observations. First, what do you think is wrong, Mr. Houthakker, with the windfall tax proposal; and second, for the panel, am I making a proper assumption that the other form of energy such as coal and gas would not be subject to that kind of a windfall tax proposal made by the President and therefore would profit very handsomely with any increase in energy prices?

Mr. HOUTHAKKER. Well, all I know about the windfall profits tax is what it says in a hand out from the White House, which has about a paragraph on the subject and includes a schedule. The way I read the schedule is the tax is applied both to old and new oil. That is why I don't think it is a windfall tax in any real sense of the word. It seems to me the windfall tax would apply only to old oil whose price would go up as a result of decontrol.

As regards coal and natural gas, I think we have to make a distinction between those two commodities. In the case of natural gas the President proposes a 37-cent-per-thousand-cubic-foot excise tax, which he says is equivalent to a $2 barrel tax on oil. Therefore, if his proposals would be enacted, and I have serious reservations about that, too, then there would be little windfall profits on natural gas because it would all be taxed away by the excise tax.

As regards coal, there will be some windfall profits, and therefore, a case can be made for extending the tax on coal. The main argument against it is that coal has not so far been very profitable as an industry and that we want to have some incentive for further expansion. Nevertheless, in strict logic there is no reason to exclude coal from the real windfall profits tax as against the one that has been proposed.

Chairman HUMPHREY. My staff man was just telling me on this gasoline business—you know, you have to have a lot of help up here on this sort of thing.

Mr. COX. Professor, it would be the equivalent of the $2 excise tax but it would not soak up anything from profits from the deregulation.

Mr. HOUTHAKKER. I am in some confusion as to what is proposed on natural gas. The statement is so brief I cannot understand it.

But my impression was that the excise tax would take the place of a windfall profits tax as far as natural gas is concerned.

Mr. SAWHILL. No, the intent of the natural gas tax was to be the equivalent to the $2 oil excise tax. On the decontrolled oil you would have a windfall tax, but not on the natural gas. I agree with your statement that you would not have windfall profits on natural gas and coal, and therefore producers of those would rebate so-called windfalls.

My own feeling is that we should not decontrol windfall prices, continue the system we have in effect, and I was pretty explicit.

Chairman HUMPHREY. You two gentlemen disagree with that?

Mr. SAWHILL. Yes, we do.

Chairman HUMPHREY. That the market price ought to prevail?

Mr. SAWHILL. Of course, I believe there is no free market price. I believe this is determined by a cartel.

Chairman HUMPHREY. Mr. Perry.

Mr. PERRY. I would associate myself with John Sawhill on the question of decontrolling oil.

Let me just add one thought. Some people argue that we can let a price go so long as we have the windfall tax and the Government gets the revenues rather than the windfall going to oil profits. But our discussion concerning the economic impact of substantially higher prices warns against this. The detrimental effects on the economy of a very substantial price increase are much the same whether the revenues go to the government or whether they become windfall profits to the oil industry.

When we are confronted with an economy that is suffering already from high prices and that would be further depressed by more price increases, we should not treat any differently a price increase that results from taxes or that is captured by a windfall tax from a price increase that is not.

The windfall tax doesn't justify a substantial price increase. The only area I can see justification for a price increase above what is now prevailing in markets is in the natural gas area where there is strong evidence that decontrol would help to expand supply.

Chairman HUMPHREY. Well, you have been very helpful, all of you today.

I have enough questions to keep all of us here for the rest of the afternoon. Let me ask you a general question. If this committee should ask your help in preparing an overall assessment of energy policy and some details of what it ought to consist of, I gather we would have your full cooperation, because I believe this Congress has about 25 separate subcommittees working on energy. We have to pull together some knowledgeable people as well as Members of Congress that have responsibility in this area and whack out and develop, I guess that is the best word, develop a real energy policy. So far what we have been able to do is to point out the short comings in the President's policy and we have come up with a number of good suggestions.

I read the other day, for example, in the automobile industry, if we could move 5 million of the compact type cars; any where from 18 to 22 to 25 miles per gallon, that it would give us a daily saving of 600,000 barrels of crude oil a day, that one, just one development, and then if you put some taxes on these luxury cars that we have, on horsepower and cubic displacement and weight—I see General Motors is contemplating new tooling in their smaller cars—but if we put taxes on the heavier cars and some tax incentives on the purchase of the smaller ones I think we might be making some progress. I don't see any reason that the Federal Government couldn't do something like that. In other words, if you purchased an automobile that could be certified at a certain cubic displacement in the engine and a certain amount of horsepower and engine efficiency, why not give somebody a tax credit. You say okay, old buddy, if you cooperate in the national policy you are rewarded. If you don't cooperate you are punished in a sense. You will have to pay. That is another idea.

Surely the President's proposals in insulation and some other things are excellent. We ought to act on them promptly. But I think it would be good if some of you who have worked for our country, and you have all helped so much, if you could just list out for us the things that looked helpful in a long-term national energy policy, recognizing that the demands for energy for a growing economy, if we want to get this GNP of ours turned around so that you have a growth rate of 3 or 4 percent—I guess a 3 percent would be considered moderate—would it not, and it is necessary to absorb your work force, now what are the demands of energy in that kind of economy? We will have to be thinking about what kind of energy we will have to meet those needs and its availability and what kind of policy we have, no matter how much conservation. I feel even if we have the best of conservation measures we will use more energy 5 years from now by far in order to maintain any economic strength in this Nation.

Mr. Sawhill, you used to give us a pretty good lecture on that, but we haven't heard much about it lately.

Mr. SAWHILL. I haven't been around much.

Chairman HUMPHREY. What has captured the public's mind is we need a million barrels per-day reduction. No one has said how much energy will be required for conversion into electrical power alone, even if we conserve with marked effectiveness, how much electrical energy will we need 10 years from now and where are we going to get it, what is the source. Let's assume you can put all kinds of nuclear plants on the line. How much of a dent will this make on fossil fuel consumption? I hear it will go up no matter how much you put into geo or solar or hydro or nuclear energy.

Any views on that?

Mr. PERRY. I think the report prepared under John Sawhill's direction was an excellent report that tried to address a lot of the questions.

Chairman HUMPHREY. That is our Project Independence report?

Mr. PERRY. It had a good deal of information about the alternatives. It would be useful to bring it to the public's attention more than has already been done.

Chairman HUMPHREY. Well, one of the problems is that we read about it in the paper one day and it is gone. That is a fact.

I want to tell you in my home State of Minnesota this last month the State planning commission took 3 days to outline the future projects of the State of Minnesota to every member of the legislature, so when the legislators were contemplating current actions on authorizations, programs and appropriations, that we had a picture of what they were contributing to, what forces they were releasing or retarding, or what population distribution they were effecting, not just this year, but 5, 10 years down the line. This Congress never does anything like that. We have no planning at all. We only plan the Congressional Record on a daily basis.

Mr. SAWHILL. You don't have a planning commission. Maybe you could create an arm of the Congress.

Chairman HUMPHREY. I have felt that a long time ago, but planning, like some other things, has just been another dirty word. We haven't be able to get anybody to settle down to it. I hope in this committee in the coming year we will talk about national growth and planning. Senator Bentsen has been doing some work on that. We need a whole new national dialog, because really what we are running around doing is patching up a hole in the wall; put on some plaster of paris, paint it over, and then go on here in another place and patch a hole.

Well, that is fine. Thank you for listening. The committee is adjourned.

[Whereupon, at 1 p.m., the committee adjourned, subject to the call of the Chair.]

THE 1975 ECONOMIC REPORT OF THE PRESIDENT

FRIDAY, JANUARY 31, 1975

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

The committee met, pursuant to notice, at 2:45 p.m., in room G-308, Dirksen Senate Office Building, Hon. Hubert H. Humphrey (chairman of the committee) presiding.

Present: Senator Humphrey and Representative Rousselot.

Also present: John R. Stark, executive director; Loughlin F. McHugh and Courtenay M. Slater, senior economists; Richard F. Kaufman, general counsel; William A. Cox, Lucy A. Falcone, Robert D. Hamrin, Sarah Jackson, Jerry J. Jasinowski, Carl V. Sears, George R. Tyler, and Larry Yuspeh, professional staff members; Michael J. Runde, administrative assistant; Leslie J. Bander, minority economist; and George D. Krumbhaar, Jr., minority counsel.

OPENING STATEMENT OF CHAIRMAN HUMPHREY

Chairman HUMPHREY. Gentlemen, I have a brief opening statement and then we will proceed with the schedule of witnesses we have. This hearing is one of a series of hearings that we are having on the President's state of the Union message. We will follow next week with additional hearings. We expect the President's budget next week and also the President's economic message to the Congress.

The duty of the Joint Economic Committee is to examine both of these basic and fundamental economic documents. We, therefore, will have the Secretary of the Treasury, Mr. Simon, on Wednesday, I believe it is. We have the Chairman of the Council of Economic Advisers on Thursday. We will have the Chairman of the Federal Reserve Board on Friday of next week. We also will be getting the reports on unemployment from the Bureau of Labor Statistics and the Cost of Living Index.

So we also will have the Director of the Bureau of Labor Statistics who will appear before us, along with Mr. Burns. That report generally is placed before this committee and we question some of its economic data.

Today, the Joint Economic Committee continues its annual hearings with a panel of distinguished local elected officials. Although it is not often recognized, the State and local government sector is certainly one of the most important in our economy. Unfortunately, the Federal Government has not done a good job in managing the

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national economy. I do not have to read the bad news to you because you know the effect upon your government that has been in many instances not only difficult but devastating. The combination of recession and inflation has seriously eroded State and local revenues and has increased the demand and cost in goods and services.

Let us take a short look at what inflation and recession has done to State and local governments.

Inflation has driven up the cost of goods and services, of course, at a faster rate than revenues have increased. Property tax does not rise as fast as goods and services because there are lags in reassessment and, quite honestly, local officials find this tax to be very distasteful.

However, as bad as inflation is, recession has a far more sinister effect on State and local governments. Tax receipts, particularly sales and income tax, are affected by the declines of real personal income and retail sales that accompany a recession. Unemployment increases demand in certain services, public assistance and unemployment compensation. The question is what is the Federal Government to do about this and what is it doing about this problem of recession and its twin—inflation? Unfortunately, we find not enough. Just when State and local governments need more assistance to retain employees and maintain levels of services, real Federal assistance has declined. I emphasize the word "real," not just dollars, but what do those dollars buy?

The real value of Federal grants and aid to State and local governments has actually fallen by 2 percent in the second half of 1973 and the second half of 1974. I can remember when we enacted general revenue sharing, which I strongly supported, and was a coauthor here in the Senate. One of the big selling points was that this would be a stable source of assistance. I do not have to tell you now what that money can buy.

We are fortunate to have before the committee today, as I said, to discuss these issues four outstanding local government leaders. Our first witness is the Honorable Joseph Alioto, mayor of San Francisco and president of the U.S. Conference of Mayors, and we have other witnesses that I will introduce as we go along.

Mayor Alioto is a longtime personal friend of mine and a man that I admire greatly, and I welcome him to this hearing and thank him for taking the time to appear before us.

Please proceed, Mayor Alioto.

STATEMENT OF HON. JOSEPH L. ALIOTO, MAYOR OF SAN FRANCISCO AND PRESIDENT, THE U.S. CONFERENCE OF MAYORS

Mayor Alioto. First of all, we thank you very much for listening to us. The past few days we have had the executive committee meeting of the U.S. Conference of Mayors. I am privileged to be president of this conference.

We had a meeting here in Washington to detail certain things and to form a declaration of policies, specific plans that we wanted to present to the Congress of the United States and to the administration. The various committees have met, committees dealing with every phase of city life, and they have produced a program that we would like to present to you.

Chairman HUMPHREY. Thank you.

Mayor ALIOTO. Senator, thank you for listening to this presentation of the mayors. We had a summit conference back here not too long ago. Most of the people that came to that conference were worried about inflation, what they were going to do to curb inflation, and we heard a lot of those 19th century proposals about how we have to deliberately create unemployment to cure inflation, eliminate incentives for building anything, eliminate incentives on projects. We heard that. There were only two groups of people conspicuously who said:

> You better quit worrying about that inflation. The rumblings we are hearing at the ground level are rumblings of unemployment, of serious recession, and you better concentrate a little bit on the recession and forget the other business at the moment. Keep it in mind, of course.

But the emphasis was always the other way. The only two groups at that summit conference who talked along those lines were, first of all, yourself, and we appreciate your comments at the time. Your talk of stimulating the economy were very prophetic at the time and everybody was going in the opposite direction. They were talking about tax increases, they were talking about increasing interest rates, keeping interest rates high. And only you and the group of mayors, Mr. Panuzio and I sat at that table.

Chairman HUMPHREY. I recall.

Mayor ALIOTO. You and that group of mayors put the emphasis where it belonged, on recession. Four or five months later everybody is talking the same way, the recession we have to cure. The administration has come around completely to that view. It is a direct contradiction of the whole philosophy which prevailed those few, short months ago at the summit conference.

Now, the mayors can get the reputation of being the country's most prized moaners, and moaners are never popular, you know. In ancient times, everytime anybody came in with a message that the hearer did not like, he or she were killed on the spot. Cassandra was never popular but she was right. And the mayors and you, having been a mayor and knowing more, and you—and I hope you do not regard this as idle flattery. There is not any man in America who knows more about the industrial and agricultural economics than you do, or what to do about it. Not any man in this country. The mayors are not smarter than anybody else. We are just literally, you know, walking the edge of a volcano, and we can get a notion of the eruption before the other folks get it.

So back in those days we were talking about this horrible unemployment that was happening. We are the victims of inflation, to be sure. Nevertheless, we felt at that time that we had to worry about employment, jobs, creating jobs, keeping people working, keeping their dignity as well as their financial independence. We thought that was more important. Now it has turned out precisely that way. We do not like to raise specters. Sometimes mayors are accused, the blood is going to run in the streets. There is going to be riots and they are accused of saying that just for the purpose of creating a specter that will somehow induce or generate some kind of action.

Let me talk to you about three hard, rough facts that are objective. Anybody who cannot make the right inference from those three facts is not really thinking very seriously about this problem.

Recently, you passed a public employment program. You were a leader in that, as you always are; 10 to 20 times, depending upon the city, 10 to 20 times the number of applicants showed up for the jobs that we had. In San Francisco, for example, more than 6,000 showed up at the latest count and we still have some more to come in; 6,000 applicants for 675 jobs.

That is one fact; it is a very hard fact.

In three American cities you had riots of applicants breaking down doors to get in. You had riots in three American cities. That is one very, very hard fact, not conjuring a specter in regard to that fact. Let me give you the second hard fact.

The chief of police of Los Angeles—I do not know why he did this but he did it—went public with the statement that he was training his police for food riots. Imagine going public with a statement like that, but he did. He thought it was necessary to warn everybody in a city which is generally regarded as more affluent than the older eastern cities, for example. He thought it was necessary to warn everybody that he is training his police to prevent or to handle a food riot. A responsible official, not a man given to hysterics. I thought it was ill advised. I thought the judgment was bad. But he said it anyway and it was widely published.

That is the second very objective fact no mayor is making up for the purpose, again, of conjuring up a specter.

Let me talk about the third. We all know Leonard Woodcock. We do not regard him as a hysterical man. He felt some compulsion to say on television to the whole country within the last 48 hours, some compulsion to say, "Either we are going to get some action on this, or there will be 250,000 people marching to Washington this spring."

If that brings up memories, if that is reminiscent of an army that marched on Washington in the 1930's, to some people our only hope is that they will act upon it.

None of these things really have to happen. I am one of those who believes that there is still enough of a basic economic strength in America to sacrifice and prevent all those things, but we have to talk about preventing them. The only way to prevent them is with programs.

There are some of us who look out on this whole problem and observe a phenomenon that we do not understand why it does not excite more people. There are five men in the world today who, acting on literally their whim can turn out the lights of Western Europe, Japan, and dim the lights considerably of America. Five men who control an oil monopoly in this world, who have a price monopoly and a supply monopoly.

We are engaged with them in an antagonistic position as far as the politics of the Middle East is concerned, yet they have this kind of tremendous power.

We think that that creates the total combination of what I am talking about, this recession, this horrible recession, the inflation that accompanies it, and the fact that five men outside of our border who have no compulsion to sell, somebody with 6 million inhabitants who is making $90 million a day, which is the Saudi Arabia situation, the largest of those producers, has no compulsion to sell it. He can always sit right there on his oil. Yet, this is the kind of power that is external to us. We have permitted this to happen. One day the story of how we permitted this to happen is going to be very interesting. We have permitted this to happen.

With these combinations of things some of us think that this is the most serious situation that has faced this country since World War II. Hitler had the potential of turning off the lights of Western Europe, Japan, and most of America. It would have made us hysterical. It did. When we had the threat with respect to breaking the atom, we reacted to it. We forgot a lot of considerations, fiscal or otherwise, we reacted to it in the Manhattan Project, as an example.

Some of us think that the present situation calls for that same sense, not of urgency but almost of emergency. Those of us who are watching this little scene being played have some misgivings about the fact that there is not the kind of unified approach to all of this in the administration and the Congress. We have some serious misgivings about that.

When we watched that little foxtrot that was being done in January, early in January, about who was going to the public first with the statement that turned out to be the state of the Union, given for the first time in advance, in giving it to the Congress of the United States. We watched them jockeying—Republicans and Democrats alike. That disturbed us a little bit.

We think that this is a time in our lives when there has to be almost a coalition thought in terms of our Government. The Congress of the United States and the administration ought to work on a program that they can agree on. If it requires compromises, let there be some compromises, but they ought to speak as one voice.

In addition to that little foxtrot that I talked about, the maneuvering about who was going to go first, in addition to that this latest spectacle of the President on one day announcing a very important, to him, important tariff policy, and the next day the Ways and Means Committee attempts to veto that tariff policy with respect to oil, this shows a sense of disunity and disorganization in dealing with the crisis. That bothers a lot of people. It bothers a lot of people in this country, particularly it is bothersome to mayors who were watching these developing problems that I talked about earlier.

So you will not think that the three things that I have mentioned, which are hard, objective facts from which anybody can make a normal inference, and I think the inference is trouble, so you will not think that it is an isolated phenomena, I would like to give for the record statements from the mayors of New York, New Orleans, Cleveland, Milwaukee, Syracuse, Gary, Ind., Newark, N.J., Saint Paul, Minn., Wilmington, Del., Houston, Tex., and my own city, and you will see that these are statements from all kinds of cities, cities that are big, cities that are little, cities that are old, cities that are new, cities that are medium.

These statements give you details, not argumentative statements nor conclusions or ultimate facts but details of the financial hardship that they are having in these cities.

Chairman HUMPHREY. We will include those statements as original testimony following your testimony, Mr. Mayor, the full text.[1]

Mayor ALIOTO. Thank you very, very much.

Chairman HUMPHREY. Might I say I am pleased you are going to give us that but I want the staff to take a look at those and to summarize their recommendations so when we look at this record that you can pick out what the salient points are. I want to make this a matter of policy. I am not for having just a lot of things put in the record. I want to summarize it so when somebody picks it up, they can look at it and come out with three or four suggestions.

All right.

Mayor ALIOTO. Let me generalize some of it. They are pointing out that at a time when they are handing out public employment jobs for $500 a month, $600 a month, $700 a month, as a maximum of $800 a month, at the time when they are handing out those jobs, on the other side they are firing civil service workers who have been there for 10 years or more. Abe Beame in New York has fired 12,000 city workers, including policemen, firemen, jail guards, medical workers, people who work in the criminal justice system, people who work in the social system, people who work in the medical systems; 12,000 people have been fired, some of them veterans of the civil service.

With the other hand he is handing out these jobs which are insufficient to handle the number of applicants that are moving in. Where are they in doing that?

For example, sometimes we say in San Francisco, "We are not firing anybody." That is only a half-truth. The truth of the matter is that we are not firing anybody but we let attrition diminish the ranks of the civil service workers. We did not replace the 10 percent of the men and women who each year either transfer, retire, die, quit, or are fired. For whatever reasons they are out of jobs, we did not replace them. There is a freeze on requisitions. That is a substantial equivalent, really, of firing in other cities.

Some of us do not have to be quite that extreme. A city like Newark has fired 3,500 people. We already mentioned Abe Beame at 12,000. In the city of Detroit, parks have been closed down. These are all objective facts. These are discernible facts, observable facts.

We have to make the kinds of inferences that are necessary to be made from these facts.

What about a positive program as to how we are to meet this situation? Let me say first of all you are always going to say that the mayors are asking for too much. We understand that there is a judgment in the Congress that is a little bit different than ours. We understand that the Congress has to look at a total picture sometimes to make a just and reasonable apportionment of limited supply. We understand that.

[1] See statements of various mayors, beginning on p. 250.

We also believe, however, that in the recent past, and also except for the very recent past, that the distribution of Federal funds has been inequitable as it relates to the cities, has been insufficient as it relates to the cities. We believe that this program can avert the natural inferences that you can make from those food riots, job riots, and the proposed march on Washington of a quarter of a million men and women to talk about their jobs.

We think, first of all, that there ought to be a 1 year, $5 billion authorization appropriation to local governments to handle their economy and the horrible effects that high prices, high wages are having on their economy. At the time that we are supplying these public employment jobs and firing older civil service workers, we are simultaneously raising the wages, particularly of those in the lower categories in the civil service in order to meet the price of sugar, the price of bread, the price of meat. These are the things—I spoke to this committee about the price of the meat and some of the monopoly features that I think exist in that at an earlier period of time. I saw some contradictions by those chains a little later on, but I was pleased to note your questions as to the false position, the invalid position that they were really taking on that—and that sugar price, if that sugar price does not have the fingerprints of monopoly, I never saw one that does have.

In order to meet that situation we have to raise those wages. The paradox of firing people and public employment jobs and raising wages is just an incredible, devastating effect on these cities, and we think we need $5 billion of authorization to just cover that thing to keep it stabilized.

One other thing. As you are lowering income taxes, as you should, to get money in this economy, as you are lowering income taxes, we are going to be forced to raise property taxes, the most regressive form of taxation.

Let me tell you, analytically and maybe sociologically, one of the horrible things that is going to result from that. We have talked a long time about the exodus from our major cities, our central cities caused by certain Federal policies relating to highways, relating to FHA financing, FHA in the suburbs not in the city, this kind of business going on.

Some of us, in an attempt to ameliorate that position, have tried to hold down assessments as distinguished from tax rates. Assessments in certain areas where families acquired a home 35 years ago for $10,000, that home due to the inflation is now worth $40,000. Those families, workers, a schoolteacher who inherited that home from her parents, if we assess the full basis of the full tax rate, it is going to make it impossible for her or him, that family, to live there and they will join the exodus. They will simply join it.

We are looking right now at raising property taxes. That always has a devastating effect. What you may grant with your slice in income tax is a very helpful thing, may very likely be absorbed in the property taxes that we are going to impose on working families, on older people who are living on pensions. It is just an incredible crunch. Those of us who have to watch it firsthand know what a sad and tragic thing it really can be.

I think we need that $5 billion just to try to ameliorate all of these things that are happening because of this combination of unemployment, inflation, loss of jobs, while you are giving public employment jobs. We think we need a rehabilitation program for existing community facilities in the amount of $3 billion. That is our second point.

Sometimes Senators ask, "If you had the money can you do something right now?" Let me point out that most of the major cities have what they call capital improvements committees which set certain priorities. As money becomes available, then the priorities take their place.

So the answer is we are prepared right now, right now, to spend money that will produce jobs, that will create work if we have that money available to us in connection with those facilities.

Sometimes Senators ask us, Congressmen ask us, "What are you prepared to give up? Do you not have some Federal programs that are not working very well?" The answer to that is yes, but we are cutting those out right now. The block-grant philosophy and the revenue-sharing philosophy that gives the local official the discretion of apportioning that money and the obligation of apportioning that money and the tough choices that have to be made, the decisions that have to be made. Unfortunately, that money, as a result of our having set up those priorities—for example, in community development and those that are ineffectual, not working, are being washed up. That point ought to be made because Congress always says, "You need this. Can you give anything up?" The answer is in the community development grant philosophy and the other block grants that are going to follow, we are getting rid of some of the ineffectual programs. We are getting rid of that, getting rid of that peculiar breed that infests the cities, the grant hustler who can get grants outside of the authority of the Government, holding on to them and does work that does not look that effectual to us or every effective to us. We are getting rid of that in the central city. That point should be made.

The third point, there ought to be a direct infusion of incentive legislation for the housing industry. That is the beginning of everything in the terms of a revival. We desperately need that. That is our third point. We think that you have to expand the public service jobs, Senator. We think an additional 500,000 jobs in the light of what we have seen, an additional 500,000 jobs at this time is absolutely indispensable.

Chairman HUMPHREY. I recommended that in my discussion on television and where the unemployment rate increases, where there is a half point increase in the rate, that we have an automatic escalator so you can pick up a couple hundred thousand more jobs.

Mayor ALIOTO. We think that is indispensable. We know of your tremendous work in this area. We think summer employment for youth, we need a supplemental $650 million.

Chairman HUMPHREY. I am glad you are bringing that up, Mr. Mayor. We are always late in getting those funds. I hope that you mayors and county officials and others, any of the local officials that have testified before other committees, that you would point out the importance of early action in the summer youth funding program because what I read about the unemployment of youth in this country is a terrifying figure.

Mayor ALIOTO. It is an area where discontent can very easily degenerate into despair, and despair to a lot of things that we do not want to contemplate.

We think that there ought to be tax reform. Our view on tax reform is relatively simple. Those so-called loopholes that create jobs ought to be distinguished from those loopholes that do not. Those tax shelters that you can pick up at an end of a year that do not really create jobs, as distinguished from those things that do create jobs, we ought to make a distinction there. That is our basic view on tax reform.

We think there has to be full utilization of existing programs. If we have programs now, all that money that is going to be impounded, postponed, deferred, ought to be put into the economy. I am talking about some of that money to build sewers. That is a very important point, we think.

We think welfare ought to be taken over by the Federal Government once and for all. We think it is a Federal program rather than a local program. There ought to be some cleaning up, cleaning up of some of the things that happen in welfare.

That is basically the nine points and we think there should be a $1 billion increase in the EEA, economic development. That means public works are not to have the kind of picture that people have built up. Public works are very good things. Today we are talking about public works with enduring value. We are talking about rehabilitating transportation systems. We are talking about extending transportation. We are talking about rehabilitating ports. We are talking about rehabilitating our school buildings. These are things we can do immediately. This kind of public work will have enduring value besides giving employment that we so desperately need at this time.

That is a program we think that ought to be put in effect so these cities can continue to be viable. We know we are going to have a very sympathetic view of these programs that I have talked about, as far as you are concerned, Senator, because most of these programs are your programs. You have initiated so many of these programs.

We think this is an indispensable minimum of a program that we have to have to keep these cities stabilized in the immediate future.

Thank you very much.

Chairman HUMPHREY. Thank you very much.

Let me say we have added up the total amount of referrals and rescissions commonly known as impoundments, that the President has initiated. I think it adds up to $28 billion. On the one hand we are talking about public service jobs out here. On the other hand, there is $28 billion of water, sewer, housing, economic development, all that goes on here that are real jobs, real construction, really needed. In most instances, the localities have already put up their share and have programed it and have their budget outlined for it. We are going to insist that these impounded funds be released as a part of the program.

I do not want to take any more of your time, Mayor Alioto. We thank you, and the entire prepared statement that you have prepared for us, along with the statements of various mayors, will be printed in the record at this point.

[The prepared statement of Mayor Alioto and the statements of various mayors follow:]

PREPARED STATEMENT OF HON. JOSEPH L. ALIOTO

Thank you very much, Senator. I am Joseph L. Alioto, Mayor of San Francisco and President of the United States Conference of Mayors. I come to you today after two full days of meetings with my colleagues who represent the great cities of America.

At the risk of stating the obvious, gentlemen, our national economy is in a serious state of disrepair; and, the state of the cities, so dependent upon the nation's economic health, reflect the severity of the problem. It is in our cities that all of its negative features are most dramatically demonstrated.

If there is any one thing that seems to be apparent in our Mayors' short stay here in Washington, it is a concern that cloaked, political arguments lurk behind the grave economic and energy problems that face our country. I don't wish to imply that I am convinced the national election of 1976 is dominating the important economic discussions that are going on between the Administration and the Congress. But, there does seem to be evidence to suggest that this may be the case.

I would hope, however, that partisan arguments will be made because of *honest differences* rather than political chicanery.

I have just come from a meeting of the leadership of the U.S. Conference of Mayors at which we adopted our economic policy recommendations for action. Before I present the Conference's economic program, I would like to insert for the record some reports from a number of my colleagues, Mayors who have been in Washington at the 43rd annual Mid-Winter Meeting of the U.S. Conference of Mayors.

These reports spell out in quite *bleak* terms how present adverse economic conditions are affecting individual cities. The nation's urban centers, gentlemen, are being severely damaged by our economic instability and unhealthiness. As chief elected spokesmen for so many of our nation's citizens, we Mayors know first-hand the demeaning impact on our people of increased costs, decreased purchasing power, and increased unemployment. The marginal employees, the minorities, the young and the older workers as well as the elderly on fixed incomes—all of whom reside in our cities in great numbers—are suffering unduly as a result of our current recessionary and inflationary crises. Inflation and recession may bring hardship to all, but the inequities produced by the current economic condition have been substantial.

Moreover, cities' *fiscal problems* have now risen to crisis proportions. Inflation and recession are cutting deeply into public budgets. Cities face a variety of steadily rising costs—inflated payrolls, more costly supplies and equipment, and capital improvements' financing at high interest rates. Revenues, provided mainly through taxes which fall short in times of recession, are inadequate to meet costs. And federal assistance to local government has not kept pace with the inflationary spiral. In FY 75, we estimate that total federal assistance to state and local government was, in real dollar terms, $600 million below the FY 74 level of assistance. As a result cities are faced with a variety of "belt-tightening" strategies: lay-offs, hiring freezes, cut-backs in services, raising of local taxes and more.

Of course, the re-enactment of general revenue sharing will be of great assistance to loyal government during this time of fiscal crunch. The U.S. Conference of Mayors has this issue as one of its highest legislative priorities for the 94th Congress. Even though the present program runs through calendar year 1976, we urge the Congress to re-enact it this calendar year, 1975. This will assure continuity and certainty for local budgetary planning. This year we will strongly urge and push for the extension of revenue sharing to fully take into account the degree to which inflation has eroded the dollar value of the program.

All of these strategies being implemented at the local level are working at cross-purposes with those federal relief measures being considered and implemented. Reductions in federal taxes are being proposed at the same time local taxes are being increased; and, public jobs programs and increased relief services are objectives of the federal government while local governments are forced to lay-off employees and reduce services.

I am glad to see that President Ford and his advisors now recognize that the American economy is in very serious trouble. This has not always been the case. Last September, I was pleased, together with some of my fellow Mayors, to participate in the President's Conference on Inflation. We were distressed, however, with the Administration's total preoccupation with inflation. At that time, we stated that inflation was but one dimension of the current domestic crisis and anti-recessionary measures had to be enacted to guarantee the restoration of economic stability and viability of our urban economies. We said this at a time when the national unemployment rate was 5.4 per cent, not today's 7.1 per cent; and, when the Gross National Product had fallen off for two successive quarters rather than the full year's decline with which we are now faced. And, long before 1974, the U.S. Conference of Mayors called national attention to the very issues we are discussing today. By inaction, the federal government has permitted these adverse conditions to reach crisis proportions.

We commend the President for recognizing the severity of the problem and for reversing his position from an anti-inflationary strategy to an anti-recessionary one. But, we believe that what the Administration is proposing is inadequate to deal with the magnitude of the problem confronting us in our cities.

Actions designed to arrest and reverse the immediate problems of recession and energy must not be enacted without adequate attention to their long-term effects on the functioning of the economy. Positive results this year are meaningless if our actions cause greater problems in the future.

Mayors around the country are convinced of the inherent strength in the nation's economy to withstand this period of adversity. However, we Mayors know we need a federal-city partnership. We need you and you need us.

President Ford's economic program has generated a great deal of debate around the issues of sufficiency and equity. The across-the-board rebate of $12 billion in 1974 personal income taxes is favored by many economists and politicians. And, we Mayors agree to its general thrust of getting money into the economy quickly. But, we feel that splitting the payments into two stages, one in May and the other in September, would provide too little a stimulus to have effect especially when one realizes that increased fuel costs, resulting from higher import fees on oil, will be extracting substantial dollars from the spending stream.

Second, we strongly believe that the $12 billion rebate should be concentrated on the lower and middle income groups—those most adversely affected by today's depressed economy. President Ford has suggested a $1,000 limit on the rebate. To realize such a ceiling, one has to be fairly high in the income bracket—very few of this nation's households ever achieve such a level. How many people would we really reach by using this suggested ceiling? And, the proposed additional $16.5 billion reduction in 1975 taxes would seem to be more than offset by the $30 billion in additional energy costs and taxes.

The energy issue is a highly complicated one and quick and easy solutions escape us all. Certainly, the intricate package the President has proposed is not without its faults especially when one considers the inequities it contains. Certain regions of this country, especially the Northeast, are already acutely suffering from exorbitant energy costs due to reliance on imported oil. The President's increases in fees on foreign oil are falling disproportionately on the shoulders of these regions.

The President's plan to turn back to state and local governments $2 billion of the monies raised by these higher fees to meet increased energy costs is a step in the right direction. But, it falls short of its goal because it uses the wrong vehicle—the general revenue sharing formula—to deliver the goods. Fuel consumption varies *dramatically* depending on the climate and fuel costs have *dramatic* regional variation. *Neither* of these variables are reflected in the revenue sharing formula. Surely the Administration, through its Federal Energy Administration, can find a more equitable method to distribute these funds—one that reflects the significant regional differences.

The proposal to hold increases in social security payments to 5 per cent is highly inequitable. The elderly and others on fixed incomes saw their meager incomes eaten up by double-digit inflation last year. The President is now telling them to expect more of the same this year. A Library of Congress study, of which I am sure you are aware, recently concluded that President Ford's energy proposals could cause the 1974 12% inflation rate to persist this year. A 5 per cent maximum increase in income is woefully inadequate.

Decisive action on the part of the federal government is required to restore the health and stability of our economy. The United States Conference of Mayors calls upon the Congress to support the following recommendations and to integrate them into a Congressional economic action program to be implemented immediately.

1. EMERGENCY RECOVERY AND STABILIZATION ASSISTANCE MEASURE FOR LOCAL GOVERNMENTS

A one-year $5 billion authorization and appropriation to local governments for calendar year 1975 to be re-enacted for calendar year 1976 if the economy fails to revive during this year and additional stimulus is needed. This payment to the nation's cities would be for damages caused by inflation and higher energy costs.

Funds to be distributed according to one of any number of existing formulas such as CETA or any other sensitive to unemployment and economic instability factors.

Recently, this Committee received testimony from Charles L. Schultze of the Brookings Institution in which a similar proposal was recommended.

The objectives of such a measure are threefold: to ward off increases in local government taxes at a time when the federal government is reducing taxes to stimulate the economy; to accelerate the needed economic stimulation by getting monies into the spending stream quickly, and, to help stem rising unemployment by enabling local government to reatin rather than lay-off municipal employees.

2. A REHABILITATION PROGRAM FOR EXISTING COMMUNITY FACILITIES

A two-year $3 billion program having its major impact from mid-1975 through 1976 and focusing on *labor intensive* repair, rehabilitation and restoration rather than new construction undertakings.

A specified proportion, i.e., 60-75% of total project cost would be required to be labor costs.

Basic system repairs such as plumbing, wiring, insulation, painting, etc. would be performed on libraries, schools, parks, courthouses and city halls.

This program is designed to complement the Public Service Employment program as a means to create jobs doing useful tasks which improve the capability of local government. We are pleased to note the recent endorsement of a similar program by the General Board of the AFL-CIO. We welcome its support.

The objectives of the program are: creation of jobs due to focus on labor intensive undertakings rather than new construction; quick injection of monies into the spending stream since "start-up" time for rehab and restoration is short; less demand on energy resources than new construction; and, better use of existing urban areas and facilities.

3. DIRECTING FINANCIAL ASSISTANCE TO SELECTED SECTORS OF THE ECONOMY SUCH AS HOUSING INDUSTRY

The nation's housing industry is suffering from the worst depression since the 1930's and it is having a disastrous effect on our cities. Earlier this month, the U.S. Conference of Mayors Legislative Action Committee met with the leadership of the National Association of Home Builders. As a result of that meeting, we called for:

the reduction of interest rates so that people can afford to build and purchase houses;

increasing the supply of mortgage money for housing; and,

stimulating the production of multi-family housing in urban areas, particularly for low and moderate income groups.

4. EXPANDED PUBLIC SERVICE JOBS PROGRAM

An additional $5 billion for the public service jobs program to create 500,000 jobs with local flexibility to purchase necessary materials for use by the employee and local flexibility to extend the length of the employees' term of employment.

City prime sponsors throughout the United States have committed virtually all of their dollars under Title II of the Comprehensive Employment and Training Act. We are in the process of committing monies under the new Title VI. But, we know that present resources are inadequate to meet the problem. The additional monies we are recommending with the built-in flexibility would certainly ease some of the problems our citizens are facing at this time.

5. SUMMER EMPLOYMENT FOR YOUTH

The United States Conference of Mayors calls for a $650 million supplement to the summer youth employment program. This will enable our local governments around the country to provide approximately 1.2 million jobs for urban youths. This figure is somewhat higher than that of last year. The increase is more than justified due to the soaring unemployment rates in our cities, which are due to climb even higher by the summer months. Moreover, many of these youths come from families where both the father and the mother are unemployed and the child being the main wage-earner for the household. These monies must not be confused with nor mingled with other emergency public employment monies. The objectives of the two programs are different and must remain so.

6. TAX REFORM

The U.S. Conference of Mayors has, for some time, called for *tax reform*, especially in the area of tax expenditures. If the federal government is determined to use fiscal policies as a tool in combating inflation, then it must begin to focus on the $80 billion in tax expenditures heretofore gone unevaluated. Every time the federal government grants a tax deduction or provides a tax shelter, this action must be viewed as an expenditure decision. We must begin to make these tax expenditure decisions on the basis of sound national economic and social policy and not on the basis of the needs of special interest groups.

We urge you to immediately assess the impact of all tax expenditures on the economy, particularly with respect to the effect they have on reducing revenues to the U.S. Treasury. The pattern of urban growth and urban decay are directly and indirectly affected by the various tax incentives and disincentives of the Federal income tax.

7. FULL UTILIZATION OF FEDERAL DEVELOPMENT PROGRAMS FOR REHABILITATION OF DISTRESSED LOCAL ECONOMIES

Federal economic development programs offer flexible tools unavailable elsewhere. We, therefore, urge full utilization of federal programs for the rehabilitation of distressed local economies such as the $120 million in backed-up EDA business loans which the Administration refuses to spend. These loans are targeted specifically to economically distressed areas. In addition, we advocate an *immediate implementation* of the new Title X of the EDA Act, created by the recently-passed Emergency Unemployment Act, with the full $500 million authorization to be appropriated instead of the $125 million present appropriation.

Economic development cushions communities during a period of economic transition; develops permanent, well-paying jobs; increases productivity; makes more efficient use of already available urban facilities and resources; and combats inflation and recession.

8. NATIONAL RESPONSIBILITY FOR ALL WELFARE PROGRAMS

Today, the leadership of the U.S. Conference of Mayors established a special task force to undertake, during the course of the year, a thorough examination of present welfare programs. It will develop recommendations on how to reform the present system to eventually provide for the federalization of all welfare programs. The creation of this task force is consistent with the Conference's long-standing policy of support for income maintenance and reform.

We strongly believe that welfare is a national, not a local issue. Because of the lack of standards and nationalization of present programs, people tend to migrate to those areas of the country that seemingly have higher payments. But, more times than not, these same areas also have much higher costs of living.

The present economic crisis has, in addition, caused reversals in the heretofore downward trends in welfare rolls. Localities can not continue to assume these additional burdens.

The U.S. Conference of Mayors, by adopting the eight-point Urban Economic Stabilization and Development program, does not intend it to be a substitute for or in place of other strategies being developed by the Congress. On the contrary, the items detailed above are to accompany and enhance such probable items as a tax cut.

The Conference of Mayors endorses tax relief for the low and moderate income family as well as the lowering of interest rates and the increasing of the supply of credit. But, to counterbalance the resources which will be infused into the cities by the enactment of such measures, local government needs the assistance the above array of items would provide.

We urge the Congress to Act decisively, swiftly, but most importantly, wisely, on the truly urgent problems gripping this nation. We lend you our support. Thank you!

STATEMENT OF HON. ABRAHAM D. BEAME, MAYOR OF NEW YORK CITY, BEFORE THE SUBCOMMITTEE ON INTERGOVERNMENTAL RELATIONS, COMMITTEE ON GOVERNMENT OPERATIONS, U.S. SENATE, JANUARY 30, 1975

Thank you for asking me to say a few words about the impact of the national recession on The City of New York. I also appreciate this opportunity to make some recommendations.

The recession has severely hurt cities throughout the country, and New York City is the bellwether in this problem area, because its major business is "business."

As the nation's center of commerce and finance, we serve as the early warning system for economic trends. The continuing attrition of jobs in the City, even in our strong securities, insurance and real estate sectors, and the 24 percent falloff in the past year in stock trading (from which New York City must derive tax income), are ominous indicators for the nation of the lack of confidence of the people in our national economic policies.

New York City's unemployment rate in December jumped to 8.5 percent. We received this shocking news on Tuesday from the New York State Department of Labor.

With December's figures in, we learned that total employment in New York City declined during calendar year 1974 by 90,000.

Worse yet, preliminary figures for the period from mid-December to mid-January show that a total of 131,171 initial claims were filed for unemployment benefits in four weeks, an increase of 32% over last year.

These horrendous statistics are reflected in other large cities across the country—all paying a fearful price for the national recession.

Five months ago, when the President was calling on business, labor, academic and local government leaders for recommendations on how to deal with what he called the nation's No. 1 problem, namely, inflation, I, along with other mayors of large cities, urged him to take steps not just against inflation, but also against the recessionary trends which were already quite obvious in the economies of our urban centers.

We criticized the Federal tight money policy, because of its depressive effects on local construction industries and trades.

We were concerned about the two-year-long withdrawal of Federal initiatives in the field of housing. And we had strong reservations about the President's insistence on cutbacks in Federal spending for vital urban programs.

We made clear our conviction that those Federal credit, housing and spending policies would not stop inflation and, at the same time, would actually accelerate recessionary trends. The mayors of our cities also asserted that such policies would simply transfer Federal responsibilities to local governments and impose additional burdens on local taxpayers.

Unfortunately, our call was ignored for a while and, now, because of Federal inaction, the Nation's economy has further deteriorated.

The President is now moving to take broad immediate actions to deal with the recession.

But the Administration's present plan to give Federal tax rebates and Federal tax reductions, while good in themselves as anti-recession measures, must be accompanied by programs which will help to relieve cities and local governments of the need to impose tax increases on already overburdened local taxpayers.

Also, the creation of new public service jobs is good, but it falls far short of our real needs.

Cities and States in the Northeast especially object to the third element of the President's plan, namely, his energy conservation program, which calls for additional taxes on both imported and domestic oil.

That plan, if put into effect completely, is likely to increase housing abandonment by landlords unable to cope with steep fuel oil prices and it may also jeopardize local mass transit fare structures.

The national recession affects not only our employment figures, but also our business volume and almost every other aspect of the City's economy in both the public and private sectors. Specifically, it has had an adverse impact on City tax collections.

For the past six months, The City of New York has experienced a decline of $150 million in various tax collections.

The city government's revenue shortfalls caused by the recession have been accompanied by an inflation of costs of $280 million.

The severest inflation of costs occurred in the more than $100 million in additional interest the city has to pay for the money it borrows in both the long term and short-term money market.

The city has also suffered from unanticipated extra costs of fuel oil and virtually everything else it has to buy from vendors, as well as an unexpected increase in welfare and Medicaid costs caused by the recession.

We have already taken many agonizing steps to close the budget gap, including layoffs which will affect 12,000 employees.

We are grateful, Senator Muskie, for these hearings on proposals to provide emergency assistance to cities which are extremely hard-pressed in these difficult times.

I understand this subcommittee is considering concepts like trigger mechanisms designed to help our urban centers whenever economic indicators or sets of such indicators reach certain levels.

I certainly support the concept of emergency assistance and, at first glance, favor a program which would trigger an automatic infusion of emergency Federal monies into the cities.

But I wish to take this opportunity to call your attention to the fact that New York City and the other large cities in the country are not fairly treated or adequately aided in good times and, while we are grateful for any emergency funding, when that funding ceases after the return of better times, our cities will still be lagging behind the rest of the country—which has fewer and smaller responsibilities and fewer and smaller services to provide.

I suggest that some thought be given, even now, to developing assistance programs which will eliminate inequities and bring help to those areas of the country which need it most, namely, the core cities of our metropolitan areas.

I have three recommendations:

(1) I recommend the complete Federal assumption of the cost of local welfare and medical assistance programs. This should begin now. Welfare is not a local responsibility any longer. For many years I have contended that welfare is a national problem requiring national solutions, and I am glad that finally there is no real objection voiced any longer to this conviction.

Now the same problems which beset New York City, because of large migrations of people from agricultural areas, have also become the problem of most central cities in the nation. The cities were not responsible for the interstate movement of people in search of employment, and now we have public recognition of the Federal role in solving that problem.

(2) I recommend an immediate change in the revenue-sharing formula to reflect the needs of major urban areas.

This change should take place in both general revenue sharing and in social service revenue sharing.

We were naturally pleased to receive $257 million of general revenue-sharing funds, but we were disappointed in our expectations of receiving $427 million in social service revenue-sharing funds.

Because of the national ceiling set on social service funding and because of the population formula used for allocation of such funds, we received only $148 million instead of $427 million.

So, in effect, we received $257 million in one hand and found that we had lost $279 million from the other hand.

(3) I recommend that the Federal government and its appropriate agencies move immediately to reduce interest costs for municipalities and to develop mechanisms for improving the market for local debt.

In other words, we would like you to drive interest rates down to reasonable levels which cities can manage, and we also want you to help us create an available market with the capability of absorbing local government debt.

New York City is in an extraordinary bind because of its need to go into the short-term market for large sums of monies borrowed for short periods of time against perfectly good receivables.

I need not tell you how angered we all were when we had to pay 9.4 percent at our last note sale, a rate which is quite unbelievable when you consider that those notes were tax exempt and the rate we had to pay was something like 150 basis points above taxable treasury bills of comparable maturity.

In conclusion, the impact of the national recession on New York City and other large cities is so severe that only strong, quick and massive Federal initiatives will be able to turn us around this year.

We support the concept of emergency assistance triggered by sets of key economic indicators.

To solve the real problems of our cities, however, Federal action should begin now to eliminate inequities suffered by the large cities.

The Federal government should assume the financing of all local welfare and medical assistance costs.

The needs of the cities should be reflected in appropriate changes in Federal revenue-sharing formulas.

Interest rates must be driven down nationally, if cities are to cope with their borrowing needs.

Thank you, ladies and gentlemen.

STATEMENT OF HON. MOON LANDRIEU, MAYOR OF NEW ORLEANS, LA., BEFORE THE SUBCOMMITTEE ON INTERGOVERNMENTAL RELATIONS, COMMITTEE ON GOVERNMENT OPERATIONS, U.S. SENATE, JANUARY 30, 1975

Appended to this statement are the results of a survey which has just been completed in New Orleans showing the impact of the national economic conditions on the government and people of New Orleans.[1] My city's expenditures are going up faster than the Federal budget. Labor contracts and city employee pay plans are escalating due to double digit inflation and to State-mandated costs and Federal legislation such as the Fair Labor Standards Act Amendments. The costs of all types of fuel are up. Capital improvements and maintenance are being postponed. General unemployment is up. Public employment, except for CETA Titles II & VI, is frozen. I have my economic analysis staff exploring the impact of different combinations of local taxes because I know that I am going to have to recommend a number of local tax increases

[1] The appended survey may be found in the committee room files.

to meet the coming year's budget. Options such as increasing the property tax are closed to me by the laws and constitution of the State of Louisiana. This Committee and the President and the Congress should take note that any Federal program to cure the ills of the economy by a reduction in Federal taxes without some form of direct assistance to cities will be offset by increases in local taxes. What the hand of the Internal Revenue Service puts into the pocket of the taxpayer the hand of the local tax collector will take out of his other pocket. The intended stimulus to the economy through increasing consumer purchasing power will be reduced if not cancelled out.

THE ADMINISTRATION'S PROPOSALS

I would like to comment on two aspects of the Administration's economic game plan.

The first is the proposed tax cut. Judging from the last 14 years, during which there have been 5 Federal tax cuts, the Congress and the President find the idea irresistible. Certainly there is more cause to be considering such action this year than at any time since World War II. However, I suggest that two questions are in order: (1) Is adequate attention being given to how Federal revenues are to resume their pre-recession levels when there is no longer a need to stimulate the economy? (2) Has anyone stopped to think of all the State and local income taxes that are tied to the Federal income tax and will therefore be reduced by action of the Congress and the President without prior consultation?

The second feature of the Administration's proposed program which is cause for concern is the fuel rebate. As I understand it the plan is to return to local governments $2 billion from the increased tariffs on imported petroleum. This is to offset the increased costs of fuel to local governments caused by the tariff increase. I am concerned as to how reliable this $2 billion estimate is. The original estimate of the Federal Energy Administration was that the impact per family was $275, but on Monday this was raised to $345. Is the $2 billion estimate similarly unreliable? I am also concerned that the Administration proposes to allocate the $2 billion rebate using the distribution formula used for General Revenue Sharing. I am not at all sure that the factors in that formula bear any relationship to fuel usage. It seems to me that a fuel formula should include a different set of factors, such as climate, area of city, and historic usage, which are irrelevant to General Revenue Sharing. Finally, I am concerned that this fuel rebate will have neither a stimulant effect on the economy nor a retardant effect on fuel consumption. Unless the rebate is coupled with consumption quotas and unless cities are allowed flexibility to re-program any rebate funds saved by virtue of quotas no improvement in the economy will result from the rebate.

Cities need assistance which is both more flexible and more massive than the Administration's proposed fuel rebate.

ALTERNATIVES

I concur with those economists who hold that the quickest route to economic recovery from recession is to get people into jobs and thereby get spendable income into their pockets to generate increased demand for goods and services. This suggests to me two programs: (1) A vastly improved public service employment program and (2) A public works program for deferred maintenance and repairs. I am also concerned, however, that the economy is suffering from serious inflation and I think a number of steps should be taken to get inflation under control.

What do I mean by an *improved* public service employment program? With all due respect to the Congress the existing public service employment program (Titles II and VI of the Comprehensive Employment and Training Act) was not well thought out. No private employer would have designed such a program. Every businessman knows that labor costs are only a part of the cost of creating a job. Capital expenditures are required to put a person to work. In order to perform the work which you pay an employee for he has to have a space in which to work and a desk or a workbench, and a typewriter or a truck or a lawnmower. There are also costs for consumable supplies and for overhead functions such as personnel and accounting. Congress has provided the cities with funds for labor costs and apparently assumed that cities had idle funds in their capital and equipment accounts at the same time that they have deficits in their wages and salaries account. I can tell you that this is not the case with my city's budget and doubt whether it is the case with any city represented here this morning.

As for public works, I realize that for major new construction projects there is a long lead time. The economy needs help immediately. Rather than focus on major new construction projects wouldn't it make more sense to focus public works funds toward public facilities on which we have been postponing and deferring necessary maintenance, repairs, and renovation? In my opinion these projects should aim at making our public facilities more energy efficient, which brings me to the subject of curbing inflation.

A root cause of our inflation is that we are wasting resources at a rate which no economy can endure. We need a national urban policy which will reverse the past policies of the Federal Government in support of throwaway cities and wasteful sprawl. We need a land use policy which conserves our land resources. We need more emphasis on mass transit. We need a limit on automobile engine size. We need thermal standards for buildings. We need to get serious about enforcement of anti-trust laws.

STATEMENT OF HON. RALPH J. PERK, MAYOR OF CLEVELAND, OHIO, BEFORE THE SUBCOMMITTEE ON INTERGOVERNMENTAL RELATIONS, COMMITTEE OF GOVERNMENT OPERATIONS, U.S. SENATE, JANUARY 30, 1975

The City of Cleveland has encountered the most difficult budget crunch in its history over the past three years. The two most significant reasons for this financial crisis have been the skyrocketing of labor costs together with a reduction in the property tax base.

Perhaps the most graphic example of the combination of these two factors can be illustrated in the proposed 1975 budget for the City of Cleveland. That budget shows total tax revenues from income tax, real property and tangible business property to be $74.2 million; whereas, the total safety department budget alone in 1975 will show $76 million in expenditures from city operating funds, and an additional $5 million from various federal grants.

In short, the safety department budget in the City of Cleveland is larger than all combined taxes levied for operating the government of the city.

There remains in that general fund budget $50 million in expenditures for other operating purposes which must be obtained through State and Federal sources to support health, recreation, waste collection, street maintenance, municipal courts, city council, and all the other necessary municipal services.

During the past four years, the number of city employees has dropped from in excess of 13,000 to approximately 9,900 on the payroll at the present time. This is in spite of the ever-increasing demand from the populace for increased police and fire protection as well as maintaining ample levels of service in other essential areas.

This past November the voters of Cleveland (as they did in 1970 and 1971 under the previous mayor) rejected by a margin of two-to-one a requested increase in the city income tax from the present one per cent to 1.5 percent. Furthermore, throughout the State of Ohio—and I am sure in other States as well—the majority of tax increases for local governments and school districts were overwhelmingly defeated.

I believe that the mood of the citizens can be interpreted in only one way. They are saying that their sacrifices because of inflation must be matched by government. They are saying very clearly that the only place that they can rebel against taxation at all levels of government is at the local level in the voting booth. And by saying "No" at the local level, they are demanding that a greater share of their State and Federal taxes be returned to them.

I am asking today that the voice of the people be heard—that increased aid to the local governments be the keynote of Federal spending so that we as city administrators can provide the very basic services to our citizens without further burdening their ever-diminishing purchasing power with higher local taxes.

Again, I ask simply for immediate Federal help to keep our great metropolitan areas alive.

STATEMENT OF HON. HENRY W. MAIER, MAYOR OF MILWAUKEE, WIS., BEFORE THE SUBCOMMITTEE ON INTERGOVERNMENTAL RELATIONS, COMMITTEE ON GOVERNMENT OPERATIONS, U.S. SENATE, JANUARY 30, 1975

You have asked what the impact of recession and inflation has been on State and local budgets.

Let me put it this way:

Cities are being forced to lay off employees at a time when all agree the main enemy is unemployment. Cities are being forced to *raise* taxes at a time when all agree that the stimulant needed to revive the economy is to *cut* taxes.

Presuming he is working, it is no stimulant to the economy to cut pennies from the worker's weekly withholding and add dollars to his property tax bill.

President Ford has asked for a two billion dollar payment to State and local governments for the damage his proposed energy program will do to our budgets. His proposal provides nothing to repair the ravages done to municipal budgets by double-digit inflation set in motion by misguided national policies.

There has been a great debate as to which taxpayers have suffered most from inflation and which should benefit most from tax cuts. What has been lost sight of in this national debate is the fact that the local property taxpayer is the most overburdened taxpayer of all. What is needed, gentlemen, is a parity program for property taxpayers.

I suggest Congress pass an "Emergency Recovery and Stabilization Assistance to State and Local Governments Act," not in the amount of two billion dollars as proposed by President Ford, but in an amount of at least five billion dollars.

This one-shot program must be in addition to the reenactment of the general revenue sharing program, without which our cities could no longer survive.

President Ford's program is designed to protect us against future shock. Let me give you a few examples of what has already happened to us. Here are some of the facts disclosed at our local budget hearings:

The cost of gasoline to run our police, fire, ambulance, trash-collecting and other vital service vehicles is more than doubled.

Road tar for our streets costs 120% more.

Electric street lights vital to the safety of our neighborhoods cost 39% more.

Fire hose is up 36% to 60%, depending on the size.

Electric cable costs 40% more.

Police uniforms are up 39%.

Fire engines and ladder trucks cost 25% more.

The cost of operating our refuse disposal service is up 21%.

Our street repair program costs 58% more.

The cost of maintaining city pension accounts has risen $1,225,754 over last year.

The sharp increase in the cost of living has brought about wage agreements requiring an additional $8,870,000 in 1975.

The cost of medical insurance for our employees has increased 12%.

These are just some of the hard realities of inflation faced by every mayor in this nation. In our case, we were faced with budget requests from our departments totaling twenty-two million dollars more just to maintain the existing level of day-to-day services.

Inflation, the thief who is pilfering every family budget in America, is also plundering city department budgets, including, ironically enough, our police departments.

Two years ago, the prestigious Brookings Institution estimated the gap between revenues and expenditures of municipal governments in the year 1975 would be fifteen billion dollars. Further inroads of inflation in the ensuing years has, of course, widened that gap even further.

As the studies of the Advisory Commission on Intergovernmental Relations have established, cities are particularly vulnerable to inflation. During recent years, the price deflator used to convert purchases of goods and services to a common base for a year-to-year comparison has risen half again as fast for the State and local governments as it has for the economy as a whole.

Another way the Advisory Commission on Intergovernmental Relations demonstrated the impact of inflation on cities was to point out that a city with a one hundred million dollar budget base in 1970 would have had to pay six million, six hundred thousand dollars more in 1971 to maintain its 1970 level of services, and in 1974, they would have to pay ten million, six hundred thousand dollars more to maintain the level of 1973 services.

The basic reason that prices rise more rapidly for state and local governments is that public services are labor intensive, and all labor intensive services are more subject to inflationary pressures.

Every mayor in this room can recount countless horror stories about what inflation and recession has done to his budget. But my primary concern is not with what is happening to our budgets, but what is happening to the local property taxpayer, who must bear the burden of these inflation-wracked budgets.

I urge Congress to enact immediately a five billion dollar reparations program for our cities not only because the condition of our cities is critical, but because tax relief for property taxpayers is crucial to any program designed to stimulate our flagging economy.

STATEMENT OF HON. LEE ALEXANDER, MAYOR OF SYRACUSE, N.Y., BEFORE THE SUBCOMMITTEE ON INTERGOVERNMENTAL RELATIONS, COMMITTEE ON GOVERNMENT OPERATIONS, U.S. SENATE, JANUARY 30, 1975

Thank you, Mr. Chairman and members of the subcommittee. One cannot be a Mayor for any length of time without realizing the importance of economic development as a means of local job creation. That is why the U.S. Conference of Mayors is calling for a *Rehabilitation Program for Essential Community Facilities.* This program is designed to complement the Public Service Employment program as a means to create jobs doing useful tasks which improve the overall capability of local government. Also, it gets at one area of persistent underspending in municipal operations—maintenance of public buildings.

We are proposing a two-year, $3 billion program having its major impact from mid-year 1975 through 1976 focusing on labor intensive repair, rehabilitation and restoration instead of new construction. Basic system repairs such as plumbing, wiring, insulation, painting, etc., would be performed on libraries, schools, parks, courthouses, city halls, and the like. It is our recommendation that 60-75 percent of the total costs should be required to be labor costs. The objectives of such a program are: Creation of jobs due to focus on labor intensive repair, rehab and restoration rather than new construction; quick injection of monies into the spending stream since rehabilitation and restoration have much shorter "start-up" times than new construction; less demand on energy resources than new construction projects; and, better use of existing urban areas and facilities. The AFL-CIO General Board on January 21 called for immediate Congressional action on a program similar to our recommendation. We welcome their support.

Directing financial assistance to selected sectors of the economy such as the housing industry is crucial if our urban housing needs are to be met. The nation's housing industry is suffering from the worst depression since the 1930s. The depression in the housing industry is having a disastrous effect on our cities and we are deeply concerned about what can be done to reverse the downward spiral of the homebuilding industry the past two years.

Earlier this month, the U.S. Conference of Mayors Legislative Action Committee met with the leadership of the National Association of Home Builders. As a result of that meeting, we called for:

1. The reduction of interest rates so that people can afford to build and purchase homes;
2. Increasing the supply of mortgage money for housing;
3. Stimulating the production of multi-family housing in urban areas, particularly low and middle income groups.

We appeal to you to immediately take up proposals aimed at relieving the present housing crisis.

The U.S. Conference of Mayors has, for some time, called for *tax reform,* especially in the area of tax expenditures. If the Federal Government is determined to use fiscal policies as a tool in combating inflation, then it must begin to focus on the $80 billion in tax expenditures heretofore gone unevaluated. Every time the Federal Government grants a tax deduction or provides a tax shelter, this action must be viewed as an expenditure decision. We must begin to make these tax expenditure decisions on the basis of sound national economic and social policy and not on the basis of the needs of special interest groups. We urge you to immediately assess the impact of all tax expenditures on the economy, particularly with respect to the effect they have on reducing revenues to the U.S. Treasury. The pattern of urban growth and urban decay are directly and indirectly affected by the various tax incentives and disincentives of the Federal income tax. I can see this in my own city of Syracuse where, like other cities, business and industry, due to certain tax incentives, have left.

STATEMENT OF HON. RICHARD HATCHER, MAYOR OF GARY, IND., BEFORE THE SUBCOMMITTEE ON INTERGOVERNMENTAL RELATIONS, COMMITTEE ON GOVERNMENT OPERATIONS, U.S. SENATE, JANUARY 30, 1975

Thank you, Mr. Chairman. Senators, I can speak to you about our distressed urban economies with some expertise. Gary is a prime example of a city in dire need of assistance. Federal economic development programs offer flexible tools unavailable elsewhere. We, therefore, urge *full utilization of federal development programs for the rehabilitation of distressed local economies* such as the $120 million in backed-up EDA business loans which the Administration refuses to spend. These loans are targeted specifically to economically distressed areas. In addition, we advocate an immediate implementation of the new Title X of the EDA Act, created by the recently-passed Emergency Unemployment Act, with the full $500 million authorization to be appropriated instead of the $125 million present appropriation.

Economic development cushions communities during a period of economic transition; develops permanent, well-paying jobs; increases productivity; makes more efficient use of already available urban facilities and resources; and combats inflation and recession.

Development of well-paying jobs is essential for our survival. We can no longer ask our citizens to accept rates of unemployment which climb into the two-digit range. City prime sponsors throughout the United States have committed virtually all of their dollars under Title II of the Comprehensive Employment and Training Act. We are in the process of committing monies under the new Title VI. But, we know that present resources are inadequate to meet the problem. We, therefore, call for an additional $5 billion to the public service jobs program to create 500,000 jobs. In order for us to support such legislation, however, we mayors need two assurances: The flexibility to purchase necessary materials for use by the employee; and, the ability to extend the length of the employees' term of employment. Such additional monies with this built-in flexibility would certainly ease some of the problems our citizens are facing at this time.

I would like to mention some of these problems as we are experiencing them in Gary.

STATEMENT OF HON. KENNETH A. GIBSON, MAYOR OF NEWARK, N.J., BEFORE THE SUBCOMMITTEE ON INTERGOVERNMENTAL RELATIONS, COMMITTEE ON GOVERNMENT OPERATIONS, U.S. SENATE, JANUARY 30, 1975

Mr. Chairman and Senators. My name is Kenneth Gibson. I am the Mayor of the City of Newark, New Jersey.

I am honored and challenged by this opportunity to appear before your committee. You have clearly defined the challenge. Obviously, your committee is not mentally constrained by the attitude which is rapidly seeping into the psyche of too many of our nation's people—"things are going to get worse before they get better." You are asking us: What can be done to halt the negative effects of inflation and recession on the ability of state and local governments to deliver conventional services?

My remarks will mostly reflect the experiences we have had in Newark. Yet, being sensitive to the economic blight of our nation, and also speaking as the Chairman of the Advisory Board of the U.S. Conference of Mayors, the span of my concerns are broader than just Newark.

In order to close a $35 million deficit in the City budget, we have been forced to treat nearly 400,000 wonderful people as though they were a three-headed dragon, without a heart. With the sword of inadequate resources; 433 city employees have been cut from our city's work force. That was one head.

Without the 433 employees, services have been cut, especially in the department of public works and health and welfare. That was the second head.

Next the property tax rate was raised to $8.89 per $100.00 of assessed evaluation. This cut an additional portion of money from the pockets of our people. That is nearly $1,800 per year on a $20,000 home. If you just add the inflated costs of fuel, utilities, mortgage payments, and increasing unemployment, you can understand the blight of the homeowner, who is paying for a large portion of the cost of city government.

To summarize, workers have been displaced, reducing my city's ability to deliver quality service, and charging the property taxpayer more money for less service.

The third head of the man-made dragon was severed.

Then the heart of the dragon was pierced by a reduction of $17 million in the money Newark appropriates for education. Yes, the budget was balanced; but not much else. Certainly, this will not help our young receive a balanced education.

In terms of the economics of a city, what good does it do to provide 532 public service jobs, and then fire nearly that many city employees? Moreover, this kind of economic calamity has the real potential for causing violent confrontations between workers who have lost their city jobs and people who have gained employment in those same jobs through emergency employment provisions.

The general problem of unemployment, and I am speaking of some 25,000 people out of work right now in Newark, must be sharply and clearly divided from the jobs the City of Newark budgets to provide basic services. So must the problem of seven million unemployed Americans be divided from the ability of state and local governments to at least serve them.

In times of recession and inflation, and for whatever period of time it takes to make states and cities recipients of funds coming from an equitable tax and allocation structure, cities must receive increased revenue sharing. This is the only way we can guarantee this division and the quality of services each American citizen deserves while we implement "now" economic policies to provide full employment in the United States.

Certainly, we do not want seven million Americans cast in the role of Lazarus—physchologically sick and economically disabled.

Thank you.

STATEMENT OF HON. LAWRENCE D. COHEN, MAYOR OF SAINT PAUL, MINN., BEFORE THE SUBCOMMITTEE ON INTERGOVERNMENTAL RELATIONS, COMMITTEE ON GOVERNMENT OPERATIONS, U.S. SENATE, JANUARY 30, 1975

Senator Muskie, distinguished members of the committee. Thank you very much for this well-timed opportunity to present an economic overview from a city where it gets very cold and there are a lot of old people.

I mention these demographics because in recent days I have told the people back home that the President's economic and energy proposals couldn't be more potentially harmful to Saint Paul if he had aimed the gun right at us.

My goal as mayor is to do everything possible to help provide a quality of life for the people of Saint Paul. A two-way squeeze is hurting our ability to deliver what we promise.

First, Federal programs and monies designed to assist us are being counterbalanced by economic policies that are destructive and thoughtless.

I am not as concerned with the price of gasoline as with the cost of heating fuel. Being at the end of the domestic oil pipeline, our base costs begin at a higher level. Our elderly and poor living on fixed incomes may be able to escape a gas-price increase by taking the bus . . . but they still have to pay heat bills several months out of the year.

Income tax rebates don't help people who are paying little income tax to begin with, so there is no economic stimulus from that aspect.

I said that there are a lot of old people in Saint Paul. About 16 per cent—or some 50,000 citizens—are 62 years or older, compared to the national average of 10 per cent. About half of these senior citizens own their own homes!

Because of diversified economy not too dependent on cyclical events, Saint Paul is not as susceptible to recessionary forces as some other areas. Our unemployment rate is 5.1 per cent, or about 2 points less than the national average.

However, experts such as Doctor Walter Heller and people in the labor movement have studies showing that the Twin Cities metropolitan area, while perhaps being hit slower by hard times, also recovers slower.

The unemployment rate is up 1.4 per cent in the last 13 months, or about 38 per cent. Unemployment claims in the past year are up from 6,400 to more than 11,000.

Titles two and six of the CETA program, while a noble gesture, would cover little more than 500 jobs in Saint Paul—or about 4-point-5 per cent of the officially unemployed. We all know that there are many more unemployed than those officially registered.

I don't feel the government can solve the unemployment problem through job subsidies. Rather, it's the overall economic policy that is the key . . . and it must be a policy that retains more spendable income for the poor- and middle-income groups.

Governmentally, Saint Paul is caught like all other businesses in the inflationary cycle. Further, Minnesota's cities are hampered in delivery of services by an artificial, outmoded spending-increase limitation of 6 per cent per capita per year imposed by the state. The supporting testimony I have details some of these complexities.[1]

While we raise only 36 per cent of our operating budget from real estate taxes, we are almost helpless to raise other revenues on our own due to statutory and state constitutional constraints.

In 1975, we received $5.4 million or 8.4 per cent of our operating budget from federal revenue sharing and 17 per cent from state assistance. About 18 cents of every dollar this year goes to pay off bonded debt.

So far, through sound management techniques, we have avoided any substantial layoff of government employees. But should revenue sharing end, we would have no choice but to have massive layoffs. We couldn't meet the payroll. Our police, for example, just were awarded an increase averaging better than 11 per cent.

In summary, I would urge Congress to do three things at least:

As you apparently have initiated already, re-think the economic programs and aim them at the masses, not the special interests like oil companies.

While you obviously cannot subsidize full employment—and we couldn't administer such a program without tremendous costs if you could—you *can gear up again* some of the recently neglected social service programs to take care of those who are being hurt while the hard economic decisions are being debated.

Above all, you can and must continue the general revenue sharing program . . . making it more equitable so that the cities receive a fairer share of what they contribute via the tax dollars of their individual and corporate citizens.

Thank you.

Because of time limitations, and relatively short notice of the committee hearing, we haven't provided you with as much information as we would have liked.

However, there is some more detailed information on my presentation attached for the record.

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[1] The supporting testimony may be found in the committee room files.

STATEMENT OF HON. THOMAS C. MALONEY, MAYOR OF WILMINGTON, DEL., BEFORE THE SUBCOMMITTEE ON INTERGOVERNMENTAL RELATIONS, COMMITTEE ON GOVERNMENT OPERATIONS, U.S. SENATE, JANUARY 30, 1975

Good morning, I want to thank Senator Muskie for inviting me to be with you today. The proposal for an emergency fiscal program to prevent State and local fiscal problems from undercutting Federal efforts to spur economic recovery is, in my opinion, a good one.

However, there are pitfalls which must be avoided if the program is to be an effective one.

The most prevalent danger is that of restrictions on the emergency funding under which cities will be expected to continue funding, for an indefinite period, programs which are established on a short-range basis with Federal funds.

The emergency funding must also allow cities and other local governmental agencies to fund current positions in those governmental units which will otherwise have to be eliminated, due to the severe fiscal crisis now facing local governments and intensified by the national economic situation.

Over the past two years, in the city of Wilmington, we have been able, through attrition, to significantly reduce the city work force.

We have eliminated 11 percent of our city fire fighting force.

We have reduced city garbage collection crews by 40 percent.

Cutbacks in the work force through attrition, however, can only be carried out to a limited extent. For economies, that are so vital in keeping cities competitive, the next natural step is to start terminating city employees.

I believe this is a step all city administrators like to avoid, but with the critical economic state of our cities now being magnified by the recession we face, few alternatives are left.

The city of Wilmington and cities across the nation are already faced with many Federally-financed programs which they have become locked into, either through a lack of foresight or a desperate need for the programs.

Federally-funded public housing abounds in our city. More than 20 percent of our public school students come from these low-income housing units which house persons who are unable to pay property taxes.

The city's contribution to public schools accounts for 30 percent of the city's entire operating budget.

Wilmington residents subsidize every hospital in the largest county in our State with $750,000 in foregone property taxes each. The vast majority of patients in these city hospitals are suburbanites.

Twenty-five percent of the State's senior citizens live in the city limits of Wilmington.

Most live on fixed incomes or in tax-exempt, Federally-financed housing for the elderly.

City taxpayers are currently absorbing a far greater share of the costs for the social needs of America than is equitable.

However, local services must be provided equally to all residents of the city, yet we must struggle to keep the property tax rate at a minimum if the city is to be competitive in preserving existing businesses and dwellers and in attracting new industries and residents which are so necessary to the economic growth required to reverse the critical fiscal trends of our cities.

Aid from the federal government to block the effects of the recession on local governments can come in many forms.

Local government can also be severely hurt by many federal agencies.

For example, the U.S. Army Corps of Engineers normally dredges the Delaware River at the Wilmington Marine Terminal.

We have been informed the Corps of Engineers does not have the dredging budgeted for fiscal year 1976.

. If the dredging is not completed and ships cannot enter the port, 1,000 jobs will be adversely effected and approximately $10,000,000 that would have gone into the economy may not.

Also, a new $35,000,000 processing site to be built at the port is in danger, if proper dredging is not accomplished. That facility has the potential to hire 200 new workers.

As you can see, the Corps of Engineers' refusal to continue with adequate dredging can have a crippling effect on the economy of Wilmington and surrounding areas.

85 percent of the city's operating budget goes to personnel costs. That leaves only 15 percent for materials, supplies, and equipment.

The city can do little to fight the rising costs of materials and supplies, such as fuel for our vehicles (up 75 percent this fiscal year), or for electricity (up 95 percent) or even bulk chemicals for our city water supply, which are up 59 percent over last year.

If local taxes are to remain as competitive as possible and economies to be taken, it becomes extremely apparent where the cuts must be made. We cannot survive without the equipment or materials. We *may* be able to survive with a reduced work force.

The result is an increased number of unemployed workers and a decrease in their ability to stimulate the economy. It also means a decline in the quality of services delivered to city taxpayers.

Cities are also faced with union negotiations. The spiraling cost of living has certainly not helped in making these negotiations any easier.

In Wilmington we recently secured three-year contracts with our police and fire departments in an effort to achieve some long-range economic stability.

Our negotiations would have been much easier and productivity bargaining a much more realistic goal had the economic situation faced by the city employees not been so dire.

In short, I am saying the discretionary use of these emergency funds should be left to the city administrators and not tangled in so many federal strings that it becomes both difficult and extremely dangerous for cities to avail themselves of the funding.

If too many restrictions are placed on the funding—if cities are forced to hire employees now and absorb them with local taxes later—if the funds cannot be used where they are most critically needed by various cities—if the funding forces local governments to become employers of last resort, then it is all too possible our cities may be saving themselves today for disaster tomorrow.

STATEMENT OF HON. FRED HOFHEINZ, MAYOR OF HOUSTON, TEX., BEFORE THE SUBCOMMITTEE ON INTERGOVERNMENTAL RELATIONS, COMMITTEE ON GOVERNMENT OPERATIONS, U.S. SENATE, JANUARY 30, 1975

I am very happy to be here today because I represent a City on whom fortune *still* smiles. We have not *completely* escaped the double affliction of recession and inflation which have crippled so many local economies throughout our Nation.

Houston's economy is highly diversified and resilient, and largely resistent to the national recession. In 1974 our retail sales were up 12%. Total construction awards exceeded 1.7 billion dollars, ranking Houston third in the nation behind only New York and Los Angeles. Bank deposits were up to record levels. Our unemployment rate is only slightly above 4%.

My city's fiscal situation is equally healthy. Despite the fact that we are greatly expanded municipal services in 1974, our ad valorem tax rate remains the lowest of any major city in the country. The city of Houston finished 1974 with one of the largest budget surpluses in its history. This does not mean that we in Houston do not face difficult financial decisions or that we are unsympathetic to the problems of our sister cities. To the contrary, I firmly believe that there is no more pressing domestic challenge than saving the nation's cities from the ravages of inflation and recession. No legislative goal should have higher priority than a national effort to provide our municipal leaders with wherewithal to rebuild their cities and to revitalize their economies. I heartily endorse the recommendation made by my fellow mayors for quick and decisive federal assistance to the nation's cities.

Further, even Houston's booming economy is not without its weak links. Our home-building industry, for example, is seriously depressed. Last year, housing starts in Houston fell by over 50%. We presently have a serious housing shortage for all our citizens and without Federal assistance our housing picture will not get any brighter.

Even before high interest rates and tight money brought housing starts down, low and moderate income families had high hopes for better shelter dashed when the Nixon Administration imposed a moratorium on the federally subsidized housing program—program which accounts for 25% of all new housing in the country.

Crippling blows to the home construction industry in our area would severely impair the ability of my city to continue to grow and to prosper. If the housing industry continues to falter, even Houston's viable economic and fiscal status will be undermined. Therefore, *I believe it should be a recognized national policy to get our builders and tradesmen back to work.*

To this I urge the Federal government to do everything within its power (1) to increase the volume of capital available to home builders and home buyers (2) to reduce the interest rates at which home builders and home buyers can obtain credit and (3) to channel available credit funds to the home construction industry as a priority.

I believe that the *volume* of capital available can be increased, first, by encouraging the federal reserve board to relax its restrictive money supply policies. Second, I endorse legislation to provide tax incentives or tax credits which will have an immediate impact on the availability of home construction loans. In particular, tax credits for *family educational investments* in savings and loans or thrift institutions would serve to supplement the supply of capital available for the construction in the purchase of homes. Allowing savings and loans to *pay* higher interest rates on both pass book accounts and certificates of deposit would further increase the capital available for the housing industry.

The legislation to increase investments in savings and loan will also serve to *channel* credit to the credit-starved housing industry as a priority. I also believe that the federal reserves should use its eminent power of persuasion to encourage *banks* to allocate increased credit to the housing industry.

In order to *lower interest rates,* I urge the reconstitution of the Section 235 home ownership program and the release of the funds impounded by the Republican Administration. I also believe that the federal reserve board should be encouraged to reduce both the prime rate and short terminal intent rate.

Let me speak briefly to our related program. I urge you to do everything within your power to continue the funding of Environmental Protection Agency construction grants. Houston must move forward with its Sanitary Service Program. Without EPA assistance in the upgrading of our waste treatment facilities, Houston will be forced to institute a moratorium on the new construction in a large portion of our city.

STATEMENT OF HON. JOSEPH L. ALIOTO, MAYOR OF SAN FRANCISCO, CALIF., BEFORE THE SUBCOMMITTEE ON INTERGOVERNMENTAL RELATIONS, COMMITTEE ON GOVERNMENT OPERATIONS, U.S. SENATE, JANUARY 30, 1975

Mr. Chairman and Members of the Committee, I am Joseph L. Alioto, Mayor of San Francisco and President of the United States Conference of Mayors. With me this morning are some of my colleagues from around the country—mayors of different size cities, from different parts of the country. But, even though some of the issues with which we deal are unique to our own cities, there is, today, one overriding issue which is affecting us all and around which we stand united. And, that issue, Senators, is the current economic crisis and the nation's concern with the lack of energy.

This hearing could not come at a more propitious time. Some one hundred mayors from all across the country are here in Washington today and tomorrow holding our annual mid-winter meeting of the leadership of the U. S. Conference of Mayors. We are here to identify those critical issues on which we must concentrate our energies during the next several months in order to ensure the vitality of our cities. At this very moment, many of our colleagues are meeting in various committees to identify these priority items. More meetings will be held this afternoon. And, I can assure you that central to all the discussions will be the economic and energy crises which face us today.

As chief elected spokesmen for so many of our nation's citizens, we mayors know first-hand the severe impact on our people of increased costs, decreased purchasing power, and increased unemployment. It is in this role that we are assessing the President's economic proposals contained in his State of the Union address, and other proposals being offered by Congress.

I am glad to see that President Ford and his advisors recognize that the American economy is in very serious trouble. This has not always been the case. Last September, we mayors were pleased to participate in the President's Conference on Inflation but were distressed with the Administration's total preoccupation with inflation. At that time, we stated that inflation was but one dimension of the current domestic crisis and anti-recessionary measures had to be enacted to guarantee the restoration of economic stability and viability of our urban economies. We said this at a time when the national unemployment rate was 5.4 per cent, not today's 7.1 per cent, and, when the Gross National Product had decreased for two successive quarters rather than the full year's decline with which we are now faced. And long before 1974, as early as 1971 in fact, the U. S. Conference of Mayors, through this very Legislative Action Committee here today, called national attention to the very issues we are discussing now. By inaction, the federal government has permitted these adverse conditions to reach crisis proportions.

We commend the President for recognizing the severity of the problem and for reversing his position from an anti-inflationary strategy to an anti-recessionary one. But, we believe that what the Administration is proposing is inadequate to deal with the magnitude of the problem confronting us in our cities. Actions designed to arrest and reverse the immediate problems of recession and energy *must not* be enacted without adequate attention to their long-term effects on the functioning of the economy. Positive results this year are meaningless if our actions cause greater problems in the future.

My colleagues seated here with me this morning can be specific about what is taking place in their own cities. But, I would like to make some general comments on the economic vitality of our urban centers. Fiscal problems in cities are not not a new phenomenon. Because of the concentrations of the poor and the near-poor, the elderly, the unemployed and the unskilled in our urban centers, demands on certain city services such as health delivery systems, public safety systems, public passenger transit systems and housing are more acute than they are in areas composed of the young, the employed and the more affluent. For the past two-and-a-half years, the general revenue sharing program has been providing essential fiscal relief to our cities so that they can continue to function and serve their residents.

But, the economic viability of cities is dependent upon the nation's economic health. Consequently, cities' fiscal problems have now risen to crisis proportions. Inflation and recession are cutting deeply into city budgets. Cities face a variety of steadily rising costs—inflated payrolls, more costly supplies and equipment and capital improvements' financing at high interest rates. Revenues, provided mainly through taxes which fall short in times of recession, are inadequate to meet costs. And, federal assistance to local government has not kept pace with the inflationary spiral. In FY 75, we estimate that total federal assistance to state and local government was, in real dollar terms, $600 million below the FY 74 level of assistance. As a result, cities are faced with a variety of "belt-tightening" strategies: lay-offs, hiring freezes, cut-backs in services, raising of local taxes and more.

All of these strategies being implemented at the local level are working at cross-purposes with those federal relief measures being considered and implemented. Reductions in federal taxes are being proposed at the same time local taxes are being increased; and, public jobs programs and increased relief services are objectives of the federal government while local governments are forced to lay-off employees and reduce services.

Despite such adversity, mayors are convinced of the inherent strength in the nation's economy to withstand this period of adversity. However, we mayors know we need a federal-city partnership. We need you and you need us.

President Ford's economic program has generated a great deal of debate around the issues of sufficiency and equity. The across-the-board rebate of $12 billion in 1974 personal income taxes is favored by many economists and politicians. And, we mayors agree to its general thrust of getting money into the economy quickly. But, we feel that splitting the payments into two stages, one in May and the other in September, would provide too little a stimulus to have much effect especially when one realizes that increased fuel costs, resulting from higher import fees on oil, will be extracting substantial dollars from the spending stream.

Second, we strongly believe that the $12 billion rebate should be concentrated on the lower and middle income groups—those most adversely affected by today's depressed economy. President Ford has suggested a $1,000 limit on the rebate. To realize such a ceiling, one has to be fairly high in the income bracket—very few of this nation's households ever achieve such a level. How many people would we really reach by using this suggested ceiling? And, the proposed additional $16.5 billion reduction in 1975 taxes would seem to be more than offset by the $30 billion in additional energy costs and taxes.

The energy issue is a highly complicated one and quick and easy solutions escape us all. Certainly, the intricate package the President has proposed is not without its faults especially when one considers the inequities it contains. Certain regions of this country, especially the North east, are already acutely suffering from exorbitant energy costs due to reliance on imported oil. President Ford's increases in fees on foreign oil are falling disproportionately on the shoulders of these regions—an issue Mayor Beame can speak to with some experience.

The President's plan to turn back to state and local governments $2 billion of the monies raised by these higher fees to meet increased energy costs is a step in the right direction. But, it falls short of its goal because it uses the wrong vehicle—the general revenue sharing formula—to deliver the goods. Fuel consumption varies dramatically depending on the climate and fuel costs have dramatic regional variation. *Neither* of these variables are reflected in the revenue sharing formula. Surely the Administration through its Federal Energy Administration can find a more equitable method to distribute these funds—one that reflects the significant regional differences.

One last comment on the Administration's economic package. The proposal to hold increases in social security payments to 5 per cent is unduly harsh and highly inequitable. So many who reside in our cities saw their meager incomes eaten up by double-digit inflation last year. The President is now telling them to expect more of the same this year. A Library of Congress study, of which I am sure you are aware, recently concluded that President Ford's energy proposals could cause the 1974 12% inflation rate to persist this year. A 5 per cent maximum increase in income is woefully inadequate.

If the current economic crisis is to be overcome, we are convinced that decisive action on the part of the federal government is required. We in city hall must look to Washington for the policies and programs that will reverse the recession, moderate inflation and ease the burden on its victims.

The recommendations we present to you today, Senators, are intended to assist you in deliberations on its economic programs for immediate implementation. Briefly, our proposals are:

A $5 billion Emergency Recovery and Stabilization Assistance Measure to State and Local Government

Rehabilitation Program for Essential Community Facilities

Direction of Financial Assistance to Selected Sectors of the Economy, e.g. housing

Full Utilization of Federal Development Programs for the Rehabilitation of Distressed Local Economies

Tax Expenditure Reform

Energy Emergency Transfer Payment to State and Local Governments Reflecting Regional Diversity

Expanded Public Service Jobs Program

These seven proposals will now be discussed more fully by some of my colleagues. I now introduce Lee Alexander, Mayor of Syracuse and Co-Chairman of the Conference of Mayor's Legislature Action Committee.

Mayor ALIOTO. With your permission I would like to get home 2 hours earlier.

Chairman HUMPHREY. I understand. Let me see if I have any questions, since you have to leave. I know it is a longways out to San Francisco, but it is worth the trip. It is a beautiful city, a beautiful city.

In representing the U.S. Conference of Mayors, Mayor Alioto, I want to urge that you send a letter with your recommendations to the

House Ways and Means Committee; also, we can see that a copy of your testimony gets to the Congress. I am sure your conference will do that to the Senate Finance Committee, and to the respective Public Works Committees, and to the Labor and Education Committees. This is very important.

I might also respectfully suggest that the minority and majority leaders of both the House and Senate be included with a personal communication to you in your capacity as the president of the Conference of Mayors.

Mayor ALIOTO. Very good, Senator, we will do that.

Chairman HUMPHREY. It is necessary because decisions are being made at this very time, in the next few days, many of these programs as far as the Congress is concerned.

Mayor ALIOTO. That will be done within the next 24 hours. We are geared up to that. We are going to do it.

Chairman HUMPHREY. The mayor has to leave.

Do you have a question, Congressman Rousselot?

Representative ROUSSELOT. Mr. Chairman, I will be brief because I know our good mayor from San Francisco wants to get back.

I just wanted to comment that I did not hear the testimony. I'm sorry that I was not here because we are all interested in what the good mayor from San Francisco has to say.

Mr. Chairman, I assure you that although we are on different political sides of the fence, Mayor Alioto is considered a very effective mayor. I apologize I was not here. We had too many things going in the reorganization on the House side. We never know when a new chairman is going to be thrown out. So we are busy. I am sorry I was not here. I promise that I will review your oral statement and prepared statement carefully, and I know it will be carefully listened to by the committee, although I am a freshman member.

Mayor ALIOTO. I summarized the meetings of the Conference of Mayors. We have been meeting the last couple of days. We put together a program and we are submitting it to you for your consideration as a bipartisan issue. The Conference of Mayors executive committee is bipartisan. It is really a nonpolitical situation. We have good Democrats, good Republicans, and nonpartisans like myself. We have given you a unified program.

Chairman HUMPHREY. Let me ask you one question that we ask every witness as they conclude their testimony.

Do you see the antirecession program and the President's economic proposals contained in the State of the Union message as adequate, and will they do the job as you see it of halting recession and reducing unemployment?

Mayor ALIOTO. To the extent that we have indicated they should be supplemented by the specific points that we made. Insofar as they do not include these points, we do not think it will do the job for the cities.

We do come back to another point. We believe that the emergency is so serious that there ought to be very, very quickly a unified war plan, an economic—this is an economic war with serious consequences. There should be a unified war plan on the part of Congress and the administration. It should be pursued as a strategy that we all agree upon.

Chairman HUMPHREY. I surely agree to that approach to it, and I am pleased to have your views.

You are excused, and we thank you.

Representative ROUSSELOT. May I ask one quick question? Maybe you do not want to take time to do it now.

Many of the cities that have their own municipal plants in California have written us and said that they would appreciate it, those that are kind of in the oil business, if they could allow crude oil to go to its natural market price because there are various problems that they have.

Do you know enough about that to comment on it?

Mayor ALIOTO. You may not like my comments about it, Congressman. I will be delighted to make them. There is no such thing as a natural price, domestic price as long as you have a buyer's cartel operating in the Mideast. The Shah did not form that cartel. It was formed by five American companies, a Dutch company and a British company. It was based on limiting production to stabilize oil prices.

The effects of that cartel exist so strongly throughout the world that they affect domestic prices as well. So it is an anomaly to talk about the existence of a natural market price now. There is no such thing, nor can it exist until the full effects of that monopoly pricing and monopoly supply in the Middle East, until those effects are fully dissipated, no way you can get it.

Therefore, I firmly do not believe in the so-called philosophy of this natural pricing until those effects are fully dissipated. There is no way of doing it in the next 2 or 3 years.

Representative ROUSSELOT. I appreciate the gentleman's remarks.

Chairman HUMPHREY. I thank you so much.

Mayor ALIOTO. Thank you, Senator.

Chairman HUMPHREY. We now have as our next witness the mayor of Bridgeport, Conn., Mr. Panuzio, and we welcome you. We are pleased to have you here with us today. Please proceed.

STATEMENT OF HON. NICHOLAS PANUZIO, MAYOR OF BRIDGEPORT, CONN., ON BEHALF OF THE NATIONAL LEAGUE OF CITIES

Mayor PANUZIO. I am delighted to be here with Mayor Alioto, who was so articulate on the problems and concerns of the mayors. I want to speak on behalf of the 15,000 municipalities of the National League of Cities. Our problems are not very different from the U.S. Conference of Mayors.

Chairman HUMPHREY. May I interrupt? The National League of Cities includes all of the cities that are in the U.S. Conference of Mayors, plus the smaller municipalities.

Mayor PANUZIO. Some 15,000.

Chairman HUMPHREY. 15,000, yes.

Go ahead.

Mayor PANUZIO. We speak in pretty much a unified voice, while we are both here representing organizations, we want to make clear that our statements and concerns are the same. I am submitting a prepared statement on behalf of the National League of Cities, including, interestingly enough, one or two quotes at the beginning that I am sure you will be familiar with, since you wrote them.

We think without question that the crisis now is perhaps the most difficult one we have ever seen. I also think that it is probably the best and most unique time to make some substantive changes in our approach to urban policies that we have. We do not have to go over the entire situation or the deterioration of the last 4 months. Mayor Alioto and I clearly made the statement in September—September 28 I guess it was—at a summit meeting, pointing out our concerns about energy and our concerns about public employment jobs.

The questions, frankly, back home are being raised even to a greater degree now. We are finding people who are having a difficult time adjusting to this whole question of inflation and recession. One week they learn about all of the things that we see impounded. The next week they learn about recession and unemployment.

Let me talk to you about a survey we did of some 67 cities across this country. These 67 cities were asked to give some information on the effect of the inflation and the recession.

First of all, one of the things we found: there is no big surplus back home, though last year there was some intention on some people's part to show up that suddenly government back home, and local government in particular, had surpluses. That does not exist.

Second, in terms of inflation, the budget increases for this particular projected year were 11.3 percent, just in the cost of government.

Chairman HUMPHREY. All the cities?

Mayor PANUZIO. Of the 67 cities. In terms for next year we are going to be looking at a 13.5-percent increase just in budgets. Salary increases alone are over 10 percent. We are finding in terms of fuel costs a 90-percent increase in the cost of fuel.

In my own city we had $1.4 million total budget last year. This year we have already expended for fuel $1.2 million for 6 months. You can see what kind of cost bracket we are talking about.

All of the other things that are affected—the cost of operation, the cost of paper, the cost of food in our hospitals—continue to go up.

In terms of the recession, we have the necessity on the part of a number of the communities—there is a chart in my prepared statement that shows this postponement of capital improvements—frankly cutting back and affecting areas where we would create jobs. Layoffs of city employees. A number of cities have indicated that—incidentally we did not include it because it would just throw it so out of proportion, cities like New York, Boston, Detroit, and other communities who have had to lay off so many people. Shortfalls in revenues, in my own community, a substantial decrease of some $1 million to $2 million in just taking the revenue from our taxes.

In effect, what do the cities do? Frankly, we have very few places to go. We either increase taxes or we decrease services. It is not very difficult for us. I cannot go to the council or a legislative body and say increase my debt limit, that is not there. I am precluded by State law from even having a deficit. I cannot increase too many taxes because all we have is the property tax. We have gone up on golf carts, dog licenses, and parking fees, and all the things from which we might get a few dollars. Frankly we do not have anywhere to go, except for the property tax.

We basically see that the policy in terms of the Federal Government, both the President and the Congress, and I cannot emphasize enough comments made by Joe Alioto concerning getting your package together. I am a Republican. He speaks as a Democrat. I think we both speak in unison in asking for a unified budget and not getting ourselves off into this split.

We see it basically going down three roads: One, tax relief, which we support and are pleased to see; and two, governmental relief programs, including public employment programs, individual relief programs, and unemployment compensation plans. We see all these things as good. We see it working at cross odds with what we are trying to do at the local level, or what we are forced to do at the local level. The locals increase taxes while the Federal Government puts taxes back into the system, and we take it out. No impact and no stimulation for the economy is going to take place because as you give tax decreases, we are going to increase. The Congress and the President may wear the white hats on this, and the guy back home may be the guy with the black cape. The fact remains that if you give us taxes back, we are going to take them. You are just not going to stimulate the economy.

The Federal Government says to increase public service programs. We find ourselves forced to essentially reduce public service programs.

Local governments lay off public servants. We are laying off some people that will be 10 or 15 years employed. On the other hand, we are being forced or are told to please hire public servants in terms of new people under the public employment program.

We revert to a regressive property tax while the Federal Government talks about equalizing across the board.

What are our recommendations? We have several. Obviously, the nine that Mayor Alioto talked about are certainly ones that we would agree with. We feel very strongly about the increase in public service jobs. We also think it is important to get some flexibility in that. That means flexibility in terms of the salary ceilings. By now we are unable to hire certain types or spend money for equipment. All we can buy for these public servants, frankly, that we are putting on, are brooms and so on, and we think we ought to be doing more if it is going to be a meaningful program. It will take some planning and equipment. We think we should be able to see down the road something accomplished rather than having us just clean up streets, which I think are both degrading to the person and certainly does not help the urban communities.

We think there is a need for flexibility in terms of hiring people back who have been laid off. We point out, I have heard from the Department of Labor, and it just amazed me, the fact that supposedly local governments were not hiring people fast enough. In those 67 communities, 90 percent of all the communities have hired as much as 90 percent under their title II situation. In my city we have reached 100 percent of title II jobs. We have reached 150 percent of title VI jobs. We just found out really what we are talking about in dollars.

Do not believe that the local communities are not capable of hiring public service people. If public employment jobs are given to us, we will hire. We have no problem with that at all.

Chairman HUMPHREY. Could you turn around and announce that good and loud? I read about that in the paper.

Mayor PANUZIO. I hope we get that across loud and clear. People are coming away with the feeling that local government is not able to put people to work. As indicated by Mayor Alioto, in the terms of the number of people applying for jobs, it is unusual. We had some 200 jobs open. We had over 2,000 people applying. There is no problem for hiring. Cities are hiring.

I am sure we can hire more if we were given them. I think we also better be looking at a carryover program, because what I am concerned about is while we are in the short term, I believe this country will come out of it, down the road I do not want to see us with a situation in which we literally dump out at the end of a 1-year program without a good phasedown situation, all of these public employment jobs.

Chairman HUMPHREY. I am glad you are bringing this up. This has been very worrysome to me. If we continue the public service job program strictly on a year-to-year basis, when the year is over, bingo, you are out. First of all, you have destroyed your whole employment pattern as a municipality on the one hand. Second, you have broken the spirit, frankly, of the person who is on the job. There should be some kind of way that you can phase it down so it is not an abrupt turnoff, either to the community or to the individual.

Mayor PANUZIO. We would support, obviously, the emergency general purpose relief program. We happen to believe that there is a need from $5 billion to $6 billion. The administration has pointed out some $2 billion for energy alone. If we are going to make some of these programs with regard to the economy in terms of stimulation of work, local governments are going to have to have that money not to draw it out.

We reaffirm the situation with regard to the youth employment. Congress and the administration, everybody seems to recognize the unemployment crisis of adults, but not much attention is given to young people. It is interesting to note in the New York Times yesterday a story about 1½ million jobs this summer needed.

Frankly, we really need 3.2 million jobs. What we have said is we effectively can employ in the cities the 1.2 million, but the 3.2 million is really what we need. In my own community some people say, well, you know, out of the CETA program, we set aside $300,000 in the CETA programs toward youth. Last year we spent $1.1 million. This year we are looking at a need of $1.6 million.

If we are ever going to employ young people during the summer, we are just going to have to have that additional, but your point about having it early and not having to figure out how we get the program to have all these jobs dumped in our lap during the last minute is essential.

Chairman HUMPHREY. I want to, Mr. Mayor, because of your position and the area in which you come, to really emphasize this before the appropriate committees of the Senate and House and the legislative bodies. It is a terrible waste of money and also a great disappointment to the individuals that are to be helped, and a very serious administrative problem to the local officials to have this youth employment money being argued about in July.

Then, you know, it takes a couple weeks to even get it on out there, and it only lasts until September. You have lost half of the time. It is a mess.

Mayor PANUZIO. It makes it unmeaningful. I am delighted to get some of this money back to the young people. I happen to have a very firm belief, if you are going to do that, you ought to make it meaningful to the person. If you are going to plan programs so that summer job has a meaning and they really get something out of it and after the person is through they have some basis of knowing something, you have to have some planning. You cannot just have it.

So what we literally do is put people out to cut grass. Our young people need more than that. If we are going to do it, let us do it right.

In terms of reenactment of revenue sharing, I am just amazed by all the comments and questions about reenactment of revenue sharing. In my community it meets about 3 percent of our total budget. I am amazed that there is even that many questions in Congress about the reenactment of revenue sharing. That should be one of the first things that should be done, very quickly, because the program has worked. It has worked, it has brought money back to the local communities. We use it effectively. We are not using it for any big side action. We are putting it in a budget. It is where it is supposed to be.

All these discussions about whether or not we are going to have it, the fact that we have to meet, as the Conference of Mayors and the National League of Cities, and sit down and determine how we get it reenacted is amazing to me in terms of the financial crisis we see in the cities. In terms of the accelerated public works program, it goes without saying we will put people to work. We probably have the best method of getting the stimulant into the economy that anybody does. We can do it better than putting it back into the individual hands.

In terms of the energy situation, I do not profess to be an expert on energy. First, it just seems to me, looking at the proposals, the only energy policy we seem to be seeing is the administration's. I would hope that the Congress comes up with a program quickly because we cannot wait.

Second, with regard to the administration's proposal, I see two things. First, in terms of the increases of taxes on crude oil and imported oil, domestic oil, we are talking about 12-to-20-cent increase in gasoline costs in the Northeast, California, and Florida. We see huge increases in electrical bills, which is going to again throw our own budgets out of whack. Economically, we now have a five-layered situation. We are going to put a couple of additional taxes on and we're going to find the oil companies, not by plan, but possibly ending up with a situation in which the miscalculation of oil prices is really going to put a burden on the consumer.

The question of siting of energy facilities, I am amazed about some statements about overlooking discussions with local and State governments as to these sites. We agree they are needed. If we know we are going to have a continuation of our industry as we would want it in this country, we need these sites. But we feel very strongly if there are to be sites that that should be of cooperation between the Federal Government, not one where the Federal Government comes down and says without any State or local input, we are going to put it where we think it has to go. If that kind of confrontation takes place, you are not going to get anywhere.

We believe that a 5-year moratorium on auto emission standards in exchange for increasing to 40 percent the fuel efficiency is way out of whack. We raise three questions about that. First of all, to stop in midstream the emission program we have going decreases the flexibility of local governments in controlling or obtaining or maintaining air standards. The burden again comes back to ourselves in controlling that.

Second, we could tell by the record that we are not sure that in 1980 we're going to have the auto industry come back and ask for another delay. We feel that there is nothing in the proposal that shows and guarantees that 40 percent efficiency.

Third, we find General Motors already has increased by some 28 percent their efficiency while holding to present emission standards, and we think the additional 12 percent over a 5-year period frankly can be done without waiving these emission standards.

We also see in this whole energy program no mention of energy recovery through solid waste. In my own community we are going to be constructing a $31 million solid waste building in terms of resource recovery. We find that some 24 percent of the solid waste is recoverable as fuel.

We believe that the Environmental Protection Agency says that we could equal some 500,000 barrels a day of oil, some 12 percent of our present coal utilities, just by some of these savings in terms of solid waste. We could realize some 120,000 barrels of oil a day by implementing a Federal ban on nonreturnable beverage containers.

We look down the road, Senators and Congressmen, to a day where frankly we get by this immediate crisis, and we think it is a day where we should start building a national urban policy, a national urban policy that no longer runs at odds between the Federal and local government, where we do not find the Federal Government willing to build highways out in the suburbs, while it is not willing to help local communities to redo their streets.

We think we have to have a national urban policy that does not encourage deterioration and sprawl but rather is a method of conserving those resources that we presently have.

We believe that we need a national urban policy that does not accelerate waste by Federal policies, and we believe in one that uses and conserves rather than destroys. The National League of Cities has been building a national urban program, a program that does not tear down but retains those resources and programs that we have, and we build on them to the future.

We would like to begin to work up a national urban policy. We hope this immediate crisis, which is a grave one, and one in which all of us are going back—I am going back today to make my statement as Ken Gibson has in Newark, A. Beame has in New York, and Young in Detroit, all the cities of 160,000. Whether they are small cities or large cities, we are all in the same boat.

All we are asking for is the consideration by both the administration and the Congress to listen to some of the things we say. We are where it is. We have nowhere to run. The people are at our frontdoors every day. We can feel for them and feel for their concerns and their problems. I am not a man to come down here. My whole philosophy and background is not one to come down here and propose huge spending bills just for the sake of spending bills. It is not my philosophy, not my background, not my history. I also recognize that unless that takes place with regard to local communities, and unless the help comes directly back to the local communities through a direct program such as was suggested both by the Conference of Mayors and the National League of Cities, that the crisis you will see will be greater, the need for the Federal Government to spend even more, and to get into even greater tax cuts.

We cannot wait. The foxtrot, as Mayor Alioto talks about, with regard to the Congress and administration, cannot keep going. We have to have a firm, strong national policy. It has to be a policy of the Federal Government, both Congress and administration are together on. If it is a policy that we can work with, we are ready and willing to help.

Thank you.

Chairman HUMPHREY. That was a very forceful statement. We are extremely grateful to you. We will ask that the entire prepared statement be printed in the record, along, of course, with your oral statement here, going into some of the details of your statement on behalf of the National League of Cities.

[The prepared statement of Mayor Panuzio follows:]

PREPARED STATEMENT OF HON. NICHOLAS PANUZIO ON BEHALF OF THE NATIONAL LEAGUE OF CITIES

Mr. Chairman, my name is Nicholas Panuzio and I am mayor of Bridgeport, Connecticut. On behalf of the National League of Cities, and the 15,000 municipalities which it represents here in Washington, I would like to present to the Committee our assessment of the Federal government's economic and energy policies and, in particular, an assessment of how those policies are affecting the ability of local governments to perform their vital functions. But first, I would like to refer to a quotation which I am sure the Chairman will recognize. I quote:

"We must face up to the central question of whether we wish to design or resign ourselves to our nation's future. That is the basic question underlying decisions we make today in determining what kind of nation we want to create or leave for future generations of Americans.

"For what we do—or fail to do—today clearly commits and fixes future patterns of life in this nation as well as on this planet earth. We can no longer afford the luxury of approaching the future of our nation—and its relationship to the rest of the world—haphazardly." [93rd Congress, 1st Session, Joint Committee Print, A Proposal Submitted to the Subcommittee on Economic Progress of the Joint Economic Committee, Congress of the United States, by Hubert Humphrey, U.S. Senator, February 26, 1973.]

Senator Humphrey, I have taken the liberty of quoting your words from the introduction to "A Proposal for Achieving Balanced National Growth and

Development," submitted to the 93rd Congress. Today the question is the same, only more pressing—resignation or resolution. Resignation to conditions that threaten the quality of life in our nation, especially in our cities, conditions that have in large part been produced by our own actions. Or resolution to claim responsibility for those conditions and for the measures which can effectively and permanently change them.

Some might say that attention to the current crisis makes it impossible to deliberate and to select courses of action which will meet not only immediate needs but will have staying power. We say that it is only when important actions are required that important and long-lasting results can be expected. And therefore the time is propoitious for the sorts of political decisions that become historical benchmarks. Today we want to talk about both the immediate and the long-term needs. My statement will focus upon five particular areas of concern:

I. An analysis of how local budgets are responding to the economic and energy crisis;

II. An analysis of the relationship between the local budgetary crisis and federal economic recovery initiatives;

III. Specific recommendations as to immediate action that should be taken by the federal government to alleviate the crisis confronting city government;

IV. An analysis of the President's energy proposal from the perspective of local government, and

V. Recommendations as to the long-range issues in developing and implementing a national urban policy.

It is unnecessary to recite the depressing national economic statistics that measure the depth of the current economic crisis. There is no disagreement over the necessity to fight a three-front campaign against recession, inflation and energy dependency. There are, however, great diversions of opinion over the nature of the campaign. Which of the three evils must receive the highest priority? What are the interrelationships and trade-offs if one policy is pursued as opposed to another? The list of controversial issues is endless.

Mr. Chairman, from our perspective this crisis has not developed overnight—the signs of economic recession, coupled with double-digit inflation have been in visible view for many months. Four months ago representatives of the National League of Cities spoke before the President's Economic Summit. We warned at that time, and I quote: "We reiterate that our principal concern is that the federal government must adopt a *comprehensive* set of economic policies that will focus attention and national resources on combating inflation and overcoming recession. Policies designed to combat inflation must not be allowed to deepen the recession. Conversely, economic recovery programs must not be permitted to fan the flames of inflation. The delicate balance needed to address these critical problems will require exceptional leadership from Washington."

Unfortunately, during the past four months leadership initiatives by both the White House and the Congress have failed to produce concrete action. People outside of Washington are thoroughly confused!

They do not understand how in four months the once proclaimed objective of a balanced budget has given way to a projected $40 billion deficit this year and a $60 billion deficit next year.

They do not understand how in four months a 15 percent tax surcharge proposal has been scrapped in favor of a $15-30 billion tax reduction. As we survey the many economic recovery and energy proposals now being set forth, it is also increasingly clear that Washington experts and politicians do not understand what is happening throughout the rest of the country. We do not claim to have a perfect perception or any magical solutions. But we do bring to this Committee a level of knowledge and expertise about conditions in local governments. Only when an accurate picture of the nature and scope of the current crisis is understood, can the federal government begin to provide the leadership and policies that will lead us towards economic recovery.

I. RECESSION, INFLATION AND ENERGY SHORTAGES AT THE LOCAL GOVERNMENT LEVEL

Throughout the life of the 93rd Congress, local officials were repeatedly told that additional federal assistance to the nation's cities was unnecessary due to reported surpluses in state and local government budgets. Although some surpluses did exist, especially at the state level, we vigorously argued that aggregated local statistics were masking the ongoing fiscal and economic crisis in the cities. Unfortunately, our warnings were not heeded. Somehow, the charts from the National Income Accounts showing surpluses in the state and local sector had more credibility than the numbers we were providing. It is appropriate, therefore, that in our first discussion of local fiscal conditions before the 94th Congress that we turn to the National Income Accounts. As chart #1 indicates, state and local governments had a combined surplus of $4 billion in 1973. However, the figures for 1974 now reveal a $7.5 billion deficit. Drawing upon these numbers, the Committee in its final report to the 93rd Congress made the following projection for 1975:

"The combination of inflation-affected expenditures and recession-induced revenue shortfalls will make it very difficult for many States and local governments to make it through the upcoming year without tax increases, employee layoffs, and cuts in levels of service."

Since the aggregate statistics for state and local governments now reveal a significant deficit, we are optimistic that our reports will be taken seriously. Mr. Chairman, during the past week the staff at the National League of Cities has conducted a telephone survey in an attempt to determine the impact of the economic crisis on a cross-section of American cities. Drawing upon the National League of Cities' direct member city list, the staff surveyed 67 cities. While we do not claim that our sample was scientifically selected, we do believe it to be reasonably representative—both in terms of size and geographic distribution. Nor do we claim to have thoroughly analyzed the wealth of data we have obtained. Time constraints have imposed limits. We are confident, however, that the numbers we are displaying on chart #2 tell an accurate story of what is occurring in local government. The staff of the National League of Cities will be pleased to work with the Committee staff in further analyzing the data if this would prove useful to the Committee.

Summary results of the survey are as follows:

A. Inflation Related Indicators

1. *Budget increases:* The cities in the survey were asked to indicate the percent increases in their current service budgets—that is, the increased costs of maintaining the same level of city services from one year to the next. The following results were obtained:

1973–1974—the average increase in current service budgets (56 cities)=11.3%.

1974–1975—the average projected increase in current service budgets (51 cities)=13.68%.

It should be noted that certain cities did include "new services" in their figures. However, in most cases the new services were of an extremely limited nature.

2. *Salary Increases:* The cities were asked to report the percentage increase in their most recent wage settlements. Of the 67 cities reporting, the average increase equalled 10.19% with the lowest settlement at 2.5% and the highest at 25%. Forty cities were below the average and 27 above. It is significant to note on the chart that many of the cities were reporting wage settlements, exclusive of any fringe benefits. If the fringe benefits had been included by all the cities, the average would have been substantially above 10.19%.

3. *Fuel Purchasing Cost Increases 1973–1974:* Of the 55 cities providing data, the average increase in the cost of purchasing fuel was 90% This ranged from a high of 307% to a low of 10%.

4. *Increases in Local Budgetary Expenditures for Fuel 1973–1974:* While the actual cost of purchasing fuel skyrocketed, budgetary outlays for fuel expenditures showed a somewhat less dramatic increase. Of the 31 cities providing data, the average increase was 45.7%, with a low of 9% and a high of 117%.

B. Recession Related Indicators

1. *Postponements in Planned Capital Improvement Expenditures:* Of the 67 cities reporting, 36 indicated that the current economic crisis was forcing them to postpone or cancel planned capital improvements. Chart 3 provides a partial list of some of the postponements.

2. *Layoffs of City Employees:* Seven cities indicated that layoffs had already occurred. Fourteen reported that job freezes were in effect and 46 stated that they were not at this time contemplating a reduction in their payrolls.

3. *Revenue Shortfalls:* Forty-three of the 66 reporting cities anticipate that their revenues will fall short of original estimates because of the depressed economy.

4. *Unemployment:* An effort was made to obtain unemployment numbers. However, accurate and current data at the city level is not available.

C. The Cities' Budgetary Responses to the Economic Crisis

As columns 8 and 9 indicate on Table 2 many cities are anticipating either a tax increase, a reduction in services or both. Twenty-eight cities reported that taxes would be raised, while 23 reported that services would be decreased. Comparing the two columns, there are 9 cities indicating both a tax increase and a service decrease. Therefore, 42 of the 67 cities, or approximately 63% of those surveyed, will either raise taxes and/or decrease services.

From our data the following conclusions can be drawn.

Double digit inflation is eroding the real dollar value of local budgets. Coupled with an anticipated shortfall in revenues during 1975, it will be extremely difficult for most cities to continue to maintain their current level of essential public services.

If cities are going to maintain their current levels of operation, then it will be necessary to increase local taxes.

Many local governments, either because of postponed capital improvements or decreased service operations, are in a position to provide meaningful work for the unemployed.

However, most local governments cannot be expected to provide additional employment opportunities unless outside financial assistance is forthcoming. Without such assistance increased layoffs of city employees are likely to occur.

II. THE RELATIONSHIP BETWEEN THE LOCAL BUDGETARY CRISIS AND THE OBJECTIVES OF THE FEDERAL GOVERNMENT'S ECONOMIC RECOVERY PROGRAMS

In spite of the intense controversies that surround the numerous economic proposals, it is our belief that a genuine consensus is beginning to emerge around three broad federal policy objectives.

First, there appears to be general agreement that stimulation of the private sector will be a key component of the federal government's economic recovery policy. Such stimulation is likely to occur through tax rebates or reductions which will shift money away from the public sector and into the private economy.

Second, there is wide-spread agreement that the federal government has a responsibility to cushion the effects of recession and double-digit inflation on individual Americans. Expanded unemployment compensation, public service jobs and other individual relief programs have already been initiated by the federal government. It is likely that federal policies during the coming year will be aimed at providing government-sponsored relief programs for individuals.

Third, there appears to be general agreement that the burdens of the economic and energy crises must be equitably distributed among all Americans —that the poor and the minorities must not be expected to shoulder the lion's share of the hardships, while the wealthy continue to live unaffected by the crises.

These three points: stimulation of the private sector, governmental relief programs for individuals and an equitable sharing of the economic hardships, appear to be at the center of the economic recovery proposals which are receiving serious attention. The debates over the precise mechanism should not obscure the emerging consensus around these three points.

Unfortunately, from our perspective there is one other common ingredient to the economic recovery programs circulating in Washington—by in large they all fail to address the question of how a national economic recovery program will interface with state and local governments. Our fiscal conditions force us to ask questions. Will the federal programs work in concert with state and local governments to alleviate the crisis? Will conflicts and contradictions between federal, state and local governmental policies be ignored, and the recovery program impeded?

Given the hard data we have uncovered through our survey of cities, it is our contention that local governments (and perhaps state governments) are being forced to take budgetary actions which are at cross-purposes with national economic recovery objectives. For example:

Local governments are being forced to increase taxes, while the federal government is attempting to stimulate the private sector through tax reduction.

Local governments are being forced to reduce essential public services, while the federal government is attempting to extend governmental services and individual relief programs.

Local governments are being forced to lay off their regular public employees, while the federal government is attempting to reduce private-sector unemployment through public service jobs.

Local governments are being forced to increase regressive property taxes, while the federal government is attempting to equitably distribute the economic burdens. Reductions in the federal income tax and increases in local property taxes will not achieve this federal objective.

The sheer magnitude of the state and local sector should be reason enough to carefully coordinate a national economic program with state and local governments. As of 1972, 47.5% of all governmental expenditures took place at the state and local level, and state and local government employment was four times greater than federal employment. With the public sector accounting for more than 32% of the Gross National Product and state and local governments accounting for 43% of the combined public sector, common sense should dictate an intergovernmental approach to the current crisis.

III. SPECIFIC RECOMMENDATIONS AS TO IMMEDIATE ACTION THAT SHOULD BE TAKEN BY THE FEDERAL GOVERNMENT

1. *This Committee should consider recommending the creation of an Inter-Governmental Economic Recovery Board* that would have responsibility for monitoring fiscal and economic conditions throughout our system. The information obtained by the Board would be used to recommend policies to insure the successful coordination of federal, state and local government efforts in achieving our national economic recovery goals. Such a Board might logically be created under the auspices of the Advisory Committee on Intergovernmental Relations.

2. *Additional and More Flexible Public Service Jobs*—While Congress and the Administration have recognized the unemployment crisis among adults by adopting and appropriating funds for the Emergency Jobs and Special Unemployment Assistance Act of 1974, the cities could substantially increase the number of job opportunities we are currently providing—and at this point we would like to submit for the record the results of a survey indicating full utilization of public service jobs funds received under CETA, Title II. However, spiralling costs have had an impact on our ability to continue current levels of services and have limited our ability to provide additional services even with personnel being made available. We therefore urge, that any additional public service jobs legislation include adequate provisions for the purchase of supplies and equipment. Finally some recognition must be given to the limited number of entry level and low paying jobs in municipal government and we recommend more flexibility with regard to salary ceilings. We commend the Congress for the modifications incorporated in CETA Title VI—permitting a waiver of the 30-day rule under unusually high unemployment conditions and prohibiting application of the transition requirements to CETA Title VI hires. But additional assistance can be most quickly and effectively used if the Congress grants more latitude in the use of funds for both supplies and equipment, as well as salaries.

3. *Emergency General Purpose Fiscal Relief*—Above and beyond the provisions of additional and more flexible public service employment funds, however, the cities are faced with lay-offs among their own employees. It seems incongruous to be provided with funds to hire individuals laid-off by private employers who have little or no local government experience, while at the same time dismissing our own regular employees, who have tenure and seniority to

lose but who, most importantly, are familiar and experienced at their work. While it is not yet a problem, there will shortly come a time when preference must be given to individuals who have exhausted their unemployment benefits, thus precluding, or at best restricting, the re-hiring of regular city employees. We, therefore, urge serious consideration of *emergency legislation to provide temporary fiscal relief* to financially crippled local governments. Such a relief program should be designed to insure that local governments will not be forced to implement severe budgetary measures in conflict with the objectives of national economic recovery policies.

4. Summer Youth Employment Programs—While Congress has recognized the crisis of unemployment among adults and attempted to begin to provide a solution through CETA VI and extended unemployment compensation, it is essential that it address the separate crisis of unemployment among youth this coming summer. As summer job prospects for youth in the private sector become increasingly dim, it is clear that job creation in the public sector must be greatly expanded to fill this void. With rapidly increasing local government layoffs, substantial efforts made by cities to hire youngsters during the summer months with local funds will be severely curtailed. The National League of Cities has just completed its annual summer youth jobs survey (copy attached) and has documented a need for 1,147,847 slots at a cost of $649,681,402; a need which cannot be met with current local funds. It is urgently requested that Congress appropriate adequate funds with sufficient lead time to insure an effective summer youth employment program this year.

5. Reenactment of General Revenue Sharing—The Congress should immediately begin consideration of the reenactment of the general revenue sharing program. If local governments are to play a critical role in the economic recovery process, then the federal government must insure continuation of this vital source of financial assistance. Termination of general revenue sharing would produce consequences directly contrary to national economic objectives. It would result in immediate increases in local taxes (property taxes) or an immediate reduction in the level of essential public services. Congress should establish a target of January 1, 1976, as the date by which the revenue sharing program should be reenacted. Delays beyond that date will cause major budgetary uncertainties at the local level.

6. Accelerated Public Works—The Congress should immediately consider accelerating and expanding federal public works programs. Our survey of 67 cities indicates that local governments are in a position to immediately begin work on capital improvement programs if the financial resources are available. We are pleased to note that some members of the Majority have already endorsed a program of accelerated public works.

IV. ANALYSIS OF THE ADMINISTRATION'S ENERGY PROPOSALS

The Administration proposes both a series of taxes on imported oil and an excise tax on every barrel of domestically-produced oil. This indirect method of taxing petroleum consumption affects cities in basically two ways. First, in the New England region of the country and in many parts of California and Florida the price of gasoline will skyrocket by between 12¢ to 20¢ per gallon. The cost of electricity in these areas will also skyrocket due to heavy dependency on heating oil used both as a direct source of home heating and as a primary boiler fuel for utilities.

Secondly, the establishment of an additional two-tiered pricing system virtually assures that, in addition to regional cost variations, there will be some degree of miscalculating of oil product prices by oil companies which purchase both domestic and foreign crude at substantially different prices and tax levels. This adds a further and unnecessary burden on the consumer.

A. Environmental Implications—The environmental implications of the Administration's energy package raise additional problems for the nation's cities. In the area of energy source development, the President has proposed energy facility siting legislation which will, according to the State of the Union message, "insure that final state energy facility decisions cannot be nullified by actions of local governments." A recent meeting between Interior Secretary Rogers Morton and governors of the six mineral intensive Rocky

Mountain states—at which time the Secretary indicated that ultimately the Federal government would prevail in energy facility siting decisions—raises still further doubts about the Administration's willingness, first of all, to consider the secondary impacts of massive energy resource development, and, secondly, to allow the elected officials of both state and local jurisdictions to participate in these crucial development decisions. Certainly no one would question whether we need to develop further sources of energy within the boundaries of this country. Our economic well being is dependent on a number of crucial factors not the least of which is the assurance that business and industry have ample energy supplies at their disposal. What we do question, however, is whether the Administration's approach—that of preempting state and local government from energy-related land use decisions—is the correct one to pursue. If energy sources are to be developed then let us go about the business of accomplishing this task in a rational and orderly manner. The Federal government must insure that adequate planning for expected growth be carried out well in advance at the local level by local officials. State and local officials must have veto powers over all development projects—even if such projects fall on federally-owned or controlled land. Foremost in our thoughts, however, is the firm belief that all three levels of government should attempt to pursue national energy policy objectives within a spirit of *cooperation rather than confrontation.*

Additionally, the Administration would place a five year moratorium on auto emission standards in return for a commitment on the part of the auto industry to increase auto fuel efficiency by 40% before 1980. We have several problems with this approach, the three most important being:

1. Stopping the motor vehicle emission program in mid-stream will decrease the flexibility local governments will have in attaining, and, more importantly, maintaining air quality standards within urban metropolitan areas during the next ten years. As you know, indirect source regulations are now in effect in three states and will be in effect in all states July 1 of this year, barring further Congressional action on this matter. If local governments are forced to pick up the slack for the auto industry by enduring a greater amount of noxious emissions than is necessary, there is no doubt that local economic development will suffer in the long run. This simply must not be allowed to take place.

2. There are no sanctions that can be imposed if this 40% agreement is not lived up to. Further, who is to say that the auto industry won't be back in 1980 with a similar request for an additional moratorium. The record will show that such a fear is warranted.

3. General Motors and Chrysler have increased the fuel efficiency of their product by 23% over the base year on which the agreement with the Ford Administration was reached. This increase in fuel efficiency was realized, I might add, while simultaneously complying with the rather stringent incremental increase in emission control limitations specified for the model year 1973. Essentially, then, the Administration proposes to give the two largest automobile manufacturers a free ride for the next half decade if they will show some good faith efforts to increase the fuel efficiency of their products by 17% or roughly less than 3½% per year.

B. Resource Conservation and Energy Recovery—Finally, the Administration fails to make mention of the tremendous savings that could be brought about in the short and middle term simply by encouraging the recycling of our urban solid wastes. An estimated 16 to 24% of the nation's solid waste is potentially recoverable and reusable. Each year cities dispose of $5 billion worth of metals—materials which, with adequate federal assistance, could be recycled at tremendous energy, economic and environmental savings. Additionally, energy recovery from solid waste is a potential source of non-polluting energy that, based on Environmental Protection Agency estimates could equal over 500,000 barrels per day of oil or roughly 12% of current coal utility use. I might also add that the energy equivalent of 120,000 barrels of oil per day could be realized by implementing a federal ban on the manufacture and distribution of non-returnable beverage containers. The effective implementation of these two measures alone would produce an energy savings to the nation of over 60% of the one million barrels of foreign oil the President aims to eliminate from the domestic market place this year. This would substantially cushion the impact on both individuals, personal lifestyles, and, the American economy during this most difficult time. We hope that Congress will act swiftly in these areas.

V. RECOMMENDATIONS AS TO LONG RANGE ISSUES IN DEVELOPING AND IMPLEMENTING A NATIONAL URBAN POLICY

The current economic situation presents all governments with urgent and immediate problems which require quick action. The recurring nature of some of these problems suggests that responsible deliberation should be devoted to devising means to soften their effects the next time they occur. But, while immediate action must be taken, and economic problems must be given top priority, the future should not be jeopardized by short-sighted measures, and every effort should be made to guarantee that our national goals will not be compromised through narrow attention to the economy.

Cities are only now beginning to see clearly how the policies and programs of the Federal government determine the possible range and likely effectiveness of programs undertaken at the local level. The President's recently released *Report on National Growth and Development* surveys the character and extent of "Federal Influence on Growth and Quality of Life," touching on grants and loans, federal construction, location of Federal installations, procurement of goods and services, taxation, credit management, and regulatory activities. Through all of these means, most of which must be included in an economic recovery program, Federal actions impinge on cities and city governments. The recently released annual report of the Council on Environmental Quality concludes that the Federal tax code "may be a powerful force in determining the pattern of metropolitan and rural development," and also analyzes the influence of federal regulations and public works on local land use.

The members of the National League of Cities have concluded that the inadvertent national urban policy made up of the unintended consequences of many federal policies and programs runs counter to local efforts and other intentional federal policies. Too often the results support the two-sided urban problem afflicting cities today and which will persist into the future—deterioration and sprawl. Too often the waste of urban resources is accelerated by federal policies. And too often efforts to conserve urban resources are obstructed by the powerful push and pull of social and economic trends which are given direction and force by federal policies. The Board of Directors and Policy Committees of the League of Cities have begun to investigate this inadvertent national urban policy with the intent of making its consequences more explicit and attempting to influence its redirection toward an explicit policy of nation urban conservation. Now, at a time when far-reaching and long-term decisions will be made, it is important to make the strongest possible effort to guarantee that those decisions will support the fullest and best use of our national resources—and especially our cities—if the quality of life in our country is to be kept secure for the future.

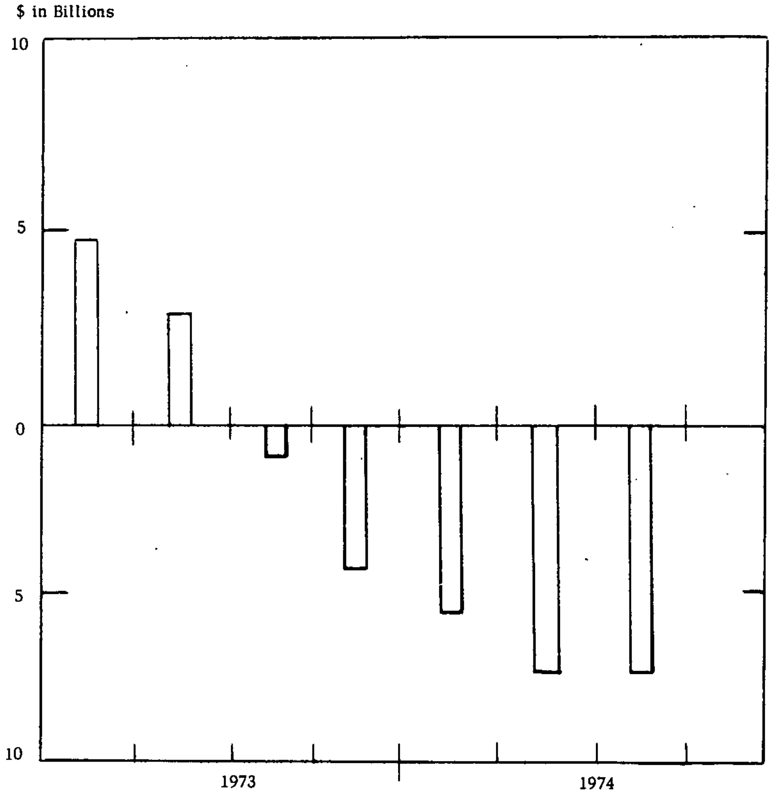
If the federal government is to be responsible for its actions; if it is to be held accountable by its citizens; and if the other governments of the nation are to be able to act effectively in their jurisdictions; the real and long-term impacts of federal policies must be known. And the costs and benefits of these impacts must be judged against explicit national goals.

This task would be easier if the executive branch had delivered more substantial biennial reports on national urban growth to the Congress. But Congress itself has developed means to more effectively gauge the likely consequences of federal legislation. Insofar as is possible, Congress should honor the spirit of the Budget Reform Act. This would mean a serious list of priorities with available funds proportioned accordingly. It would mean an investigation of the Tax Expenditures Budget to determine its consistency with avowed aims. It would mean Fiscal Impact statements for state and local governments making clear how and to what extent federal actions increase or decrease local resources.

Though action on the current economic problems is urgently needed, it must not be heedless or short-sighted. Cities expect that Congress will take seriously its responsibility to legislate in the national interest, that it will respect the responsibility of local governments to further the interests of their citizens and that together the governments of the United States can cooperate to deal with today's problems without compromising the nation's future.

FISCAL POSITION OF
STATE AND LOCAL GOVERNMENTS

CHART 1



(Excludes Social Insurance Fund)

SOURCE: National Income and Product Accounts Dept. of Commerce

CHART 2

NATIONAL LEAGUE OF CITIES

SURVEY OF CITIES' FISCAL CONDITIONS

[In percent]

City	Budget increases		Recent wage settlements				1974 increases in fuel costs			1974 increased city expenditures for fuel
	1973–74	1974–75	Police	Fire	General government	Other	Gas	Fuel oil	Other	
Alaska: Anchorage	[1] 25.2	[1] 18.6	[3] 25		20		35.3		83	19.8
Alabama:										
Birmingham	[2] 13	[2] 13		[4] 15			33			30
Huntsville	[1] 9					[4] 8				
Arkansas: Pine Bluff				[3] 18	13		30			
Arizona:										
Phoenix	[1] 18.1	[1] 19.9	[3] 9.7	[3] 14.7			120		143	117
Tucson						[3] 2.5	121		144	
California:										
Anaheim	[1] 19.2	[1] 14		[3] 10.4			64			64
Englewood	[1] 6	[1] 13				9	68		25	
Fullerton	[2] 8.6	[2] 16.6	[3] 8	[3] 10.4			63.4		54.4	34
Garden Grove	[1] 12	[1] 18	10	11			84		204	
Huntington Beach	[1] 20.8	[1] 16.6				5	61			
Richmond	[1] 9	[1] 10				[1] 8	60	73		
San Diego	[1] 13.8	[1] 5				[3] 8	82			82
San Jose	[1] 10.7	[1] 10	[4] 8.5	[4] 7.5			81		78	80
Santa Ana	[1] 17	[1] 20		[3] 13			218		307	15
Colorado:										
Denver	[2] 14.2	[2] 11.6	[3] 11.5	[3] 13.5			55	38	25	
Pueblo	[1] 14.2	[1] 2.5	[4] 13		10		35		112.7	100
Connecticut:										
Danbury	[2] 25	[2] 25	6					10		27.5
New Haven	3.1		[3] 15.8					117		50.6
Waterbury	[1] 10	[1] 10		[3] 5.5				100		
Delaware: Wilmington	4.6			[4] 8.8		[4] 7.1				
Florida: Jacksonville	[1] 13	[1] 9		[3] 4		[3] 10	100		62.5	
Georgia:										
Augusta	[2] 10					5.5		50		
Savannah						13.6	100			
Illinois:										
De Kalb	[1] 18	[1] 16.5	[3] 15		[3] 8.9		60			21
East St. Louis	[2] 9	[2] 19		[3] 16			40			28
Peoria	[1] 9	[1] 30				14	20	80		20
Indiana:										
Gary	[1] 1.8	[1] 2.6				[4] 9				
South Bend	[1] 2.3	[1] 5.4				[3] 10	100		80	100
Iowa:										
Ames	[2] 9.1	[2] 34				[3] 7.5			81.9	34
Des Moines	[1] 18.9	[1] 18				[4] 10	56			27

[1] Current service budget only.
[2] May include relatively small expenditures for additional city services.
[3] Wages only.
[4] Wages and fringe benefits.

CHART 2

NATIONAL LEAGUE OF CITIES—Continued

SURVEY OF CITIES' FISCAL CONDITIONS—Continued

City	Postponement of capital improvements	Layoffs and freezes in city employment	Anticipated revenue shortfalls	Anticipated tax increases for 1975	Reduction in city services
Alaska: Anchorage	Yes	No	Yes	Yes	Yes.
Alabama:					
Birmingham	Yes	No	No	No	No.
Huntsville	Yes	No	Yes	Yes	No.
Arkansas: Pine Bluff	No	No	No	Yes	No.
Arizona:					
Phoenix	Yes	No	Yes	No	Yes.
Tucson	No	Yes	Yes	No	No.
California:					
Anaheim	Yes	No	Yes	No	Yes.
Englewood	Yes	Yes	Yes	Yes	Yes.
Fullerton	No	No	Yes	No	No.
Garden Grove	No	No	Yes	No	No.
Huntington Beach	Yes	Yes	Yes	No	Yes.
Richmond	No	No	No	Yes	No.
San Diego	Yes	Yes	Yes	No	Yes.
San Jose	No	No	Yes		Yes.
Santa Ana	Yes	No	Yes	No	No.
Colorado:					
Denver	No	Yes	Yes	No	Yes.
Pueblo	No	No	No	No	No.
Connecticut:					
Danbury	Yes	No	No	No	No.
New Haven	Yes	No	No		No.
Waterbury	Yes	No	No	Yes	No.
Delaware: Wilmington	No	No	Yes	No	No.
Florida: Jacksonville	Yes	No	Yes	Yes	No.
Georgia:					
Augusta	No	No	No	Yes	No.
Savannah	Yes	Yes	No	No	No.
Illinois:					
De Kalb	Yes	No	No	Yes	Yes.
East St. Louis	Yes	Yes	Yes	No	Yes.
Peoria	Yes	No	Yes	Yes	No.
Indiana:					
Gary	Yes	No	Yes	No	Yes.
South Bend	Yes	Yes	Yes	No	No.
Iowa:					
Ames	No	No	No	Yes	No.
Des Moines	No	Yes	No	No	Yes.

CHART 2

NATIONAL LEAGUE OF CITIES—Continued

SURVEY OF CITIES' FISCAL CONDITIONS—Continued

[In percent]

City	Budget increases		Recent wage settlements				1974 increases in fuel costs			1974 increased city expenditures for fuel
	1973–74	1974–75	Police	Fire	General government	Other	Gas	Fuel oil	Other	
Kansas: Wichita	[1] 7	[1] 14		10		8			151	
Kentucky: Lexington	[1] 4	[1] 10				[3] 9.5	65			40
Maine:										
Auburn	[2] 17.5	[2] 7.5				[3] 12	150	100		10
Portland	[1] 2.2	[1] 16.5	6.6				83			
Maryland: Baltimore	[1] 5.3	[1] 4.8				[4] 13	100			20
Massachusetts:										
Brockton						[3] 12			70	
Lowell						[3] 5.5				
Worcester						5		100		
Michigan:										
Flint	[1] 18		[4] 15	[4] 16			300	2.5		
Kalamazoo	[1] 8.6	[1] 13.1		[3] 9		[3] 9.5			100	
Minnesota: Minneapolis	6	6				[4] 10				
Missouri: Kansas City	[1] 8.3	[1] 2.5		[3] 8.5		[3] 8				
New Jersey:										
Newark			12			6	30	30		
Trenton	[1] 8	[1] 2				[4] 8.3		100		100
New Mexico:										
Albuquerque	[2] 11.4	[2] 11.1	[4] 8	[4] 14			53.6		78.2	25.2
New York:										
Binghamton	[1] 12.5	[1] 8.8	[4] 9.6	9						
Buffalo	.04			[3] 8.2			25		25	
Manchester	[1] 8.5	[1] 7.5				[3] 6		100		15
Rochester	[1] 8.7	[1] 11.5		[3,5] 6.3		[3] 9.2				
Syracuse	7			[5] 11.7				123		
North Carolina:										
Greensboro	[2] 12	[2] 8			[4] 8					
Ohio:										
Cleveland	[1] 3	[1] 3		[3] 8.7		[3] 10.3	99	100.3		
Dayton	[1] 8	[1] 13	[4] 10.4			[4] 8 9	100			100
Oklahoma: Norman	[2] 24.9	[2] 34				[4] 7.5	90		170	
Oregon: Portland	10	10		[5] 7.4		10.4				
Pennsylvania:										
Harrisburg	[1] 13	[1] 10		[4] 15						
Pittsburgh			[3] 13			[3] 8	35.5			35
Rhode Island:										
Pawtucket	[2] 8	[2] 25				[4] 5.5		30		15
Providence		[1] 7.5	[3] 7.5					100		100
South Carolina:										
Charleston	[1] 27	[1] 30			5		33	33		40
Texas: Fort Worth		[1] 122	[4] 13			[4] 18				9
Vermont: Burlington	[1] 20	[1] 30				[3] 11.8		15		20
Virginia: Alexandria	[1] 13.5			[3] 8				208	207	
West Virginia:										
Morgantown		[1] 16.9				[3] 10	99		40	
Wisconsin: Racine	[1] 11.5	21		[4] 11			100			
Summary averages	11.3	13.68			10.19			90		45.7

[1] Current service budget only.
[2] May include relatively small expenditures for additional city services.
[3] Wages only.
[4] Wages and fringe benefits.
[5] Police and Fire combined.

CHART 2

NATIONAL LEAGUE OF CITIES—Continued

SURVEY OF CITIES' FISCAL CONDITIONS—Continued

City	Postponement of capital improvements	Layoffs and freezes in city employment	Anticipated revenue shortfalls	Anticipated tax increases for 1975	Reduction in city services
Kansas: Wichita	Yes	No	Yes	Yes	No.
Kentucky: Lexington	No	No	Yes	No	No.
Maine:					
Auburn	Yes	No	Yes	Yes	Yes.
Portland	Yes	Yes	Yes	Yes	No.
Maryland: Baltimore	No	Yes	No	No	No.
Massachusetts:					
Brockton	No	No	Yes	No	No.
Lowell	No	No	Yes	Yes	No.
Worcester	Yes	No	No	Yes	No
Michigan:					
Flint	No	No	Yes		No.
Kalamazoo	Yes	Yes	Yes	Yes	No.
Minnesota: Minneapolis	Yes	No	No	No	Yes.
Missouri: Kansas	No	No	Yes	No	No.
New Jersey:					
Newark	Yes	Yes	No	Yes	Yes.
Trenton	No	No	Yes	Yes	No.
New Mexico: Alburquerque	No	No	No	No	Yes.
New York:					
Binghampton	Yes	No	No	Yes	Yes.
Buffalo	Yes	Yes	Yes	Yes	Yes.
Manchester	Yes	No	Yes	Yes	No.
Rochester	No	No	Yes	Yes	No.
Syracuse	No	Yes		Yes	Yes.
North Carolina: Greensboro	No	No	No	No	No.
Ohio:					
Cleveland	Yes	Yes	Yes	Yes	Yes.
Dayton	Yes	No	Yes	No	No.
Oklahoma: Norman	Yes	No	Yes	No	No.
Oregon: Portland	Yes	No	Yes	No	No.
Pennsylvania:					
Harrisburg	No	No	Yes	No	Yes.
Pittsburgh	No	No	No	No	No.
Rhode Island:					
Pawtucket	Yes	No	Yes	Yes	No.
Providence	Yes	No	Yes	Yes	No.
South Carolina: Charleston	No	No	No	No	No.
Texas: Fort Worth	Yes	No	No		Yes.
Vermont: Burlington	Yes	No	No	No	Yes.
Virginia: Alexandria	No	No	Yes		No.
West Virginia: Morgantown	No	Yes	Yes	No	No.
Wisconsin: Racine	No	No	Yes	Yes	No.
Summary tabulations	36 yes, 31 no.	21 yes, 46 no.	43 yes, 23 no.	28 yes, 34 no.	23 yes, 44 no.

CHART 3

POSTPONEMENT OF PLANNED CAPITAL IMPROVEMENTS

1. Gary, Indiana

a. Farmer's market—$300,000 project, open air market—only two-thirds of original project to be built.

b. 150 units public housing—not at all.

c. Street and sewer projects.

d. Need 1000 public housing units which cannot be done at original expectations.

2. Santa Ana, California

a. Storm drain construction.

b. Park development—own property, can't develop.

c. Sewer reconstruction—20-30 year-old sewers now failing.

d. Branch library.

3. Cleveland, Ohio

a. Bridge improvements.
b. Fire stations.

4. Worcester, Mass.

Cut backs in all departments.

5. Waterbury, Conn.

a. Roads.
b. Lighting.
c. Police cars.

6. San Diego, California

a. Park and recreation improvements.
b. Libraries.

7. Anaheim, Calif.

a. City Hall.
b. Park development.
c. Various public works projects.

8. Huntington Beach, Calif.

a. New fire station.
b. Park development expansion, including recreation facilities.

9. Phoenix, Arizona

a. Street and bridge projects deferred.
b. 74–75 capital improvements were 50% less than 73–74.

10. Anchorage, Alaska

a. Water utility.

11. East St. Louis, Illinois

a. Construction modifications of police building.
b. Street improvements.
c. Sewer work.

12. Ft. Worth, Texas

a. Building upgrading.
b. Delay in purchase of equipment, vehicles, heavy equipment.

13. Savannah, Ga.

a. Bond rates causing pavement programs to be postponed.

14. Huntsville, Alabama

a. Sidewalks.
b. Bicycle paths around schools.

15. South Bend, Indiana

a. Moritorium on installation of new street lights due to possible 26% rise in cost of electricity.
b. Street programs.
c. Police cars—6 months' delay.

16. New Haven, Connecticut

$8.1 million for public works.

17. Auburn, Maine

Road construction.

18. Burlington, Vermont

a. Roads.
b. Parks.

19. Manchester, N.H.

a. Branch library.
b. Sewage lines.

20. Danbury, Connecticut

a. Roads.
b. Drainage.
c. Plans delayed on expanding present facilities.

21. Portland, Maine

In all areas.

22. Providence, R.I.

Equipment.

23. Peoria, Illinois

a. Purchasing land.
b. Public works facility.

24. Minneapolis, Minn.

a. Parks.
b. Sewers.
c. Paving.

25. Jacksonville, Fla.

a. Water, sewage and solid waste treatment.
b. Parks.
c. Library.

26. DeKalb, Illinois

a. Addition of fire station.
b. Curtailment of street improvement projects.
c. Improvements to water system.

27. Inglewood, Calif.

a. Water.
b. Parks.
c. Jail improvements.
d. Street improvements.
e. Construction of day care center.
f. Housing and redevelopment is delayed or killed in private sector.

28. Pawtucket, R.I.

Schools.

29. Kalamazoo, Mich.

a. Street work cut out.
b. Remodeling of police department.

30. Portland, Oregon

a. Parks.

31. Wichita, Kansas

a. Major street projects.
b. Drainage-canal lining project.

32. Norman, Okla.

a. Streets.
b. Sewer and water drainage.
c. Sanitation.
d. Parks and recreation.
e. Sidewalks.
f. Traffic signals.

33. Buffalo, N.Y.

a. Street light standards.
b. Paving of streets.
c. Purchase trucks and heavy equipment.
d. Concrete products for buildings, sidewalks showing 20% increase in cost each year.

TITLE II PUBLIC SERVICE EMPLOYMENT SURVEY

During the past month, the cities have been criticized by Labor Department officials for failure to implement the public service jobs program funded under Title II of CETA. The National League of Cities has surveyed the cities and requested information on the following questions:

(1) According to the latest approved plan or modification, how many jobs are to be funded under Title II (FY 74 and 75) in your city?

(2) According to the latest approved plan or modification, how many Title II participants should be on board as of January 15, 1975 in your city?

(3) How many Title II participants in your city are actually on board as of January 15, 1975?

While some cities have had technical problems in implementing the program as rapidly as they might have wished, based on responses to date from over 100 cities, 90.7 percent of the funds are currently in use and providing jobs to the unemployed.

The following chart contains the city responses.

City	Number of jobs to be funded	Planned number of participants as of Jan. 15, 1975	Actual number of participants as of Jan. 15, 1975
Baltimore	159	149	149
Boston	[1]869	[1]900	400
Buffalo	470	308	290
Chicago	1,618	1,499	1,300
Cincinnati	571	292	343
Cleveland	412	412	396
Dallas	16	1	1
Denver	100	75	30
Detroit	2,278	1,500	970
Fort Worth	45	45	39
Honolulu	1,046	650	500
Houston	390	140	140
Indianapolis	330	125	25
Jacksonville	[1]173	150	151
Kansas City, Mo	103	0	0
Long Beach	283	170	100
Los Angeles	3,741	760	1,075
Louisville	121	68	60
Miami	200	200	200
Milwaukee	281	130	135
Nashville	34	0	1
New Orleans	950	750	700
Newark	183	183	172
Norfolk	272	272	120
Omaha	220	155	113
Philadelphia	1,547	1,500	1,414
Phoenix	166	160	157
Pittsburgh	412	205	247
Rochester	151	70	80
San Antonio	210	135	120
San Diego	845	549	507
San Francisco	1,600	700	800
San Jose	150	80	31
St. Louis	380	250	184
St. Paul	282	138	40
Seattle	610	171	150
Washington, D.C	843	561	901
Akron, Ohio	94	79	63
Albany, N.Y	57	57	57
Albuquerque, N. Mex	114	114	114
Anaheim, Calif	50	50	49
Baton Rouge, La	223	180	180
Bridgeport, Conn	324	290	290
Cambridge, Maine	170	160	170
Canton, Ohio	26	22	22
Columbia, S.C	23	13	13
Des Moines	34	34	32
Duluth	106	106	116
Elizabeth, N.J	79	55	55
Erie, Pa	8	8	8
Evansville, Ind	70	68	50
Flint, Mich	355	100	97
Fremont, Calif	73	40	40
Garden Grove, Calif	26	30	32
Gary, Ind	83	104	130
Hampton, Va	22	20	16
Huntsville, Ala	54	54	54

See footnote at end of table.

City	Number of jobs to be funded	Planned number of participants as of Jan. 15, 1975	Actual number of participants as of Jan. 15, 1975
Knoxville	22	15	15
Jackson, Miss	75	75	45
Jersey City, N.J	345	274	44
Kansas City, Kans	50	25	24
Lansing, Mich	178	108	70
Lexington, Ky	24	22	21
New Bedford, Maine	196	196	178
New Haven, Conn	77	77	159
Newport News, Va	64	52	52
Pasadena, Calif	22	26	24
Richmond, Va	122	105	74
Rockford, Ill	46	46	49
Salt Lake City, Utah	129	0	0
Santa Ana, Calif	115	97	91
Shreveport, La	95	95	114
South Bend, Ind	11	11	11
Spokane, Wash	87	39	31
Syracuse, N.Y	60	32	25
Tacoma, Wash	249	242	133
Torrance, Calif	20	18	18
Tucson, Ariz	15	15	15
Warren, Mich	69	69	65
Wichita, Kans	50	45	29
Winston-Salem, N.C	50	33	33
Worchester, Mass	80	80	80
Yonkers, N.Y	105	76	80
Youngstown, Ohio	53	53	14

[1] Pending approval of plan modification.

Responses from 108 cities have been received. These cities were allocated over $95.4 million of FY 74 Title II funds (26.1% of the $365 million total) and over $90.7 million of FY 75 Title II funds (26.7% of the $340 million total). According to the latest approved plans, these cities have funding to provide 28,300 jobs. Of this total, their plans call for 18,648 persons to be hired as of January 15, 1975. As of January 15, 1975 there were 16,911 persons actually on board—90.7% of the plan.

NATIONAL LEAGUE OF CITIES SUMMER YOUTH EMPLOYMENT SURVEY

City	1974 actual		1975		
	Funding[1]	Slots[2]	Number eligible	Effectively employ	Fuiding need[3]
Region I: Boston	$2,480,867	4,637	18,000	18,000	$10,188,000
Region II:					
Buffalo	1,275,620	2,384	40,000	10,000	5,660,000
Newark	3,442,799	6,435	25,900	11,000	6,226,000
New York	24,473,511	45,744	426,000	80,000	45,280,000
Rochester	637,558	1,191	6,000	2,000	1,132,000
Region III:					
Baltimore	4,183,526	7,819	17,600	12,000	6,792,000
Norfolk	1,535,979	2,870	11,680	3,500	1,981,000
Philadelphia	4,315,810	8,066	52,792	22,000	12,452,000
Pittsburgh	2,568,647	4,801	7,000	7,000	3,962,000
Washington, D.C	6,563,092	12,267	25,000	18,000	10,188,000
Region IV:					
Atlanta	1,489,979	2,785	10,000	5,388	3,049,608
Birmingham	1,123,440	2,099	7,700	2,774	1,570,084
Jacksonville	844,711	1,578	20,000	2,500	1,415,000
Louisville	1,210,223	2,262	15,000	4,000	2,264,000
Memphis	1,445,064	2,701	12,250	2,716	1,537,256
Miami	2,354,311	4,400	6,500	4,400	2,490,400
Nashville	738,378	1,380	4,000	2,500	1,415,000
Tampa	1,192,915	2,229	7,000	6,515	3,687,490
Region V:					
Chicago	19,209,563	35,905	85,000	50,000	28,300,000
Cincinnati	1,533,527	2,866	40,000	5,000	2,830,000
Cleveland	4,919,923	9,196	24,200	18,000	10,188,000
Columbus	899,175	1,680	2,500	2,500	1,415,000
Detroit	5,095,798	9,524	40,000	23,000	13,018,000
Indianapolis	1,056,816	1,975	12,000	4,500	2,547,000
Milwaukee	1,319,978	2,467	6,000	3,713	2,101,558
Minneapolis	1,104,440	2,064	6,000	3,500	1,981,000
St. Paul	431,679	806	3,200	3,200	1,811,200
Toledo	673,997	1,259	2,000	1,400	792,400
Region VI:					
Dallas	1,017,619	1,902	45,000	4,000	2,264,000
El Paso	546,547	1,021	6,000	4,672	2,644,352
Fort Worth	459,190	858	2,500	1,600	905,600
Houston	2,126,840	3,975	12,000	4,000	2,264,000
New Orleans	1,607,513	3,004	10,000	10,000	5,660,000
Oklahoma City	557,096	1,041	3,000	2,400	1,358,400
San Antonio	2,856,730	5,339	10,000	5,500	3,113,000
Tulsa	553,663	1,034	2,000	1,300	735,800
Region VII:					
Kansas City, Mo	1,835,348	3,430	13,000	5,000	2,830,000
Omaha	1,069,481	1,999	2,500	2,000	1,132,000
St. Louis	2,810,441	5,253	9,900	7,500	4,245,000
Region VIII: Denver	1,578,466	2,950	9,250	4,000	2,264,000
Region IX:					
Honolulu	966,788	1,807	3,000	2,500	1,415,000
Long Beach	764,769	1,429	7,500	2,500	1,415,000
Los Angeles	6,902,818	12,902	75,000	30,000	16,980,000
Oakland	1,705,211	3,187	10,000	5,850	3,311,100
Phoenix	2,146,338	4,011	60,000	9,000	5,094,000
San Diego	2,017,157	3,770	25,000	6,000	3,396,000
San Francisco	2,167,803	4,051	8,000	8,000	4,528,000
San Jose	1,178,891	2,203	4,000	3,535	2,000,810
Region X:					
Portland	1,024,404	1,914	5,000	5,000	2,830,000
Seattle	4,136,643	7,732	13,000	5,000	2,830,000

See footnote at end of table.

SAMPLING OF CITIES OTHER THAN 50 LARGEST

City	1974 actual Funding[1]	1974 actual Slots[2]	1975 Number eligible	1975 Effectively employ	1975 Funding need[3]
Region I:					
Bridgeport, Conn	1,074,314	2,008	4,500	3,000	1,698,000
Cambridge, Mass	616,566	1,152	1,200	1,000	566,000
Lowell, Mass	385,052	719	1,600	1,000	566,000
Worcester, Mass	348,291	651	1,700	1,200	679,200
Region II:					
Elizabeth, N.J	173,228	322	1,500	375	212,250
Albany, N.Y	401,086	749	5,000	5,000	2,630,000
Yonkers, N.Y	178,286	333	900	600	339,600
Carolina, Puerto Rico	498,180	931	6,000	4,000	2,264,000
San Juan, Puerto Rico	1,166,329	2,180	12,296	3,117	1,764,222
Region III:					
Erie, Pa	185,745	347	2,500	650	367,900
Hampton and Newport News, Va	557,863	1,042	2,000	1,300	735,800
Region IV:					
Huntsville, Ala	264,980	495	2,000	1,200	679,200
Montgomery, Ala	658,920	1,231	1,800	1,800	1,018,800
Savannah, Ga	297,401	555	2,500	1,050	594,300
Lexington, Ky	502,790	939	3,000	1,200	679,200
Jackson, Miss	551,117	1,030	3,000	1,200	679,200
Durham, N.C	449,046	839	1,800	839	474,874
Greensboro, N.C	297,574	556	1,500	1,000	566,000
Chattanooga, Tenn	548,910	1,026	2,175	1,975	1,117,850
Knoxville, Tenn	712,386	1,331	4,500	2,000	1,132,000
Region V:					
Peoria, Ill	260,742	487	2,000	650	367,900
Evansville, Ind	745,308	1,393	3,040	1,500	849,000
Fort Wayne, Ind	584,414	1,092	2,000	2,000	1,132,000
Gary, Ind	2,713,313	5,071	7,000	6,500	3,679,000
South Bend, Ind	522,918	977	2,000	1,101	623,166
Dearborn, Mich	36,540	68	120	120	67,920
Duluth, Minn	143,135	267	4,000	2,000	1,132,000
Akron, Ohio	772,002	1,442	2,300	1,800	1,018,800
Canton, Ohio	317,121	592	700	667	377,522
Youngstown, Ohio	1,048,872	1,960	10,000	6,000	3,396,000
Region VI:					
Little Rock, Ark	768,039	1,435	2,200	1,481	838,246
Shreveport, La	314,340	587	4,035	1,200	679,200
Albuquerque, N. Mex	475,776	889	10,500	2,500	1,415,000
Region VII:					
Cedar Rapids, Iowa	77,053	144	1,400	300	169,800
Des Moines, Iow	471,468	881	4,500	1,200	679,200
Kansas City, Kans	391,248	731	1,600	1,142	646,372
Wichita, Kans	525,768	982	2,000	1,300	735,400
Springfield, Mo	114,589	214	300	300	169,800
Region VIII: Salt Lake City, Utah	285,128	532	2,000	700	396,200
Region IX:					
Tucson, Ariz	814,416	1,522	4,500	3,000	1,698,000
Glendale, Calif	71,155	133	2,000	200	113,200
Region X:					
Spokane, Wash	318,724	595	3,404	600	339,600
Tacoma, Wash	641,021	1,198	2,500	2,000	1,132,000
50 largest total	138,151,082	258,202	1,268,972	458,463	259,490,058
Balance of cities	241,843,918	450,998	1,909,593	689,384	390,191,344
Total	380,000,000	709,200	3,178,565	1,147,847	649,681,402

[1] Department of Labor figures.
[2] Figures based on consortia (where applicable) dollar allocations averaging $535 per slot.
[3] Figures based on a cost of $566 per slot; 26 hours per week at $2.10 per hour for 9 weeks.

Chairman HUMPHREY. Mr. Scott, Mr. James M. Scott, is our next witness, supervisor of Fairfax County, Va. He is accompanied by Mr. Samuel Turner.

Mayor PANUZIO. I wonder whether I would be able to leave.

Chairman HUMPHREY. I know you are under pressure. Mr. Scott, I wonder, you are closer in Fairfax County, would you permit Congressman Rousselot to ask some questions?

Representative ROUSSELOT. A couple of things, quick ones, if you will. I was interested in your comments about revenue sharing, which is under consideration before Congress, because it does expire in a year and a half.

Are you suggesting that we pump more into it?

Mayor PANUZIO. We believe it should be increased along the guidelines that we recommended, gradual increase.

Representative ROUSSELOT. Even between now and then?

Mayor PANUZIO. We are talking about a separate lump sum of money in terms of the national needs that we have now. Revenue sharing, when we talk about it, as I say, in my old budget we have 3 percent, when we are talking about increases in the budget——

Representative ROUSSELOT. I think you said 3 percent.

Mayor PANUZIO. Three percent. We are talking about an increase in our own budget of 12, 13, 14 percent a year. You can see what kind of input that is right now. So we think it——

Representative ROUSSELOT. How do we answer the question that comes to us, maybe the facts are wrong? Maybe the National League of Cities has developed different statistics than we have, that the combined treasuries of all cities in the country presently—and I realize there are a lot of cities—but the combined group across the country have a surplus of roughly—when I say surplus it really is not a surplus—a cash reserve, I guess, of roughly $20 billion. When we started revenue sharing they had roughly $15 billion.

We are having a terrible time with deficit financing here. The President and Mr. Simon have told us if we do nothing our deficit will be $100 billion over the next 2 years, $100 billion.

How are we going to be adding onto a program that we already have, and we are just adding more deficit? You know what the competition in the marketplace for the money is when Treasury gets out there and starts carousing around for money.

Mayor PANUZIO. I do not know where the figures come in terms of a surplus. I know in terms of some of it was including some of the pension funds that some cities have and including that, the amount that really is available is very limited.

Representative ROUSSELOT. It should not be labeled surplus. In many cases it is reserves.

Mayor PANUZIO. As far as I am concerned that greatly throws it out of proportion.

We point out with regard to getting the money—I refer to the prepared statement. There is a bar graph that talks about it. I would also talk to you about the fact that we understand deficits. We live with them. As I said, we have to live with them every day.

Representative ROUSSELOT. You have bonding.

Mayor PANUZIO. We happen to believe there are some priorities and some ways of spending funding. Bringing the money directly back to the local communities in that way can enable us to use it far more efficiently and far more effectively than if we do it in any other category.

Representative ROUSSELOT. I do not disagree with your concept of bringing it to the communities. Some of us believe we should not take it from the community in the first place.

Mayor PANUZIO. I do not disagree with you.

Representative ROUSSELOT. That is another argument. The question I really have is how we add on the programs we now have. If we did nothing else we are talking about an add-on to our present deficit of $100 billion.

Mayor PANUZIO. I happen to believe if we are going to stimulate the economy at all—I do not profess to be a brilliant guy in economics—it is going to be done back home at the local level. We happen to believe by putting the money back that way, we can stimulate it enough so, hopefully, revenue will come in.

I would point out when the cuts are taking place it always seems to us the first place they look to are some of the grants and aids that go back to the local communities. That is not the place to look. Yesterday we were asked on the Hill—I am pleased that Joe Alioto commented on—about this whole question, "What programs would you do away with?"

Sure, we know there are some inefficient programs.

Representative ROUSSELOT. Would you cut foreign aid?

Mayor PANUZIO. Would I personally?

Representative ROUSSELOT. Yes.

Mayor PANUZIO. I think there are more problems here in our own backyard that we should take care of before we take care of foreign aid.

Representative ROUSSELOT. Thank you.

Chairman HUMPHREY. We welcome that testimony. We have made a good whack at it this year. More is coming, would you not say?

Representative ROUSSELOT. I hope.

Chairman HUMPHREY. I think your hopes would be realized. I want to thank you again. May I say that this committee will try to be very helpful to you on one segment particularly of your recommendation. I hope on all parts of it because we are going to share the thrust of your testimony. You proposed an intergovernmental board, the economic recovery board, that had the responsibility for monitoring fiscal and economic conditions throughout our system. We have an Urban Affairs Subcommittee headed by Congressman Moorhead, a subcommittee made up of several Members here and we also have staff that is assigned to this subcommittee. I just said here we will try to use our subcommittee as a monitoring mechanism to work closely with the National League of Cities, the National Association of Counties, and the National Council of Governors, and so forth, so we can have a good monitoring system as to what is happening at the budgetary and tax levels and the revenue levels of the State and local governmental organizations.

I think your point is so well made that, on the one hand, we are here talking about a tax cut, which I happen to support. We look like nice guys, but at home, where I left a few days ago, the mayor of Minneapolis, where we have the same problems you are talking about. The big headline was an increase in the property tax.

They are sitting there looking like they are the real dragons or the ogres and we are looking around here like we are going to hand back the folks a rebate. We are going to give them a little withholding tax, a reduction, all of which is very nice. It adds up to where you are taking with one hand and giving with the other, in a very real sense, however, losing some very valuable services that local government can provide that no one else can provide.

The question boils down as to whether or not the Federal Government is going to reach out and establish a whole new Federal network of agencies and instrumentalities to do some of the things that need to be done, or whether we are going to put some trust and faith in local government institutions to take care of it.

I know you will make some mistakes. You made some mistakes in revenue sharing. You have no monopoly on mistakes. You are in the hall of mistakes. We have made a lot of them. It is a human fallibility.

I for one came to the conclusion a long time ago of much of what we do with respect to Federal assistance and sometimes with Federal guidelines that they ought to be pretty flexible. We could leave much of this up to you if you had the resources. I thought I knew a little bit more about Minneapolis than any Senator or Congressman did when I was mayor of Minneapolis. Frankly, I think I know more about Minnesota than anybody in the bureaucracy of Washington, D.C. If you want to find out what is going on out there, come see me. I have to live on that. Most people do. All of our districts are different. Every community is different. Let me give you an example.

Just two communities in my State in the last month have lost 500 employees, two small towns. Two businesses have had to lay off that many. One community, it is the single largest employer in a small city, and is the single largest employer. They needed an SBA loan. It is a good business. It has been there for years. The people that run it are good but they are involved in housing. The housing industry has had a terrible blow, particularly out our way. In the winter there just is not any housing. We have lots of snow and cold winters. Besides that, we have the same problems of credit and interest rates. In fact, we have even worse because we have a usury law. Nobody is about to change it. We say you cannot borrow money and pay over 8 percent interest. Even when the Federal funds come in we cannot even use it because our people are not going to change that law. We think that is plenty for housing. We just feel that is a decent, reasonable rate.

I think it is too high. I do not think you ought to have it that high for housing. I do not think young couples can afford even 8 percent on housing.

Anyway, leave that as it may. Here is the SBA that is supposed to be doing something that a private bank is not supposed to be able to do. I do not blame a private bank that has a fiduciary responsibility; we cannot loan you money; the market does not look good for these months; we are sorry we cannot loan it.

The SBA, they came in and they are more a banker than the bank. They come in and say, "We have had that analyzed. The bankers do not think it is a good loan. We simply cannot do anything about it."

What happens? Instead of giving a loan of a modest amount to a fine enterprise that has a good record of years but is caught in a major housing depression—we have 40 percent unemployment of skilled workers and our housing workers out there in the trades—instead of giving them a loan, they put the people off and put them on unemployment compensation. These are all family, practically all family people in a fine community. The whole community is disrupted, the whole community, the whole county. Of course, they cannot understand down here in Washington a rural county. They cannot comprehend it, if you will pardon me.

Here we sit with the SBA acting like a blind, dumb, paralyzed ox in permitting a whole community to go down the drain and management to be dissolved and they are going to put him on government payrolls. Now they are going to have public service jobs for them—"Go around and pick this up"—and they are going to have welfare and food stamps and unemployment compensation when all they need to do is give this company a little credit. Unless the whole country is going down the drain I think like you, I think we are going to get out of this recession. I think with some sensible activities we will get this country back on the road again. We do not have a terminal illness, as I said the other evening. We have a temporary infection. We can get over this. But the Government acts like, "Well, we cannot trust you, no." You know, our SBA just turns them down. I hope the SBA gets this message loud and clear. I have written them two or three letters that have disrupted the mails. If you heard about fire in the mail, that is what it is all about. I am damn mad. I think it is stupid, asinine that we are like that.

So may I say if you have 500 people laid off at one of our big factories, and good Lord, I do not want that to happen, that is a story. If it is 200 people up in this town, 272, 321 over here, it gets kind of lost, it's 175 miles from Minneapolis. They do not get a big deal. Nobody ever heard of them in Washington except the Congressmen and Senators. Two Senators and a Congressman—we have been working to help them all the time.

Let me tell you something: I could get a loan for Afghanistan twice as fast as I can get a loan for my constituents. Do not think I am sizzling, sir. You have never seen a hot tomato in your life.

I just thought I would unload once again. I am going to do this every day until this message gets a loan.

Mayor PANUZIO. Mayors are used to that. People have to unload their feelings. I thank you very much for your time, and to my fellow colleagues for allowing me to go first.

Thank you.

Chairman HUMPHREY. Mr. Scott, go right ahead. You have heard my plea. I will listen to yours.

STATEMENT OF HON. JAMES M. SCOTT, MEMBER, BOARD OF SUPERVISORS, FAIRFAX COUNTY, VA.

Mr. SCOTT. Mr. Chairman, thank you very much for allowing us to speak today for the National Association of Counties and particularly, I am testifying not only as a spokesman for the counties but suburban counties throughout the United States and my own county of Fairfax, of which I am sure you are familiar.

Chairman HUMPHREY. I am, and we are very familiar with the National Association of Counties. I want to commend that organization for its splendid work in what it has been trying to do for counties and the work that it does for Congress.

Mr. SCOTT. Mr. Chairman, we also extend to you our appreciation for the work that you have done in helping to gain recognition for the work of counties and for your efforts in assisting us. We have no better friend on Capitol Hill than the chairman.

I would like to summarize briefly and submit my full prepared statement and the statement on behalf of the National Association of Counties for the record. Then I will describe in a little bit more detail the situation of a county which is populous and reasonably affluent just across the river.

If I may submit the statements.*

Chairman HUMPHREY. We will include both statements at the end of your oral remarks.

Mr. SCOTT. Inflation affects all levels of government, but its impact at the county and local level is particularly severe. Our revenue sources are limited and restricted, and in most cases are not keeping pace with inflation. County governments' expenditures almost doubled from 1967 to 1972 and costs during the past year have increased 10 percent or more. These increases coupled with our inability to generate greater revenues will leave counties no choice but to cut back our level of services or to increase property taxes.

Counties are responsible for providing most human services—health care, welfare, social services, and manpower programs—to all residents both inside and outside incorporated areas. From 1967 to 1972 county expenditures for health increased 150 percent; for welfare, 121 percent; and for police, 98 percent. County officials are particularly concerned about the impact of inflation on the needy, and they urge Congress and the administration not to cut back on programs designed to help them.

County governments are attempting to reduce wastes and costs at the local level. I might add my own county has been very much engaged in a productivity program we are very proud of. We would urge Congress to take a look at that program and consider its implementation at the Federal level.

Representative ROUSSELOT. Would the gentleman yield? The productivity program among government workers?

Mr. SCOTT. Yes, sir.

Representative ROUSSELOT. Is that included in your packet?

Mr. SCOTT. Actually, it is not, Congressman.

Representative ROUSSELOT. I thank the gentleman for yielding.

Mr. SCOTT. Thus, counties urge the Congress and administration to implement those programs which enable States and localities to take advantage of Federal funds without additional costly bureaucratic requirements and redtape. When specified amounts of money for an extended time period are authorized, States, counties, and cities can plan rationally for the use of funds without creating a local bureaucracy to handle redtape.

The National Association of Counties suggests four priority programs to help counties meet their local responsibilities for providing services as well as assisting in the national fight against recession and inflation.

First, one of the first priorities of the 94th Congress should be the extension of general revenue sharing legislation. General revenue sharing offers local governments the flexibility to direct resources into programs that best meet the needs of their people and permits long-range and efficient planning.

Second, public service employment is the best economic weapon we have to defeat the two-edge problem of rising unemployment and double-digit inflation. Every effort must be made to avoid increasing unemployment in order to curb inflation.

Third, our Nation needs a national health insurance program which will stem the rising cost of health care for all Americans. It is clear that our country is facing a crisis in health care and counties have a major stake in the delivery of health services. A national health insurance system must have controls to prevent new funding from merely adding to the factors influencing the upward spiral of health costs.

Fourth, Congress and the administration should again turn their attention to welfare reform. The welfare legislation enacted in 1972 reformed only one-third of the welfare system. While the supplemental security income—SSI—program covers more than 3.3 million people, there are nearly 11 million still under the widely disparate and inefficient AFDC program and almost a million receiving benefits under State and county general assistance programs. Public assistance is a national problem requiring a national solution. Only under a national program can the inequities of the current system be eliminated, efficiencies be realized, and an adequate level of subsistence be maintained for all.

Mr. Chairman, in order to supplement the National Association of Counties' statement, I should like to point out some of the problems of one particular large metropolitan urban county.

Fairfax County, as you probably know, is generally considered an affluent community. It is a mistake, however, to conclude that the bleak national economic outlook does not seriously affect suburban jurisdictions as well as rural areas and the central cities. It is a mistake to believe that these so-called affluent areas do not also contain large numbers of people of low and moderate income, many of them aging, many of them unemployed or underemployed, and many of them with neither automobiles nor access to adequate public transportation.

One of the effects of the present economy is that these jurisdictions, some of which are just beginning to face up to their responsibilities for social programs, are facing a fiscal crunch which can be alleviated only by reducing services or raising taxes. This is not a period in which local government should do either.

Although some local governments are authorized to impose piggyback income taxes, the primary source of revenue for most is the general property tax. Fairfax County, for example, obtains more than 60 percent of its general fund revenues from taxes on real and personal property. The largest single item of taxable personal property is automobiles. As the members of this committee well know, the real estate market—especially the construction of new houses—and the automobile market are among the most seriously depressed in today's economy.

Without reading in complete detail my prepared statement, I would like to mention some of the specific impacts for our county's current situation. I have in my prepared statement addressed several problem areas for county government: Employee compensation; the fact that our jurisdiction is heavily impacted with Federal installations and Federal wage and salary patterns are a driving force to increase the cost of local government; that Federal legislation mandates certain actions by local governments but no corresponding funding mechanism for meeting those mandated obligations.

Representative ROUSSELOT. You have no way to tax.

Mr. SCOTT. That is right.

Utility increases—the Virginia Electric rates increased since 1974 per kilowatt-hour without a fossil fuel adjustment to 1.7 cents per kilowatt-hour for the regular rate, plus nine-tenths of a cent for fossil fuel adjustment, for a total of 2.6 cents per kilowatt-hour.

A comparison of the impact of the above rate applied to 1974 budget dollars for electricity increased from $2.2 million in 1974 to $5.8 million in fiscal year 1975. If the rate continues, it will be $16 million in fiscal year 1976.

Petroleum costs—we have increases, 30.5 percent per county from fiscal year 1974, increases of 142.5 percent for heating fuel. The price of gasoline is 60 percent up since July 1973.

Operating expenses—the county has an agency monitoring price increases and found that the price of sewage treatment supplies alone has increased 101 percent since 1974. Paper products up 32 percent; food products, 50 percent; maintenance and construction supplies up to 54 percent; safety and equipment and firefighting supplies up 27 percent; mail, printing, and advertising, 35 percent; classroom and office supplies up 31 percent.

Economy measures simply cannot compensate for costs increasing at this rate.

Capital equipment—in 1974 the county spent $1.9 million for capital equipment. Increases in this area include automobiles up 28 percent; trucks up 26.5 percent; typewriters 38 percent: communication equipment, 26 percent. I have not even mentioned the increasing cost of capital construction.

To help deal with these costs Fairfax County, as well as NAC, strongly support and continue to support the reenactment of Federal revenue sharing, a significant source of funds for local governments.

Through fiscal year 1974, the county received a total of $12,507,059 in Federal revenue sharing funds including interest on investments. Fiscal year 1975 receipts are estimated at $5,683,238.

With present limitations on local resources, it would have been difficult or impossible for Fairfax County to have proceeded on many of the worthwhile projects initiated under the revenue sharing program without this Federal assistance. In addition to major public improvements and the decentralization of many essential county services, Fairfax County set aside $2 million in revenue sharing funds to purchase land and provide for the development of low- and moderate-income housing in the county. This is in addition to local funds provided for low-income housing rehabilitation, housing assistance and matching funds for other Federal and State housing programs.

If the same revenue sharing funded programs were to be provided with general local tax dollars collected from real property taxes, it is estimated that a tax increase of 19.82 cents on the tax dollar per $100 of assessed valuation would be required. Thus, Mr. Chairman, reenactment of the revenue sharing program is critical to Fairfax County and other local governments facing today's desperate economic problems.

In addition, Mr. Chairman, we call for the swift consideration of additional Federal financial assistance on an emergency basis. Such assistance would recognize the escalating operating costs of local government which will be unbearably burdensome if the President's petroleum import tax is not greatly changed.

This assistance might be offered either as distinct special emergency legislation or as a revenue-sharing escalator provision. Just as wages, energy and other operating costs are tied to national inflationary trends, so might the revenue-sharing program be adjusted to reflect the rising expenditures of local governments over which they have little or no control.

In conclusion, Mr. Chairman, all local governments in the United States face a bleak economic future. By their nature, local governments generally lack legal authority to improve or expand their revenue base. They have responsibilities which can be neither shifted nor ignored, and there are many areas of service in which they have little or no control over costs.

To insure their continued capability to meet their responsibilities, we ask five things:

First, and most important of all, we ask that the Congress, working with the executive branch, adopt effective means to halt inflation and turn the economy away from the gloomy prospect of depression which overshadows the entire Nation.

Second, we call for a continuation of the federal revenue sharing program, which gives responsible local governments significant discretionary funds for local purposes, and which can, at least in part, bridge the gap between local revenue and local needs.

Third, we ask for emergency assistance, preferably in the form of a revenue sharing escalation provision, which helps localities meet unusual costs which are caused by national policies, trends, and programs.

Fourth, we would join with the National League of Cities, National Association of Counties, and other local government spokesmen in support of versatile manpower programs.

And finally, we ask you to help local governments find their way out of the trap of regressive taxation created by their predominant dependence on property tax revenues. In this connection, I would urge this committee and the Congress as a whole to give serious consideration to a federally assisted "circuit-breaker" program which would relieve low- and moderate-income persons—particularly the aged—from the heavy burden of property taxation without depriving local governments of the revenue to continue providing desperately needed services.

At this time, when we have had a great deal of discussion about tax reduction, we are asking for that final measure, Mr. Chairman, because we believe this is the time to make the property tax a much more equitable tax.

Chairman HUMPHREY. Have you spelled out your suggestion of what you call a federally assisted "circuit-breaker"?

Mr. SCOTT. We do not have it in the statement.

Chairman HUMPHREY. Congressman Rousselot.

Representative ROUSSELOT. Thank you, Mr. Chairman. I was interested, Mr. Scott, in your comments at the end of your statement about moving away or finding a way of moving away from the heavy burden of property taxation by a more equitable distribution of property tax.

Do you want the Federal Government involved in telling you how to make that more equitable?

Mr. SCOTT. Mr. Congressman, we are aware of several measures that have been introduced in the past to help break the circuit of property tax, the burdensome property tax, and one such measure that has been introduced would combine the Federal program with the State programs—when there are State programs—for example, if a family pays more than a certain percentage of its income for property taxes, it would be able to get a rebate, from the State which has an income tax, as in our situation, or from the Federal Government.

Representative ROUSSELOT. That describes more fully what the Senator was inquiring about, the circuit-breaking concept is that the Federal Government would provide on the Federal tax forms some kind of relief, 3 or 4 percent of their personal income going to property tax.

Mr. SCOTT. Right.

Representative ROUSSELOT. That, in effect, would be a Federal tax reduction by that method.

Mr. SCOTT. Right.

Representative ROUSSELOT. I would be very interested to see that.

Chairman HUMPHREY. We would be interested in having that spelled out for us. Needless to say, the property tax is one of the tough ones.

Mr. SCOTT. Yes, sir.

Representative ROUSSELOT. Has that been endorsed by the entire county organization, the National Association of Counties or those——

Mr. SCOTT. That was coming from our county specifically.

Representative ROUSSELOT. Have you had it submitted to the National Association of Counties? Are you planning to submit it to them?

Mr. SCOTT. We have discussed this. The National Association of Counties has adopted a platform that calls for the reform of the property tax. I do not believe NAC has a specific plank endorsing the circuit-breaker idea at this point. I think their general thrust is toward reform of the property tax.

Representative ROUSSELOT. The State and Federal Governments would share the tax reductions.

Mr. SCOTT. Right.

Representative ROUSSELOT. Thank you.

Chairman HUMPHREY. Thank you very much. We will include the entire text of your testimony in the record.

[The prepared statement of Mr. Scott and the statement of the National Association of Counties follow:]

PREPARED STATEMENT OF HON. JAMES M. SCOTT

Mr. Chairman, I am James Scott, Supervisor of the Providence District of Fairfax County, Virginia. I am testifying today not only as a representative of that county, but as a spokesman for suburban governments—and especially urban counties—throughout the United States.

These governments provide a full range of services to their constituents. They are labor-intensive enterprises, and therefore are greatly impacted by rising salary costs. Many have contracts with public employee unions which specify cost of living formulas. All have a moral obligation to pay decent wages and to maintain some parity with private employment and with the rising cost of living, whether their employees are organized or not.

Most operate school systems, school buses, police and fire departments, and other agencies which use large quantities of petroleum products for heating and transportation. All, unfortunately, use large amounts of paper, another commodity subject to drastically increased costs. All have limited revenue resources which, in virtually every jurisdiction, are either actually contracting or expanding at a rate lower than the rate at which necessary expenditures have increased.

Many, like Fairfax County, are generally considered affluent communities. It is a mistake, however, to conclude that the bleak national economic outlook does not seriously affect suburban jurisdictions, as well as rural areas and the central cities. It is a mistake also to believe that these so-called affluent areas do not also contain large numbers of people of low and moderate income, many of them aging, many of them unemployed or underemployed, and many of them with neither automobiles nor access to adequate public transportation.

One of the effects of the present economy is that these jurisdictions, some of which are just beginning to face up to their responsibilities for social programs, are facing a fiscal crunch which can be alleviated only by reducing services or raising taxes. This is not a period in which local government should do either.

Although some local governments are authorized to impose "piggy back" income taxes, the primary source of revenue for most is the general property tax. Fairfax County, for example, obtains more than 60% of its general fund revenues from taxes on real and personal property. The largest single item of taxable personal property is automobiles. As the members of this Committee well know, the real estate market—especially the construction of new houses—and the automobile market are among the most seriously depressed in today's economy.

Because property taxes generally are assessed at the beginning of the year, assessible values for this year reflect the business conditions of the year just ended. And because the actual taxes are collected later in the year, the effect of an economic downturn on local government revenues may lag behind economic conditions by as much as two years. This, Mr. Chairman, means that local governments now are feeling revenue effects of economic conditions in 1973, and that the effects of the much more serious conditions of 1974 have yet to be felt. At the same time, however, we are feeling the painful effects of 1975's inflated prices in everything we buy.

THE IMPACT OF INFLATION

In July 1973, Fairfax County instituted a price increase monitoring program in an attempt to track rapidly rising costs in all areas affecting the County. Data from this effort illustrate the wide-ranging effect of the inflationary spiral on services provided by the County. I will address these under five headings: employee compensation, electric utilities, petroleum products, general operating expenses, and capital equipment.

Employee compensation

Inflation has hit hardest in the area of employee compensation since personnel costs constitute approximately 80% of the total General County and School operating budgets. In FY 1975 County employees other than teachers received a cost of living increase totalling $13.1 million. In FY 1976 County teachers are scheduled to receive an 11.1% cost of living increase plus a .9% increase in fringe benefits under the terms of the current teaching contract which will cost $14.328 million. This is tied to the Consumer Price Index from August 1973 to August 1974.

If all cost of living increases were tied to increases in the CPI, the cost in FY 1976 based on the CPI for calendar year 1974 (about 15%), would be $31,660,000. The FY 1976 cost of living increase for County school teachers ($14.328 million) is greater than the total cost of living increase for all County employees approved in FY 1975 and double the amount approved in FY 1974. It should be pointed that the dollar amounts shown for cost of living for FY 1976 do not include cost of living for other County employees since contracts are currently being negotiated.

This, Mr. Chairman, is for a jurisdiction with population slightly more than one-half million and a General Fund budget of $220.1 million for FY 1975.

In the Washington Metropolitan Area and other areas heavily impacted with Federal installations, the Federal Government has caused an important part of the wage pressure faced by local governments through a 42% increase in federal salaries since July 1969. Local governments cannot keep pace with federal wages or the inflationary spiral without drastically raising taxes or cutting services. Still another federal wage pressure has been created by the Fair Labor Standards Act as amended to apply to local governments. Through required payment of time-and-a-half for overtime, including coverage for fire and police services, the federal government has contributed dramatically to increased costs of local government services. While this issue remains under court review, the experience with the Fair Labor Standards Act, as applied to local governments, suggests a lact of appreciation on the part of the federal government of the impact of their policies on local budgets and local taxpayers.

Electric utility increases

Virginia Electric and Power Company rates for Fairfax County increased since FY 1974 from one cent per kilowatt hour without a fossil fuel adjustment to 1.7¢ per kwh for the regular rate, plus nine-tenths of a cent for the fossil fuel adjustment, for a total of 2.6¢ per kwh. This is an increase of 160%. Just this month, the fossil fuel adjustment charge increased 15% over the amount charged in December 1974. If the rate continues to increase at this level for the remainder of 1975, we can expect a basic charge of almost 2¢ per kwh plus a fossil fuel charge of more than 5¢, for a total of about 7.2¢ per kwh, up another 177% in 12 months.

A comparison of the impact of the above rate applied to the base 1974 budget dollars for electricity indicates a cost which increased from $2.2 million in FY 1974 to $5.8 million in FY 1975 and almost $16 million in FY 1976.

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Petroleum costs

Increases in petroleum product costs since the beginning of FY 1974 have ranged from 30.5% for greases to 142.5% for #5 heating fuel. The price of gasoline has increased 59.1% since July 1973. It is currently estimated that the County will consume 3,676,764 gallons of gasoline in FY 1975 at a cost of $994,564 based on the current price. As for heating fuels, our costs at the midpoint of this fiscal year already exceed the total for last year by 14% with six months to go.

We have been speaking of the County government's fuel costs, but I would add parenthetically that in suburbs with less than adequate public transportation—which is to say most of them—the impact of gasoline prices on working people who must commute by automobile is truly staggering.

Operating expenses

Operating expenses have escalated $1.7 million over the FY 1974 actual expenses for the same level of services for items such as office supplies, cleaning supplies, sewage treatment supplies, wearing apparel, auto operating supplies, and food service costs. The County's agency monitoring price increases has found that the cost of sewage treatment supplies alone has increased 101% since FY 1974, while paper products are up an average of 32%; food products up 50%; maintenance and construction supplies up 54%; safety equipment and fire fighting supplies up 27%; mail, printing and advertising up 35%; and classroom and office supplies up 31% over the same period. Economy measures simply cannot compensate for costs increasing at this rate.

Capital equipment

In FY 1974 Fairfax County spent approximately $1.9 million for capital equipment. Increases in this area include automobiles up 28%; trucks up 26.5%; furniture up 17%; athletic equipment up 19%; sewing machines up 43.8%; typewriters up 38%; and communications equipment up 26%. And I have not even mentioned the increasing cost of capital construction.

Federal revenue sharing

Fairfax County strongly supports the reenactment of federal revenue sharing, a significant source of funds for local governments. Through FY 1974, the County received a total of $12,507,059 in federal revenue sharing funds including interest on investments. FY 1975 receipts are estimated at $5,683,238.

With present limitations on local resources, it would have been difficult or impossible for Fairfax County to have proceeded on many of the worthwhile projects initiated under the revenue sharing program without this federal assistance. In addition to major public improvements and the decentralization of many essential county services, Fairfax County set aside $2 million in revenue sharing funds to purchase land and provide for the development of low and moderate income housing in the County. This is in addition to local funds provided for low income housing rehabilitation, housing assistance and matching funds for other federal and state housing programs.

If the same revenue sharing funded programs were to be provided with general local tax dollars collected from real property taxes, it is estimated that a tax increase of 19.82 cents on the tax dollar per $100 of assessed valuation would be required. Thus, Mr. Chairman, reenactment of the revenue sharing program is critical to Fairfax County and other local governments facing today's desperate economic problems.

In addition, Mr. Chairman, we call for the swift consideration of additional Federal financial assistance on an emergency basis. Such assistance would recognize the escalating operating costs of local government which will be unbearably burdensome if the President's petroleum import tax is not greatly changed.

This assistance might be offered either as distinct special emergency legislation or as a revenue-sharing escalator provision. Just as wages, energy and other operating costs are tied to national inflationary trends, so might the revenue-sharing program be adjusted to reflect the rising expenditures of local governments over which they have little or no control.

CONCLUSION

Mr. Chairman, all local governments in the United States face a bleak economic future. By their nature, local governments generally lack legal authority to improve or expand their revenue base. They have responsibilities which can be neither shifted nor ignored, and there are many areas of service in which they have little or no control over costs.

To ensure their continued capability to meet their responsibilities, we ask five things:

First, and most important of all, we ask that the Congress, working with the Executive Branch, adopt effective means to halt inflation and turn the economy away from the gloomy prospect of depression which overshadows the entire nation.

Second, we call for a continuation of the Federal Revenue Sharing Program, which gives responsible local governments significant discretionary funds for local purposes, and which can, at least in part, bridge the gap between local revenue and local needs.

Third, we ask for emergency assistance, preferably in the form of a Revenue Sharing Escalation Provision, which helps localities meet unusual costs which are caused by national policies, trends and programs.

Fourth, we would join with the National League of Cities, National Association of Counties, and other local government spokesmen in support of versatile manpower programs.

And *finally*, we ask you to help local governments find their way out of the trap of regressive taxation created by their predominant dependence on property tax revenues. In this connection, I would urge this Committee and the Congress as a whole to give serious consideration to a Federally-assisted "circuit-breaker" program which would relieve low and moderate income persons—particularly the aged—from the heavy burden of property taxation without depriving local governments of the revenue to continue providing desperately needed services.

COMPARISON: COUNTY COST-OF-LIVING INCREASES WITH CHANGES IN THE WASHINGTON SMSA CONSUMER PRICE INDEX AND WITH INCREASES GRANTED FEDERAL EMPLOYEES

County civil service increases	Consumer price index, Washington SMSA—percent change preceding 12 month period	Federal Government increases
July 1969, 6.0 percent	August 1968, 5.0 percent; August 1969, 6.2 percent.	July 1969, 9.1 percent; December 1969, 6.0 percent.
July 1970, 6.0 percent	August 1970, 5.3 percent	January 1971, 6.0 percent.
July 1971, 5.4 percent	August 1971, 4.4 percent	January 1972, 5.5 percent.
July 1972, 4.4 percent	August 1972, 3.4 percent	October 1972, 5.1 percent.
July 1973, 5.48 percent	August 1973, 6.8 percent	October 1973, 4.8 percent.
July 1974, 9.25 percent	August 1974, 12.1 percent	October 1974, 5.5 percent.
July 1975,—		
Total, 36.53 percent	Total, 43.20 percent	Total, 42.00 percent.

ATTACHMENT I

Items monitored through the price impact study, July 1973 to December 1974

1. Food products and food service supplies—Up an average of 50 percent:

	Percent
General	+7.0
Milk	+28.2
Cheese	+8.6
Foodstuffs	+37.5
Donuts	+31.0
Bakery goods	+61.5
Meat products	+9.3
Dinnerware	+30.0
Sugar	+300.0
Ice cream	+21.7
Cola	+20.5

	Percent
2. Petroleum products—Up an average of 81 percent:	
Gasoline	+59.1
Diesel	+79.7
No. 2 heating fuel	+76.9
No. 4 heating fuel	+118.8
No. 5 heating fuel	+142.5
Motor oil	+61.7
Greases	+30.5
3. Paper products—Up an average of 32 percent:	
General products	+55.0
Mimeograph	+23.0
Bond	+75.0
Toilet tissue	+24.0
Copy	+55.0
Envelopes	+43.0
Electrostatic	+5.0
Clinical	+34.0
Drawing	+10.0
Xerox	+47.5
IBM column cards	+12.0
Disposable sheets/pillow cases	+21.0
Color stock	+41.0
Shipping container paper	+26.0
Printed forms	+20.0
Paper towels	+20.0
4. Automotive products and heavy equipment—Up an average of 20 percent:	
Automobiles	+28.0
Trucks	+26.5
Automotive parts	+45.0
Heavy equipment	+18.0
Labor rates—Heavy equipment	+13.8
Automotive glass	+12.0
Automotive test equipment	+15.0
Retread tires	+12.0
Batteries	+10.0
5. Maintenance and construction—up an average of 54 percent:	
Rubber cement	+103.0
Wooden tool handles	+15.0
Lawn seed	+72.9
Locks	+10.0
Brooms	+29.0
Ceramic tile	+1.5
Lumber	+22.5
Sand	+16.0
Concrete test cylinders	+35.0
Quarry products	+9.0
Fertilizer	+472.6
Industrial hosing	+12.0
Asphalt	+17.0
Paint	+80.0
Lawn mowers	+15.1
Cold rolled steel	+16.0
Steel—General	+100.0
Construction equipment—General	+8.0
Construction supplies—General	+10.0
Janitorial supplies	+30.5
Cleaning cloth	+80.0
Cheese cloth	+80.0
Detergents	+17.0
Polish	+45.0
6. Furniture—Up an average of 17 percent:	
General	+37.0
Steel case	+16.0
Wood	+6.0
Metal	+10.0

	Percent
7. Electrical and plumbing supplies—Up an average of 20 percent:	
Plumbing—General	+13. 0
Drain cleaning equipment	+7. 5
Water closets	+6. 5
Hammond valves	+10. 0
Pipe hangers	+20. 0
Pipe tools	+15. 5
Electrical supplies	+69. 3
8. Chemicals—Up an average of 101 percent:	
General	+70. 0
Silver acetate	+285. 0
Silver nitrate	+160. 0
Acetone	+92. 0
Coboltous chloride	+43. 0
Lime	+60. 6
Chlorine	+60. 0
Raw materials—Cleaning	+34. 0
9. Athletic and recreation equipment—Up an average of 19 percent:	
General	+15. 0
Physical education equipment—Rubber	+21. 0
Tennis balls	+20. 0
10. Safety equipment and fire fighting supplies—Up an average of 27 percent:	
Fire hose	+18. 0
Brass couplings	+44. 0
Firefighting supplies	+36. 0
Fire apparatus supplies	+22. 0
Firearms protective clothing	+41. 7
Asbestos fire blankets	+22. 0
Safety equipment	+20. 0
Safety shoes	+9. 3
11. Mail/printing/advertising—Up an average of 35 percent:	
Postal rate	+23. 1
Newspaper advertising	+36. 0
Printing labor	+20. 0
Printing—Directory	+60. 0
Printing—General	+25. 0
Offset plates (metal)	+30. 0
Printing ink	+60. 0
Flat litho printing	+25. 0
12. Textiles—Up an average of 27 percent:	
Cloth products	+32. 7
Leather goods	+20. 0
Uniforms	+48. 0
Work clothes	+6. 0
13. Classroom and office supplies—Up an average of 31 percent:	
Textbooks	+5. 0
Plastic binders	+25. 0
Educational supplies—General	+30. 0
Pianos	+9. 6
Musical instruments	+21. 0
Art equipment	+56. 0
Kindergarten equipment	+30. 0
Sewing machines	+43. 8
Dictionaries	+22. 0
Carbon sets	+38. 0
Plastic products	+12. 3
Typewriters	+38. 0
Office supplies—General	+52. 6
Cotton twine	+3. 0
Office equipment—General	+10. 0
Ink and chemicals	+40. 0
Metal products	+40. 0
Duplicating fluid	+68. 0

	Percent
14. Communications and electronics—Up an average of 26 percent:	
General communications equipment	+5.0
Communications antennas	+27.0
Pike poles	+55.0
Communications workers wage increase	+33.0
Electronics supplies and equipment	+12.0
15. Miscellaneous supplies—Up an average of 24 percent:	
Wood pallets	+2.5
Rubber bands	+28.0
Industrial commodities	+30.4
Intravenous solutions	+7.5
Aluminum ingots	+64.0
Interstate freight bills	+2.0
Oxygen supplies—Medical	+40.0
Photography printing film	+20.0
Audiovisual equipment—Lighting	+65.0
Machinery and power tools	+48.3
Keypunching services	+2.0
Computer maintenance	+5.0
Engineering and drafting supplies	+15.0
Ambulance supplies—First aid	+22.5
Typewriter repair parts	+15.0
Vacuum cleaners	+10.0

Attachment II

PRICE INCREASES

Item	Price A/O, fiscal year 1974[1]	Price A/O, fiscal year 1975[2]	Price change	Percentage change
Paper/printing:				
Bond, 8½ x 11", Xerox use (per 1,000)	$1.60	$2.75	$1.15	71.9
Envelope, No. 10 (per 1,000)	7.57	10.00	2.43	32.1
Black printing ink (per pad)	2.60	[3]3.90	1.30	50.0
Metal printing plates, 10 x15" (per plate)	.84	1.05	.21	25.0
Petroleum products:				
Gasoline (per gallon)	.1700	.2705	.1005	59.1
Diesel (per gallon)	.1745	.3135	.1390	79.7
No. 2 heating (per gallon)	.1730	.3060	.1330	76.9
No. 4 heating (per gallon)	.1588	.3474	.1886	118.8
No. 5 heating (per gallon)	.1331	.3228	.1897	142.5
Motor Oils (16 products)	11.6200	18.7900	7.1700	61.7
Greases (7 products)	7.5950	9.9100	2.3150	30.5
Firemen's protective clothing:				
Coats	65.11	77.82	12.71	19.5
Pants	19.26	28.68	9.42	48.9
Boots	18.90	27.41	8.51	45.0
Uniforms, police:				
Blouses	67.95	76.50	8.55	12.6
Trousers	26.95	29.75	2.80	10.4
Shirts	11.50	11.75	.25	2.2
Reefers	76.75	89.75	13.00	16.9
Uniforms, fire:				
Blouses	67.75	73.75	6.00	8.9
Trousers	27.95	29.95	2.00	7.2
Shirts	6.95	7.15	.20	2.9
Jackets	63.75	68.75	5.00	7.8
Safety shoes:				
Style No 1536	15.95	18.45	2.50	15.7
Style No. 1677	13.75	15.75	2.00	14.5
Lumber:				
4 x 8 x ¾" (per square foot)	.274	.324	.050	18.2
4 x 8 x ½" (per square foot)	.212	.250	.038	17.9
4 x 8 x ¼" (per square foot)	.132	.171	.039	29.5
Office supplies:				
Paper clips (per box)	.05	.18	.13	260.0
File folders (per box)	2.06	3.25	1.19	57.8
Binders, 2" capacity	1.10	1.61	.51	46.4
Carbon paper, legal (per box)	2.63	4.82	2.19	83.3
Vehicles:				
Subcompacts	2,800	3,200	400	14.3
Dump trucks	7,500	10,000	2,500	33.3
Food:				
Milk, whole, 8 oz	[4].0705	[5].0775	.007	9.9
Beef patties, frozen, IMPS No. 137 (per pound)	[6].8500	.6200	(.23)	(27.1)

See footnotes at end of table.

ATTACHMENT II—Continued

Item	Price A/O, fiscal year 1974	Price A/O, fiscal year 1975[2]	Price change	Percentage change
Furniture:				
Desk, executive	146.08	167.37	21.29	14.6
Chair, executive	80.38	96.75	16.37	20.4
Paint:				
Latex, flat (per 5-gallon)	13.40	15.90	2.50	18.7
Latex, semigloss (per 2-gallon)	5.44	8.30	2.86	52.6
Chemicals:				
Lime hydrated:				
50 lb bags (per ton)	31.50	62.80	31.30	99.4
Bulk (per ton)	24.65	46.44	21.79	88.4
Chlorine:				
1 ton cylinders (per cylinder)	84.90	266.60	181.70	214.0
150 lb cylinders (per cylinder)	11.96	32.89	20.93	175.0

[1] All prices A/O July 1973 unless so noted.
[2] All prices A/O January 1975 unless so noted.
[3] October 1974.
[4] September 1973.
[5] November 1974.
[6] December 1973.

STATEMENT ON BEHALF OF THE NATIONAL ASSOCIATION OF COUNTIES, PRESENTED BY HON. JAMES M. SCOTT, SUPERVISOR, FAIRFAX COUNTY, VA., AND HON. SAMUEL A. TURNER, COMMISSIONER, WAYNE COUNTY, MICH.

SUMMARY OF STATEMENT

Inflation affects all levels of government but its impact at the county and local level is particularly severe. Our revenue sources are limited and restricted, and in most cases are not keeping pace with inflation. County government's expenditures almost doubled from 1967 to 1972 and costs during the past year have increased 10 per cent or more. These increases coupled with our inability to generate greater revenues will leave counties no choice but to cut back our level of services.

Counties are responsible for providing most human services—health care, welfare, social services and manpower programs—to all residents both inside and outside incorporated areas. From 1967 to 1972 county expenditures for health increased 150 per cent, for welfare, 121 per cent and for police, 98 per cent. County officials are particularly concerned about the impact of inflation on the needy, and they urge Congress and the Administration not to cut back on programs designed to help them.

County governments are attempting to reduce wastes and costs at the local level. Thus counties urge the Congress and administrators to implement those programs which enable state and localities to take advantage of federal funds without additional costly bureaucratic requirements and red tape. When specified amounts of money for an extended time period are authorized, states, counties and cities can plan rationally for the use of funds without creating a local bureaucracy to handle red tape.

The National Association of Counties suggests four priority programs to help counties meet their local responsibilities for providing services as well as assisting in the national fight against recession and inflation:

(1) One of the first priorities of the 94th Congress should be the extension of *general revenue sharing* legislation. General revenue sharing offers local governments the flexibility to direct resources into programs that best meet the needs of their people and permits long range and efficient planning.

(2) *Public service employment* is the best economic weapon we have to defeat the two-edge problem of rising unemployment and "double digit" inflation. Every effort must be made to avoid increasing unemployment in order to curb inflation.

(3) Our nation needs a *national health insurance* program which will stem the rising cost of health care for all Americans. It is clear that our country is facing a crisis in health care and counties have a major stake in the delivery of health services. A national health insurance system must have controls to prevent new funding from merely adding to the factors influencing the upward spiral of health costs.

(4) Congress and the Administration should again turn their attention to *welfare reform*. The welfare legislation enacted in 1972 reformed only one third of the welfare system. While the Supplementary Security Income program, covers more than 3.3 million people, there are nearly 11 million still under the widely disparate and inefficient AFDC program and almost a million receiving benefits under state and county general assistance programs. Public assistance is a national problem requiring a national solution. Only under a national program can the inequities of the current system be eliminated, efficiencies be realized, and an adequate level of subsistence be maintained for all.

STATEMENT

Inflation affects all levels of government, but its impact at the county and local level is particularly severe. The county welfare dollar buys fewer services; the road dollar provides less construction and lower maintenance; and capital projects—such as juvenile homes, health clinics, alcohol and drug treatment centers—must be deferred. County governments' revenue sources are limited, and in most cases are not keeping pace with inflation.

County governments are moving to assure that the management of their services and finances are designed along anti-inflationary lines. Counties are searching out every practice, every service, every expenditure that could possibly feed the fire of inflation. Anti-inflation measures used by counties include the reduction of costs by refining programs, modernizing and streamlining our governments, and reexamining and consolidating duplicative county and city services. We believe that administrative savings can be made by all levels of government including the Federal Government.

County officials are acutely aware of human needs and the levels of basic local government services needed to provide for them. It is estimated that 93 percent of the United States population lives in counties. Elected county officials representing these 188 million people are held responsible for the health and welfare of citizens in urban areas as well as rural areas. Counties provide a wide range of services from airports and solid waste management to hospitals and jails.

Counties provide human services—health care, welfare, social services, manpower training—to all residents both inside and outside of incorporated areas. In many states, county governments spend more in central cities for human services than cities themselves spend.

The phenomenal growth of county government during the last decade is a reflection of the need for financing services on an areawide tax base and the granting of additional local authority to encourage areawide services. From 1967 to 1972, county expenditures almost doubled. During the same period, county health expenditures increased 150 percent, public welfare and social services costs increased 121 percent and police protection increased 98 percent. Counties increasingly are assuming responsibility for services previously provided by municipalities resulting not only in a more even spreading of the tax burden but also improved efficiency and lower costs.

Although county governments' responsibilities are growing, they are nonetheless limited in their tax resources. The property tax still accounts for 40 percent of local revenues. Even in fast growing suburban counties with frequent reassessments, the property tax lags behind recent inflationary increases. We do not have the benefit of a highly elastic tax source such as the federal graduated income tax.

It also should be noted that many counties and municipalities have state legal limitations on their property tax levies and sales tax rates. In the name of property tax reform there is an increasing tendency for states to impose new limitations. There are state restrictions on counties which prohibit deficit financing, forbid the use of more progressive sources of revenues, limit bonded indebtness ceilings and interest rate ceilings on local bonds.

It is obvious why states, counties and municipalities must increasingly rely on federal assistance. In fiscal year 1975, it is estimated that state and local expenditures will reach approximately $238 billion of which $51 billion or 23 percent will come from federal contributions. While there has been an increase in the dollar amount of federal assistance, it has decreased as a percentage of local budgets during the last several years. This is despite large new programs such as general revenue sharing.

Many skeptics continue to believe that state and local governments maintain large surpluses in their total account. But these "surpluses" include retirement funds not available for operating expenditures. Subtracting retirement funds from total accounts, the combined state and local government accounts did maintain a slight surplus in 1972 and the first half of 1973 but, the surplus has now become a deficit, one which is growing.

The federal government has amplified the fiscal problems of all levels of government by reducing the real constant dollar value of grants-in-aid. The large increases in the early '70s dwindled to only two per cent increase from 1972 to 1973, and actually declined 2.4 per cent from the beginning of 1973 to the beginning of 1974. These grants-in-aid reductions hit at a most inappropriate time, as other county revenues decreased too.

Over the last year, the costs of maintaining county services at current levels have jumped 10 percent or higher. These increases, coupled with the inability to generate greater revenues will leave counties no choice but to cut back our levels of service. This funding problem also will dampen the enthusiasm for consolidating county and city services and restructuring and streamlining programs.

The example of Los Angeles County, California's 1974–75 budget offers a specific example of the effect of rising costs on county governments. To meet inflationary increases the county's property tax rate was increased 12 percent from $3.87 to $4.35 per $100 of assessed valuation. Adding other increases required by cities, schools and special districts the total property tax rate rose to over $14 per $100 of assessed value. This means the property tax rate is close to 4 percent of the true market value of property within the county. This is approaching the five percent level which many economists say becomes the point of diminishing returns from this tax source. Just to compensate for increased energy costs the county budget was increased by $12 million in 1974–75.

A look at some of the spiraling costs in the areas of highway construction and materials, water pollution construction and materials, health services and medicaid can perhaps better tell the story of how inflation is affecting the budgets of counties.

Counties have been struggling to maintain and upgrade their roads while construction costs have increased 82.6 percent in the last seven years. More recent figures show an 8.2 percent increase during the last quarter of 1973, and 11.7 percent beyond that for the first quarter of 1974. Bituminous concrete which is used on 93 percent of highways in the United States increased 22.6 percent during the last year.

Counties are required to perform a number of pollution abatement activities in the areas of air, water and solid waste. In the area of water pollution, much of our activity entails construction of wastewater treatment plants. Due to federal impoundments of funds and complicated federal requirements, construction has been delayed. In the two years since the Water Pollution Control Act of 1972 was passed, cost escalation for waste treatment plant construction has been of a frightening nature. Over the last year, prices for materials alone have increased by at least 18½ percent. Of this, labor costs only accounted for 6½ percent.

With construction and material costs rising at such alarming rates, county governments cannot afford to consider deferring capital expenditure projects. Deferral of these projects is not feasible for counties which finance them through a bond issue which is always for a fixed amount. Deferring construction forces counties to refinance the project which in itself is a costly administrative process. San Diego County, California delayed construction of its solid waste resource recycling plant for 12 months and found its cost jumped from $4.5 million to $9 million.

Deferring capital projects not only increases the costs of construction, but also aggravates unemployment in many areas. This brings us to the other major problem with which counties must battle—recession. Unemployment reports are growing daily.

Across the nation, massive unemployment has persisted in counties in recent years. San Diego County, California saw its September, 1973 unemployment rate of 7.6 rise to 10.2 in October, 1974. 62,863 individuals could not find jobs at that time, an increase of 17,182 during the year. And the picture is not improving.

Genesee County, Michigan has had an unemployment rate of over 9.4 percent since December of 1973.

Cumberland County, New Jersey is now faced with a severe natural gas shortage which threatens to cost thousands more jobs this month. The county already suffers from a 9.6 percent unemployment rate.

County officials are rightfully worried about an unemployment disaster unparralled since the Depression, an unemployment problem which has been evident since 1970 and only seems to get worse.

Inflationary trends in our health care programs are also following an alarming trend. Looked at from the total picture, it is estimated national health expenditures will increase by 141 per cent from $105 billion in FY 1974 to over $120 billion in FY 1975. Medicare expenditures will increase by over 25 percent from $11.3 billion in FY 1974 to an estimated $14.3 billion in FY 1975. Total Medicaid expenditures will rise from $10 billion in FY 1974 to over $12 billion in FY 1975. States and counties pay almost half of this medicaid cost.

Inflationary trends are magnified by the fact that counties' budgets are inelastic. Much of counties' budgets go into programs which are mandated by states and the federal government. These mandated responsibilities, plus the basic costs of running a county government, do not leave room for a county to deal with emergency situations such as inflation and recession.

A typical FY 74 budget for a county in California shows that 70.1 percent of outlays are for mandated responsibilities. 47.5 percent of the total outlays is for mandated public welfare programs. Courts and other public protection—including the district attorney, public defender, jail and other corrections, juvenile probation (required by state law and funded by counties)—claims another 17.6 percent, and health and sanitation accounts for another 5 percent.

We in county government realize that there is no one overall panacea in our battle against inflation. But one thing that must not be done is to reduce the level of federal assistance to state and local government. The most vulnerable seem to be social programs—those whose sole purpose is help the needy.

Inflation deals most harshly with needy people. It would be a cruel double blow to these individuals were we now to make unjustifiable cuts in the federal-state-local programs designed to help them. Cutting back on these "people" programs, would only pass the buck on to county governments who are required and obligated to provide these services to those in need. As can be seen, county budgets are already at the breaking point and there is nowhere they can turn to find the additional revenue to sustain the ongoing programs at even their current operating levels. Therefore, it is imperative that we do not fight inflation by cutting back on the $52 billion of funds to state and local governments this fiscal year and that they be substantially increased as a recession fighter for Fiscal 1976.

We do not mean to imply that all federal domestic programs are operating as efficiently and as economically as they could be. On the contrary, there are many areas of wasted expenditure in domestic programs caused by improper planning, inefficient operation and poor evaluation that can be reduced. It is here, that all levels of government must work together and through long-range planning develop well-coordinated programs which will reduce program duplication and administrative costs, especially through wasteful and time consuming regulations.

It is in this vein that counties urge the Administration and the Congress to put a greater emphasis on those programs which enable states and local governments to take advantage of federal funds without the costly, bureaucratic requirements and red tape. When certain specified amounts of money for an extended time period are authorized, we can better plan for the use of our funds without creating a local bureaucracy just to handle paperwork.

The National Association of Counties, therefore, suggests four priorities federal programs to help counties meet their local responsibilities for providing needed services as well as assisting in the national fight against recession and inflation. County governments' priorities for the 94th Congress are:

(1) Reenactment of general revenue sharing.
(2) Expansion of public service employment programs.
(3) Provision of national health insurance.
(4) Reform of the welfare system.

General revenue sharing

General Revenue Sharing offers a fine example of this non-bureaucratic, action oriented approach. Revenue sharing offers local governments the flexibility of directing their resources into programs that they know will best meet the needs of their people without requiring the creation of large bureaucracies at federal or county level. It is for this reason that state and local officials are unanimous in their desire to see an extension of the program during the first session of the 94th Congress.

In the most recent report to the Congress by the GAO, it has been reported that counties have spent 22.6 percent of their revenue sharing funds on health, 10.3 percent for social services and 41 percent for public safety. Although critics have been fast to point out that more of these revenue sharing funds were used for capital projects than for human services, revenue sharing expenditures cannot be examined in a total vacuum. In many cases, other local funds have been freed up because of revenue sharing to be spent on human service programs. Cutbacks in federal categorical programs and impoundments which have occurred during the last few years have also restricted local governments use of revenue sharing. Also, expenditures for capital projects often include construction of human resource related facilities such as hospitals, health centers and day care centers. In Los Angeles County California (the nation's largest county) nearly three-fourths of the $82 million of revenue sharing funds received in 1974 have been spent on "people" programs. $25 million went for social programs and $35 million is being used to keep transit fares at $.25 which certainly benefits low income people.

Public service employment

Before the August recess, Congress should appropriate the additional $1.625 billion remaining in the authorization under the Emergency Jobs and Unemployment Assistance Act of 1974. In addition, Congress should consider an authorization for FY 76 under this act at the level of $5 billion.

In 1973, Congress enacted the Comprehensive Employment and Training Act (CETA) which gives states, counties and cities of 100,000 population the responsibility of providing comprehensive manpower services to their residents. The test for this law has occurred in implementing the two public service employment titles. CETA has gone a long way to help states and local governments cope with manpower and training programs in normal times, but these are not normal times. We are currently in an unemployment rate of 7.1 percent and even the most conservative economists predict 8 percent by late spring. In many areas of the country, unemployment rates are twice that high.

Increased funding in public service employment is perhaps the best economic weapon counties have to defeat the two-edged problem of rising unemployment and double-digit inflation. Public service employment serves multiple purposes because unemployed and under employed persons are able to work. At the same time, money is returned to the public coffers in the form of tax dollars. Public service employment also provides a useful delivery pattern of services that would otherwise not be provided to citizens of that community. In addition, public service employment generates savings in decreased payments for welfare, unemployment benefits, food stamps, medicare and other assistance programs.

National health insurance

Congress should enact a national health insurance plan which will stem the rising cost of health care as well as guarantee comprehensive health care for all Americans. It is clear that our country is facing a crisis in health care and counties have a major stake in the delivery of health services.

According to a recent survey more than two-thirds of all counties provide medical care and medical assistance programs, as well as the "traditional" public health or community health care program, including hospitals, ambulatory, preventive health, community education and home care services. Counties also play a major role in health manpower training programs and often represent the primary source of new medical manpower in the community.

Without the assistance of a national health care system, counties alone cannot cope with both the inflationary spiral and the adequate delivery of services.

Since the removal of price controls on medical costs (April 1974), physicians' fees and hospital costs have increased 17.4 percent and 23.4 percent respectively. These figures are much higher than the national over-all inflation annualized rate of 13.7 percent.

We maintain that current economic conditions necessitate enactment of such a program. A national health program would set up a mechanism for cost control, quality control and utilization review. It would also generate employment opportunities.

The financial impact of providing health care programs upon counties is tremendous. Census data shows that counties spent over $2.4 billion in local funds for hospitals, and $775 million for public health services, in 1972. We estimate that those figures have increased 25 percent in the past two years. As we have stated before many counties are already operating at the maximum taxation level.

A national health insurance system must have controls to prevent new funding from merely adding to the factors influencing the upward spiral of medical costs. Alternative lower costs of health care services must be included as reimbursable benefits, with incentives for such utilization. As in all of our recommendations, planning for services and financing is essential. Regulatory functions must be consolidated to promote better regulation rather than additional piecemeal regulations. Such improved regulations must reflect (1) careful advance planning; (2) pre-determined budgeting; (3) reasonable and appropriate ceilings on cost; and (4) development of principles reflecting equitable reimbursement of justified costs.

Welfare reform

Congress and the Administration should again turn their attention to welfare reform. We applaud the efforts of many people in both the executive and legislative branches who have worked over the past years to enact a meaningful welfare program. Part of the task of welfare reform was accomplished with the enactment of the New Supplemental Security Income (SSI) program which went into effect on January 1, 1974, and which replaced the state and county programs of aid to the aged, blind and disabled with a national program guaranteeing a monthly income to people in those categories. However, Congress only reformed about a third of the welfare program when it enacted SSI.

The April 1974 monthly figures show that 3.3 million people received SSI payments while 10.9 million were still on public assistance and another 717,000 received general assistance. The federal government's April 1974 costs for SSI were $392.1 million while the costs for AFDC were $700 million. The general assistance costs to local and state governments were $60 million.

While the issue of welfare reform has to center on adequately meeting the needs of the poor, equally important is the availability of local government to continue delivering services. Public assistance is a national problem requiring a national solution. There are continually large shifts of population in our highly mobile society. Our present economic and social problems result in millions of people being unable to adequately support themselves. There continue to be gross inequities between the states on payment levels and program coverage. Successive annual cost increases of 20 to 30 percent to maintain the current welfare system has caused a fiscal crisis for states and counties with limited tax sources—especially for counties who are primarily dependent on property tax revenues. There is tremendous waste in the administrative cost of the present 50 separate systems.

Congress should establish a national program for full federal financing of public assistance and income maintenance. Only under a national program can the inequities in the current system be eliminated and an adequate level of subsistence be maintained for all. Relieved of the costs of financing public assistance programs, state and counties will be able to develop and coordinate comprehensive human service programs to assist people in attaining economic self-sufficiency and personal independence.

Chairman HUMPHREY. Mr. Turner, we want to welcome you. Mr. Turner, we appreciate your consideration and courtesy. I did not want to have this hearing without Wayne County being represented.

I have great affection for your county. More importantly, it is one of the great counties in the Nation, with many problems.

So you go ahead.

STATEMENT OF HON. SAMUEL A. TURNER, COMMISSIONER, BOARD OF COMMISSIONERS, WAYNE COUNTY, MICH.

Mr. TURNER. Mr. Chairman, before I go into my statement I would like to say that the citizens of Wayne County feel the same way towards you as you feel towards us. In the past we have demonstrated our feeling in that direction.

Chairman HUMPHREY. You have done very well, sir, may I say in the most explicit fashion.

Mr. TURNER. My purpose is to report to you briefly on the severity and the extent of the impact of the current inflation-recession on the government of the county of Wayne.

Our county is the heartland of the automobile industry of the world. It contains 2.6 million of the 4.6 million persons in the seven counties of southeastern Michigan, an area referred to as Greater Detroit.

As with most metropolitan areas, the impact of any economic recession, as well as the impact of every inflationary pressure, is most keenly felt at the urban core.

The county of Wayne contains 43 communities, and within these is the city of Detroit, with approximately 1.4 million residents.

In the pocket at the core of the city of Detroit are perhaps 600,000 residents. Among these residents, the current rate of unemployment approximates 30 percent. In the best of recent times, it has always hovered between 10 and 15 percent.

I submit to you, Mr. Chairman, that the economic distress among these people, both white and black, constitutes a malady of major consequence. In this core, there is not only a recession but a depression of the severest magnitude.

In the city of Detroit, as a whole, the unemployment rate at present hovers near 15 percent, and for the county of Wayne it is between 12 and 13 percent.

In view of these stresses, I am sure that this committee and the Members of the Congress will respond to the needs of the government of the county of Wayne, as well as to the needs of the governments of other counties in urban areas, and to the needs of the people and communities within these areas.

Our basic position is that a crisis is already upon us. Unless there is immediate and sufficient help, the government of the county of Wayne will be required to cut back on services already severely curtailed because of continuing restrictions.

Revenues and income from within our county are relatively fixed. We function on countywide property taxes at a rate of 7.07 mills. Of this, 6.07 mills are available under tax allocation provisions of State law, and the added 1 mill is available only because the voters approved a ballot issue by a very narrow margin.

The property tax millage provides about one-third of our total budget of $305 million. Fees and charges provide about 40 percent of the total. Federal and State grants fund about 25 percent of our budget. We are not permitted under State law to borrow money by bonding for operations.

Our only recourse, in the event the crisis becomes more acute, would be to borrow with tax anticipation notes pledging the succeeding year's tax collections, provided the Municipal Finance Commission of the State of Michigan approves.

The county of Wayne sought such borrowing authorization in 1972 when the first Federal revenue sharing funds become available to us. These amounted to $11.5 million.

The Wayne County Board of Commissioners is proud that in the 5 years since it replaced the board of supervisors—a polyglot group comprised of elected and appointed officials—the government of the county of Wayne has operated under a balanced budget.

Chairman HUMPHREY. I want to note you now operate on a balanced budget. Is that correct?

Mr. TURNER. We operate a balanced budget.

The economic crunch, created by the inflation-recession condition that impacts the Detroit area more severely than any other in the Nation, threatens to wipe out that record.

The result could be layoffs of employees of the county that would further deepen the Detroit area depression and convert the economic downturn into a downslide.

The dilemma we face is indicated by two sets of figure samplings: One deals with the increasing costs of providing Government service because of inflation; the other deals with the loss of revenues and the threat of even greater fund shortages in the face of a variety of increased costs.

Among the facilities and services funded by the taxpayers of the county of Wayne is a general hospital which provides services for hundreds of indigent persons. The cost of operating this hospital increased by 15 percent in the past year.

An even greater increase—22 percent—is reported for our costs for the mentally ill.

The 6,000-odd employees of the county are working under a 3-year contract calling for a 4½ percent per annum increase in their salaries, plus a cost-of-living increase factor.

Inflation is increasing the dollar amount of that cost-of-living factor to the county from $6.1 million in 1974 to an estimated $9.7 million in 1975.

Our retirement fund costs are similarly on the increase. These costs are comprised of our social security tax and pension fund investments for employees. In dollar value, these are increasing from $17.9 million in 1974 to $22 million in 1975—an increase of 13 percent.

Yes, we in the government of the county of Wayne are very much aswirl in the inflationary spiral.

We are caught in this swirl because we believe, as do the employees of the county, that the purchasing power of these employees should be protected by increasing their salaries and wages at a pace equal to that of the rising costs of living.

Because of the pressures for funding the programs I have just described, and many others, we have been forced to restrain expenditures in many worthwhile programs, including those for child care.

Our cost spiral is further aggravated by the need to continue many of the programs that have been initiated with Federal grant moneys on a trial basis, and then found mandatory for the safety, health, and welfare of our citizens.

Several of these are the result of services initiated under the Law Enforcement Assistance Administration.

However, there is a long-term price tag to these LEAA programs and others provided through other Federal agencies, particularly the Department of Health, Education, and Welfare.

That price tag presently is $2 million—this sum is almost the same as the $2.1 million in Federal revenue sharing which has increased during during the past 2 years—and, thus, our so-called increase in revenue sharing funds has been absorbed by increased costs of programs initiated with Federal grant moneys.

The factors I have just cited are among the inflationary impacts increasing our costs of maintaining appropriate services through the county level of government in the county of Wayne.

Creating a crunch from the recession, which, as I mentioned earlier, is in Detroit's inner city a deep depression, are reductions in revenues.

We are receiving less money than was anticipated for services rendered at Wayne County General Hospital. Individuals are less likely to make direct payments. More and more of those who seek medical aid are not working, and therefore are not insured, so that our payments from insurers are decreasing.

Revenues from property transfer are reduced. Revenues for other services, a source of 40 percent of our county's income, are trending down, as the pace of related transactions is slowed.

We are threatened with a shortage of anticipated funds from the State as State income tax revenues diminish, and our share is thus proportionately diminished.

Our cash flow has slowed, as taxpayers tend to pay their property taxes later, or not at all. This means that some interest on short-term deposits is diminished. This may seem like an insignificant portion of our income, but it becomes a matter of extreme importance when our backs are against the wall financially.

At this point we cannot clearly foresee our needs for supplemental income.

We have continued a freeze on the filling of vacated positions in our labor force. Last year, we sought to effect a mandatory savings of $4.2 million by this method. For 1975, we have increased this amount by 40 percent to $6 million. We are holding open 450 such positions.

This, then, in brief, summarizes the financial plight of the government of the county of Wayne as 1975 begins.

Chairman HUMPHREY. I want to interrupt here to say that Mayor Alioto and Mayor Panuzio said that here you are laying off people by the freeze, you have the natural attrition of people that resign, sickness, death, or whatever purpose they leave the payroll, and you have 450 positions open that were once needed in your county government.

On the other hand, we come up with public service jobs. Public service jobs, thank goodness, provide some temporary assistance.

In another real sense, if you had the funds that you needed, you would have had 450 more people working right now; would you not?

Mr. TURNER. That is correct, Mr. Chairman.

We are endeavoring to maintain a minimal level of service and to avoid cutbacks in the labor force that would further aggravate the depression mood in and around Detroit.

Whether or not we can do this, or for how long we can hold out, is a guess at this point in time.

We urge the Federal Government to increase the funds shared with counties as one means of helping counties, particularly in those urban areas where social services and other humanitarian services costs are high, to meet realistically the needs of these very depressing times.

Thank you very much.

Chairman HUMPHREY. We are very grateful to you for your testimony. It would have been an incomplete record not to have the testimony from Wayne County because of the very serious conditions that afflict the economy there due to the cutback in automobile production and many other related industries or industries related to the automobile industry.

We thank you very, very much. I know that you are going to share a copy of this testimony with your two Senators. I hope that you will do that. It is very important.

Also, might I respectfully suggest that every member of your delegation, not only those from the immediate Wayne County but your congressional delegation, gets a copy of this testimony and tell them that I suggested from the Joint Economic Committee that they might want to see the testimony that you made here.

I think this is very important, Mr. Scott, with as many places as you men and women on the National Association of Counties have contacted; you obviously have throughout the entire Congress. I do think it is important that the message that comes to a subcommittee or committee such as this are given to your own delegation, in particular, so that there is a feedback.

Might I suggest that when you send that letter you might extract just the pertinent part of your own testimony in the letter itself simply to remind them, "Look on page 6 or 7," because Senators get very busy. I tell you it is impossible around here to read all that comes to you. One way we generally get it is by somebody picking out the things that are really important.

If you only just take out your recommendations, Mr. Scott, for example, it would be very helpful and enclose the whole testimony. The same with you, Mr. Turner.

Mr. TURNER. Thank you very much, Mr. Chairman.

Chairman HUMPHREY. Thank you and give my greetings to your colleagues.

That concludes the session today.

[Whereupon, at 4:30 p.m., the committee adjourned, to reconvene subject to the call of the Chair.]

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