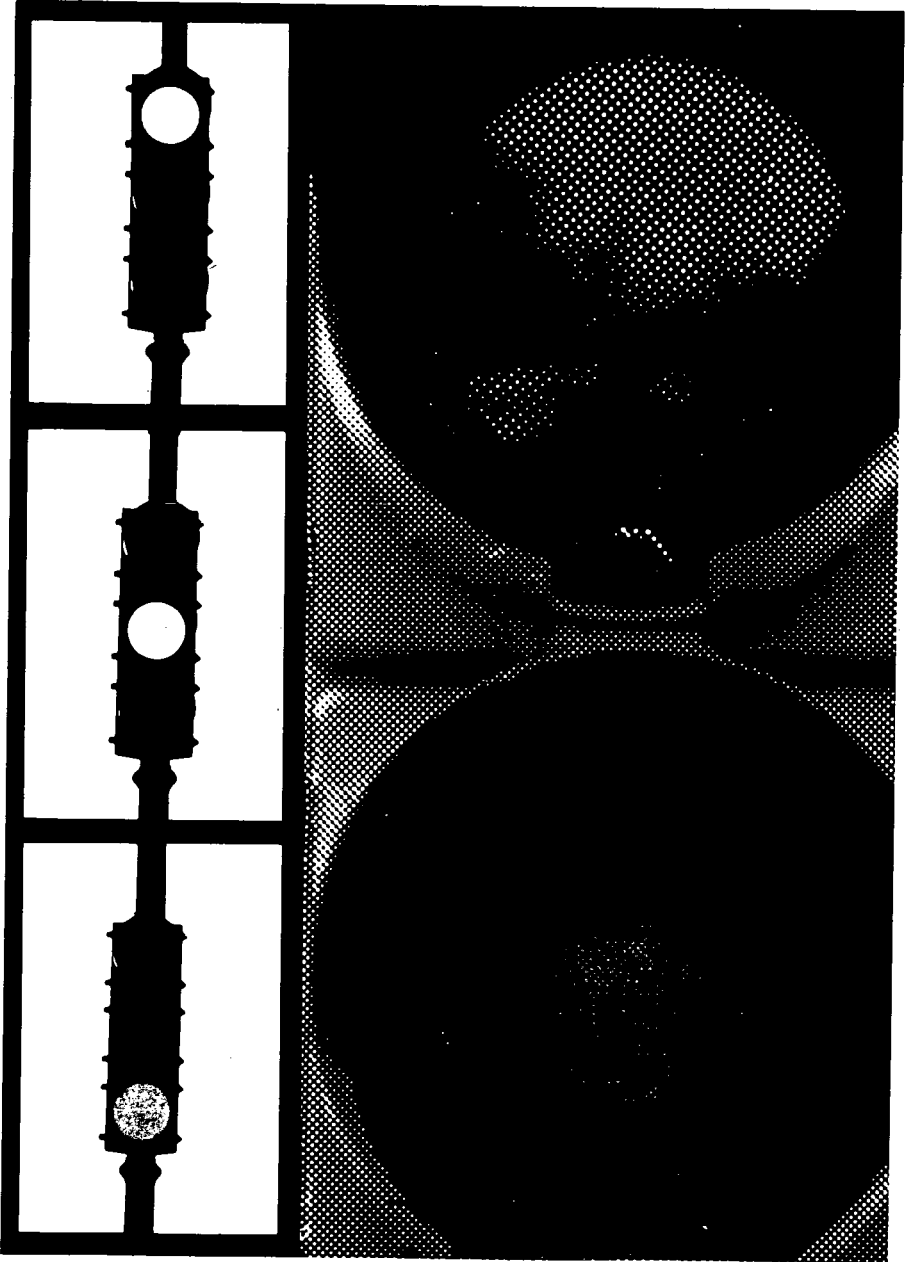


880

joint economic report 1978

Joint Economic Committee / Congress of the United States / House Report No. 95-995



employment / inflation

THE 1978
JOINT ECONOMIC REPORT

REPORT
OF THE
JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES
ON THE
JANUARY 1978 ECONOMIC REPORT
OF THE PRESIDENT
TOGETHER WITH
MINORITY AND ADDITIONAL VIEWS



MARCH 21, 1978.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

U.S. GOVERNMENT PRINTING OFFICE
WASHINGTON : 1978

23-928 O

JOINT ECONOMIC COMMITTEE

(Created pursuant to sec. 5(a) of Public Law 304, 79th Cong.)

RICHARD BOLLING, Missouri, *Chairman*

LLOYD BENTSEN, Texas, *Vice Chairman*

HOUSE OF REPRESENTATIVES

HENRY S. REUSS, Wisconsin
WILLIAM S. MOORHEAD, Pennsylvania
LEE H. HAMILTON, Indiana
GILLIS W. LONG, Louisiana
PARREN J. MITCHELL, Maryland
CLARENCE J. BROWN, Ohio
GARRY BROWN, Michigan
MARGARET M. HECKLER, Massachusetts
JOHN H. ROUSSELOT, California

SENATE

JOHN SPARKMAN, Alabama
WILLIAM PROXMIRE, Wisconsin
ABRAHAM RIBICOFF, Connecticut
EDWARD M. KENNEDY, Massachusetts
GEORGE McGOVERN, South Dakota
JACOB K. JAVITS, New York
WILLIAM V. ROTH, Jr., Delaware
JAMES A. McCLURE, Idaho
ORRIN G. HATCH, Utah

JOHN R. STARK, *Executive Director*

LOUIS C. KRAUTHOFF II, *Assistant Director*

RICHARD F. KAUFMAN, *General Counsel*

ECONOMISTS

G. THOMAS CATOR
THOMAS F. DERNBURG
ROBERT D. HAMRIN

KENT H. HUGHES
L. DOUGLAS LEE
PHILIP McMARTIN

DEBORAH NORELLI MATZ
GEORGE R. TYLER

MINORITY

CHARLES H. BRADFORD
M. CATHERINE MILLER

GEORGE D. KRUMBHAAR, Jr.
MARK R. POLICINSKI

LETTER OF TRANSMITTAL

MARCH 21, 1978.

Hon. THOMAS P. O'NEILL, JR.,
Speaker, U.S. House of Representatives,
Washington, D.C.

DEAR MR. SPEAKER: Pursuant to the requirements of the Employment Act of 1946, I hereby transmit the report of the Joint Economic Committee containing its findings and recommendations with respect to each of the main recommendations made by the President of the United States in his 1978 Economic Report. This report is to serve as a guide to the several committees of Congress dealing with legislation relating to economic issues.

Sincerely yours,

DICK BOLLING,
Chairman, Joint Economic Committee.

(III)

CONTENTS

	Page
I. Introduction.....	5
II. The economic situation and outlook.....	10
1977.....	10
1978.....	14
1979.....	15
The longer term.....	16
III. Goals for economic policy.....	17
Growth and employment goals for 1978 and 1979.....	17
Longer term economic goals.....	22
The Full Employment and Balanced Growth Act.....	23
The path to a high employment economy.....	25
Full employment budget estimates.....	26
IV. Monetary and fiscal policy.....	29
Monetary policy.....	30
Policy in 1977 and 1978.....	31
Obstacles to monetary expansion: The international position of the dollar.....	34
Fiscal policy.....	37
Expenditure policy.....	37
Economic priorities in the budget.....	38
Urban policy and housing.....	40
Total spending.....	42
Tax policy.....	42
Crowding out.....	45
Improvements in policy coordination.....	46
V. The control of inflation.....	49
Inflation and recovery.....	49
Inflation prospects.....	50
Indexation and incomes policy.....	53
VI. Structural unemployment.....	58
Youth unemployment.....	61
Adult women.....	61
Eliminating bottlenecks.....	62
Geographic employment problems.....	63
VII. The current services budget.....	66
Additional views of Vice Chairman Lloyd Bentsen.....	69
Additional views of Representative Henry S. Reuss.....	70
Additional views of Representative Lee H. Hamilton.....	72
Additional views of Senator William Proxmire.....	78
Additional views of Senator George McGovern.....	80
Minority views on the 1978 Economic Report of the President.....	83
Additional views of Senator Jacob K. Javits.....	131
Additional views of Representative Clarence J. Brown.....	135
Additional views of Senator William V. Roth, Jr.....	136
Additional views of Senator James A. McClure and Senator Orrin G. Hatch.....	140
Committee and subcommittee activities.....	143
Subcommittee membership, 95th Congress, 1st session.....	157

Union Calendar No. 498

95TH CONGRESS } HOUSE OF REPRESENTATIVES { REPORT
2d Session } No. 95-995

REPORT ON THE JANUARY 1978 ECONOMIC REPORT OF THE PRESIDENT

MARCH 21, 1978.—Committed to the Committee of the Whole House on the State
of the Union and ordered to be printed

Mr. BOLLING, from the Joint Economic Committee,
submitted the following

REPORT

together with

MINORITY AND ADDITIONAL VIEWS

[Pursuant to sec. 5(b)(3) of Public Law 304 (79th Cong.)]

This report is submitted in accordance with the requirement of the Employment Act of 1946 that the Joint Economic Committee file a report each year with the Senate and the House of Representatives containing its findings and recommendations with respect to each of the main recommendations made by the President in the Economic Report. This report is to serve as a guide to the several committees of Congress dealing with legislation relating to economic issues.

(1)

**Report of the
Joint Economic Committee
on the
January 1978
Economic Report of the President**

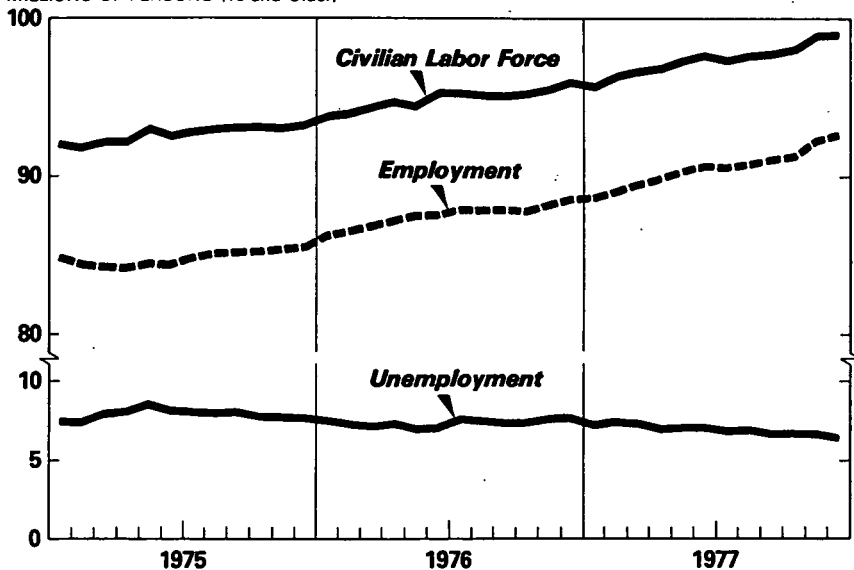
I. INTRODUCTION

The U.S. economy made substantial progress in 1977. Unemployment for the year fell to 7 percent and dropped at yearend to 6.4 percent. The number of employed people increased by more than 4 million. Real gross national product (GNP) grew about 5 percent, while gross private domestic investment rose about 13 percent in real terms. Profits improved substantially.

Although these developments are gratifying, we cannot forget that the Nation has still not fully recovered from the worst recession since the Great Depression. The national economy has come only about 60 percent of the way back to full employment. The capacity utilization rate is 83 percent, several percent below the desirable level, and unemployment is still above 6 percent. Inflation continues to be a stubborn problem; the increase in consumer prices of 6.8 percent is much too high, and the productivity increase of 2.4 percent for the year is not reassuring.

Employment - Unemployment

MILLIONS OF PERSONS (16 and Older)



SOURCE: Department of Labor

Our overall progress should not conceal the serious situation of certain groups and certain sectors of our economy. The unemployment rate for blacks and for black teenagers is far above the average. In the absence of specific structural programs unemployment for minorities can be expected to remain chronic and severe. In many cases structural unemployment has been exacerbated by serious urban problems. Many central cities have not recovered from the recent recession. Public services have been reduced, local taxes are high, and urban infrastructures are deteriorating. Our national transportation system is deficient. An energy program is urgently needed. Certain industries have required government assistance, and there are sections of the country that are plagued by stagnation.

The international economy gives rise to difficulties for U.S. policy. Our balance-of-payments deficit caused by slow recovery in Europe and heavy oil imports will continue. Serious credit problems among the developing nations persist. Energy dependency makes our economy vulnerable to external shocks.

The Administration has addressed itself to most of these problems in a responsible manner. Its program has much to commend it. With the stimulus of the proposed tax reduction, the Administration projects a real growth rate of 4.7 percent for 1978, with unemployment dropping to the 6-6¼-percent range. For 1979, a similar rate of growth is projected, with unemployment falling below 6 percent.

The basic question is whether or not our economy can do better. We believe that it can. With the proper policy mix, real growth rates of 5 to 5.5 percent in 1978 and 1979 are attainable, and should be our national goal. Our analysis of the outlook and the policy mix leads us to the conclusion that such goals can only be reached if the President's tax proposals are accompanied by a monetary policy that will move short-term interest rates in the direction of 1977 levels.

Additional stimulus is definitely needed for 1979. That stimulus, however, should come in the form of an expansionary monetary policy that will reverse the recent rise in short-term interest rates. Even if monetary policy should become gradually more restrictive, greater reliance will have to be placed on increased Federal spending or larger

tax cuts. And even then, a restrictive monetary policy could prevent the achievement of 1979 goals for production and employment, enlarge the Federal deficit, and retard needed capital formation.

An examination of the President's discretionary budget choices reveals little evidence that a major change in priorities is taking place. There are some signs that a foundation is being laid for future changes. But so far, this year's priorities are similar to those of prior budgets. Further, there is likely to be less economic stimulus in the budget requests than is apparent from the figures because of the composition of the increases.

Inflation will continue to concern U.S. policymakers as it does the rest of the world. Obviously, it cannot be cured overnight. It requires a composite of measures, both public and private, and substantial public consensus. We believe that the Administration's initiatives, while in the right direction, can be improved. We urge strengthening of the Council on Wage and Price Stability and greater efforts to reduce the inflationary impact of Federal programs.

We recognize that full employment and price stability cannot be achieved by fiscal and monetary means alone. Only with a coordinated program of structural measures dealing with such problems as manpower, investment, supply bottlenecks, international factors, and the like can we accomplish high employment objectives in a balanced and stable setting. In carrying out our role under the Employment Act we have stressed the importance of a longer term perspective and of improved coordination of public programs.

In this Report, as in previous ones, we have attempted to provide longer range insights, and we commend the Budget Committees for placing emphasis on five-year projections in their forthcoming review of the Budget. At the same time, we see obvious need for improving substantially our national capacity for the planning and coordination of policy to meet the objectives of the Employment Act of 1946. For that reason, we accord high priority to enactment of the Full Employment and Balanced Growth Act (generally referred to as the Humphrey-Hawkins bill).

The major recommendations of the Joint Economic Committee are set forth below. These and additional recommendations are discussed in the following chapters.

We strongly endorse the Humphrey-Hawkins bill and urge its swift enactment by the Congress. The Congress should enact specific, quantitative long-term economic goals that will serve as the basis for congressional fiscal, monetary, and other economic policies.¹

Economic stimulus, in addition to that proposed in the Budget, is needed in 1978 and 1979. This should be implemented through an expansionary monetary policy. To achieve this stimulus, the growth of the money supply should be such that the rise in short-term interest rates is reversed. Policy in 1978 should tend to move short-term rates toward their 1977 levels. Interest rates should be maintained at these lower levels in 1979.^{2 3}

Domestic recovery is too important an objective to permit monetary policy to be diverted to other goals. We therefore oppose the recent increase in the Federal funds and rediscount rates because they represent deliberate attempts to use domestic monetary instruments to achieve an international purpose. Intervention in foreign exchange markets should be strictly limited to measures designed to correct "disorderly markets."

In fiscal year 1979, total Federal expenditures should fall within a \$500-\$505 billion range and total tax receipts should be approximately \$440 billion. This fiscal policy, combined with the monetary policy discussed above, will achieve the economic goals set forth in this Report.⁴

Congress should immediately begin a review of the social security financing legislation recently

¹ Senator Proxmire states: "In addition to an unemployment goal, the Humphrey-Hawkins bill should include a complementary specific goal for the rate of inflation, the equally overwhelming problem our economy faces."

² Representative Moorhead states: "Here and subsequently the Report recommends a strongly expansionary monetary policy for 1978 and 1979. I do not believe that the Federal Reserve should be a slave to its present targets for growth of the monetary aggregates and concur that these targets might properly be raised somewhat in the period ahead to assure continued expansion of the economy. I would hope that the outcome would be lower interest rates. But I would regard as too risky a monetary policy explicitly aimed at driving down the present level of short-term rates regardless of the consequences in the growth of the aggregates. Given the present and prospective rate of inflation, the Report implies a negative real rate of interest for a sustained period, and this may not be a realistic target."

³ Senator Bentsen states: "I support an expansionary monetary policy as long as that policy is consistent with the goal of a reduction in the rate of inflation."

⁴ Senator Proxmire states: "This level of spending is excessive. There is hardly a program in the Government which could not be improved through a cut in expenditures, attention to detail, and a reduction in inefficiency and waste. A \$25 billion, or 5 percent, cut should be achievable."

enacted. Special attention must be given to the long-term macroeconomic consequences of any financing proposal.

The Federal Reserve should issue a written report to the Congress shortly after the receipt of the Economic Report of the President. After consultation with the House and Senate Banking Committees, the Joint Economic Committee would review this report and make its recommendations. The Federal Reserve's report would be expected to meet three basic requirements:

(1) Analyze the desirability, consistency, and feasibility of the quantitative goals for employment, growth, and inflation for the forthcoming fiscal year as set forth by the President.

(2) Provide the Federal Reserve's own quantitative forecast of economic activity for the forthcoming year on a quarterly basis.

(3) Discuss in exact quantitative terms how the proposed monetary policies are designed to reconcile the President's targets and the Federal Reserve's own forecast.⁵

As part of its annual report to the Congress, the the Council on Wage and Price Stability should determine whether Federal actions have resulted in a net reduction or increase in inflation. Any specific actions which have had a significant impact should be thoroughly discussed and these impacts should be quantified.

⁵ Senator Bentsen states: "While I understand the need for coordination of monetary and fiscal policy, these proposals could undermine the traditional independence of the Federal Reserve System and hence I reserve judgment on them."

II. THE ECONOMIC SITUATION AND OUTLOOK

1977

The turnaround in the economy that began in mid-1975 continued through 1977, making it a year of good and reasonably balanced economic growth. Real GNP grew at an annual rate of 4.9 percent in 1977, compared with a 6.0-percent increase in 1976. The continued recovery was led by the strength of the household sector—especially in the demand for consumer durable goods and housing. However, the business sector has not responded vigorously. Nonresidential construction has not yet reached its 1974 peak and producers' durable equipment only matched its 1974 level. Business fixed investment in the current recovery has continued to lag behind the performance that other business cycles have taught us to expect.

The current economic recovery has depended heavily upon consumer spending, which was spurred initially by the personal income tax reduction in the spring of 1975. In 1976, nominal personal consumption expenditures grew by 11.6 percent while personal income grew only 10.3 percent. This caused the personal saving rate to drop sharply, reaching the extremely low level of 4.1 percent in the first quarter of 1977. During subsequent quarters, consumers slowly returned to more normal patterns of saving. The preliminary figures for the fourth quarter of 1977 estimate a savings rate of 5.7 percent. For the two-year period 1975-77, consumption grew more rapidly than income, leaving consumers with a large burden of debt.

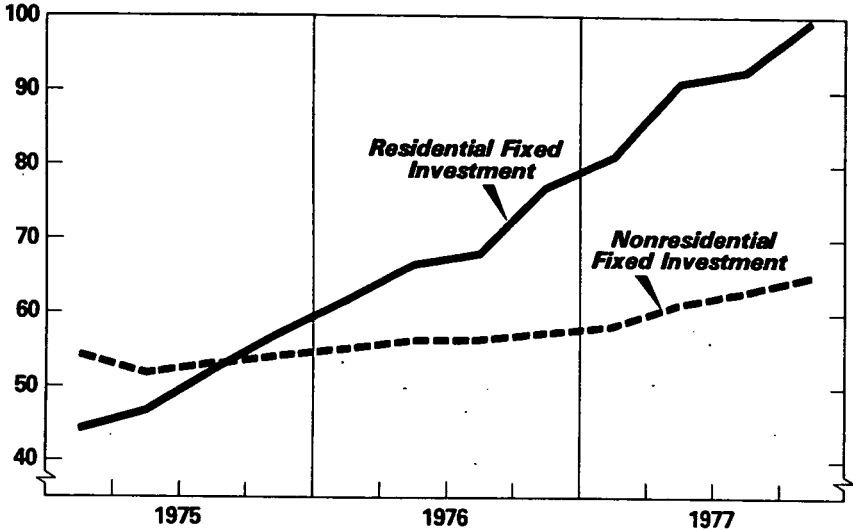
In real terms, business fixed investment rose by roughly 8½ percent in 1977—about the same as 1976. Compared with previous recoveries, this reflects a very sluggish pace. Although 8½ percent does not sound like a poor growth rate, it must be remembered that in the fourth quarter of last year, investment was still below its previous peak. At this stage in previous recoveries fixed investment had exceeded its earlier peak by an average of 14 percent. Investment in nonresidential structures has been particularly poor; the increase was only 3.5 percent in real terms in 1977.

After almost no change in 1976, nonfarm inventory accumulation increased substantially in 1977. The ratio of inventories to final sales, however, has shown a gradual decline since the third quarter of 1976, indicating that the inventory buildup has not been excessive. In fact, the sharp drop in the fourth quarter figures—partly attributable to the coal strike and some auto plant closings—set the stage for some inventory building in the first half of 1978.

The year 1977 proved to be good for the home construction industry. Although the record-setting levels of 1972 were not matched, privately owned housing starts were estimated at 1.986 million units, 29 percent above the level for 1976. By far, the largest increase was in the South where 274,000 new units were started from December to December.

Residential and Nonresidential Fixed Investment

BILLIONS OF DOLLARS



SOURCE: Department of Commerce

Spending by Federal, State, and local governments was another important source of expansion in 1977, increasing 2.5 percent in real terms as compared with 0.5 percent in 1976. The growth occurred largely in the Federal sector which had experienced a decline in 1976. Purchases at the State and local level grew very slowly although they did speed up as the year progressed. As a result of this slow spending growth, the surplus in State and local government operating budgets increased almost \$10 billion. National Income and Product Accounts (NIPA) estimates are not available on a State-by-State basis, and certainly not all States are in surplus, but other information indicates that the general surplus condition is widespread. This condition will probably lead to some moderate tax reductions or foregone tax increases in 1978. Further expenditure growth will depend heavily on grants supplied by the Federal Government.

Because of the strong economic growth, total employment increased during 1977 by about 4 million, bringing civilian employment to 92.6 million persons by the end of the year. Substantial gains were made in reducing unemployment as well, with the unemployment rate declining from 7.7 percent in 1976 to an average of 7.0 percent in 1977. Using the newly revised seasonal adjustment factors released in December by the Bureau of Labor Statistics, the unemployment rate showed a steady decline beginning in July. The December rate of 6.4 percent was good news, marking the lowest rate since late 1974. The decline was sustained in January 1978 as the rate dropped slightly to 6.3 percent. Over the year, the number of unemployed persons dropped by more than 1.1 million.

Most groups in the labor force enjoyed lower unemployment rates. From January 1977 to January 1978, the rate for all male workers declined from 5.8 percent to 4.7 percent, while female unemployment dropped from 6.9 percent to 6.1 percent. However, the unemployment rate for minorities was virtually unchanged and the rate for minority teenagers increased from 36.2 percent to 38.7 percent.

The labor force participation rate continued to rise throughout the year, reaching an alltime high of 62.8 percent in November and December. This is primarily a reflection of the increasing number of women entering the labor force. By yearend there were 98.9 million persons in the civilian labor force.

Although 1977 was a very good year for employment gains, unemployment remains a serious problem. It is not only a racial and demographic problem, it is also a geographic problem as described in detail in Chapter VI. Unemployment in the older U.S. cities during 1977 bears this out, with unemployment rates that are typically higher than the national average.

The Consumer Price Index rose 6.8 percent from December 1976 to December 1977. This does not compare favorably with the increase of 4.8 percent in 1976. The acceleration in 1977 was due primarily to food prices which rose 8.0 percent in 1977, following a rise of 0.6 percent in 1976. Prices rose in 1977 for many grocery store foods, such as meats, poultry, processed fruits and vegetables, sugar, fats and oil products, and cereal and bakery products. Prices for new cars, fuel oil, and gasoline increased more in 1977 than in 1976, but used car prices declined in 1977 after a substantial rise in 1976.

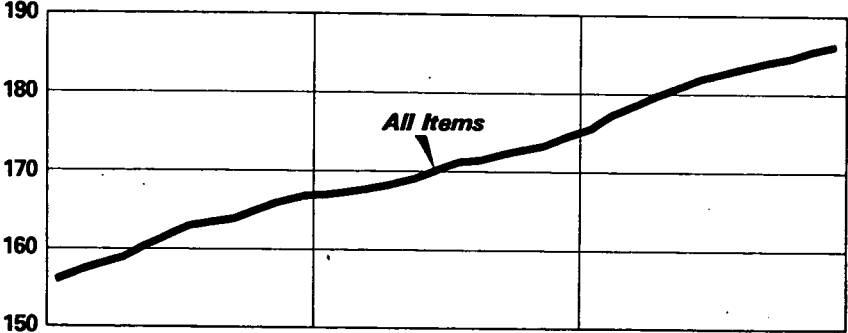
The Finished Goods Index, which is a better indication of prices paid by producers than the All Commodities Wholesale Price Index, rose 6.6 percent from December to December. The Bureau of Labor Statistics began emphasizing the Finished Goods Index in August because it includes only changes in prices received by producers for those commodities that are in the form in which they will eventually be sold to users. In this calculation, price changes are not counted repeatedly as goods move through various stages of processing. Producer finished goods were 7.2 percent higher in 1977, consumer food prices rose 6.6 percent, and the index for consumer finished goods excluding food rose 6.1 percent.

While consumer prices rose 6.8 percent during 1977, adjusted hourly earnings for private nonagricultural workers rose by 7.5 percent, resulting in a real gain for the consumer of 0.6 percent. This was much smaller than the gain last year when real hourly earnings rose 2.3 percent.

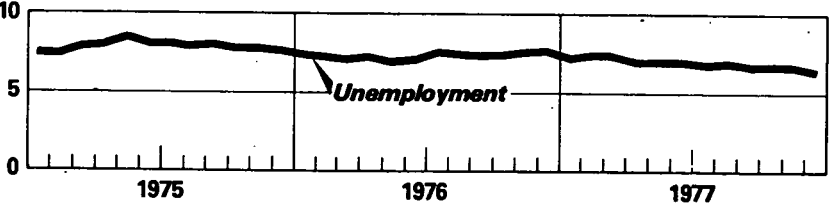
Productivity growth in the private business sector in 1977 did not match the pace of 1976. The 2.4-percent increase in 1977 reflected a 6.0-percent increase in output and a 3.6-percent increase in hours worked. During 1976, productivity rose 4.2 percent. The growth of hours worked by all persons accelerated in 1977—the largest increase since 1973. The durable goods sector, which is typically the most sensitive to cyclical fluctuations, showed an increase in productivity of 1.5 percent in 1977 compared with 7.2 percent in 1976.

Consumer Prices

INDEX, 1967 = 100



MILLIONS OF PERSONS (16 and Over)



SOURCE: Department of Labor

In contrast to 1976, the external sector acted as a brake on economic expansion in 1977. Net exports of goods and services fell from a 1976 surplus of \$7.8 billion to a deficit of \$10.1 billion in 1977. A \$4.1 billion improvement in the surplus on services from \$17.1 billion in 1976 to \$21.2 billion in 1977 was more than offset by a \$21.2 billion increase in the merchandise trade deficit. With U.S. exports concentrated in the agricultural and capital goods manufacturing sectors, slow growth abroad meant weak export markets for the United States. Sharply increased imports of oil also contributed to the widening deficit. The \$10 billion in added oil imports amounted to roughly half the larger merchandise trade deficit and well over half of the \$17.9 billion swing that marked the shift from surplus to deficit on the balance of goods and services.

Deficits in the balances for merchandise trade, goods and services, and the current account are likely to continue through 1978 and beyond. However, there may be some reduction in all three deficits during 1978.

Because there is a considerable lag between rising import prices and the substitution of domestic for imported goods, a depreciating dollar could upset this calculation. The dollar value of 1977 imports was given a boost by the 5.4-percent fall in the multilateral trade weighted value of the dollar. Large trade and current account deficits in 1978 coupled with persistent inflation at the 6-percent level could lead to further depreciation of the dollar in 1978.

Somewhat more rapid growth abroad should result in a higher level of U.S. exports. Nonfuel imports can be expected to fall slightly as growth in this country slows in 1978 and 1979. Imports of oil jumped 20 percent in 1977 in response to cold weather, stockpiling, and a decision to build up strategic reserves. North Slope production and the existence of adequate stocks will tend to stabilize the level of U.S. oil imports. The major imponderable remains the price decision that will emerge from the midyear meeting of the Organization of Petroleum Exporting Countries (OPEC).

The money supply grew at the relatively rapid rate of 7.4 percent from the end of 1976 to the end of 1977. This growth rate, however, did not prevent short-term interest rates from moving up sharply. The three-month Treasury bill rate rose from 4.4 percent in December 1976 to 6.1 percent in December 1977. Long-term rates, however, fell during the year. Monetary policy and its relationship to overall economic performance is discussed in detail in Chapter IV.

1978

Looking ahead into the remainder of 1978, we foresee a continuation of recovery. The Administration's forecast of 4.7 percent real growth is within a reasonable range of probable outcomes. The unemployment rate should therefore decline gradually, falling to the neighborhood of 6 percent by the end of the year. While we wish the President success with his incomes policy, we do not consider it strong enough to produce a dramatic change. Barring uncontrollable events, prices should increase approximately 6 percent in 1978.

Although we do not have any serious differences with the Administration over its view of the economic outlook, we sense a tendency to accept this economic performance as the best that can be expected. We believe that economic performance can be improved. In the following chapter we recommend more ambitious goals for both the near-term and the more-distant future.

Fiscal policy for 1978 has been largely determined. If the proposed tax reduction goes into effect October 1, most of the economic impact will occur in 1979. Expenditures have been set by the Second Concurrent Resolution and even if they are raised moderately as the President's Budget indicates, this will only validate existing policy. As indicated in Chapter IV we have no serious problems with the fiscal policy implied by the President's Budget for fiscal year 1979.

Monetary policy is far more flexible than fiscal policy and offers a much greater opportunity to influence economic activity in the second half of the year. If short-term interest rates continue to rise through 1978 as they did in 1977 and as the Council of Economic Advisers and others expect in 1978, there would be a serious impact on economic growth in 1979. An analysis prepared by the Committee staff, discussed more fully in Chapter IV, concludes that unless short-term interest rates stabilize and begin to decline it will be difficult to reach the Council's growth projections.

In accepting the Administration's view of the economic outlook for 1978, we are quite cognizant of the pressures now developing in finan-

cial markets. We are aware that loan demand has been increasing and that foreign funds which in the past have helped finance part of the Federal deficit may not be depended upon this year. Nevertheless, we have concluded that the dangers of financial "crowding out" are minimal this year. We are confident that with cooperation from the monetary authority, both the Federal deficit and private demands for funds can be accommodated without sharp increases in interest rates.

The pattern of the recovery in 1978 promises to be erratic. The coal strike will have an adverse impact on output in the first quarter. The severity of this impact will, of course, depend upon how long it takes to get production moving again, but we can easily foresee a significant national effect. This factor alone would tend to reduce growth in the first quarter and raise the growth rate in the second and third quarters as inventory rebuilding occurs.

The social security tax increases which became effective January 1, 1978, will also have a dampening effect. Growth in the final quarter of 1978 will remain strong if, as expected, consumption is stimulated by a combination of tax reductions, social security benefit increases, and Federal pay increases.

Despite the likelihood of strong growth rates in the second half of the year than the first, fundamental forces in the economy could weaken as the year progresses. If interest rates are allowed to rise, this would have an adverse impact on business investment in 1979. If they rise enough to cause the flow of funds into savings institutions to be curtailed, housing, which has a significant impact on other sectors of the economy and which is already expected to be weaker in 1978, will drop substantially. If consumers decide to repay debt or increase saving, or if energy prices are increased significantly, these factors will also dampen economic growth in late 1978 and set the stage for a weak performance in 1979.

1979

As usual it is difficult and risky to project events more than a year into the future. On the other hand, our ability to influence the path of economic growth increases as we look further into the future and take steps to prepare for it.

The Administration has forecast real growth of 4.8 percent in 1979 coupled with an inflation rate of 6 percent and an unemployment rate of 5.8 percent. We believe that this forecast is achievable—in fact we have recommended more ambitious goals. Nevertheless, there are many potential problems which could cause 1979 to be far weaker than expected.

As indicated earlier, economic growth in 1979 is heavily dependent upon the path of monetary policy in 1978. If interest rates are stable or decline moderately in 1978 and remain stable in 1979, we could reach a growth target of 5 percent in 1979; if interest rates rise throughout 1978 it will be impossible to achieve this target without an unacceptably large deficit in the Federal budget. In our judgment, if interest rates are allowed to rise further, we run a serious risk of growth below 3½ percent in 1979.

THE LONGER TERM

The years 1978 and 1979 are critical in accomplishing our long-term objectives of moving the economy back to full employment. If we achieve the targets suggested by this Committee, we will be within 2 percent of potential GNP by the end of 1979. As we approach this goal, we must be careful that Federal policies do not overstimulate demand while creating capacity shortages. It is for this reason that we stress the need to rely more heavily on monetary policy for stimulus in 1978 and 1979. Lower interest rates will stimulate investment and expand capacity thus reducing the problems that might be encountered as we approach potential output. If we do not expand industrial capacity and if we rely solely on fiscal policy to stimulate demand, we risk creating a situation where a small amount of excess demand two or three years from now will set off a new inflationary spiral that will trouble us for years to come. It is essential to change the mix of policy to provide a balanced expansion.

III. GOALS FOR ECONOMIC POLICY

Despite steady improvement in the economy during 1977, the economy is still a long way from full recovery. To make satisfactory progress in sustaining further growth and reducing unemployment, the Congress should adopt specific targets for 1978 and 1979.

In proposing economic goals to the Congress, we must be careful not to put excessive emphasis on a particular policy instrument, and we must be very careful not to confuse means with ends. Just such confusion may have been created by the present system of congressional oversight of Federal Reserve monetary policy. Current law instructs the Fed to maintain growth of the monetary aggregates "commensurate with the growth of potential output." As a result, the monetary aggregates have been treated as the targets rather than as instruments of monetary policy. By relating monetary policy only to long-run objectives, no real burden has been placed on the Fed to relate its monetary policies to such economic goals as the growth in production, the level of unemployment, or the rate of inflation. In Chapter IV we present specific recommendations to remedy this situation.

The Administration came perilously close to confusing means and ends by making a balanced budget a key target of national economic policy. Balance in the budget should be a secondary aim of economic policy. The budget deficit or surplus should be determined by the fiscal needs implied by current economic conditions.

During the past year, the Administration has put its goal of a balanced budget in a clearer perspective. Although budgetary balance remains a matter of importance to the Administration, this view is now put forward with considerably less rigidity than earlier and the size of the deficit is to be determined with an eye first to the overall performance of the economy. We note that the Report of the Council of Economic Advisers conceded, as our staff argued in an evaluation of the 1981 targets, that structural weaknesses may be such that it might be unwise to balance the budget even at full employment.

The President's Economic Report and Budget place considerable emphasis on reducing the Federal Government's relative role in the economy. While a variety of factors could combine to alter the components of Federal expenditures, the total should be determined by the needs of the Nation and the economy. In setting national economic goals, we should keep in mind that it is rising production and employment that are the principal measures of economic well-being and not the size of the budget deficit or the level of Federal expenditures.

GROWTH AND EMPLOYMENT GOALS FOR 1978 AND 1979

In its 1977 Annual Report, the Joint Economic Committee recommended specific goals for real growth in GNP and the rate of unem-

ployment. For 1977, we recommended a real rate of growth of 6 percent and a reduction in the unemployment rate to 6.5 percent by year end.

As a result of moderate fiscal stimulus and the strong performance of the private sector, the economy has come quite close to meeting those goals. Real GNP grew by almost 5 percent. Although somewhat below our recommendation, the U.S. performance still exceeded that of all her major trading partners except for Japan. The record of unemployment reduction was even better. Overall, the rate of unemployment fell 1.4 percentage points in 1977 and exceeded our goal by one-tenth of 1 percent.

The relatively strong performance of the economy in 1977 partly reflected the establishment by the Administration and the Congress of specific quantitative goals. By focusing on ambitious but attainable goals, the Congress and the Administration have a clearer basis on which to build economic policy. The Administration's endorsement of the Full Employment and Balanced Growth Act (generally referred to as the Humphrey-Hawkins bill) indicates a clear commitment to continue and improve this process.

We strongly recommend that the Congress formally establish specific targets for employment, growth of real output, and productivity.¹

Employment and unemployment goals should be broken down into goals for specific demographic groups, so that programs for aiding specific groups and for reducing differential unemployment rates can be developed.

As the United States becomes more involved with foreign economies, the success or failure of many domestic policies will depend on decisions made in foreign capitals. Similarly, U.S. economic policies will have a significant impact on the economies of other countries. While each country must consider its own domestic interests, growing interdependence makes greater international coordination of domestic economic policies vital. At the London summit in May 1977, the President and the leaders of the major Western industrial powers took a step in this direction by establishing goals for real growth of GNP in their respective countries. The attempt was far from successful. Only the United States achieved its goal for growth, and then only after revising it downward. The existence of goals can invite public pressure by one country on another, but their absence would do nothing to promote international coordination. Despite the disappointing performance in 1977, it is highly desirable that the process be continued.

At special economic meetings and through the Organization for Economic Cooperation and Development (OECD), the United States should encourage the major industrial powers to set specific quantitative goals for growth in real GNP.

As we have already noted in Chapter II, there is a broad consensus that without stimulus, the economy will begin to weaken in the latter part of 1978. If its proposals for net tax reductions are adopted, the

¹ Senator Proxmire states: "Congress would be remiss if it did not also establish goals for a decline in the rate of inflation."

Administration anticipates real GNP growth for 1978 in the range of 4½ to 5 percent with the unemployment rate declining to between 6 and 6¼ percent.

Barring any unexpected shocks, the Administration foresees a similar performance in 1979 with real GNP growth in the 4½- to 5-percent range. The rate of unemployment would continue to decline to a rate somewhere between 5½ to 6 percent at yearend. We agree that growth should slow somewhat as the economy approaches potential GNP. Nevertheless, we favor somewhat more ambitious goals than the Administration.

Real GNP growth between 5 and 5½ percent in calendar year 1978 is a desirable and attainable goal. This growth target is consistent with an unemployment rate averaging no more than 6.4 percent during the year and falling to 6 percent or less by yearend.

If 1978 is marked by a strong economic performance, we would endorse a growth target in the neighborhood of 5 percent for 1979. This would reduce the unemployment rate to approximately 5½ percent by the end of the year and place economic output within 2 percent of potential by yearend. Fiscal and monetary policy should be structured to achieve these goals.

In setting economic policy, the Congress must also consider other problem areas that may not lend themselves to specific quantitative goals. The Congress is concerned about the composition as well as the level of Federal spending. Likewise, adequate and balanced levels of consumption and investment in the private sector are a matter of congressional interest. The persistent problems of inflation and structural unemployment and local economic development also warrant congressional attention. The growing importance of world markets for the U.S. economy has raised new questions about the U.S. position on international trade and payments.

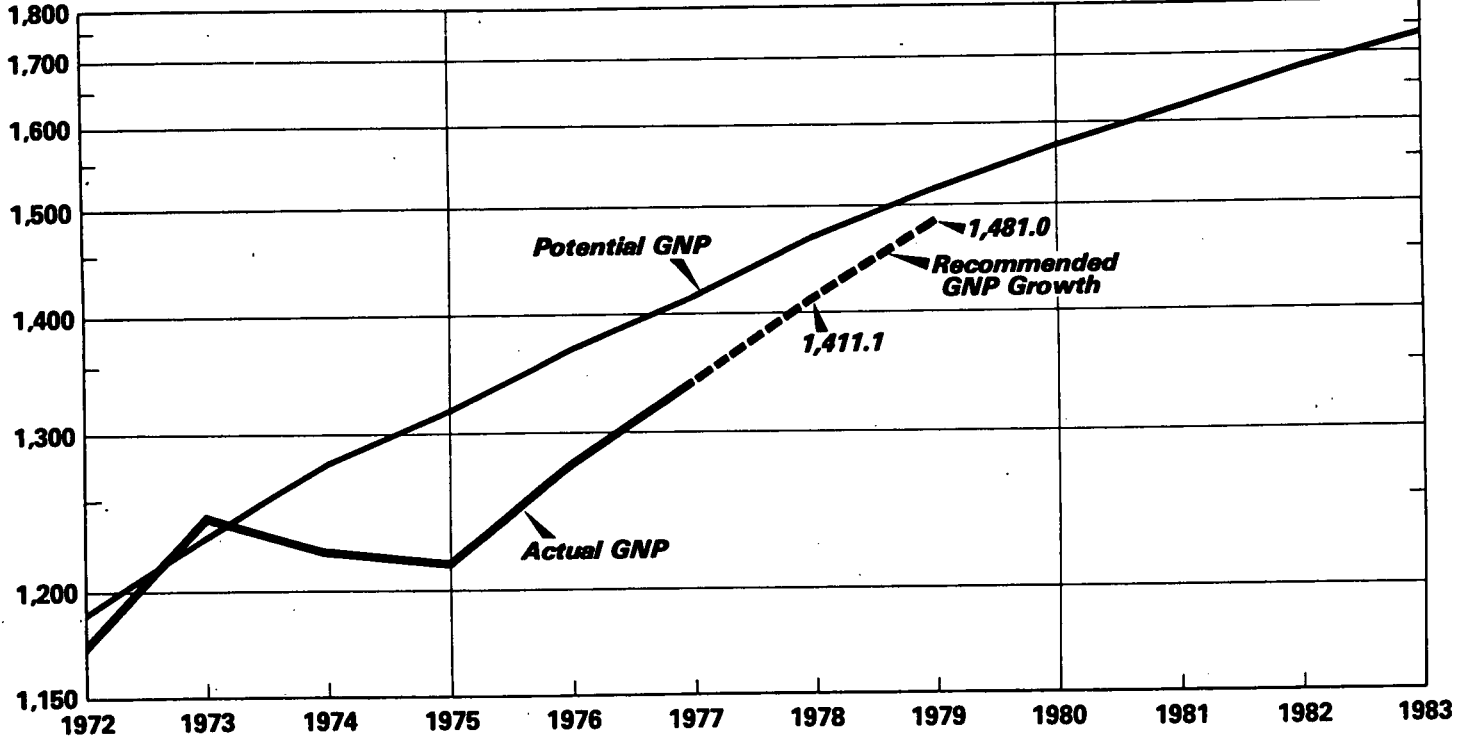
The President's program is based on a particular mix of tax, spending, and monetary policies. Chapter IV discusses a staff study which explored three specific alternatives to the Presidential program. The economic effects of a more expansionary monetary policy, a larger tax cut, and somewhat greater spending were analyzed in turn.

After considering these alternatives, we are convinced that greater reliance should be placed on monetary policy. By pursuing a monetary policy which will reverse the rise in short-term interest rates and move them in the direction of the average level of 1977, the economy could grow and invest more while actually decreasing the level of the budget deficit.

Throughout the 1970s, rising prices have created a whole series of economic problems. In 1977, consumer prices grew by 6.8 percent, a sharp increase over the 4.8 percent rate recorded for 1976. The prospects for significantly reducing inflation in 1978 are not bright. The underlying rate of inflation and the rate of increase in unit labor costs are both over 6 percent. A depreciating dollar, increases in the minimum wage, rising payroll taxes, and a number of other policies will all push prices upward. The Administration hopes to achieve a modest

Potential and Recommended GNP Growth

\$BILLIONS (1972 Dollars)



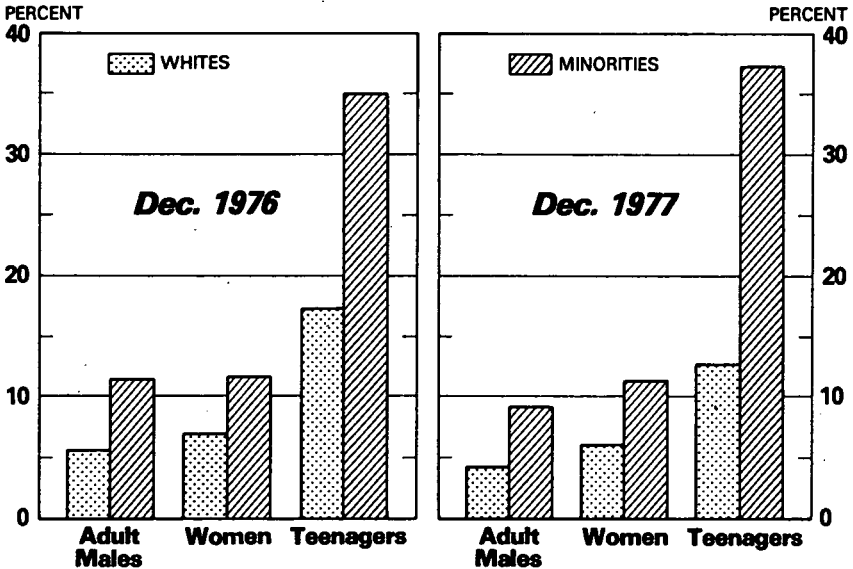
SOURCE: Joint Economic Committee, Department of Commerce, Council of Economic Advisers.

reduction in the rate of consumer price increase to about 6 percent a year. We agree that this is a reasonable target. To reach that and future targets for reducing inflation, the Congress should begin to explore several methods of directly attacking the problem of rising prices. Chapter V examines a variety of potential policies and solutions.

Despite a record increase of 4.1 million jobs and a steady drop in the unemployment rate during 1977, serious employment problems continue to exist for several groups. Members of minority groups, teenagers, and women all suffer significantly higher rates of unemployment than do adult males. Although steady growth in GNP is a precondition to opening employment opportunities for these groups, in many cases structural measures must be adopted. The need for structural programs will become particularly acute as the economy approaches the stage where rising demand begins to create serious inflationary pressures. In Chapter VI, we assess a number of present and potential structural programs.

The very large trade and current account deficits pose serious problems for U.S. policymakers. As the trade deficit approached \$30 billion for 1977, the dollar began to fall in value against the Japanese yen and several European currencies. The Treasury and Federal Reserve Board both moved to intervene in foreign exchange markets to stabilize the international value of the dollar. In addition, the Federal Reserve raised the Federal funds and discount rates in an attempt to increase the demand for the dollar. Because the current account deficit drains aggregate demand away from the domestic economy, compensating fiscal action is needed. Faced with inadequate demand

Unemployment - Whites, Minorities (Unemployment rates, seasonally adjusted)



SOURCE: Department of Labor.

elsewhere in the economy, the current account deficit necessarily increases the size of a compensating fiscal stimulus package and budget deficit. In Chapter IV, the domestic impact of a depreciating dollar is discussed in more detail.

Developments in the international economy now have such a pervasive impact on the U.S. economy that international issues are discussed throughout this Report. We wish to place particular emphasis on two points.

First, the principal causes of the trade deficit are slow growth abroad and an increased reliance on imported oil. The deficit reflects a faster pace of growth and greater economic strength of the United States relative to the rest of the world. In addition, the current dollar deficit also reflects the large oil price increase. This large deficit does not warrant or justify a turn toward protectionism. This is not to say that individual industries are not experiencing considerable pressure from import competition. However, specific industry problems should be handled on a case-by-case basis in the context of a carefully designed policy for economic adjustment.

Second, we strongly advise against using domestic monetary policy for international purposes.² An increase in domestic interest rates to stabilize the dollar would vitiate the President's tax incentives for investment, slow the pace of the economic recovery, and raise the budget deficit.

LONGER TERM ECONOMIC GOALS

The achievement of longer term growth and employment goals is heavily influenced by current fiscal and monetary policy. By establishing specific quantitative longer term goals for economic performance, fiscal and monetary policy can be better tailored to assure steady, non-inflationary growth.

As the economy approaches a high-employment level, the existence of structural imbalances increases the dangers of inflation. A five-year perspective can help focus attention on the sectoral and industrial imbalances that would disrupt growth.

Present-day labor policy can also be improved by viewing the problem from a longer range perspective. A shortage of skilled workers can create inflationary bottlenecks and regional imbalances in the supply and demand for labor. This implies labor shortages and wage inflation in some areas and unemployment and lost production in others. A long-term goal for employment and GNP growth would help to determine the appropriate timing and composition of structural programs needed to improve labor market conditions.

During the past three years, capital formation has been very disappointing relative to previous recoveries. Part of the explanation lies in the severity of the recession which forced the recovery to start from a base of very low capacity utilization levels. Various sources of increased business uncertainty have also deterred capital investment. Through the use of specific long-term goals, the Government could sharply reduce uncertainties that arise from the confusion about the nature and intention of the Federal Government's economic policy.

² Senator Ribicoff states: "This statement is too strong. I would agree that monetary policy should not be used *primarily* for international purposes."

THE FULL EMPLOYMENT AND BALANCED GROWTH ACT

The Employment Act of 1946 established the Council of Economic Advisers and the Joint Economic Committee of Congress, and required the President to submit an annual economic report to the Congress. It was landmark legislation that for the first time acknowledged the responsibility of the Federal Government for promoting "maximum production, employment, and purchasing power." Although the Act has served the country well, it is clear that the increasing complexity of economic policymaking demands that the Employment Act be augmented by supplemental legislation. This is the purpose of the Humphrey-Hawkins bill.

The bill has undergone many revisions. In an earlier form, the present CEA Chairman testified that it carried with it potentially disastrous inflationary effects. Yet today Chairman Schultze endorses the bill. Earlier provisions—such as the right of an individual to use courts of law to sue the Federal Government for satisfactory employment have been discarded. In its present form it is a blueprint for economic progress that sets larger objectives, provides for their implementation through a coordinated approach, and places the responsibility on policymakers for failures to achieve its targets.

Specifically, the Act requires the President to state explicit short-term goals and to recommend the fiscal and monetary policies needed to achieve these goals. It also requires the President to set forth his five-year goals each year. This must be consistent with the Act's objective of reducing the overall unemployment rate to 4 percent within 5 years following enactment.

The bill itself does not contain specific, job-creating programs. Rather, the legislation establishes the structure and the procedures with which the Administration and Congress, with the cooperation of the Federal Reserve, will determine the state of the economy, will identify problems, and implement the comprehensive and coordinated policy and program mix necessary to help guide the economy toward our national goals. It is within this framework that specific, job-creating tax and spending proposals would be considered and enacted.

Unlike the Employment Act, which is silent on the subject of inflation, the Humphrey-Hawkins bill establishes the goal of price stability as a high priority objective.³ The bill proposes to deal specifically with inflation by instituting early warning systems to detect impending capacity shortages, by stockpiling of agricultural and other critical raw materials, and by vigorously enforcing antitrust laws.

The Act is flexible enough to allow for alternatives should the quest for full employment prove to be incompatible with inflation control. Beginning in the third year after enactment of the bill, the President may propose to the Congress modifications of the employment goal to delay the time of its achievement if economic circumstances require it.

Second, the bill recognizes the likelihood that its employment and inflation targets will be very difficult to achieve simultaneously as long as a purely macroeconomic approach to policy is employed. It

³ Senator Proxmire states: "But it does not establish a goal for decreasing the rate of inflation, as it does for reducing unemployment, and is flawed by that omission."

therefore recommends to the President a large number of "structural" options. Among these options are countercyclical employment programs including public works and public service employment, countercyclical revenue sharing, and regional and structural employment policies to reduce unemployment among particular groups and in particular places. Youth employment, training, counseling, and other options are included in the provisions to achieve the goals of the Act.

The bill's stated order of priorities places primary emphasis on promotion of private-sector performance to create the bulk of the job opportunities needed to meet the legislation's employment goals. This would be done through general and targeted fiscal and monetary policies and programs aimed at simultaneously reducing both cyclical and structural unemployment. The next levels of priority action prescribed focus on expansion of employment in the private sector through Federal assistance and through the use of existing Federal jobs and job training programs. New programs could be proposed no sooner than 2 years following enactment in order to give the private sector an opportunity to respond to employment needs. Jobs provided through new programs, for the most part, would be confined to lower paying and lower skilled levels. Thus, the legislation guards against the automatic increase of the bureaucracy or the creation of massive new programs.

While the bill emphasizes private sector performance, it also contains a clear prohibition against government interference with private sector activity. It states that "no provision of the Act shall be used, with respect to any portion of the private sector of the economy, to provide for government control of production, employment, allocation of resources, or wages and prices, except to the extent authorized under other legislation."

The process for implementing the Act begins with the *Economic Report of the President* which is sent to the Congress each January. Under the new law, the Report will discuss the goals of the Act and how the Administration proposes to meet these goals. Part of the latter must include an outline of budgetary policy for the next five years as it relates to the intent of the bill. Shortly after submission of the President's Report, the Federal Reserve System will be required to report how its intended monetary policies support the President's stated numerical goals for employment, production, and prices.

The expanded Economic Report of the President will be sent to the Joint Economic Committee. The Committee will seek the views of various legislative committees and expert witnesses. The Joint Economic Committee will then report a concurrent resolution endorsing or modifying, as appropriate, the President's numerical targets, as well as his intended policies. Changes in these targets will be recommended when they are needed.

The Joint Economic Committee will discuss with the Budget Committees the relationship between appropriate goals and their consistency with the First Budget Resolution. Under the proposed procedure the Budget Committees will be better able to make their decisions because more information about the course and intention of monetary policy will be made available to them. This will permit them to develop a more reliable set of economic assumptions on which to base their outlay and revenue targets.

If we resort to tight fiscal and monetary policies as the only way to control inflation, then the twin goals of low inflation and low unemployment will be unattainable. The Humphrey-Hawkins bill offers a realistic solution to this unpleasant problem. In Chapter V we outline ways of approaching inflation control without resort to the harsh traditional remedies, and in Chapter VI we outline the policy requirements that are needed to bring more of the structurally unemployed back into the mainstream of our national economic life.

We strongly endorse the Humphrey-Hawkins bill and urge its swift enactment by the Congress.

THE PATH TO A HIGH EMPLOYMENT ECONOMY

According to estimates in the President's Economic Report, last year the American economy was operating almost \$75 billion dollars or 5.3 percent below its full capacity. The Administration expects that the economy will reach its high employment potential sometime in late 1981. Adopting the Committee's goals would speed up this timetable.

In the 1977 *Economic Report of the President*, the historic series for potential GNP was substantially revised. For a number of years the benchmark level of resource utilization implicit in the Council of Economic Advisers' estimates was an overall unemployment rate of 4 percent. The new estimates assume that full employment of fixed capital is reached when the manufacturing capacity utilization index calculated by the Department of Commerce reaches 86 percent. This new definition of potential GNP is consistent with a 4.9 percent unemployment rate in 1977 and 1978 and a rate of 4.8 percent in 1981. The unemployment rate consistent with a specified capacity utilization rate will vary as the composition of the labor force changes.

The present Council of Economic Advisers has examined these revisions and has concluded that they represent a major improvement. The Council notes, however, that further improvements are possible. We agree that the accurate definition of potential GNP and the high employment-unemployment rate are matters that demand further analysis. The Council of Economic Advisers and the Joint Economic Committee should continue to refine their analysis of this issue.

Regardless of the final determination of an appropriate high employment-unemployment rate, it seems clear that the dangers of triggering additional inflation increase as the unemployment rate falls below 5 percent. The "full employment" estimates presented below accept the Council's definition of potential GNP as a reasonable guide to the output levels we can expect to achieve through macroeconomic policy tools without creating excess demand inflation. However, we do not accept the associated 4.9 percent unemployment rate as an appropriate goal for social policy. We believe that the 4.9 percent level of unemployment can be reached using macroeconomic policies and that an interim target of 4 percent unemployment can be achieved by adding appropriate structural programs. The key to achieving low levels of unemployment with stable prices is to supplement sound fiscal and monetary policies with structural programs designed to attack unemployment and inflation. In Chapters V and VI, we explore a number of possible approaches to these problems.

FULL EMPLOYMENT BUDGET ESTIMATES

The full employment budget estimates can be quite helpful in understanding the direction and magnitude of fiscal policy changes. These estimates are more complicated than usual this year and therefore must be interpreted with care.

Part of the confusion arises from the different methods of calculating the full employment budget estimates. The budget document shows such estimates on a unified budget basis for fiscal years. The unified budget basis estimates show the full employment deficit increasing each year from 1977 to 1979. In the report of the Council of Economic Advisers, full employment budget estimates are shown on a national income and product accounts (NIPA) basis by calendar years. These estimates show the deficit increasing between 1977 and 1978, then declining between 1978 and 1979. Both sets of estimates are shown in Table III-1.

TABLE III-1.—HIGH EMPLOYMENT DEFICIT (-)

[In billions of dollars]

	1977	1978	1979
Unified budget basis (fiscal years).....	-10	-32	-37
National Income and product account basis (calendar years).....	-17.9	-26.9	-22.6

Source: "The Budget of the United States Government, Fiscal Year 1979"; the "Economic Report of the President," January 1978.

Confusion can be reduced by focusing attention on only one set of estimates. Economists generally regard the NIPA estimates as being the most useful for judging macroeconomic policy. This is because the NIPA attempts to measure current income and production. Transactions which represent an exchange of existing assets such as loans are not included in the NIPA. Income and outlays are recorded in the NIPA when the income is earned or the liability is incurred without regard to when the transaction actually occurs. This method of accounting gives a better indication of when Federal policy affects the economy than alternative methods that record transactions at the time checks are written. Other major differences between unified budget and NIPA estimates relate to timing adjustments and the accounting treatment of asset sales.

Estimates of full employment receipts and expenditures have been prepared by the Joint Economic Committee staff on a half-yearly basis and are shown in Table III-2. These estimates assume the President's budget policy for 1979 is enacted but they adjust 1978 expenditures to reflect the lower levels currently anticipated.

TABLE III-2.—HIGH EMPLOYMENT BUDGET ESTIMATES

[NIPA basis, billions of dollars, annual rates, half years]

	1977:2	1978:1	1978:2	1979:1	1979:2
Receipts.....	406.0	434.7	450.5	464.8	495.2
Expenditures.....	435.1	449.6	483.3	449.2	552.5
Deficit (-).....	-29.1	-14.9	-32.8	-34.4	-27.3

Source: Joint Economic Committee staff.

To utilize the full employment estimates as a measure of discretionary fiscal policy, one should look at changes in the deficit. The movement from a \$15 billion deficit in the first half of 1978 to a \$33 billion deficit in the second half indicates an \$18 billion movement in the direction of greater fiscal stimulus. This is the result of the President's proposed tax reduction which would become effective in the fourth quarter of 1978. After the middle of 1978 the changes in the deficit are very small, indicating that discretionary fiscal policy will be relatively neutral. However, by the last half of 1979 the various sources of fiscal drag begin to exert a restraining force, which causes the full employment deficit to diminish.

The full employment budget surplus, as well as changes in that surplus, are fiscal policy indicators that have been asked to supply more information than they can reasonably be expected to provide. On the one hand it is important to know what the budget surplus or deficit would be if the economy were at full employment. If this computation discloses an alarmingly large deficit, we might wish to avoid the addition of sizable new permanent expenditure programs. Such programs would be ill-advised because they would add to the fiscal base. Recovery in the private sector might then cause total expenditure in the economy to be excessive and therefore inflationary.

However, it is very important that estimates of what the budget surplus would be if the economy were at full employment are not affected by new expenditure programs if these programs are to be phased out as full employment is approached. The obvious reason for this is that the programs neither add to nor subtract from the budget deficit or surplus at full employment.

To estimate full employment revenues, the added revenues that would result from a movement to full employment are estimated and are added to actual revenues to obtain full employment receipts. Similarly, on the expenditure side the reduction in unemployment compensation that would occur from moving to full employment is calculated and this is deducted from actual expenditure to obtain the estimate of full employment expenditure.

Unfortunately, the treatment of other expenditure components is not consistent with this procedure. Programs such as countercyclical revenue sharing; extended unemployment compensation benefits; outlays on food stamps, welfare, and medicaid; and even social security benefits are either deliberately triggered by the unemployment rate or automatically fluctuate with it. Yet no account is taken of this in the full employment budget computation.

On the other hand, because we also wish to measure the magnitude of the impact of discretionary fiscal policies, the CEA calculations raised the full employment deficit when, for example, countercyclical revenue sharing programs were introduced. This would have no effect on the full employment surplus since the revenue sharing grants are eliminated as full employment is approached.

This hodgepodge approach should be changed. Full or high employment budget computations should be clean, clear, and consistent estimates of where the budget would stand if the economy were producing at potential levels of GNP. This should be separated from measures of discretionary fiscal impact. It is unrealistic to ask one calculation to describe movement in fiscal policy and to tell us what the budget

would look like if the economy were operating at potential levels of output.

Table III-3 below shows the levels of receipts and expenditures which might be expected if the economy were operating at potential levels of output and if the foregoing recommendations were put into practice. The level of receipts is unchanged from that shown in Table III-2 but expenditures are lower because many programs—e.g., Aid to Families with Dependent Children (AFDC), Aid to Families with Dependent Children-Unemployed Fathers (AFDC-UF), food stamps, medicare, countercyclical grants—are sensitive to the unemployment rate. As Table III-3 shows, beginning with the tax reductions in the second half of 1977 and continuing through 1979 the Federal Government is providing substantial support to the economy.

TABLE III-3.—FEDERAL RECEIPTS AND EXPENDITURES AT POTENTIAL LEVELS OF GNP
[NIPA basis, billions of dollars, seasonally adjusted annual rate]

	1977:1	1977:2	1978:1	1978:2	1979:1	1979:2
Receipts	398.5	406.0	434.7	450.5	464.8	495.2
Expenditures	396.4	429.3	444.6	479.0	495.6	519.4
Deficit (-)	+2.1	-23.3	-9.9	-28.5	-30.8	-24.2

Note: This table assumes the fiscal year 1979 budget is adopted as proposed by President Carter.

Source: Joint Economic Committee.

It would be a mistake to interpret this support as stimulating economic growth because both the net export sector and the State and local sector are draining purchasing power away from the economy. For example, in 1977 State and local governments ran a surplus of \$29.2 billion—almost three times as large as the deficit shown in Table III-3 above. If the net export deficit of \$10 billion is included, one quickly reaches the conclusion that in 1977 the purchasing power supplied by the Federal Government was grossly inadequate to offset that being drained away by other sectors.

The foregoing discussion raises an important question: Can we expect to balance the budget as we return to potential levels of output? The answer depends largely on the behavior of other sectors of the economy. State and local governments are currently running a surplus of \$13.7 billion in their operating budgets. This will not continue indefinitely, but neither do we expect it to disappear in 1978. At the same time, they are running a surplus of \$15.5 billion in their social insurance funds. This surplus has grown slowly and can be expected to continue—in fact, for the next several years it will rise faster if State and local employment continues to expand. Our net export position deteriorated rapidly in 1977—as recently as the fourth quarter of 1976, we were running a \$3 billion surplus—and this situation could turn around again. Although we expect net exports to remain in deficit in 1978, as the economies in the rest of the world improve and as we learn to conserve energy, our net exports should return to a position close to balance. Taking all of this into consideration we cannot reject the conclusion that it will be necessary to run a deficit in the Federal budget even after we return to potential levels of output in order to offset purchasing power drains from other sectors of the economy. However, as the economy returns to full capacity, the amount of support necessary from the Federal Government (measured as a percentage of potential GNP) should diminish.

IV. MONETARY AND FISCAL POLICY

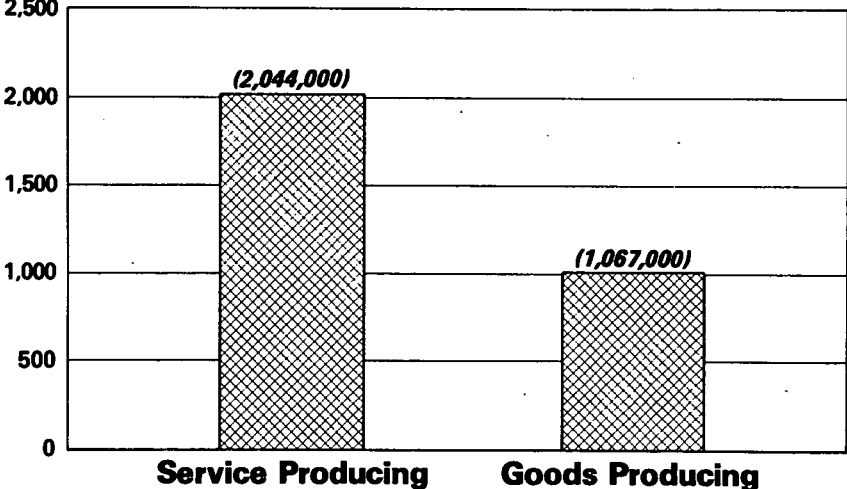
The best economic news about the last year is that from the fourth quarter of 1976 to the fourth quarter of 1977 almost four million new jobs were created in spite of the relatively modest 5.7 percent real growth rate over the same time span. Unfortunately this combination was made possible by very slow productivity growth.

Much of the productivity lag occurred because production and employment growth in 1977 were heavily concentrated in low productivity sectors—wholesale and retail trade, services, and government. It is this fact, too, which explains why manufacturing capacity utilization rates have not risen as sharply as might have been expected in correspondence with the huge increases in employment. Finally, this situation threatens future stagnation of real wages and more inflation as money wage increases add to unit labor costs without the benefit of moderation by productivity growth.

Unemployment is still excessive among most groups in the labor force. Many adult males are unemployed because our manufacturing establishment is still well below its potential and because industrial construction remains depressed. Nevertheless, more balanced growth of demand could quickly reduce excess productive capacity in the near future. Because our labor force has grown so rapidly, we may be in the

Increased Employment January 1977-January 1978^(P) (Seasonally Adjusted)

THOUSANDS OF PERSONS



(P) Preliminary

SOURCE: Bureau of Labor Statistics

process of creating structural imbalances that will combine future capacity shortages with labor surpluses, thereby producing continued stagflation.

The paradox of our present situation is that future considerations point to the need to raise the share of investment in the GNP, whereas the continued presence of excess capacity, together with other factors that have created an inclement investment climate, have caused the performance of capital spending to be exceedingly disappointing. Nonresidential fixed investment in 1977 was only 8.8 percent of GNP—far too little to provide the plant and equipment needed to provide jobs and rising real incomes for a growing labor force.

It goes without saying that the task for monetary and fiscal policy is to sustain the recovery of the economy without exceeding inflationary speed limits. To do this, special attention must be paid to the lagging capital spending sector. This is essential to provide the demand needed for sustained growth and to avoid impending structural problems.

MONETARY POLICY

It is fair to say that the brunt of support for recovery in the last three years has come from fiscal policy while monetary policy has remained preoccupied with the problems of slowing inflation and with the international condition of the dollar. The rate of real M_1 (currency plus deposits) growth was negative in 1975; it became barely positive in 1976; and it reverted to zero in the first half of 1977.¹ One consequence of this one-sided monetary-fiscal policy mix is that consumption and government spending have expanded strongly, while investment and net exports have been retarded. Housing, to be sure, has made a good recovery, but one has to bear in mind how far it had to come from its depressed conditions of 1975.

The budgetary and international consequences of monetary policy are explored in subsequent sections of this chapter. Here we are concerned with the effect on capital spending. Restrictive monetary policies have raised interest rates, thereby lowering bond prices. While many factors have acted to depress the stock market, tight money certainly cannot have helped. High interest rates and low bond prices attract funds to the bond market and this exerts downward pressure on stock prices.

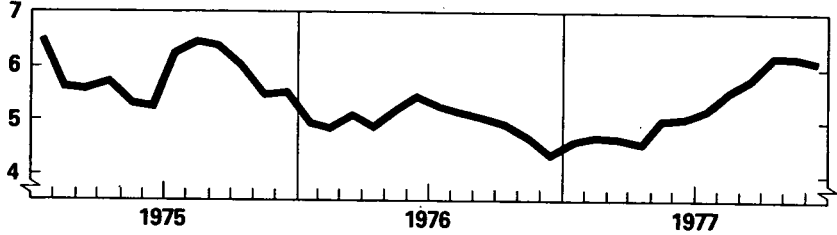
The combination of high interest rates and low stock prices creates an environment that is exceedingly inhospitable to capital spending. High interest rates make borrowing costly, and low stock prices make the flotation of new capital issues difficult and unrewarding. As measured by stock and bond prices, the market value of firms' physical assets is now very low relative to their physical replacement costs. As long as that continues to be the case, the incentive to construct *new* capital facilities will be very weak.

The clearest and most immediate way to alleviate this situation is through more expansionary monetary policy. Without an expansionary monetary policy, the growth and unemployment goals set forth in Chapter III are not attainable.

¹ Senator Bentsen states: "There is, however, considerable disagreement among monetary experts regarding whether the real rate or the nominal rate of growth of the money supply is the proper index by which monetary policy should be judged."

Interest Rate Changes - Treasury Bills

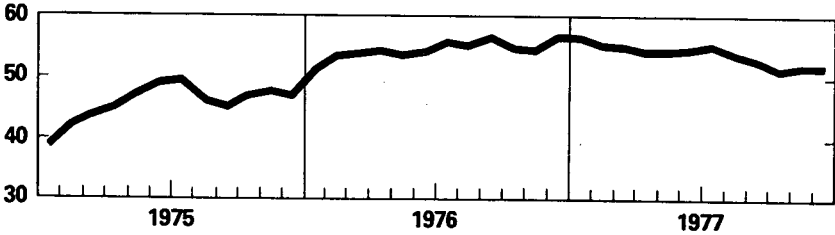
PERCENT PER ANNUM



SOURCE: Federal Reserve Board.

Composite Stock Price Index

INDEX, Dec. 31, 1965 = 50



SOURCE: New York Stock Exchange

Policy in 1977 and 1978

The nominal stock of money, as measured by M_1 , grew 7.4 percent between the fourth quarter of 1976 and the fourth quarter of 1977.² This is the fastest rate of monetary growth since 1972. Despite this, and despite any spectacular growth in real GNP, short-term interest rates (as measured by the Treasury bill rate) rose from an average of 5.0 percent in 1976 to 5.3 percent in 1977. At year end the bill rate was over 6 percent.

The quarterly pattern in 1977 was even more puzzling. Whereas the annual rate of M_1 growth was 6.2 percent in the first half of the year, the growth rate rose dramatically to 11.0 percent in the third quarter. Nevertheless the Treasury bill rate in September was more than 70 basis points above its June level even though GNP growth in the third quarter was unspectacular. The economy experienced a paradoxical situation in which faster monetary growth was more than offset by a slowing of velocity growth. The result is that the rate of monetary growth has had an unpredictable effect on interest rates and on the rate of economic expansion.

What is the explanation for the third quarter that found a higher rate of monetary growth associated with higher short-term interest rates? Monetarists maintain that an increase in the nominal rate of monetary growth raises inflationary expectations and that this puts an

² Senator Proxmire states: "This growth of the money supply over the past year has exceeded the high end of the target goals. I question if different managers would have changed this policy more than marginally."

inflation premium into interest rates. However, that hypothesis would imply a rise in long-term interest rates, and these rates moved very little in 1977.

At quarterly appearances before the Banking Committees, the Chairman of the Federal Reserve Board announces its targets for the growth of the monetary aggregates for the coming quarter. However, there generally is no explanation of how the Fed intends to react if the actual rate of monetary growth deviates from its targets. This fact created a great deal of trouble in the last half of 1977 when the rate of M_1 growth was much higher than the target ranges. In the third quarter, for example, the target range for M_1 was from 4 to 6½ percent, whereas the actual rate of monetary growth proceeded at an annual rate of 11 percent.

In this situation the Fed could have announced that it had decided to support economic growth and was therefore raising its targets. But this option was not available because the Chairman had consistently maintained that growth of the monetary aggregates had been excessive throughout the recovery. Under these circumstances, a rise in the announced monetary growth targets would surely have been interpreted as evidence that the Fed was letting up in its battle against inflation.

In the third quarter the rate of monetary growth and the targets went their own separate ways. The Fed claimed that it could not really exert effective control over the money supply. Convinced that the Fed would not raise its targets, the sharp divergence between the actual and the target rates of monetary growth produced the general belief in financial markets that the Fed would subsequently squeeze down the rate of monetary growth in order to get back on target. This created the expectation of an impending monetary crunch and caused an unloading of various types of assets in favor of cash balances. There was, in more traditional words, a sharp increase in liquidity preference. The result was a slowdown in the rate of velocity growth combined with a very steep rise in short-term interest rates.

This diagnosis suggests that monetary policy may have inadvertently short-circuited itself. Because of the low target range and the expectations created by an above target rate of monetary growth, the faster rate of monetary growth caused velocity growth to decline. This was not accompanied by the usual expected decline in short-term interest rates. In fact, in the third quarter, interest rates actually rose. This causes a serious problem for the economy since it means that we cannot enjoy the benefits of a faster rate of monetary growth because they are automatically offset by countervailing movements in velocity.

The present system of congressional oversight of the Federal Reserve System is clearly in need of reform. It produces the kinds of unfortunate events described above, and it has not served to inform the Congress adequately of the intentions and consequences of monetary policy. Our recommendations for reform are presented below.

As noted in our discussion of the outlook, the 4.5 to 5.0 percent real growth projection for 1978 and the 4.0 to 5.0 percent projection for 1979 presume the adoption of the President's Budget, including his proposal to reduce taxes by about \$25 billion on October 1, 1978. Without the tax reduction, the economy would be very weak at the end of 1978; even with the reduction a marked slowdown is expected in 1979.

Presently planned fiscal policy for fiscal year 1979 is certainly not sufficient to reach our growth targets. It must be recalled that the upper ranges of our forecast presumed a reasonably accommodative monetary policy throughout the period.

For reasons discussed subsequently, most forecasters do not expect monetary policy to be highly stimulative in 1978. Data Resources, Inc. (DRI), for example, looks for the rate of M_1 (currency plus deposits) growth to fall from its 7.4 percent rate of 1977 (fourth quarter over fourth quarter) to rates of 5.7 and 6.3 percent in 1978 and 1979 respectively. These monetary growth rates, combined with the Administration's fiscal proposals, are not sufficient to finance projected nominal GNP growth without a continuation in the updrift of short-term interest rates. This is consistent with the expectations that the Council of Economic Advisers outlined in its Report. As a result of this inappropriate policy mix, DRI forecasts a real GNP growth rate of about 4.5 percent in 1978, and an even less satisfactory rate of 3.9 percent in 1979. Unemployment under these conditions will still be well over 6 percent in 1979, and capital spending will continue to lag as the consequence of high borrowing costs and low stock prices. It must be remembered, in appraising this issue, that under the President's Budget proposals the economy will receive no additional fiscal stimulus until late 1978.

A Joint Economic Committee staff analysis compared the effects of a monetary policy that would bring short-term interest rates back to the average Treasury bill rate of 5.3 percent in 1977 to a DRI baseline solution. The attainment of the interest rate target would require the fourth-over-fourth quarter rate of M_1 growth to be stepped up to about 7 percent of 1978, and to 8 percent in 1979.

It is important to note that "stepping up" means raising the rate of monetary growth relative to the forecasted rates of monetary growth and *not* relative to the 1977 rate. Indeed, if the 7.4 percent rate of 1977 could be maintained, the Committee's goals would very likely be met. Meanwhile, however, it is very important that the Fed's monetary growth targets be raised so as to avoid the problems created by divergence of the actual from the target rate noted above. We believe that the 1977 M_1 growth rate would probably be adequate to achieve the interest rate policy recommended below.

Since monetary policy affects the economy with a considerable lag, the staff analysis shows that it has little effect until late in 1978. But in 1979 GNP would be \$40 billion higher, the real growth rate would be increased a full percentage point, and the unemployment rate would be one-half of one percentage point lower. Thus, monetary growth above 7 percent can eliminate all risk of recession in 1979 and contribute some 500,000 additional jobs.

The effect of this change in the policy mix would be to provide impetus to the investment sector. Nonresidential fixed investment may be \$7 billion higher in 1979 and homebuilding may rise by more than \$13 billion. Because of the clear need to stimulate investment, a more expansionary monetary policy should be high on our list of policy priorities.

Expansionary monetary policies tend to reduce the Federal budget deficit while expansionary fiscal policies do the opposite. Our staff

estimates that attainment of a 5.3 percent short-term interest rate target will reduce the deficit by between \$10 to \$15 billion in 1979. The stronger economy will generate additional revenue from all taxes—personal, business, social insurance, and indirect—and it will reduce outlays for unemployment compensation and welfare. In addition, the lower interest rates will reduce the cost of financing the national debt.

The growth of the money supply should be such that the rise in short-term interest rates is reversed. Policy in 1978 should tend to move short-term rates toward their 1977 levels. Short-term interest rates should be maintained at these lower levels in 1979.

Obstacles to Monetary Expansion: The International Position of the Dollar

Witnesses before the Committee have suggested that the principal reason for expecting monetary growth rates to be held back in 1978 is the Federal Reserve's perceived need to prevent the dollar from falling relative to foreign currencies. Recent increases in the Federal funds and rediscount rates bear witness to the desire to shore up the dollar even at the expense of domestic expansion. If this orientation of monetary policy is continued, the pessimism expressed by some of our witnesses will be justified.

On the other side of this debate are those who believe that our large trade deficit implies the need for a decline in the international value of the dollar. This policy would tend to improve the competitive position of our export industries and would raise the cost of imports, thereby diverting employment from foreign to domestic production.

We believe that so many special factors presently influence our trade balance that neither of these views is acceptable without modification. Flexible exchange rates play an important role in allowing gradual adjustment to take place before severe imbalances develop. But depreciation of the dollar to such an extent that it would eliminate the deficit is simply not feasible or desirable. The prospect of continuing current account surpluses for the OPEC cartel implies continuing current account deficits for the rest of the world. If the United States experiences satisfactory rates of growth, it will bear a substantial share of that deficit.

Much of the trade deficit stems from the fact that the United States is at a stage of the business cycle different from her major trading partners. Relatively strong growth in the United States has led to a rapid increase in U.S. imports. Slow growth abroad has meant weak markets for U.S. exports. Since the volume of trade adjusts slowly to exchange rate variations, a sharp drop in the value of the dollar would, in the short run, simply lead to higher prices for imports (and thus more inflation) and greater turbulence in international money markets. Because of the dollar's role as the world's principal reserve currency, severe fluctuations in its value can impede orderly world economic growth by distorting trade and investment decisions.

The faster the dollar drops, the greater are the risks that the OPEC cartel will raise its prices. Rising oil prices would further depress the dollar and this could then lead to another round of increases in oil

prices. Although domestic fuel prices are almost certain to rise in the future, it is preferable that this be brought about through a reasoned and planned domestic energy program, rather than through the kind of external shocks that were visited upon us in 1974. It will be several years before a national energy policy can significantly reduce our imports of energy. But by signaling the adoption of a long-term strategy to reduce the U.S. trade deficit, a national policy would help stabilize the international value of the dollar.

The view that the dollar must be rigidly defended at all costs is equally unacceptable. Directing monetary policy towards such a goal would return us to the Bretton Woods system in which international considerations took priority over domestic economic objectives. Such a policy would perpetuate the trade deficit, even as it eliminates the overall deficit by artificially stimulating capital inflows. It would be deflationary not only because a perpetual trade deficit represents a perennial net purchasing power drain, but also because it implies high interest rates and therefore vitiates the important role that monetary policy should play in reviving capital spending.

The Joint Economic Committee has long been on record as opposing the use of monetary policy for international purposes. Similarly, we have been opposed to the use of foreign exchange market intervention for the purpose of achieving a domestic monetary objective. We reaffirm this view.³

Domestic recovery is too important an objective to permit monetary policy to be diverted to other goals. We therefore oppose the recent increase in the Federal funds rate and the rediscount rate because they represent deliberate attempts to use domestic monetary instruments to achieve an international purpose. Intervention in foreign exchange markets should be strictly limited to measures designed to correct "disorderly markets."⁴

Our deteriorating foreign trade position is a source of serious concern. We believe that, over time, a part of our trade deficit can be remedied by the speedy adoption of a national energy policy and that the remainder of the problem is inherently temporary and external in origin. Once growth rates abroad pick up, the U.S. current account will strengthen, as will the dollar. Sound policy calls for patience and the resistance of efforts to restrict trade by resorting to protectionist measures. Dumping is to be deplored and may require an appropriate response if the countries involved refuse to change their trade practices. On the other hand there is little evidence that American industry is losing its international competitive edge. Efforts to limit imports would surely be offset by foreign retaliatory responses against our exports. Protectionism might not increase the number of jobs in the U.S., and it could well undo the very significant progress we have made through the years in liberalizing trade.

It is important to the maintenance of the international value of the dollar that capital be encouraged to flow into the United States. How-

³ Senator Ribicoff states: "This statement is too strong. I would agree that monetary policy should not be used *primarily* for international purposes."

⁴ Senator Ribicoff states: "Monetary policy is inherently both a domestic and international instrument. We certainly have disorderly markets."

ever, as we have stated many times, this should not be done through monetary policies because such monetary policies would necessarily be restrictive and interfere with domestic recovery.⁵

Under the circumstances it seems entirely appropriate for this Committee to urge American banks to reconsider their lending policies in a way that would reduce their foreign lending operations somewhat in favor of more generous lending policies to domestic business. A moderate shift in bank portfolios in the recommended direction would take a great deal of pressure off the dollar and would help to finance the capital spending we so badly need. It would also take considerable pressure off the Federal Reserve because it would permit interest rates to be brought down without excessively rapid growth in the money supply.

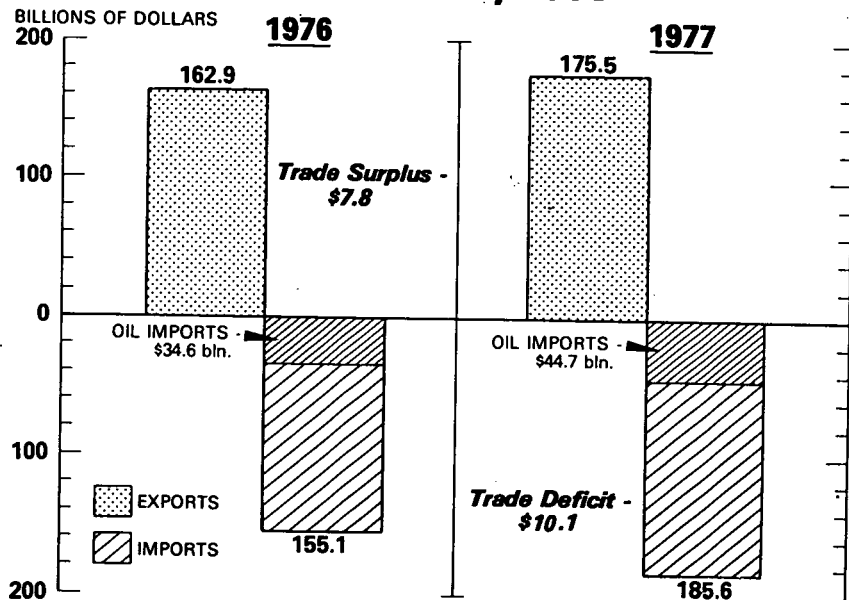
This is a reasonable request to make of our banking system. The United States provides an investment climate of political and economic stability not common elsewhere. Taking this into account, interest rates are not unfavorable. Lending opportunities surely abound. Further, with the new Witteveen facility, foreign credit demands should be eased. It will then make sense for our banks to look home-ward more than they are presently doing.

Correction of our international trade imbalance necessitates that we take measures to restrain our huge appetite for foreign oil. The United States enjoyed a net export surplus of \$7.8 billion (NIPA basis) in 1976, at which time we were spending \$35 billion on foreign oil. However, the trade surplus moved into a deficit of \$10 billion in 1977; \$10 billion out of the total swing of \$16.8 billion was attributable to increased oil imports. Until recently, we were able to pay for our imported oil by our export sales. However, it is also quite clear that we cannot hope to continue to increase our oil imports by \$10 billion each year. Fortunately, much of this increase in 1977 was attributable to special factors including the stockpiling program, the very harsh winter of 1976-77, and the drought in the West which forced utilities to resort to oil to supplement their inadequate hydroelectric resources. In 1978, Alaskan oil and the hoped-for OPEC price freeze provide reasons for optimism.

There is no doubt that we must develop an energy program that reduces our reliance on imported oil. Such a program must consist in part of reduced consumption of oil and of greater domestic production of oil and substitute fuels. Producers must be provided with incentives to raise production and consumers must be provided with incentives to curtail consumption. It seems inevitable that this cannot be done without substantial increases in fuel prices. Although the Members of the Committee have varying views about the President's energy program, we strongly believe that energy price increases should be phased in slowly. Abrupt price increases would produce a sharp reduction in consumer real income and needlessly subject the economy to the same kind of stagflation-producing shocks that were experienced in 1974. We are also persuaded that the fragility of the recovery makes it absolutely imperative that energy taxes be handled in such a manner that they impose no fiscal drag on the economy.

⁵ Senator Ribicoff states: "This statement is too strong. I would agree that monetary policy should not be used *primarily* for international purposes."

Balance of Trade 1976, 1977



SOURCE: Departments of Commerce and Energy

FISCAL POLICY

The President's budget proposal for FY 1979 is for outlays of \$500.2 billion and receipts of \$439.6 billion, implying a deficit of \$60.6 billion. This deficit is roughly the same as the Administration's estimated deficit of \$61.8 billion for FY 1978 and suggests that planned fiscal policy, despite a major proposed tax reduction and reform program, is to be neutral in FY 1979. That is, it will neither add to nor subtract substantially from aggregate demand, relative to the budget for FY 1978.

Expenditure Policy

The Administration estimates that expenditures will total \$462.2 billion in fiscal year 1978 and \$500.2 billion in fiscal year 1979. After allowance for inflation, this implies an expenditure increase in real terms of roughly 2 percent. It should be noted, however, that the \$462.2 billion estimate is \$4 billion above the level specified in the Second Concurrent Resolution on the Budget for fiscal year 1978. In order to spend this amount, Congress would have to pass a Third Concurrent Resolution on the Budget. Further, current spending is running slightly below the \$458 billion level approved in the Second Concurrent Resolution. According to the Congressional Budget Office, the rate of spending is currently in the \$450-\$455 billion range. This implies that the President's outlay estimates for FY 1978 are too high and that spending in fiscal year 1979 will grow 4 to 5 percent in real terms rather than the 2 percent that has been claimed. Comparisons of the Second Concurrent Resolution and the President's estimates for fiscal year 1978 are shown in Table IV-1.

TABLE IV-1.—FEDERAL OUTLAYS—FISCAL YEAR 1978
[In billions of dollars]

	2d concurrent resolution	President's budget	Potential status
National defense	110.1	107.9	105.2
International affairs	6.6	6.5	6.3
General science, space and technology	4.7	4.8	4.7
Natural resources, environment and energy	20.0	20.2	18.8
Agriculture	6.3	9.1	9.8
Commerce and transportation	19.6	19.8	19.1
Community and regional development	10.6	10.6	11.7
Education, training, employment and social services	26.4	26.7	26.2
Health	44.2	44.3	44.3
Income security	146.1	147.6	146.2
Veterans benefits	20.2	18.9	19.1
Law enforcement and justice	4.0	4.0	3.9
General government	3.9	3.9	3.9
Revenue sharing and general purpose fiscal assistance	9.7	9.8	9.6
Interest	41.7	43.8	42.4
Allowances	1.0	0	9
Undistributed offsetting receipts	-16.8	-15.6	-17.0
Total	458.3	462.2	454.9

Note: The functional categories listed here are those shown in the 2d concurrent resolution. Presidential budget estimates have been adjusted accordingly.

Sources: 2d concurrent resolution on the budget, and Senate Budget Scorekeeping Report, Mar. 6, 1978.

Although the President's Budget appears reasonable in light of historical spending patterns, there are several areas where the spending estimates could prove to be too low. For example, the President has proposed a program to aid college students from middle-income families. According to the Budget, funds for this program were included in the \$1.7 billion contingency fund. This same contingency fund is also supposed to include money to pay for the urban program scheduled for presentation later this year. Inasmuch as the original urban aid program called for additional spending of \$3-4 billion, it is difficult to see how the \$1.7 billion contingency fund will prove to be adequate to fund these two initiatives, as well as the other contingencies which will arise during the year.

Elsewhere in this Report, we recommend new initiatives to address our structural unemployment problem. If adopted, these programs would add about \$1.5 billion to 1979 expenditures.

ECONOMIC PRIORITIES IN THE BUDGET

The best way to understand the Government's priorities is through an examination of the annual budget. As the President stated in his message, this year's proposed budget "is the Administration's first full statement of its priorities, policies, and proposals for meeting our national needs."

The key to judging budgetary priorities in any given year is an analysis of the planned use of discretionary budget authority. Budget authority gives the best indications of future plans because it often carries over from one year to the next; outlays in the current year are heavily influenced by earlier decisions on budget authority. Discretionary budget authority represents the amount in requested appropriations over and above what the Government is required to request because of past decisions. The budgetary consequences of past decisions are contained in the Office of Management and Budget's (OMB) current services estimates.

The current services estimates are based on the anticipated costs of continuing ongoing Federal programs and activities at 1978 levels without policy changes. OMB characterizes the estimates as an answer to the question, "How would the budget come out if we simply left the Federal Government on automatic pilot through next year?" The discretionary budget proposals are the difference between the current services estimates and the amounts requested in the Budget.

Table IV-2 shows a breakdown of government functions and compares current services estimates with the President's actual requests. Column 3 in the table shows the incremental differences. For example, the request for National Defense is \$2 billion higher than what would have been spent had the program been left on automatic pilot. Similarly, an additional \$4.5 billion in new budget authority is being requested for Education, Training, Employment, and Social Services.

TABLE IV-2.—CURRENT SERVICES ESTIMATES AND PRESIDENTIAL BUDGET PROPOSALS FOR FISCAL YEAR 1979
BUDGET AUTHORITY BY FUNCTION

(In billions of dollars)

	Current services	Presidential proposal	Discretionary change
National defense.....	126.4	128.4	+2.0
International affairs.....	11.5	13.8	+2.3
General science, space, and technology.....	5.2	5.2	-----
Energy.....	6.9	9.5	+2.6
Natural resources and environment.....	12.2	12.7	+ .5
Agriculture.....	6.6	7.2	+ .6
Commerce and housing credit.....	6.5	6.6	+ .1
Transportation.....	15.5	18.6	+3.1
Community and regional development.....	7.2	7.7	+ .5
Education, training, employment, and social services.....	29.1	33.6	+4.5
Health.....	52.1	52.6	+ .5
Income security.....	189.2	190.9	+1.7
Veterans' benefits and services.....	18.6	19.1	+ .5
Administration of justice.....	3.9	4.1	+ .2
General government.....	4.2	4.4	+ .2
General purpose fiscal assistance.....	9.5	16.6	+7.1
Interest.....	48.7	49.0	+ .3
Allowances.....	1.2	4.2	+3.0
Undistributed offsetting receipts.....	-16.0	-16.0	-----
Total.....	538.3	568.2	30.2

Source: Special Analyses of the Budget of the U.S. Government, Fiscal Year 1979.

Two cautionary notes must be made about these figures. First, the current services estimates for a number of functions are questionable. As a general rule, current services estimates include anticipated inflation. Where inflation is not taken into account—principally, Veterans' Benefits and General Purpose Fiscal Assistance—the current services estimates are understated and the differences between them and the budget requests are overstated. Secondly, the figures by themselves may be misleading unless one understands the context of the program and how the funds are intended to be spent.

Large amounts of discretionary budget authority are being requested for functions that produce relatively little domestic economic activity. In this category are National Defense (\$2 billion), International Affairs (which receives \$2.3 billion, mostly for the Witteveen facility) and Energy (\$2.7 billion, mostly to import and store foreign fuel).

The growth in Defense appears to be primarily in the support categories for a wide variety of conventional forces. This growth is partially offset by a large decline in strategic forces caused largely by a planned reduction in the number of Trident submarines to be built this year. The reduction in Trident construction tends to understate the overall increase in Defense.

The largest single increase is for General Purpose Fiscal Assistance (\$7.1 billion). This item consists of the proposed taxable municipal bond option intended to provide interest rate subsidies to States and municipalities who want to sell taxable bonds. Although the bonds would be used mostly to finance capital improvements, it is not clear that a greater volume of improvements will be undertaken just because they are financed in the taxable bond market. It is also interesting to note that despite the large request for budget authority, the Administration anticipates spending very few of these funds.

Large increases in discretionary authority are being requested for Transportation (\$3.0 billion) and Education, Training, Employment, and Social Services (\$4.5 billion). Most of the Transportation increase is the result of changing the Urban Mass Transportation's funding from contract authority to annual appropriations. While this represents an improvement in the presentation of the budget, it does not indicate a commitment of increased resources to Transportation. The increases requested for Education, Training, Employment, and Social Services are spread across a number of programs. In the employment area, however, the proposed increase in budget authority provides no additional public service employment jobs. Budget authority requests are actually being reduced slightly for the Youth Employment and Demonstration Act and significantly for the Jobs Corps program. The requested increase for the Comprehensive Employment and Training Services Administration may not be adequate to cover the increased costs of Title I that will result from the rise in the minimum wage.

There are relatively small discretionary increases requested for the Agriculture, Community and Regional Development, and Health functions. The request for Veterans' Benefits would show a decline if inflation were taken into account. The increase requested for Income Security will mostly be absorbed by inflation. Much of the large request shown under Allowances is to pay for Federal Government civilian pay raises.

An examination of the President's discretionary budget choices reveals little evidence that a major change in priorities is taking place. There are some signs that a foundation is being laid for future changes. But so far, this year's priorities are similar to those of prior budgets. Further, there is likely to be less economic stimulus in the budget requests than is apparent from the figures because of the composition of the increases.

URBAN POLICY AND HOUSING

The President has stated his commitment to the revitalization of declining urban economies. The Budget, however, contains no major initiatives for the cities, does not redirect Federal assistance into areas of greatest need, and does not provide for improved coordination of

existing programs.⁶ We await the announcement of the Administration's urban policy, but remain doubtful that urban problems can be significantly reduced without eliminating the shortcomings in the existing programs.

Despite the NIPA data which indicate an annual State and local government surplus of \$30 billion, many localities still face serious fiscal problems. These data should be collected and released on a State-by-State basis indicating operating revenues and pension trust fund accounts for each State. Many proposals to assist urban areas have been brought to our attention. The following deserve serious consideration:

As a general rule, Federal programs in urban areas could target assistance to people in greatest need. Too often government funds have been distributed in a way that does not achieve the objectives that Congress intended.

The Countercyclical Fiscal Assistance Act of 1977 expires on September 30, 1978. This Act could be made permanent. Assistance could be made available by using local unemployment rates as the trigger rather than a national rate which masks high rates of local unemployment.

The Administration has proposed extending the Investment Tax Credit to apply to industrial and utility structures as well as plant and equipment. It is feared that the effect may be to divert private investment away from older cities. Consideration could be given to adjustments which place investment in rehabilitation on a net equal footing with investment in new construction.

The deterioration of public facilities in the cities has been exacerbated by the recent recession. The deferral of maintenance and repair of roads, sewers, and bridges poses a grave threat to the cities' greatest asset—their infrastructure. The Federal Government could provide guidelines for localities to inventory their public facility maintenance, repair, replacement, and expansion needs. Such an inventory could be required for participation in the Community Development Block Grant and Economic Development Assistance programs.

The existing housing rehabilitation program could be significantly expanded to improve the housing stock and increase job opportunities in cities with deteriorating residential areas.

The Public Works and Economic Development Act of 1965 could be funded at its authorized level of \$1 billion. An increase from the budgeted amount of \$533 million would require no new legislation and would assist distressed areas in revitalizing their economies.

Many of the cities which are experiencing population growth are finding it difficult to meet the increased demands for housing, roads, sewers, schools, and other public facilities. Every effort must be made to prevent these cities from developing the problems which confront our older cities. The Department of Housing and Urban Development could provide extensive technical assist-

⁶ Senator Proxmire states: "The cities now receive \$65 billion or more a year from the Federal Government. This is ample and should not be increased. Instead, a major effort must be made to reorder priorities and to channel funds into areas of greatest need, rather than to meet the demands of the most affluent and political powerful groups in the cities who have clout all out of proportion to their numbers."

"The emphasis by the Secretary of Housing on new starts, the change in the formula for Community Development, and the effort to get FNMA to do its job are correct and the kind of reordering of previous priorities which can get the job done."

ance to these areas. Preventing blight is less costly and less difficult than eliminating it.

A National Domestic Development Bank could provide long-term, low-interest loans to municipalities, private industries, and nonprofit organizations for economic development purposes. This Bank could provide municipal loans for development of public facilities as well as business loans, including venture capital for business investment in high unemployment localities.

Many small cities are beset with serious problems. Small cities, however, find it difficult to compete with larger cities for Federal funds. Special consideration may be necessary to ensure that small cities are able to meet their needs.

TOTAL SPENDING

In broad terms we endorse the tax-expenditure policy mix proposed by the Administration. This does not imply that moderate expenditure increases and tax reductions are the only means of providing economic stimulus. Certainly the alternative of greater spending and lower tax reduction deserves consideration, and we have clearly indicated that in any event monetary policy must be expansionary.⁷

*Tax Policy*⁸

It may seem surprising that the 1979 Budget provides almost no net additional stimulus in calendar year 1979 even though it contains a proposed income tax reduction of about \$25 billion. The reason is that the tax reduction is largely offset by tax increases that will take place automatically in 1978 and 1979.

The possibilities for expanding existing spending programs are limited. We have recommended increases in public sector job programs and countercyclical grants, and we have also indicated areas where the President's Budget estimates appear to be low. These proposals yield a total expenditure estimate of \$500-\$505 billion.

⁷ Senator Proxmire states: "I reject this alternative. We should cut spending, and if possible, increase tax cuts, not the other way around."

⁸ Senator McGovern states: "The Joint Economic Committee does not discuss the Administration's individual tax proposals in this Report. However, there is one reform proposed by the President that is so urgent and so long overdue that I feel it is my responsibility to call attention to it and to urge its enactment."

"The proposal in question is the President's plan to scrap the present system of providing each family with exemptions of \$750 per dependent and to replace this with a per capita tax credit of \$240. This reform would greatly improve the equity of our income tax system since the exemptions are of principal benefit to high income taxpayers. To illustrate, if a high-income family that pays a marginal rate of 40 percent has an additional child, that family will save 40 percent of \$750 or \$300 in taxes. On the other hand, a low income family paying a 10 percent marginal rate would save only \$75. This is clearly an unfair system. If it were replaced by the \$240 tax credit, both families would save \$240 if they gained an additional dependent."

"I would like to carry the President's proposal one step further. A low income person whose computed tax liability (prior to deduction of the credit) does not come to \$240, cannot avail himself of the full amount of the credit. I therefore propose that the credit be made fully refundable. This would further improve the equity of the tax system: it would provide a family of four with a minimum income of \$960 and therefore establish the basis for a rational start towards welfare reform. It would provide an incentive for more low-income persons to file a simple tax return and to acquire social security numbers. This would be of tremendous assistance to the so-called "outreach" programs that presently spend large sums attempting to identify and locate low-income persons so that they can receive the various benefits to which they are entitled. Finally, by consolidating the present \$30 per capita credit with the new \$240 credit, combined with the elimination of the exemption, the personal income tax would be greatly simplified."

"I have asked the staff to estimate the budget cost of this proposal and have learned that its cost would be about \$21.5 billion in calendar year 1978. In view of the very serious danger of a recession in 1979, it seems to me that this proposal would not only be humane and improve the equity of our tax system, but would be very sound fiscal policy as well."

If we choose to rely exclusively on spending increases to provide economic stimulus, we would need to consider major new initiatives. While we are not prepared to make specific recommendations at this time, there is certainly no shortage of opportunities. National health insurance and welfare reform are two issues which have been debated and which, depending upon the specific proposal, could imply sizeable spending increases. We are also very aware of the deficiencies in our transportation infrastructure and of our enormous urban needs. Many farmers are also in trouble and need help.

There are, obviously, many ways to raise spending should be decided to do this rather than lower taxes. The problem is to buy the time necessary to plan the programs so that the funds will be spent productively and at the same time provide a speedy economic impact.

In fiscal year 1979, total Federal expenditures should be between \$500-\$505 billion and total tax receipts should be approximately \$440 billion.⁸ This fiscal policy, combined with the monetary policy discussed above, will achieve the economic goals set forth in this Report.

If social insurance payroll taxes were to rise by the same percent as the forecasted rise in nominal GNP in calendar year 1978, the taxes would increase by about \$13 billion. However, the forecasted increase is closer to \$19 billion. The extra increase of about \$6 billion is attributable to the fact that both the social security tax rate and base rose at the beginning of 1978 and to the fact that the minimum taxable Federal base for unemployment insurance increased from \$4,200 to \$6,000, thereby raising Federal payroll taxes on employers, and forcing many States to raise their unemployment insurance payroll taxes.

Because of the progressivity of the personal income tax, this tax tends to rise automatically by 1.5 to 1.6 times the percentage rise in nominal personal income. If income taxes were proportional, they would rise by about \$19 billion in calendar year 1978. But because of the progressivity factor they will rise by \$29 billion. The difference of \$10 billion between the two figures is the fiscal drag attributable to the personal income tax. Added to the substantial payroll tax increase, this amounts to a net fiscal drag from these two sources of about \$15-\$16 billion, and wipes out about two-thirds of the stimulus that would be provided by a \$25 billion tax reduction.

Those who propose to reduce taxes by more than \$25 billion certainly have a strong case. They can point to the severe fiscal drag that will occur in 1978. They can also emphasize that this drag will be magnified to \$30 billion in 1979 when the new social security law begins to affect the level of payroll taxation.

In general we are favorably disposed toward the Administration's specific tax reduction proposals. Because of the combination of tax reduction with controversial tax reforms, a somewhat larger tax reduction than the President's \$25 billion may emerge.

Congress has recently enacted a social security financing bill that relies entirely on increased payroll taxation and that is likely to have very serious economic consequences. Payroll taxes charged to em-

⁸ Senator Proxmire states: "I believe expenditures are at least \$25 billion too high and that the Government could be more efficient at the lower figure."

ployees are generally regressive so that income tax relief may not provide an adequate offset. Payroll tax increases on employers raise labor costs and are passed forward into higher prices. This reduces consumer real income and consumption and therefore simultaneously adds to inflation and unemployment.

We are impressed by the proposal to fund Hospital Insurance under Medicare (HI) and Disability Insurance (DI) through general revenue. For calendar year 1978 this would eliminate the need to raise \$33 billion in payroll taxes.

Serious consideration should be given to a \$33 billion reduction in payroll taxes as a substitute for the Administration's tax proposals. Since business costs would be reduced by about \$16 billion, corporate tax liability would rise by about \$5 billion, so that the net revenue loss would be about \$28 billion. Employers would benefit from lower labor costs and higher profitability; output and employment would expand; inflation would be slowed; and our tax system would become far fairer and more equitable. Unlike the retirement system, benefits from DI and HI are not closely linked to contributions and therefore, there is no particular justification for financing these programs from earmarked payroll taxes.

Fortunately, there is ample time to undo the harm of the recently passed social security bill because Congress wisely delayed the addition of any new taxes until 1979. Some provisions of the bill, such as the elimination of double indexation of benefits, were badly needed changes which should be retained.

Congress should immediately begin a review of the social security financing legislation recently enacted. Special attention must be given to the long-term macroeconomic consequences of any financing proposal.

Because of the extraordinary drains caused by the deep and protracted recession, the Unemployment Insurance (UI) system is in financial distress. State and Federal Governments have raised their payroll taxes on employers. This has been very harmful to the economy because it raises labor costs and therefore adds to inflation and unemployment.

The Administration's proposal to reduce the Federal tax rate on employers from 0.7 percent to 0.5 percent of taxable wages merely reverses the rate increase that went into effect in January 1977. It would be more useful to rescind the Federal tax base increase (from \$4,200 to \$6,000) that went into effect in January 1978 since this base increase raises the minimum taxable base for the States and therefore forces many of them to raise their UI taxes.

Additional measures to assist UI are urgently needed. Specifically:

(1) Federal Trust Fund deficits attributable to Extended Benefit and Supplementary Benefit Programs should be forgiven by a one-time emergency transfer from the general fund to the Federal UI Trust Fund. Such a transfer is entirely appropriate since UI was never intended to deal with long-term unemployment. The transfer would add nothing to the budget deficit.

(2) Assistance to the States in reducing present debt should be provided by transfers from the general fund. So-called "cost equalization" grants are entirely appropriate. These grants should be allocated on the basis of the amount of extraordinary unemployment suffered in a State during the recent recession. It is important that the allocation not be related to the size of a State's Trust Fund deficit, since that would penalize those States that have worked to maintain the financial viability of their UI systems and would be a "bail-out" for States that have not.¹⁰

(3) The present system of imposing Federal penalty taxes on employers in States whose UI systems are in debt to the Federal Trust Fund accounts should be discontinued because it causes States to raise employer payroll taxes during periods of high unemployment. This system should be replaced by a 5 to 10 year repayable loan program, and the incentive to repay should be provided by a modest interest charge rather than by harmful taxes on employers. The term of the loan should be extended by one year for any year in which unemployment in a State exceeds 6 percent.

(4) General funds should be infused into the State UI system whenever the unemployment rate in the States rises above 6 percent. This would enable States to avoid tax increases during periods of high unemployment.

We believe that these reforms are extremely important. The viability of our unemployment insurance system makes it imperative that the Federal Government assume major financial responsibility during periods of economic emergency. Failure to do so merely means higher burdens of payroll taxation on employers with the consequence of more inflation and higher unemployment.

CROWDING OUT

The prospect of a \$60 billion deficit has caused renewed expressions of concern about the possibility that Federal competition for funds would raise interest rates and "crowd out" private investment spending. It is therefore important to reexamine this issue.

Crowding out would certainly be the consequence of an increase in government spending or a reduction in taxes at a time when the economy's resources are fully utilized. Under such circumstances, the share of national output that accrues to one sector of the economy cannot be expanded without reducing the share that goes to other sectors. However, this is not currently a problem because the presence of idle resources makes it possible for all sectors to expand simultaneously.

To conduct a greater volume of business, individuals and businesses will need more money in their pockets and in their bank accounts. When the Federal Reserve fails to supply this accommodation, interest rates rise. To get the money balances which they need, people will

¹⁰ Senator Bentsen states: "I disassociate myself from this recommendation."

attempt to borrow and to sell some of their earning assets—bonds, stocks—and as a result, bond prices will fall and interest rates will rise. This produces monetary crowding out of interest-sensitive expenditures. However, such crowding out is entirely avoidable by sufficiently accommodative monetary policy. On March 7, 1975, we reported to the Senate Budget Committee as follows:

If heavy government borrowing does drive up interest rates, it will be because the Federal Reserve has not made sufficient credit available, not because the financial system cannot handle the flows.

We continue to subscribe to this view.

Nevertheless, one may ask why the budget deficit remains so large despite substantial economic recovery. One answer is the bias of recent years towards restrictive monetary policy combined with expansionary fiscal policy. This policy bias has weakened investment. A second reason is the very sizeable surplus that is now being run by State and local governments. This surplus came to \$29.2 billion in calendar year 1977 on an NIPA basis and represents a net withdrawal of purchasing power that is appropriately offset by the Federal deficit. A third reason is our foreign trade deficit. As long as imports exceed exports, there will be a net drain of purchasing power out of the United States. Unless we are willing to let such a drain slow the economy, we will have to offset it either with a deficit in our Federal budget and/or with other measures that stimulate spending in the private sector of the economy.

IMPROVEMENTS IN POLICY COORDINATION

Many committees in the Congress are concerned with economic policy. It is the unique responsibility of the Joint Economic Committee to review the overall economic situation and to ensure that policies are adequate, consistent, and properly coordinated. Under the Employment Act of 1946, the Joint Economic Committee reports to Congress early in the year on the President's Economic program, and in this Report the Committee provides its own evaluation and recommendations on the entire program and its component parts.

Monetary policy is a central ingredient in the annual policy strategy, and it is therefore essential to review monetary policies in detail and to consider their impact and interrelation with other elements in the economic outlook. Of particular concern to us is the appropriateness of the monetary-fiscal mix. We must ensure that monetary and fiscal policies do not work at cross purposes. To see that these policies are coordinated in the common interest is one of the essential functions of the Joint Economic Committee.

Over the years we have frequently called attention to serious inadequacies in the coordination of monetary and fiscal policy. It was this concern that led us in 1975 to urge that the Federal Reserve report regularly to the oversight committees on its monetary policies and the operation of such policies. Subsequently, legislation was enacted to require quarterly reporting to the House and Senate by the Federal Reserve.

While the legislation has represented a great improvement over past practice, subsequent experience has disclosed imperfections. An ex-

perience such as that of the third quarter of 1977, which was described earlier, leads us to urge further changes in the oversight process of the Federal Reserve. As noted earlier, there are some technical deficiencies of the Federal Reserve's reporting system, and we are also concerned with the development of a rational monetary-fiscal strategy. To deal with both of these problems, we make the following recommendations:

The Federal Reserve should issue a written report to the Congress shortly after the receipt of the Economic Report of the President. After consultation with the House and Senate Banking Committees, the Joint Economic Committee will review the report and make its recommendations. The Federal Reserve's report would be expected to meet three basic requirements:

(1) It would analyze the desirability, consistency, and feasibility of the quantitative goals for employment growth, and inflation for the forthcoming fiscal year as set forth by the President.

(2) It would provide the Federal Reserve's own quantitative forecast of economic activity for the forthcoming year on a quarterly basis.

(3) It would discuss in exact quantitative terms how the proposed monetary policies are designed to reconcile the President's targets and the Federal Reserve's own forecast.

This reform would eliminate many serious problems. It would provide this Committee with the information it needs to perform its policy coordination role effectively. It would also ensure that monetary and fiscal policies aim at the same goals rather than work at cross purposes as has happened all too frequently in the past. Such biases as the one that has supported consumption but held back investment during the course of the current recovery would be eliminated.

It should be understood that the Federal Reserve System is responsible and accountable to the Congress. In the event that there is conflict between the targets of the Administration and the goals of the Congress, the Federal Reserve must be guided by the will of the Congress.¹¹

Finally, in the past the Budget Committees have been hampered in their attempts to estimate future expenditure and revenue levels because these variables depend on the state of the economy, and that cannot be known with any certainty as long as there is no precise knowledge about the intentions of monetary policy. We therefore make the following recommendation:

The timing of the Federal Reserve's reporting cycle should be changed to coincide with the congressional budget cycle. The Chairman of the Federal Reserve would therefore appear before both Banking Committees in time to permit these com-

¹¹ Senator Ribicoff states: "We should not forget the benefits of an independent Federal Reserve System. While I support moves toward increased communication and coordination. I would oppose any attempt to eliminate or seriously damage the independence of the Federal Reserve System."

mittees, and the Joint Economic Committee, to report to the Budget Committees on monetary policy prior to the First and Second Concurrent Resolutions on the budget.¹²

None of these proposals is in any way inconsistent with, nor are they meant to change, any of the requirements of the Full Employment and Balanced Growth Act described in Chapter III. It is essential to reform the present Federal Reserve reporting system and to ensure the planning and coordination of monetary and fiscal policies in the national interest. Passage of the Full Employment and Balanced Growth Act would greatly facilitate the aims set forth here.

¹² Senator Proxmire states: "This recommendation is subject to the actions of the House and Senate Banking Committees. As Chairman of the latter I reserve judgment on it."

V. THE CONTROL OF INFLATION

Inflation continues to be among the most serious and intractable problems confronting our economy. Under the impact of increased oil prices and poor world food harvests, consumer prices rose 11.0 percent in 1974. In 1975, despite enormous slack as the economy reached the bottom of the worst recession since the Great Depression, the Consumer Price Index (CPI) still grew 9.1 percent. Substantial improvement occurred in 1976 with a slowing of the inflation rate to 5.8 percent, but this once again gave way to a worrisome rise of 6.5 percent in 1977. It is important to note that none of the cited years could be regarded as years in which aggregate demand was excessive.

The central theme of our *1977 Midyear Review of the Economy*¹ was that inflation is the principal impediment to the recovery of the economy. That theme is still valid. In 1975 it was thought that an annual real growth rate of 7 percent was feasible and that full employment could be restored no later than 1980. Because of the failure of inflation to abate, policymakers are fearful that rapid rates of real growth will set off new waves of inflation. This fear has been a serious impediment to the adoption of stimulative policies designed to speed the recovery of the economy.

INFLATION AND RECOVERY

Excessive unemployment calls for expansionary policy, but this risks renewed inflation, while a high rate of inflation calls for restrictive policy, thereby risking higher unemployment. Unfortunately, during the 1970s inflation has hampered the implementation of the Employment Act by fostering the adoption of economic policies that slow economic growth and increase unemployment.

A notable example is the Federal Reserve's action to reduce the real quantity of M_1 by a full 9 percent from the end of 1972 to the middle of 1977. Another is the cautious fiscal policies pursued during this same period. We have had very large budget deficits, but these have been the automatic consequences of the recession. The recession has depressed revenues from all tax sources, and it has raised outlays for unemployment compensation, welfare, food stamps, and the like. The bulk of the deficits have been due to these automatic factors which overshadow the effects of the discretionary policies that have been put in place. Although Congress has granted tax relief and has created new public service and youth employment programs, it is nevertheless true that the budgets of the last few years have provided very little new net fiscal stimulus, and the budget for fiscal year 1979 is no exception. Fear of inflation has been the principal source of this fiscal caution.

¹ *The 1977 Midyear Review of the Economy*, Report of the Joint Economic Committee, Congress of the United States, together with Minority and Additional Views, September 30, 1977.

Inflation produces restrictive effects that automatically slow growth and raise unemployment. It lowers the real quantity of money, raises interest rates, and reduces investment. It also reduces the real value of public debt and has an adverse wealth effect that may lower consumption. Perhaps worst of all, it moves taxpayers into higher brackets, even without benefit of any rise in real income, so that their average tax rate increases, real disposable income therefore declines, and consumption expenditure is curtailed.

We have repeatedly pointed out that inflation cannot be dealt with through demand restriction without exacting intolerable costs in terms of lost production and employment.

Dr. Otto Eckstein, President of Data Resources Incorporated, has made the results of a DRI study of stagflation available to the Committee. This study shows that inflation could be reduced to about 4 percent by 1981 by restrictive policies that would steadily raise the unemployment rate to about 10 percent. In an alternative, but equally unacceptable scenario, it was calculated that inflation can be reduced to about 4 percent by 1983, but at the cost of an immediate sharp rise in unemployment to about 8 percent and subsequent indefinite maintenance of the unemployment rate at that level. Analysis by other competent researchers are consistent with these unacceptable trade-off estimates.

Clearly, demand restriction is not the answer to a cost-push inflation triggered by sharp increases in oil and raw materials costs and propelled onward by subsequent spirals of wages and prices attempting to keep up with each other. We have maintained our opposition to demand restriction consistently and we are gratified that the present Administration is in full agreement. In his Economic Report, the President states (p. 17):

Recent experience has demonstrated that the inflation we have inherited from the past cannot be cured by policies that slow growth and keep unemployment high. Since 1975 inflation has persisted stubbornly at a 6 to 6½ percent rate—even though unemployment went as high as 9 percent and still stands above 6 percent, and even though a substantial proportion of our industrial capacity has been idle. The human tragedy and waste of resources associated with policies of slow growth are intolerable, and the impact of such policies on the current inflation is very small. Moreover, by discouraging investment in new capacity, slow growth sows the seeds of future inflationary problems when the economy does return to high employment. Economic stagnation is not the answer to inflation.

In view of the basic agreement that stagnation is not the answer to inflation, the question before us is how to stop inflation without resorting to the tight budgets and monetary restriction that have been the centerpieces of the futile and costly antiinflation policies of the last several years.

INFLATION PROSPECTS

Earlier in our Report, we accepted the Administration's goal of a 6-percent rate of inflation in both 1978 and 1979 as a limited improve-

ment that is attainable. As a goal, 6 percent is realistic. As a projection, it can only be termed optimistic. There are several reasons for this conclusion.

If recovery proceeds as hoped we may run up against specific capacity bottlenecks. Such a prospect sounds remote with unemployment still above 6 percent, but the lagging capital spending that we discussed in the preceding chapter makes it entirely possible. If reliance is placed exclusively on monetary and fiscal policy, we cannot expect the inflation rate to decline as the economy approaches full employment and full capacity because this will be accompanied by tightening of labor, materials, capital goods, financial, and product markets.

In addition, government policies keep pushing up costs and prices. While some of these policies may be unavoidable and justifiable, they nevertheless raise prices. Even when the price increase comes from a one-time change such as a decision to increase a payroll tax, or a decision by a State to increase its sales taxes, the higher prices become a part of the cost of living. This affects subsequent wage negotiations which, in turn, affects the behavior of unit labor costs, and therefore is likely once again to show up as a price increase. Consequently, even one-time changes that raise the price level tend to become embedded in the wage-price spiral.

To cite a few examples of inflationary Federal policies, in 1977 the importation of color television sets was sharply limited by a quota system, and at present a new program is being implemented that would deny domestic consumers the option of using low-cost foreign steel. Import quotas were also placed on shoes, and the International Trade Commission has been pressured by demands for protection from the manufacturers of a wide variety of products. As our Midyear Review noted, "One of the best ways to slow domestic inflation is to avail ourselves of inexpensive supplies of foreign goods."² Recent trends have moved in the opposite direction and, in the light of our trade deficit, there is little ground for hoping that this situation will change in the near future.

During 1977 price supports on milk and other agricultural products were raised. Although we do have a serious farm problem at the present time, it is important to recognize that the traditional approach of raising farm prices through supply restriction contributes to inflation. Farming is a hazardous occupation, and farm income is volatile and in need of stabilization. But certainly in the era of rapid and stubborn inflation, it would be preferable to achieve income parity by means other than price supports.³

² *The 1977 Midyear Review of the Economy*, p. 60.

³ Senator McGovern states: "The Committee Report is correct in its statement that we now have a serious farm problem. I take issue, however, that traditional approaches necessarily contribute to inflation. In the first place, the Committee print does not address itself to posing an alternative to the necessity for raising net farm income nor does it recognize that it is more probable that any inflationary tendencies that result from price supports are ascribable to other sectors within the food chain. Adjusted net farm income for 1977 fell to \$20 billion. It was \$30 billion in 1973. Farmers cannot produce for a market whose prices are below their cost of production. I feel that it is shortsighted for the Committee to conclude that it is preferable to achieve parity by means other than price supports without considering what means of achieving parity it would consider to be in the national interest.

"May I further point out that in my judgment the Committee has failed to focus on the intensity of the present farm crisis. My years of public service indicate to me that the present day revolt is more serious than anything the Congress has seen since the 1930s. For these reasons, I respectfully wish to disassociate myself from that paragraph of the Report relating to agricultural prices."

Environmental regulations are laudable but they deter investment and they raise prices. More careful scrutiny of the employment and inflation generating effects of such regulations is badly needed.

Minimum wages were raised during 1977 from \$2.30 to \$2.65 (effective January 1, 1978), and under the new law additional increases are scheduled for 1979 and 1980. While designed to provide minimum income to low-income workers, it tends to decrease their prospects for employment. In addition, higher labor costs are transmitted into higher prices, and this may tempt the Federal Reserve to pursue more restrictive monetary policies.

Some people are harder to employ than others and minimum wage legislation often creates the severest employment problems for those it most intends to assist. We therefore suggest that an experimental system of wage subsidies for employers be designed for high unemployment labor markets that would equalize employment opportunities for unskilled teenage Americans. Hopefully, this would remove many of the present obstacles to the hiring of young people—especially minority teenagers—and it would permit them to develop work habits and skills that would provide future value to the economy far in excess of the cost of the program.⁴

In January 1977 the Federal payroll tax on employers that finances the Federal Government's share of the unemployment insurance (UI) program was raised from 0.5 percent of taxable wages to 0.7 percent. This past January the taxable wage base increased from \$4,200 to \$6,000. In combination, the two changes doubled the payroll taxes per worker that employers must pay to the Federal Government for unemployment insurance. Since the Federal base sets a minimum base for the States, the rise in the base is forcing many States to raise their payroll taxes. As noted in the previous chapter, employer payroll tax increases raise labor costs, are pushed forward into higher prices, and lead to additional inflation and unemployment.

Similarly, the new social security law has adverse consequences for growth and price stability. The legislation calls for steady increases in both the tax rates and the taxable wage base for both employers and employees. For employees the tax is generally regressive and burdensome. For employers it implies a tripling in the payroll taxes per employee they have had to pay to finance social insurance in the last decade. This substantial rise in payroll taxes will raise labor costs, it will contribute to the curtailment of production and employment, and it will increase the level of prices. This legislation poses a serious threat to growth and price stability throughout the indefinite future.

Congress has yet to pass an energy bill. Necessary as it is, the legislation will surely cause the prices of oil, natural gas, and other fuels

⁴ Representative Reuss and Representative Long add the following: "Should such a program prove successful on an experimental basis, yielding demonstrable increases in employment without displacing workers who do not qualify for subsidy, then we recommend further experimentation with a differential minimum wage for new teenage workers in certain job classifications in, say, three selected labor markets. Such experimentation would serve to test whether any benefit may be had by allowing young people to earn pocket money at subminimum rates in jobs that might not otherwise exist. Such a program should be designed with the strictest safeguards against any undermining of wage standards for those already employed or likely to become employed by the natural growth of employment in existing organizations. If experimentation with wage subsidies shows that such safeguards can be designed, then it is our opinion that differential minimum wages offer the prospect of a sufficiently attractive alternative (at no cost to the budget) to outright unemployment, to justify such limited experimentation."

to rise. It is important that these price increases take place slowly so that consumers of energy, whether industrial or residential, can adjust to the higher costs with a minimum of disruption.

At present, there is no program that offsets the inflationary impact of such essential measures as the proposed energy program and the other price raising policies that have been noted above. We should adopt policies that would help to offset the inflationary impact of other government programs. As noted in Chapter III, the proposed Humphrey-Hawkins bill enumerates a number of direct anti-inflationary measures that could be taken. We urge the Administration to move expeditiously on such programs even before enactment of the Humphrey-Hawkins bill.

Apart from overall fiscal and monetary policies, Federal actions have tended to raise rather than lower the rate of inflation. This situation needs to be reversed. The specific measures that raise prices either need to be more carefully considered or to be offset in a systematic and intelligent manner.

One example of a policy that would act as an offset to Federal price level raising programs would be a payroll tax reduction. As discussed in the previous chapter, \$33 billion in payroll taxes could be eliminated by removing hospital and disability insurance from social security. This would reduce Federal payroll taxes by almost one third and would have enormously beneficial consequences for production, for employment, for business profitability, for equitable taxation, and finally, for slowing inflation.

INDEXING AND INCOMES POLICY

There are two approaches to inflation that do not rely on policies that slow growth and raise unemployment. One is to learn to live with inflation by moderating its harmful effects through programs of inflation correction or "indexing." The other approach is to attempt to stop the inflation by an incomes policy. The two approaches are not incompatible. European economists have tended to view indexing of the personal income tax as an indispensable ingredient of a successful incomes policy because high marginal rates of taxation are among the principal factors that disrupt incomes policy agreements. In the United States we have tended to view the two approaches as incompatible and conflicting in economic philosophy. That is because we have foolishly permitted indexing to become an ideological issue.

As noted in the previous chapter, the Administration's tax proposals will offset the unfortunate impact of inflation on our tax system in 1978. However, Congress should begin giving consideration to measures which will offset these effects without requiring annual legislation. For example, we might consider following the Canadian practice of changing the exemption level, bracket limits, and tax credits of the individual income tax at a rate equal to the rate of inflation. In this way the real values of the exemptions, brackets, and credits would remain constant, and the average tax rate would not rise unless the real income of the taxpayer increased. Such "indexing" of the individual income tax would eliminate one of the major sources of automatic restriction discussed in Chapter IV.

Another reform is to discontinue taxing nominal capital gains. When a capital asset rises in value at a rate no greater than the rate of inflation there is no real gain. The current practice of taxing nominal capital gains is, therefore, a capital transfer tax that varies arbitrarily in response to the rate of inflation. Whether or not real capital gains should be taxed is a separate issue.

A third possibility is to discontinue the taxation of nominal interest and replace this by a taxable *real* interest rate equal to the nominal rate of interest minus the rate of inflation. This would eliminate such inequities as those that occurred in 1974 when small savers earned nominal (and taxable) interest of 6 percent, but lost ground in real terms as their savings were eroded by an inflation rate that greatly exceeded the nominal rate of interest.

A final proposal is to provide small savers with an opportunity to inflation-proof their savings by making available Federal Government purchasing power bonds in small denominations. This would be particularly helpful to the small savers who do not have the resources to overcome the fixed brokerage costs that full access to capital and real estate markets provide. This change would create difficulties for savings and loan institutions and, therefore, would have to be accompanied by changes in Regulation Q. The latter is a reform that many believe to be overdue, but it should be accompanied by measures that ensure an adequate supply of mortgage credit.

We are quite aware that proposals to provide for inflation correction are gaining support, and we realize the need to moderate the arbitrary redistributive effects of inflation. At the same time, we cannot yield to inflation. Incomes policy, defined as direct government involvement in the wage-price determination process, is employed in various forms in nearly every industrial country. It was tried in the United States in the early 1960s and it helped hold back inflation during the period of rapid economic expansion of 1961 to 1965.

Conventional incomes policies tend to break down when demand in the economy is so strong that employers gladly grant wage increases that exceed the guideposts in order to retain valued employees. Foreign experience suggests that incomes agreements tend to break down under the pressure of unanticipated and sharp cost-of-living increases such as those that occur when the costs of imported food and fuel rise suddenly. It has also been clear from the experience of foreign countries that conventional tax policies may be incompatible with an incomes agreement. Such agreements generally imply a willingness to accept a freeze in the relative shares of the national income between wages and profits. However, high marginal income tax rates and increases in social security taxes raise the Government's share of national income which puts pressure on the incomes agreement.

Aggregate demand in the United States is not excessive at present; yet cost-push factors keep the inflation rate rising at an annual rate of 6 percent. Since demand restriction is a costly and inefficient way to slow this kind of inflation, this is the time to consider the reintroduction of an incomes policy.

We have long been on record in opposition to comprehensive wage-price controls and we do not recommend them now. However, we are deeply concerned that pressures will mount for such policies if we do

not get inflation under control. We should therefore implement an incomes policy now so that we will not be driven into more drastic measures later. There is no anti-inflation program that, by itself, is adequate to reduce the inflation rate significantly. Many anti-inflation initiatives must be pursued if progress is to be made in slowing the rise in prices.

At present, the Council on Wage and price Stability (CWPS) is the principal government agency responsible for analyzing the inflationary effect of public and private sector activities. Under its statutory authority, CWPS reviews the inflationary impact of government policies, programs, and regulations, and together with the Office of Management and Budget, reviews the inflationary impact statements now required of Federal agencies. The Council also monitors and reviews private sector price and wage increases.

We believe that public policies designed to contain inflation must contain both short-run and long-run strategies. We have previously recommended that the functions of CWPS must be strengthened and expanded in order to enforce the Federal Government's commitment to reduce inflation. Last year in our Report, we stated :

Legislation should be enacted authorizing the Council on Wage and Price Stability to require prenotification of planned price increases from selected industries and to delay for modest periods wage or price increases which could have serious inflationary effects on the economy.

The President should support the efforts of the Council on Wage and Price Stability by directing all government agencies to cooperate with it and to make available such information and assistance as the Council may require. The President should also be prepared to help make available to the public the facts, findings, and recommendations developed by the Council.

We continue to believe that prenotification and delay of wage and price increases in selected industries is a reasonable start toward an incomes policy, short of voluntary or mandatory controls, which would allow the Council to review and comment on the justification for wage and price increases. In addition, prenotification and delay of wage and price increases would help give the Administration and the Congress time to consider and develop long-run measures to reduce inflation.^{5, 6}

We also support the Administration's effort to require Executive Branch agencies to prepare an economic analysis of proposed regulations and to submit it to CWPS for review. This procedure will help check the Federal Government's additions to inflation. CWPS could focus more national attention on the Federal responsibility to fight inflation by including in its annual report an analysis that would summarize Federal actions which either raised or lowered prices.

⁵ Representative Reuss states: "Prenotification is a useful idea under certain circumstances. However, the present nervous business climate is such that prenotification requirements may do more harm than good. Such requirements may impair the willingness of business to undertake new ventures and to expand their capacity, and as a consequence, impede the attainment of full recovery and full employment."

⁶ Senator Bentsen has provided additional views on this recommendation at the end of the Report.

As part of its annual report to the Congress, the Council on Wage and Price Stability should determine whether Federal actions have resulted in a net reduction or increase in inflation. Any specific actions which have had a significant impact should be thoroughly discussed and these impacts should be quantified.

Increasing the power and authority of CWPS alone is not sufficient. Additional measures must be adopted which will attack the structural underpinnings of inflation. One idea which deserves serious consideration is a tax-based incomes policy (TIP). Governor Henry Wallich of the Federal Reserve Board testified before the Committee and discussed two basic versions of TIP.

One has been characterized as the carrot approach, while the other has been characterized as the stick approach. The approaches are not incompatible and could easily be combined. There is a central theme to raise the demand for labor and to raise employment, it is important to reduce the real labor costs that confront employers. On the other side, the desire of workers for higher real compensation works against the expansion of employment. By using the tax system to lower real labor costs to employers while raising the real after tax compensation to employees, both higher employment and wage-price stability can be attained.

The stick proposal is commonly known as the Wallich-Weintraub plan. It would impose a tax penalty on firms that grant wage increases in excess of a predetermined Government guideline. It would therefore provide employers with incentives to resist excessive wage demands.

As Governor Wallich pointed out, this proposal would restrain wages but because the penalty tax would be paid by employers, evenhandedness would be maintained. Because compensation of employees comprises 75 percent of national income, reducing wage increases would necessarily slow price increases. The proposal is highly flexible in that the tax could be imposed as an increase in the corporate income tax, as a payroll tax, or through disallowance of tax deductions of any excessive wage increase.

The so-called carrot proposal associated with Arthur Okun is a second TIP variant specifically directed to the present economic situation. However, except for numerical details, its application is general. Okun's plan is to provide tax relief as an incentive to workers and businesses to "enlist in a cooperative anti-inflation effort." For 1978 Okun proposes that participating firms pledge:

. . . to hold its employees' average rate of wage increase below 6 percent and its average rate of price increase below 4 percent.⁷

In return for voluntary participation in this plan, employees of the firm would receive a tax rebate of 1.5 percent of their wage incomes with a ceiling of \$225 per person. At the same time, the participating firm would receive a tax rebate on its business income tax liabilities of 5 percent.

⁷ Arthur M. Okun, "The Great Stagflation Swamp," *The Brookings Bulletin*, vol. 14 No. 3 (fall, 1977), p. 6.

One of the advantages of the Okun plan is that it is voluntary. The basic idea is that wage bargains should be based on a target inflation rate. The workers who agree to bargain on the basis of this target rate will not be penalized if the actual inflation rate exceeds the target rate because their participation in the wage-price restraining program entitles them to tax rebates that make up for any wage losses incurred by less aggressive bargaining.

Okun estimates that his plan will cost about \$15 billion a year in tax reductions. A second attraction of the proposal therefore is that while it slows inflation it also stimulates production and employment.

The Wallich-Weintraub and Okun proposals rely on market incentives rather than on coercion and control. We are aware that each program has many shortcomings and administrative complexities. Dr. Rudy Oswald, Research Director of the AFL-CIO, brought many potential problems to our attention. Nevertheless, inflation is so serious and pervasive that we must address these problems and design a program which can be implemented in the near future. We believe it is time for the Congress to consider some such proposal. We prefer the Okun-type approach because it is voluntary. Yet it is an approach that has genuine force and could be quite effective.⁸

Instituting a tax-based incomes policy and increasing CWPS power and authority are just a few promising examples of a direct attack on inflation. In Chapter III, we emphasized the contribution the Humphrey-Hawkins bill could make by focusing on a series of specific policies that could contain and reduce inflation without restricting aggregate demand. The Administration has taken several steps in the right direction on the inflation front. We would like to see them take several more. As we argued elsewhere, the Council on Wage and Price Stability should be greatly expanded and strengthened. The inflationary impact of Federal programs must be carefully assessed, and price reducing Federal policies should be given priority. The key point is that a series of individual programs can make a substantial contribution to reducing overall inflation.

⁸ Representative Reuss adds the following suggestion: "Undoubtedly it will take considerable time before we and the Administration are fully convinced that TIP is an appropriate means of controlling inflation. Meanwhile, it is important that we learn more about TIP. I therefore recommend that the Council on Wage and Price Stability (CWPS) be asked to study various TIP proposals and report to us on their effectiveness and on their ability to be implemented in practice. Further, I ask for periodic reports from CWPS estimating the extent to which the inflation rate would have been altered had a TIP policy been in place, its effect on incomes, and its budget costs, if any. Adoption of this proposal would be an important and appropriate step in making CWPS the inflation monitoring agency we have always intended it to be."

VI. STRUCTURAL UNEMPLOYMENT

The economy is now in its 35th month of recovery following the trough of the 1974-75 recession. Employment has increased by a total of 7.8 million persons since the bottom was touched in early 1975. More than half of the total increase in employment, 4.1 million, occurred in 1977, the largest annual increase on record. All major demographic occupational groups, except farmers, experienced substantial employment gains.

Joblessness has declined from a recession peak of 9 percent in May of 1975 to 6.3 percent at the end of January 1978. The prospects for continued expansion of employment and continued reduction of unemployment as we approach potential levels of real output will depend heavily upon carefully designed policy.

Primary reliance on aggregate fiscal and monetary policies, while needed to continue to raise employment, may begin to generate new inflationary pressures as the economy approaches full capacity. Given the combination of rapid labor force growth and slow capital stock growth, the risk will be especially great if the policy mix continues to be characterized by almost total reliance on fiscal policy for economic stimulus. The overall unemployment rate for January 1978 is less than 1.5 percent from the point (4.9 percent) where tightening labor market conditions for prime age workers are expected to begin bidding up wages. Consequently, expansion generated by general macroeconomic policies and programs may only reach the periphery of the Nation's deep and chronic joblessness caused by structural, demographic, and geographic problems. However, it must be emphasized that no structural programs will be effective unless there is sufficient overall activity to create a demand for additional workers.

As the slack in the economy declines, greater stress must be placed on microeconomic approaches targeted at the structurally unemployed. Concern for the welfare of such potential workers should dictate action regardless of the state of the economy. But the need to supply continuing labor market demands for qualified workers, and to check the inflation that would otherwise occur, provides any additional incentive needed to move in this direction.

The employment gains for all nonfarm workers during the recovery were accompanied by very rapid increases in civilian labor force participation. As a result, the number of new job seekers and labor market reentrants equaled or exceeded the expansion of job opportunities in some important areas. As indicated by Table VI-1 the unemployment rate for minority women remained unchanged while the jobless rate for minority teenagers actually increased since the recession trough. Intolerably high levels of joblessness continue to exist for minorities, teenagers, and women. In fact, in relative terms only the unemployment rate for white males has improved and all other groups are worse off. Table VI-1 shows a two-tier labor force, one which is

white and male and benefits the most from stimulative macroeconomic policies, and one which is composed of minority workers many of whom require effective, targeted structural programs if they are to be permitted to engage in productive employment.

TABLE VI-1.—SELECTED UNEMPLOYMENT INDICATORS

	Unemployment rate		Ratio of unemployment rate to national unemployment rate		Percent of civilian labor force		Percent of unemployment	
	1975:2	1977:4	1975:2	1977:4	1975:2	1977:4	1975:2	1977:4
White total.....	8.2	5.8	0.92	0.88	88.7	88.3	81.7	76.9
White males, 20 plus.....	6.5	4.2	.73	.64	49.4	48.1	36.4	30.2
White females, 20 plus.....	8.0	6.0	.90	.91	30.9	3.18	27.8	28.7
White teenagers.....	18.3	14.1	2.06	2.14	8.5	8.5	17.5	18.0
Black and other total..	14.2	13.3	1.60	2.02	11.3	11.7	18.1	23.6
Black males, 20 plus.....	12.0	10.1	1.35	1.53	5.6	5.7	7.6	8.6
Black females, 20 plus.....	11.8	11.8	1.33	1.79	4.7	5.1	6.2	9.0
Black teenagers.....	36.7	38.3	4.12	5.80	1.0	1.0	4.3	6.0

Source: Unpublished Bureau of Labor Statistics data and Joint Economic Committee staff.

The ratio of the unemployment rate of minority adult women and minority teenagers to the national unemployment rate increased significantly during the recovery period. The ratio of the unemployment rate of minority women to the national unemployment rate increased by nearly 35 percent, from 1.3 to 1.8 by the fourth quarter of 1977. The minority unemployment rate ratio increased by more than 40 percent.

As emphasized throughout this Report, monetary and fiscal policies designed to promote vigorous and sustained economic expansion are essential to lower both the national unemployment rate and the unemployment rates for various groups in society. Table VI-2 indicates that the economy still has an ample supply of unemployed labor in all categories. The second quarter of 1969, shown in the first column of the table, is the prerecession quarter with the lowest unemployment rate. The second column shows the unemployment rates at the beginning of the recession. As shown in the last column, all of the fourth quarter 1977 unemployment rates, except that for white teenagers, were higher than the comparable rates in either of the base periods. There are presently no tight labor markets as measured either by demographic groups or occupational classifications.

Increased aggregate demand will also serve to reduce joblessness among minority workers, teenagers, and others who fall into the category of the structurally unemployed. However, these reductions will be less than the reduction in the unemployment rate of white adult workers. During the Committee's annual hearings, the Secretary of Labor, estimated that potential output will be achieved when overall unemployment is reduced to 4.75 percent. Yet as indicated by Table VI-3 which presents hypothetical jobless rates in 1983 and assumes an overall unemployment rate of 4.75 percent, unemployment will continue at unacceptable levels for teenagers and all minority workers.

Special measures are needed to aid the structurally unemployed—those who remain jobless when the economy reaches potential output

TABLE VI-2.—UNEMPLOYMENT RATES BY SELECTED CHARACTERISTICS,
[Selected quarterly averages, seasonally adjusted]

	1969 :2	1974 :3	1977 :4
Selected characteristics:			
Total, 16 yr and over	3.4	5.6	6.6
Men, 20 yr and over	2.0	3.7	4.8
Women, 20 yr and over	3.7	5.5	6.8
Both sexes, 16 to 19 yr	12.2	16.3	16.7
White, 16 yr and over			
Men, 20 yr and over	3.1	5.1	5.8
Women, 20 yr and over	1.8	3.5	4.2
Both sexes, 16 to 19 yr	3.4	5.1	6.0
Black and other, 16 yr and over			
Men, 20 yr and over	10.6	14.2	14.1
Women, 20 yr and over	6.4	9.7	13.3
Both sexes, 16 to 19 yr	3.6	6.7	10.1
Occupations:			
White-collar workers	6.1	8.1	11.8
Professional and technical workers	25.0	33.3	38.3
Managers and administrators, except farm	2.0	3.3	4.1
Sales workers	1.3	2.3	2.9
Clerical workers .....	.9	1.8	2.7
Blue-collar workers	2.8	4.0	4.9
Craft and kindred workers	2.8	4.8	5.7
Operatives, except transport	3.8	6.8	7.6
Transport equipment operatives	2.1	4.4	5.3
Nonfarm laborers	NA	8.2	9.2
Service workers	NA	4.9	5.7
Farm workers	6.4	10.6	11.4
	4.4	6.4	7.9
	1.9	2.9	4.1

Source: Bureau of Labor Statistics, unpublished data.

TABLE VI-3.—HYPOTHETICAL UNEMPLOYMENT RATES IN 1983

	Rate	Level (thousands)
Total, 16 yrs and over	4.8	5,044
White		
Men, 20 yr and over	4.2	3,854
Women, 20 yr and over	3.1	1,566
Both sexes, 16 to 19 yr	4.2	1,459
Black and other		
Men, 20 yr and over	11.0	829
Women, 20 yr and over	9.2	1,190
Both sexes, 16 to 19 yr	7.2	463
	9.4	523
	22.1	204

Note: This table assumes an overall unemployment rate of 4.75 percent and no change in historical structure.

Source: Testimony of Secretary of Labor Ray Marshall, Joint Economic Committee Annual Hearing, Feb. 10, 1978.

levels. These special measures can dramatically help reduce overall unemployment and the unemployment rate differentials between particular demographic groups. As the Secretary of Labor testified:

If, by structural programs, we are able to reduce the 1983 differential between the black and white rates of unemployment from a ratio of 2.2 to 1.0 to a ratio of 1.5 to 1.0, the overall unemployment rate would fall by 0.4 of a percentage point.

If we develop programs that cut in half the differential between the unemployment rate for those aged 16-24 and that for adult men, the unemployment rate would fall by 0.6 of a percentage point.

If the adult female unemployment rate could be reduced from 30 percent higher than the male rate to 1.5 percent higher, the overall unemployment rate would fall by 0.25 of a percentage point.

These illustrations show the important role that structural unemployment programs can play in improving the operation of the labor market.

YOUTH UNEMPLOYMENT

Although teenage employment grew last year by 341,000, these gains were disproportionately enjoyed by whites, and youth unemployment still accounted for nearly one-half of all unemployment in 1977. The jobless rate for workers aged 16 through 24 was 13.6 percent. For teenagers alone it was 17.7 percent and for young persons 20 to 24 years old the rate was 10.9 percent.

Black teenage unemployment increased by 23,000 in 1977 and averaged 41.1 percent for the year. Joblessness among Hispanic teenagers increased slightly, but their unemployment rate decreased to 22.3 percent because their labor force expanded even more rapidly. Unemployment among American Indians on reservations is also exceedingly high—about 40 percent in 1977.

Several reasons have been suggested as causes of youth unemployment. It has been asserted that the minimum wage has caused youth unemployment to increase. However, in the 1970s the minimum wage has been lower relative to the average wage of production workers than it was throughout most of the 1950s and 1960s. Therefore, based solely on relative wages, there has been a comparative advantage in hiring young people in the 1970s. Most studies show that the significance of the minimum wage is small, and the testimony of Dr. Joseph Kasputys of Data Resources, Inc. confirmed this fact.

The problem of teenage unemployment is not the inability to hold a job, but to get one in the first place. In 1977, 42.8 percent of total teenage unemployment was among youths who had never worked before. The situation was even more critical for minority teenagers. Nearly one-half of minority teenage unemployment in 1977 was among persons who had never worked before.

ADULT WOMEN

The unemployment and employment problems of women are similar to those of young people. Since 1970, the female unemployment rate has been higher than it was in the latter half of the 1960s. The disparity between the female unemployment rate and male unemployment rate has worsened. As testimony from Dr. Beatrice Reubens indicated, in the 15 years from 1947 to 1961, the women's rate exceeded the male rate by 1 percent or more in only 2 years. In the succeeding 16 years, the differential exceeded 1 percent or more in every year. She concluded, "It appears that a new higher level of female unemployment rates in relation to male unemployment rates may have never been established.

Much of the disparity between the male and female unemployment rates is accounted for by a widening gap between female and male

rates in the 25-44 year old age group, probably because reentrants to the labor force form a larger share of female unemployment than male unemployment and reentrants are most likely to fall into the 25-44 year old age group. In 1977, 37.3 percent of the unemployed females 20 years and older were reentrants into the labor force, while 19.3 percent of the unemployed males 20 years and older were reentrants.

Two other factors should be noted with respect to female unemployment. First, hidden unemployment—defined as persons too discouraged to look for work and therefore not counted as labor force participants—is much greater among women than among men. According to the Bureau of Labor Statistics, during 1967-76 there were approximately twice as many female discouraged workers as male discouraged workers. Consequently, the official unemployment rates underestimate the disparity between female and male unemployment rates.

Second, although 36 percent of the women who were unemployed in 1977 had employed husbands, this does not mean that joblessness is not a serious problem for such women. In many families it is essential for the wife to supplement the husband's income in order to attain an adequate standard of living. The frequently propounded notion that all women job seekers are not seriously in need of employment would make them second class citizens. Needless to say, this attitude and its implications are unacceptable.

In the case of both youth and women whose primary labor market problem is a lack of job skills and a relative lack of job experience, easing their entry and re-entry problems into the labor market is the necessary first step towards reducing their unemployment.

ELIMINATING BOTTLENECKS

The central focus of eliminating these problems must be to provide better mechanisms to match job seekers with jobs. Much of the present responsibility for this task lies with the U.S. Employment Service. But the Service's link with private employers has not been fully and effectively developed. An understanding between the Employment Service and private business of each other's needs and services is necessary before job seekers will be effectively matched with job opportunities. Congress should consider increasing employment service funding to improve and expand the services it offers to private business.

Schools, businesses, and unions should expand the scope of the activities that link classroom activity to work. There are approximately 600,000 persons enrolled under Titles II and IV of the Comprehensive Employment and Training Act (CETA) who could be matched with private sector job opportunities. Greater coordination between CETA Prime Sponsors and private business should be developed to place these persons in the private sector when their public service employment ends.

To help offset wage and fringe benefit costs, CETA Prime Sponsors should be given the resources for provision of "bonuses" to private employers for employment of selected hard-to-employ workers in the private sector.

Such a program could easily be monitored by local Prime Sponsors to prevent abuse and it would fit into the existing CETA framework. Prospective employees must have the requisite skills for employment. Public service employment and manpower training programs must be geared to providing the skilled labor which meets the needs of employers.

Current Federal manpower training programs provide the basic training and retraining necessary to equip unemployed workers with skills to meet entry level requirements, but these programs are inadequately funded. Such programs should be expanded by about \$1.5 billion over the next two years. Training programs should also put more emphasis on upgrading employees from entry level jobs in order to assure their employability. Career ladders should be developed to give employees greater incentive to remain with an employer.

GEOGRAPHIC EMPLOYMENT PROBLEMS

Many areas of the country continue to face high rates of unemployment and net employment losses. At the same time they suffer from relatively slow or even stagnant economic growth.

Between 1960 and 1970, employment in central cities in the East declined 2.4 percent, while it rose by 7.0 percent in the Midwest, 23.1 percent in the South, and 28.0 percent in the West. The 1974-75 recession induced further job losses in the East, but it also aggravated the situation in central cities across the country.

The decline in central city employment opportunities is especially serious for minorities. In 1977, 54.4 percent of the nonwhite civilian labor force resided in central cities, while minority central city unemployment accounted for 60.2 percent of total minority unemployment. Concurrently, the central city minority teenage unemployment rate increased from 40.5 percent to 43.0 percent and employment has declined. The nonwhite teenage central city employment-population ratio has declined from 22.1 percent in 1975 to 21.2 percent in 1977.

Although the unemployment problem for minorities is primarily an urban problem, the geographic aspects of structural unemployment are significantly related to poverty areas. In 1977, nearly 15 percent of the white civilian labor force and 39.9 percent of the nonwhite civilian labor force resided in urban and rural areas officially designated as poverty areas. Among blacks and other minorities, most of the civilian labor force living in poverty areas resided in metropolitan areas; among whites, most of the civilian labor force living in poverty areas resided in nonmetropolitan areas.

As Table VI-4 shows, in metropolitan poverty areas the overall white and nonwhite unemployment rates were significantly higher than their respective rates in metropolitan nonpoverty areas. The greatest differentials in both cases occurred among adult males and teenagers. In nonmetropolitan areas, with the exception of nonwhite adult females, the unemployment rates in poverty areas were actually lower than their corresponding rates in nonpoverty areas.

Structural changes in the economy have created growth differences between regions. First, there has been a pronounced regional shift in

TABLE VI-4.—DISTRIBUTION OF THE LABOR FORCE AND OF UNEMPLOYMENT IN POVERTY AND NONPOVERTY AREAS

	Metropolitan areas				Nonmetropolitan areas			
	Poverty areas (%)		Nonpoverty areas		Poverty areas (%)		Nonpoverty areas	
	1976	1977	1976	1977	1976	1977	1976	1977
WHITE								
Percent of total civilian labor force.....	3.4	3.3	62.8	56.9	8.6	8.5	19.6	20.0
Percent of total unemployment.....	4.6	4.6	51.9	49.3	6.9	6.7	16.9	17.8
Unemployment rate (percent).....	10.5	9.7	7.0	6.1	6.1	5.5	6.6	6.3
Male, 20 and over.....	9.4	8.8	5.4	4.5	4.4	3.8	5.0	4.6
Female, 20 and over.....	9.1	8.8	6.7	6.1	6.4	5.9	6.9	6.3
Both sexes, 16 to 19.....	22.9	19.0	17.3	15.4	15.7	14.7	15.3	15.0
NONWHITE								
Percent of total civilian labor force.....	3.0	2.9	5.9	6.0	1.7	1.7	.9	.9
Percent of total unemployment.....	6.6	7.4	8.9	9.8	2.6	2.8	1.5	1.6
Unemployment rate (percent).....	16.9	17.6	11.5	11.4	12.2	12.0	13.5	12.4
Male, 20 and over.....	15.1	15.1	9.2	8.4	7.7	8.0	10.5	8.1
Female, 20 and over.....	12.6	14.1	10.1	10.3	12.7	12.8	12.8	11.5
Both sexes, 16 to 19.....	43.3	45.4	35.2	37.3	33.8	30.7	30.8	34.7

¹ Poverty areas are those census geographical divisions in which 10 percent or more of the residents were poor according to the 1970 census.

Source: "Employment and Earnings," Bureau of Labor Statistics, January 1978, p. 173.

the distribution of manufacturing employment over the last 20 years. New England, Mid-Atlantic and East-North Central States have lost a large share of manufacturing employment since 1956. The largest loss has been in the Mid-Atlantic States which had 25.2 percent of manufacturing employment in 1956 but have only 18.4 percent today. Other changes in manufacturing employment by region during the period 1956-76 are indicated in Table VI-5.

TABLE VI-5.—MANUFACTURING EMPLOYMENT

[Percent distribution]

	1956	1976
Total, United States.....	100.0	100.0
New England.....	8.7	7.0
Mid-Atlantic.....	25.2	18.4
East North-Central.....	27.9	24.8
West North-Central.....	5.7	6.6
South Atlantic.....	11.2	14.5
East South-Central.....	6.4	7.9
West South-Central.....	4.7	7.3
Mountain.....	1.3	2.3
Pacific.....	9.0	11.1

Source: U.S. Department of Labor, Bureau of Labor Statistics.

To aid in the fight against structural unemployment, the Committee supports the Administration's recommendation for continued funding of 725,000 CETA public service employment jobs through fiscal year 1979.

The Committee recommends two steps to help insure that public service employment achieves this goal:

First, the "overhead" payments permitted to Prime Sponsors should not be made on the basis of wages paid. Existing

legislation permits overhead payments for nonwage costs equal to 15 percent of the wage bill. This provides that the largest overhead payments will be for highest paying jobs, exactly those jobs not matched for the structurally unemployed. As an alternative, the overhead payment could be made to vary on the basis of an employee's labor market skills or could be made to vary inversely with the wage level.

Second, tenure in public service employment should be limited to 18 months. Requiring this periodic turnover would increase the public service job opportunities and the availability of on-the-job training for the structurally unemployed.

Expansion of public service employment as a countercyclical tool has created a dependency among many local governments on CETA. In some cities, up to one-third of the city work force is composed of CETA employees. Many of these cities still suffer from revenue shortfalls, the need to maintain current levels of municipal services, and a declining tax base. The continued decline in unemployment raises the prospect of the termination of CETA programs in many localities. If this happens, the severe fiscal conditions of some of these localities, now partially relieved by CETA funding, will become even more intense. Therefore, consideration should be given to new programs which would provide fiscal relief to localities that will be affected by loss of CETA funding before that loss occurs.

The Administration's budget contains \$400 million in outlays to provide incentives for private business to hire the hard-to-employ. We strongly support this effort. Private business involvement in manpower training programs for the hard-to-employ is less today than it was a decade ago. The Administration's proposal to create local Private Industry Councils, made up of business and labor representatives, to provide local job training slots is a positive step toward increasing private sector involvement in this area. We call attention to an extensive list of successful job training and employment programs which are being operated by many companies in cooperation with local councils throughout the Nation. A useful survey of those programs has been published by the Committee for Economic Development. Such efforts should be encouraged and expanded. The long-term solution to the unemployment problem resides in the private sector, which employs 5 out of 6 Americans.

VII. THE CURRENT SERVICES BUDGET

Section 605 of the Congressional Budget Act of 1974 requires the Office of Management and Budget to submit by November 10 of each year "the estimated outlays and proposed budget authority which would be included in the Budget . . . for the ensuing fiscal year if all programs and activities were carried on during such . . . year at the same level . . . and without policy changes." It further requires that the Joint Economic Committee "shall review the estimated outlays and proposed budget authority so submitted, and shall submit to the Committee on the Budget of both Houses an economic evaluation thereof on or before December 31. . . ." The following discussion is presented in accordance with this requirement.

When the Joint Economic Committee presented the first Current Services Budget estimates in December of 1973, they were explained as follows:

The figures for 1975 in this study are baseline projections. They are not an attempt to predict the future or to anticipate the official 1975 Budget. However, they represent an effort to show how existing programs will change based on current law and projected changes in prices, wages, and workloads.¹

In subsequent reports we elaborated on this idea :

A baseline, or Current Services Budget, is especially helpful in calculating alternative budget proposals made by the President and Congress. Since the baseline assumes no policy changes, the difference between an up-to-date baseline and the Budget estimates presented in the Presidential recommendations submitted in January would be the policy proposals of the President.²

The problem generally encountered in trying to apply these ideas to the actual numbers was that up-to-date estimates were seldom available. The Current Services estimates were prepared in November or December of each year, but by the time the President's estimates were submitted in late January or February, the economic assumptions had changed enough to keep the numbers from being precisely comparable. The result of this procedure was that the estimates were not as helpful as Congress had hoped when the Congressional Budget Act, which required their submission, was passed.

In 1977, in an effort to improve the usefulness of these figures, the Director of the Office of Management and Budget requested permission to engage in a one-year experiment. During this experiment, the Cur-

¹ *The 1975 Budget: An Advance Look*, a staff study prepared for the use of the Subcommittee on the Priorities and Economy in Government of the Joint Economic Committee, Congress of the United States, December 27, 1973, p. 10.

² *An Economic Evaluation of the Current Services Budget, Fiscal Year 1977*, a staff report prepared for the use of the Joint Economic Committee, Congress of the United States, December 22, 1975, p. 4.

rent Services estimates would be presented as part of the President's Budget submission and would therefore be based on the same economic assumptions as the President's policy recommendations. This experiment was undertaken with the concurrence of the Chairman of the Joint Economic Committee, the House and Senate Budget Committees, and the House and Senate Appropriations Committees.

In our judgment, this experiment has been a success. The presentation of the Current Services estimate in the Budget Summary clearly shows the impact of the President's policy recommendations on the Budget. The discussion in Special Analysis A, which compares the Current Services estimates with the President's Budget request on a program-by-program basis, is a significant improvement over previous reports.

Presenting the Joint Economic Committee's views in the context of our Annual Report has the added advantage of allowing a more complete evaluation of the economic analysis underlying both the Current Services estimates and the President's recommendations. We have therefore focused our comments in this section of the Report on specific recommendations regarding the Current Services estimates and have left the economic analysis for earlier sections.

The Congressional Budget and Impoundment Control Act of 1974 should be amended to allow the President to submit Current Service Budget estimates concurrently with his Budget proposals and to allow the Joint Economic Committee to submit its evaluation of these estimates concurrently with its Annual Report to the Congress.

Although the reporting procedures have been improved, we still consider the Current Services estimates inadequate. Our primary objection is to the treatment of inflation. The current practice is to include an allowance for anticipated inflation in the Current Services estimates for those programs where inflation adjustments are mandatory under existing law or those programs included in the Department of Defense. Estimates for programs which are not military or are not linked by law to the cost of living include no inflation allowance.

This unequal inflation treatment means that the Current Services estimates are sometimes misleading and unnecessarily difficult to use. For example, if one compares the Current Services outlay estimate for the Department of Defense—military (\$114.3 billion) with the President's request (\$115.2 billion), one could correctly conclude that the President has requested a real increase in military spending. However, a similar comparison for the Veterans' Administration (a Current Services estimate of \$18.9 billion compared to a presidential request of \$19.2 billion) could lead to the erroneous conclusion that the President has requested a real increase here as well. If the Veterans' Administration estimate had included an inflation allowance, the Current Services figure would have exceeded \$20 billion and, by comparison, the Administration's estimate would appear to be a real reduction. By the Administration's own estimates, if an inflation adjustment had been made for all programs not limited by statutory ceilings, the Current Services outlay total would have been about \$3 billion higher than the estimate presented.

The Administration's treatment of inflation in the Current Services estimates is misleading and confusing. All programs in the Budget should receive comparable inflation treatment in the Current Services estimates.

Since 1963 when we held hearings and issued a report on the "Federal Budget as an Economic Document," the Joint Economic Committee has stressed the need to view the Budget in the context of a broad, long-range set of projections. Gradually, with the adoption of Planning-Programming-Budgeting (PPB) systems in 1965, the Legislative Reorganization Act in 1970, and the Budget and Impoundment Control Act in 1974, the executive branch of Government has moved in the direction of providing more long-range estimates. The fiscal year 1979 budget which provides Current Services estimates on an aggregate basis through 1983 is a further step in this direction.

The usefulness of five-year budget projections is not to predict what budget totals will actually be in future years but to examine the scope for and desirability of changes in budget policy. Since no one can foresee policy changes several years into the future, we are convinced that the Current Services projection method is the most sensible way to make long-range budget projections. We commend the Administration on the work done thus far and recommend that it be extended.

In future budgets, the five-year Current Services estimates should be expanded to include functional and agency-level detail.

ADDITIONAL VIEWS OF VICE CHAIRMAN LLOYD BENTSEN REGARDING THE PRENOTIFICATION RECOMMENDATION

I disassociate myself completely from this proposal which I regard as a very serious mistake. Despite its reluctance to admit it, this Committee is recommending mandatory price and wage controls. The Report recommends that the Council on Wage and Price Stability be given authority "to delay for modest periods wage or price increases." The authority to delay wage or price increases is logically the authority to fix and control wages and prices. So despite the Report's disclaimer that this proposal is "a reasonable start toward an incomes policy, short of voluntary or mandatory controls," the Committee is in fact calling for mandatory wage and price controls.

Government dictation of wages and prices has never worked to control inflation in peacetime. Wage and price controls attack the symptoms of the disease, but not the disease itself. They may provide a temporary disguise, they may present a comforting illusion, but sooner or later consumers will confront the harsh reality of shortages, low quality products, and hundreds of devices designed to circumvent the controls. Price and wage controls put the economy in a straight-jacket which invariably results in inequities among both workers and business enterprises.

We should have learned by now that wage and price controls cannot be imposed on our economy without exacting a heavy cost in the form of serious misallocation of resources, inefficient production, and the potential domination of our daily lives by faceless government bureaucrats. We should have learned by now that excessive government regulation of business, which results in waste and inefficient production, is one of the major reasons for our inability to bring down the cost of living. It is, therefore, fundamentally unsound to recommend additional bureaucratic authority to regulate the private enterprise system in the name of fighting inflation.

Most leaders of business and labor strongly oppose the concept of wage and price controls. Businessmen fear that controls will result in less investment, low productivity, and slow growth. Labor leaders know that it is more difficult for workers to circumvent wage controls than it is for business to get around price controls. Both business and labor leaders correctly recognize that there is no easy, simple solution to the problem of inflation. We will bring inflation under control when we reduce excessive government regulation of business, which drives up the cost of doing business; when we develop ways to encourage competition through the entry of new businesses into our Nation's marketplaces; and when we provide adequate incentives for business to invest in more productive machinery and equipment.

LLOYD BENTSEN.

ADDITIONAL VIEWS OF REPRESENTATIVE HENRY S. REUSS

I agree with the analysis and major conclusions of this report. It lacks only a concise statement on an action program for the economy that is required. In my view, the key elements of such a program are these:

Unemployment.—We need a maximum attack on structural unemployment suffered by young people, minorities, and residents of the central cities. The President should detach his proposal to double public service employment, from 700,000 jobs to 1.4 million, from his welfare reform program and send it to Congress for immediate action. Measures to stimulate private-sector employment: wage subsidies, tax credits for new hiring, and (on an experimental basis in several labor markets) minimum wage differentials for high unemployment areas or new labor market entrants.

Taxes.—The rate increases recently effected in the Social Security payroll tax should be rolled back. Additional scheduled rate increases should be repealed. The difference (\$5 billion in 1979) should be collected from general revenues, with a compensating reduction in the amount of personal income tax relief proposed by the Administration.

The proposed extension of the investment tax credit to structures should be dropped. Instead of this measure, which will exacerbate the decline of job opportunities in the central cities, job-preserving measures should be enacted: a tax credit for rehabilitation only, for example.

Monetary Policy.—I agree with the report's assessment that a moderately expansive monetary policy is needed in the year ahead. The shift to relative monetary ease, should, however, be accompanied by some relative fiscal restraint. This can be achieved by substituting direct job creation measures for a larger dollar volume of less effective tax reduction.

Energy.—The proposed wellhead tax on domestic crude oil has become a political stumbling-block and should be dropped. The energy bill with the remaining four elements of the President's plan should become law promptly. Work should then begin on a Phase Two energy program, including more support for the development of alternative energy sources, such as solar, wind and geothermal, and a standby gasoline rationing system to ensure fair allocation in the event of a supply shortage.

Agriculture.—As the report points out, higher price supports are an inefficiency and inflation-causing way to ensure a decent income to farmers. The Administration should develop instead (1) a supplementary program of direct income supports, enabling the family farm to weather bad years without imposing unnecessary costs on consumers or socially wasteful restrictions on production; and (2) a meaningful war-on-hunger program.

International Policy.—We must continue to resist protectionist, interventionist, and inflationary measures designed to close out our trade gap or support the precarious level of the dollar. Such measures are ineffectual or undesirable or both. In the short run, the pressure on the dollar will continue, and there is little the monetary authorities can or should do about it, disorderly markets aside. In the long run, if our trading partners expand their economies, our exports will pick up; and if our energy policy succeeds in reducing our reliance on imported oil, our import bill will decline. These two measures can cure the patient: tinkering with the thermometer cannot.

HENRY S. REUSS.

ADDITIONAL VIEWS OF REPRESENTATIVE LEE H. HAMILTON

I generally support the goals and recommendations of the Committee's Annual Report. The Report provides a clear view of many of the major economic problems that confront the Nation and suggests new and promising directions for economic policy. My additional views reflect a desire to emphasize some of the added complexities that lie in the path the Committee recommends. Because any report must narrow its focus, I also want to mention economic problems that should be considered by future Joint Economic Committee reports.

HUMPHREY-HAWKINS

The Committee Report strongly endorses the Full Employment and Balanced Growth Act of 1977, better known as the Humphrey-Hawkins bill. I find myself in sympathy with the broad purposes of the Act and many of the specific proposals it contains. The emphasis on setting long-term goals as a guide for year-to-year policy is basically sound. There is a definite need to assure coordination of monetary and fiscal policies. The bill pushes our view beyond the traditional remedies of macroeconomic policy to the need for specific structural programs to attack inflation and unemployment. Nonetheless, I do not share the unrestrained enthusiasm that some of my colleagues have for Humphrey-Hawkins and I do have reservations about it. My reservations boil down to two interrelated points.

First, can we deliver on the promises that Humphrey-Hawkins is making to the American public? Is it desirable, in a day of deep public cynicism about Government's performance, to encourage the view that it is possible to reach a 4-percent overall rate of unemployment by 1983 without a serious outburst of inflation? Second, does the bill provide enough emphasis on fighting inflation?

If we succeed in achieving the goals contained in this Report, the economy will reach its full potential some time in 1981. At that point, there will still be millions of Americans out of work and the unemployment rate should be in the neighborhood of 4.8 percent.

The hard fact is that it is unlikely that we will be able to achieve all of our desired economic goals. The likelihood is that we will have to face difficult trade-offs among program goals, full employment, inflation, and balanced budgets. I am not at all sure that Humphrey-Hawkins treats the American people with the candor about our central economic realities that they deserve.

How can we go beyond the short-term goals of this Report and not trigger new inflationary pressures? The answer has always been that specific structural programs will get us the rest of the way without pushing up prices.

At the annual hearings of the Joint Economic Committee we heard extensive testimony about what structural programs had worked in the

past, how existing programs could be improved, and even what approaches we might adopt in the future. It is also a possibility that the added pressure of our ambitious employment goal will force the Administration and the Congress to be more imaginative with regard to employment programs. In effect, goals may become the mother of invention.

But we must keep in mind that the Humphrey-Hawkins bill sets an extremely ambitious target. We may not be able to meet it. The bill itself recognizes that economic circumstances of one sort or another may force a delay in reaching the 4 percent goal. We should be honest with the American people about how difficult it will be to reach the 4 percent unemployment rate in 1983 and tough with ourselves in moving away from the goal if economic reality dictates.

Usually viewed as just a full employment bill, Humphrey-Hawkins also puts considerable emphasis on reducing inflation. However, the bill specifically directs the President to adopt a number of policies that will tend to lower prices. I am in full sympathy with many of the specific proposals for fighting inflation and the importance the bill assigns to reducing inflation. Nevertheless, I still have some reservations about whether the bill can effectively reduce the price level. Reaching a 4 or even a 4.8 percent unemployment level will tighten labor markets and strain productive capacity. That is a situation that could well lead to more inflation. The individual programs contained in the bill promise some relief, but may simply not be enough.

I just do not have any feeling that the President's anti-inflation program is succeeding. With the basic inflation rate stuck at at least 6 percent, we are getting no relief from inflation, and I have no confidence that relief will come soon. Inflation apparently is the most intractable of all our economic challenges. Most of the witnesses before this Committee suggested inflation is more likely to accelerate than to decelerate.

I am not comfortable with an exclusive emphasis on growth and investment as the way to cure inflation any more than I am comfortable with the view that restrictive policies applied long enough will wring inflation out of the economy. I think we must be willing to try other approaches. I approve the Report's interest in the proposal to grant tax relief for price and wage restraint. It would probably be imprudent to introduce such relief before subjecting it to much wider discussion and evaluation with regard to its effectiveness and administrative feasibility, but the momentum of inflation is so great this proposal should be seriously considered immediately.

Other steps must also be taken. Those of us in government must become much more serious about assuring that government action does not raise costs. So often, government regulatory and tax policies generate their own inflationary pressures. I like the Committee's proposal that the President's Council on Wage Price Stability report annually on which government programs have raised prices and which have lowered them. It may be too soon to adopt Arthur Okun's suggestion that we should set a target of zero new Federal impact on the price level, but we should begin to move in that direction.

We must set our course for declining Federal deficits coupled with the skillful use of a wide variety of employment programs designed

to deal with structural unemployment. Well tailored training, public service employment, youth programs antidiscrimination laws, and better labor market information can all help us achieve full employment without adding to inflation. I was particularly impressed with the recommendations of the Committee for Economic Development to encourage private sector jobs for the hard to employ through the use of incentives such as tax credits, stipends for trainees, or an exemption from the minimum wage.

During the annual hearings of the Joint Economic Committee, a number of witnesses stressed the fact that we just did not know how to control inflation as effectively as we could the level of production or employment. I do not disagree with that. But we must also recognize that in many cases inflation is less a result of ignorance than of political expediency. As Gardner Ackley has reminded us, the major obstacle to containing inflation is not a lack of knowledge, or even a lack of devices to deal with it, but a lack of political will and leadership to take the right action at the right time. If the Humphrey-Hawkins bill is to be an effective guide to future public policy, it will require both good judgment and rare political courage.

DEFICIT

For fiscal year 1979, the President has proposed taxing and spending policies that will result in a deficit of just over \$60 billion. Although I am uneasy about a large deficit this far into the recovery, I am prepared to tolerate a deficit of that size for this year. So long as unemployment is high and there is slack capacity in the economy, there is a little danger of inflation from excess demand. What I do not accept is one deficit after another, and we are perilously close to that situation.

The principal targets of national economic policy are growth, low levels of unemployment, and price stability. It can be costly and self-defeating if these goals are sacrificed for admitted secondary targets like the balanced budget. But the costs of budget deficits cannot be ignored. If we continue to run massive budget deficits year in and year out we run the risk of further eroding public confidence in the Government. The size of the deficit may not worry the professional economist, but it does worry the average American. By one recent poll, 65 percent of all Americans think a balanced budget is a "very important" goal and another 24 percent think it is a "fairly important" goal. The huge deficits may have more to do with the lack of confidence in the economy than many experts realize. Within the bounds of prudent economic policy we should begin to get serious about moving to reduce our dependence year after year upon these huge deficits. By relying principally on the private sector for growth and the new jobs demanded by a growing labor force, we can begin to reduce our dependence on Federal spending. The President has taken the right tack in emphasizing the private sector and working to reduce the share of Federal expenditures in our gross national product. And the cost of interest on mounting Federal debt can be a burden on the taxpayer for years to come. Within the bounds of prudent economic policy we have to start moving toward a balanced budget.

THE INTERNATIONAL VALUE OF THE DOLLAR

In recent months the value of the dollar has decreased relative to the Japanese yen, the Swiss franc, the German mark, and European currencies tied to the mark. The fall has been steep and disorderly.

For several years now, the United States and other major economic powers have lived in a world of flexible exchange rates. By and large, they have served us well. High levels of world demand coupled with the oil shock of 1973 led to high and widely divergent rates of domestic inflation. The Bretton-Woods system that assumed only occasional changes from otherwise fixed exchange rates would have been hard-pressed to function in the early 1970s.

The sharp fall in the value of the dollar against certain key currencies should not be interpreted as a fundamental weakness of the dollar. It may be regrettable, but it is not disastrous. Compared to the currencies of all our major trading partners, the dollar fell by about 5 percent in 1977—far less than the 20 percent fall against the yen. It should also be remembered that the dollar and other key world currencies have fluctuated in value several times since the Bretton-Woods System ended in 1971.

At the same time, we cannot turn our back on a special international responsibility that comes with the dollar's role as the world's principal reserve currency. Sharp and disorderly fluctuations in the dollar create the kind of uncertainty that can affect trade and investment decisions. In turn, such decisions could lead to a loss of growth and employment opportunities for many nations.

If the decline of the dollar continues, it could cause severe political difficulties for many of our allies. The sheer rapidity of the dollar's fall against the currencies of Germany and Japan has already created a severe threat to their export industries. Slow growth and painful adjustments for their major industries could be the result.

The steady erosion of the international value of the dollar is also of understandable concern to the OPEC cartel. Not only is oil priced in terms of dollars, but many of the OPEC members have substantial dollar denominated assets. A further drop in the value of the dollar could precipitate an increase in the price of oil and a movement away from American investments.

The fall in the international value of the dollar, therefore, is a matter that demands the careful consideration of the Administration. On the other hand, it is not so serious as to constitute a crisis either for the domestic or international economies. In addition, we must recognize that the United States is limited in what it can do to control the international value of the dollar. The Joint Economic Committee is properly critical of using domestic monetary policy to stabilize the dollar. By tending to attract more foreign capital to the United States, higher domestic interest rates would tend to increase the foreign demand for dollars and therefore the value of the dollar relative to other currencies. That process is both uncertain and costly. There is already a substantial interest rate differential between the United States and Western Europe. That has not been enough to overcome the expectations that additional decreases in the international value of the dollar are sure to come. Higher domestic interest

rates will also come only at the expense of slower growth, less investment, and higher rates of unemployment. The international economy is crucially important to the United States—the value of our exports is now almost 50 percent greater than the total value of residential construction. But the domestic economy remains our principal focus. Using monetary policy to stabilize the international value of the dollar would be a case of allowing the international tail to wag the domestic dog.

We can intervene in foreign exchange markets to make sure adjustments in the international value of the dollar are smoother. I support recent activities of the Department of the Treasury and the Federal Reserve System that move in this direction. Intervention designed to actually support a currency, however, is costly and only temporarily effective.

We should also do everything we can to deflate widespread expectations that the dollar may fall further in value. The President's recent strong commitments to maintain a sound dollar are helpful. Although a national energy program will not have a direct effect on the trade balance for some time, it would be an unmistakable signal that the United States has begun to adopt a long-term strategy to reduce its oil imports and its trade deficit. The same could be said about aggressive and imaginative plans to reduce inflation and increase exports. We should also exercise our imagination in the international arena—searching out those policies and proposals that can help stabilize the dollar without sacrificing domestic growth. In any case, the United States should make it clear that it understands the pressures on German and Japanese industry that have come from such a rapid increase in the relative value of the mark and yen.

PROPOSED DIRECTION FOR FUTURE JEC REPORTS

Traditionally, the Annual Report of the Joint Economic Committee has dealt with specific economic problems as well as the broad macroeconomic issues. With a strong emphasis on the need for structural programs to fight both inflation and unemployment, this year's Report is very much in that tradition. Looking ahead to future Committee reports, I would like to suggest some areas that merit detailed study by our Committee.

Research and Development.—Research and development (R&D) have played a critical role in American growth since the end of World War II. New products have expanded vastly the range of choice confronting the American consumer, and new processes have steadily reduced the amount of labor, capital, and material needed to produce American goods. By contributing to increase productivity, R&D fights inflation and makes American goods more competitive in foreign markets.

The need for further R&D is evident in almost every industrial sector of the country. American productivity is no longer growing as rapidly as it did for most of the post-World War II period. Many industries must find more efficient ways to function or face constant pressure from foreign imports. America's longstanding strength in high technology items can only be maintained by a constant R&D

effort. The sharp increase in energy prices forces us to find new sources of fuels as well as new ways to conserve energy. The Joint Economic Committee should take a detailed look at the current status of future prospects for R&D in the United States.

Small Business.—Too often the serious problems of small business are lost in a focus on broader, more abstract problems. But small business occupies a unique and valuable role in the American economy. In many ways, small business is the urban equivalent of the family farm. For generations of Americans, small enterprises have offered everyone the opportunity to build his own future. In addition, small businesses have been the source of a considerable share of the Nation's new inventions. There can be no doubt that the small businessman is under intense pressures, many of which are caused by government policy. It is time we took a detailed look at the problems that beset small business in America and what public policy can do about them.

Agriculture.—Administration after Administration has been content to keep American agriculture on a roller coaster that mixes sudden prosperity with hard times. We need to take a close look at the changes that are sweeping American agriculture. Support programs should be designed to assure the American farmer an adequate income without relying solely on price increases. Mechanisms to stabilize agricultural prices and income should also be explored. America has been blessed by unparalleled bounty in agricultural resources. It is a part of the economy that we neglect at our peril. The farmer, as well as the small businessman, deserves our sympathetic consideration of his problems.

LEE H. HAMILTON.

ADDITIONAL VIEWS OF SENATOR WILLIAM PROXMIRE

I believe that both the President's proposed \$500 billion budget and this Committee's estimate of expenditures of \$500 to \$505 billion are too high. These expenditures represent an enormous burden on American taxpayers. They should be cut by a minimum of \$25 billion and better yet, by \$35 billion in order to provide a freeze on Federal outlays of about \$465 billion as the distinguished financial expert Henry Kaufman proposed before the House Committee on the Budget.

First of all, this is an achievable cut. It represents only a 5 to 7 percent cut in the President's budget and would provide for total budget outlays at about the fiscal 1978 level. Further, as one who has routinely examined the budgets of numerous Government agencies as a member of the Senate Appropriations Committee, I assert without fear of contradiction that there is not a single general Government function where a 5 to 7 percent cut of the funds could not result in a more efficient or less wasteful program combined with better service to the American public. One can name the function—defense, foreign aid, delivery of mails, welfare, housing, education, law enforcement, highways, public works, reclamation, sugar or mineral subsidies, etc.—and know from experience that the budget could be cut without harming the function.

Second, modern economists have for too long merely looked at the overall or "macro" effects of spending. Very little attention, if any, is paid to the genuine benefits of the proposed increase in outlays. They are justified on such spurious grounds as necessary to "keep even" because of inflation, to stimulate the economy to offset fiscal drags, or as no more than provided by a Current Services Budget.

The general has overcome the specific. Spending is justified for these economic purposes without any or few arguments justifying their specific benefits. We are urged to keep wasteful military projects going to avoid cuts in jobs, to continue pork barrel public works programs because the local communities want them, and to universalize spending because if all 50 states aren't cut in on the proposal it will fail of passage. The amounts of money which are taxed by the Federal Government from the earnings or savings of 220 million Americans for inefficient purposes has grown beyond any justification on macro-economic grounds.

It is true, as Justice Holmes remarked, that with taxes we buy civilization. But we are not required to buy a wasteful or bloated or super-civilization.

Third, the new totals are essentially unprecedented. Henry Kaufman put it succinctly in testimony before the House Budget Committee on February 6, 1978. Here's what he said:

The sharp acceleration in Federal expenditures during fiscal 1978 and 1979 has few parallels in the postwar years.

Judged against the size of the economy, Federal budget outlays in fiscal 1978 represent a record postwar high of 22.6 percent of total GNP. While this ratio is expected to decline to 22 percent in fiscal 1979, it will still be the fourth highest in the last 25 years.

The yearly percentage increase in officially projected expenditures, totalling 15 percent for fiscal 1978, has been exceeded only twice in the past 25 years, once in a recession year (1975) and another in a war-related year (1967). It is twice as large as the average annual rate of increase over this 25-year period.

The officially proposed increases in Federal expenditures are far greater on a percentage basis for this time in the business cycle in the present economic expansion than in the previous four business recoveries.

Finally, I wish to remind my colleagues and the public of what former Senator Paul H. Douglas, once Chairman of this Committee said on this subject. The phrase he coined was that "A liberal need not be a wastrel." Wasted funds build no schools, feed no hungry children, clothe no person, and help no one in need.

There is now general agreement that proper and appropriate Government functions are far greater than ever envisaged by the Founding Fathers or by the so-called rugged individualists of the industrial age. That is no longer in question.

But what is in question is our ability to live within our means, to use public funds wisely and efficiently, and whether the Government is to provide subsidies to everyone everywhere.

We are probably providing more welfare for the well-to-do than for those in genuine need.

I believe we should carry out Lincoln's definition of the legitimate objects of Government as doing for the people "whatever they need to have done, but cannot do at all, or cannot so well do for themselves in their separate and individual capacities."

Even a generous interpretation of that sentiment would allow us to reduce Government spending by more than the \$25 to \$35 billion I have proposed.

WILLIAM PROXMIRE.

ADDITIONAL VIEWS OF SENATOR GEORGE McGOVERN

The President's Economic Report of 1978 is obviously less restrictive than those of the last few years. I believe it provides a useful starting point for budget policy considerations, and this Joint Economic Committee Report, by and large, represents an excellent positive critique of the budget as a document of economic policy.

In some respects the President's Budget is encouraging. I am heartened by the Administration's recognition of the need for a fiscal stimulus to reduce projected unemployment rates that are still disgracefully high. It is also worth special note that the fiscal 1979 military budget would have been some \$2.9 billion higher if the B-1 bomber had not been cancelled.

My basic concern is that the President's 1978 Economic Report represents too cautious and traditional an approach to curbing inflation and lowering unemployment. It has provided very little new fiscal stimulus, and thereby lacks almost entirely any social vision. Events have brought us beyond the luxury of viewing fiscal and monetary policy as socially neutral blueprints.

As a result, I have to say that I am in sharp disagreement with the Administration's approach on several fundamental questions.

First, we have already raised a regressive tax—the social security payroll tax; now we hear that part of the justification for a \$25 billion cut in the more progressive income and excise taxes is to compensate for the payroll tax hike. The combination makes no sense. It will make a bad tax system worse. In part, middle-income workers will be paying more to finance a new tax break for people in higher brackets. I will propose instead that we forgo the \$25 billion tax cut, and that we pay \$7.7 billion of the savings into the social security trust fund so we can cancel next year's increase in payroll taxes.

Second, with the remaining \$17 billion in savings, as well as with funds which can be saved by permitting a smaller increase in military spending, I believe we ought to move to stimulate the economy through direct investments in high priority public investment.

There are a number of other pressing needs that cry out for attention.

One area of emphasis should be a systematic effort to help our major cities through their severe financial crises. A substantial public sector contribution to urban transportation, housing, and other public services would both help meet that crisis and provide millions of jobs where they are most needed. I note that the National League of Cities and Conference of Mayors has just recently called for an \$11.3 billion commitment beyond that proposed by the President to enterprises of this kind. That is the kind of program we could afford if we were to forgo a quick tax cut as the standard remedy to a sluggish economy.

Research and development in the use of renewable energy resources could pay the highest of dividends—by helping to provide thousands of jobs while at the same time eroding our terrible growing reliance on imported oil.

I would also favor a substantial program to bolster farm income. The national farmers' strike has helped spotlight the fact that the new farm program adopted last year, while a distinct improvement, is still gravely insufficient. We are in real danger of losing the family farm structure that is central to a productive, efficient agriculture. And if that happens it will be a crushing blow to farmers and consumers alike.

Another priority investment should be in rail transportation—particularly in reconstructing and upgrading rail lines. Here, too, we could provide large numbers of jobs, while at the same time investing in the kind of energy-efficient transportation the country urgently needs.

What I want to underscore is my firm conviction that a tax cut now is not the wisest method to achieve economic stimulus and social progress. A properly conceived budget can both stimulate the economy and set hopeful new priorities.

Certainly no taxpayer will turn down a tax cut. But I believe the American people also understand that their country needs things which personal spending cannot give it. I think they understand that healthy cities, employed workers, prosperous farms, and efficient rail lines will enrich us all far more than a few dollars in tax cuts for each family or business.

In my opinion this Annual Report is excellent. The only shortcoming I wish to dwell upon is its failure to specify and discuss in detail those areas of social and human needs which deserve our priority attention. I see no reason why we can't develop priorities for addressing public needs (energy, for example) and analysis of how treatment of these needs will affect employment, inflation, balance of payments, capital development, etc. Unless we create a mechanism for this kind of evaluation and coordination, our most serious social and economic problems will continue to be discussed and treated separately, which cannot be in our best interests. It is my hope that in the future the Members and staff will use this Report to comment more explicitly on the President's Economic Report as a blueprint for meeting the unmet needs of our people.

I believe the Joint Economic Committee has been especially perceptive in outlining ways to attack inflation directly and in explaining the role that monetary policy can and should play in stimulating the economy. Finally, by clearly pointing out that rising productivity and employment are the true measures of our economic well-being, not the size of the deficit or the level of Federal expenditures, the Committee has correctly redirected our attention to the basic issues at hand. Hopefully, all this effort will help to create a new and wiser public understanding of our economy.

GEORGE MCGOVERN.

Minority Views
on the
1978 Economic Report
of the President

CONTENTS

	Page
I. Introduction	87
II. Review and outlook for 1977-78	88
III. Economic growth: Why and how	93
The need for growth	93
Savings and growth	94
Productivity and savings	95
Fiscal policy and growth	96
Inflation and growth	97
IV. Monetary policy: Domestic and international	101
Recent history	101
Money and investment	102
International considerations	102
Exchange rate policy	104
V. Tax policies	107
Effects of social security, increases on tax policy	107
The Carter tax package	109
Tax policies affecting small business	116
VI. Employment	118
The employment situation in 1977	118
Policies for full employment	119
VII. Agriculture	121
Legislative proposals in keeping with the free market concept ..	122
Enhanced marketing	123
Expand commercial export markets	123
The farmers' heavy costs	124
VIII. Urban policy	126
Additional views of Senator Jacob K. Javits	131
Additional view of Clarence J. Brown	135
Additional views of Senator William V. Roth, Jr.	136
Additional views of Senator James A. McClure and Senator Orrin G. Hatch	140

I. INTRODUCTION

The picture on economic growth is not encouraging, and the policies being proposed by the Administration will not meet our goals.¹ However, we believe there are policies that will meet our growth objectives without threatening price stability. We believe that such noninflationary growth is possible, that it is desirable, and indeed that our major social and economic problems can be solved if we pursue sound policies. Savings and investment are needed to produce growth without inflation, and these are the focus of this report.

¹ See the Additional Views of Representative Clarence J. Brown of Ohio on the seriousness of the economic outlook.

II. REVIEW AND OUTLOOK FOR 1977-78

1977 was a moderately good year. Although the rate of growth slowed appreciably from the first to the fourth quarter, annual real GNP grew a respectable 4.9 percent for the year as a whole. Unfortunately, the slowing of activity was accompanied by an increase in the rate of inflation (as measured by the chain price index) to an annual rate of 6.2 percent in the fourth quarter. The inflation rate reflected an acceleration of farm prices, the Government pay increase, and rising prices for housing and business investment. Employment for the year expanded at a fast clip—3 million workers—but because of the large increase in the labor force, the unemployment rate dropped only 1 percentage point by the yearend. Industrial production grew almost 6 percent; auto unit sales increased 11.1 percent over 1976; and housing starts edged over a 2 million unit rate in the latter half of 1977. State and local expenditures accounted for substantial increases in government spending. The fourth quarter ended with a net export deficit of \$15 billion in current dollar terms. The personal savings rate has increased from a low of 4.1 percent in the first quarter of 1977 to 5.5 percent in the fourth quarter.

The outlook for policy for the rest of 1978 and 1979 is influenced by two main factors; namely, the shape and condition of the current expansion and the narrowness of the gap believed to exist between potential and actual GNP. The Administration has proposed three general conclusions concerning the expansion. (1) The expansion has been largely "uncoordinated." Some sectors have provided a substantial push throughout its three-year cycle, while other sectors have either grown slowly or have remained stagnant. (2) This imbalance may prolong the expansion beyond the average postwar recovery period of four years. Because not all sectors have exceeded their past peaks of activity, growth in the lagging sectors will provide continuing stimulation to the economy. (3) There is additional room for economic stimulation because capacity constraints have not begun to exert themselves, and so there is less danger of a reignition of inflation.

The Administration has made little attempt to harmonize the growth of the various sectors. As a result, the last year has been characterized by the continuation of sudden spurts of economic growth and periods of flatness. Personal consumption expenditure increases and accelerated inventory investment spurred GNP growth in early 1976 and the first half of 1977, but 1978 should witness slower increases. Residential investment made a strong recovery (averaging over a 2 million unit rate in the last half of 1977) but is not expected to continue at that pace through 1978. Business investment has continued to lag, although desultory promises of accelerated activity from orders for capital goods emerge occasionally. The outlook for State and local spending is

not very promising, and the sluggish growth of exports is expected to continue exerting a significant drag on the economy, though perhaps less than in 1977.

The Administration has proposed a nonstimulative tax program, which only offsets the increasing tax bite from social security taxes and the impact of inflation on tax rates. The Administration has admitted that their tax cut proposals will not be sufficient to encourage economic growth; it is quite probable that additional stimulus will be necessary in 1979. At best, we must expect 1978 and 1979 economic activity to do well in spite of the government and not because of it.

The extent to which capacity utilization of business has risen has direct implications for the Administration's conclusion that excess industrial capacity presently leaves room for additional stimulus without increasing inflation. The industrial production index for total manufacturing reached 82.8 in the fourth quarter of 1977. For industrial materials, the index stood at 82.3 for the same period. It is generally understood that operating rates in harmony with moderate price behavior are well below 100 percent of capacity utilization; e.g. 88 percent was the peak rate for manufacturing in 1973, when inflation reached 8.8 percent, as measured by the Consumer Price Index. Moreover, the aggregate capacity utilization indices often do not accurately portray the situation in the individual industries. Some industries may already be experiencing capacity constraints even though other industries are operating at capacity rates well below the average.

If capacity bottlenecks occur in selective basic industries, inflationary pressures could occur which also would exert pressure on other sectors. In addition, capacity utilization indices do not measure such things as distribution systems which could impose significant constraints upon manufacturers. For example, a recent shortage of available railroad cars in the West curtailed needed coal shipments to the Midwest which was suffering from a shortage of coal.

Inflationary pressures also can emerge from sources other than capacity problems. Agricultural prices have been depressed for the greater part of 1977. However, farm prices are expected to rise more rapidly in 1978 and will exert upward pressure on consumer food prices. As discussed in more detail in the agricultural section, the Administration has not addressed this issue. The only major Administration proposal for the agricultural sector is set-asides, and these will neither assure adequate supplies, nor protect the viability of farms and farmers. More important to this discussion, set-asides will possibly increase inflationary pressures.

Another source of inflationary pressure is Federally mandated cost increases—that is, the bigger bite of social security taxes, the increase in the minimum wage, and the requested, although undetermined, new energy taxes. These measures will cause significant upward movement in business costs and will consequently push upward on prices. Unfortunately, the Council on Wage and Price Stability continues to have an uncertain mission and even less certain powers. Witnesses before the JEC have described the Administration's anti-inflation program as largely worthless. Moreover, witnesses feared any discussion of wage or price guidelines might fuel fears of eventual price controls.

Dr. Gerard Adams from Wharton Econometric Forecasting Associates stated that "some (government policy impact) is unavoidable, but it is terribly important for Congress to realize and the President to realize that many of the regulatory measures which have been imposed on the economy do have an inflationary impact." He stated that "I am very skeptical that voluntary price-wage guidelines . . . lead anywhere, and I am even more skeptical of price-wage ceilings or freezes or anything else." Dr. Jack Carlson of the U.S. Chamber of Commerce named still other cases of Federal inflationary pressure—farm price supports, Federal pay increases, and labor law reform as legislative measures with an inflationary impact.

Another source of inflation is the continuing depreciation of the dollar, a development for which there is no fully acceptable solution. Imports are costing business and consumers more. For businesses, the higher costs of materials, parts, and subassemblies will have to be reflected in higher domestic prices. For consumers, the higher prices may well generate increasingly aggressive wage demands in the near future.

Wage settlements are a key element of cost pressures. For example, whatever the final resolution of the coal strike, one aspect is clear: the terms of the original contract rejected by the workers called for a 37 percent wage increase over three years. Such a settlement necessarily would have inflationary implications for the remaining collective bargaining agreements to be negotiated in 1978.

Because 1978 will be a light bargaining year, deferred increases and cost-of-living adjustments will be major elements in the total wage-rate increase for the year. New contract negotiations are expected to affect about 2 million workers with the largest groups in construction, food stores, transportation equipment and Postal Service workers. From already existing contracts at least 6.3 million employees will receive deferred wage increases averaging 5.1 percent (In 1977, the average deferred wage increase was 5.9 percent). Moreover, 4.1 million of these workers probably will receive cost-of-living increases. The Consumer Price Index went up at an average rate of 6.5 percent in 1977 (6.8 percent December 1977 over December 1976) compared to 4.8 percent the previous year. Contract formulas typically do not provide for one-to-one increases, but the growing use of cost-of-living escalator clauses in collective bargaining does result in a more ingrained momentum.

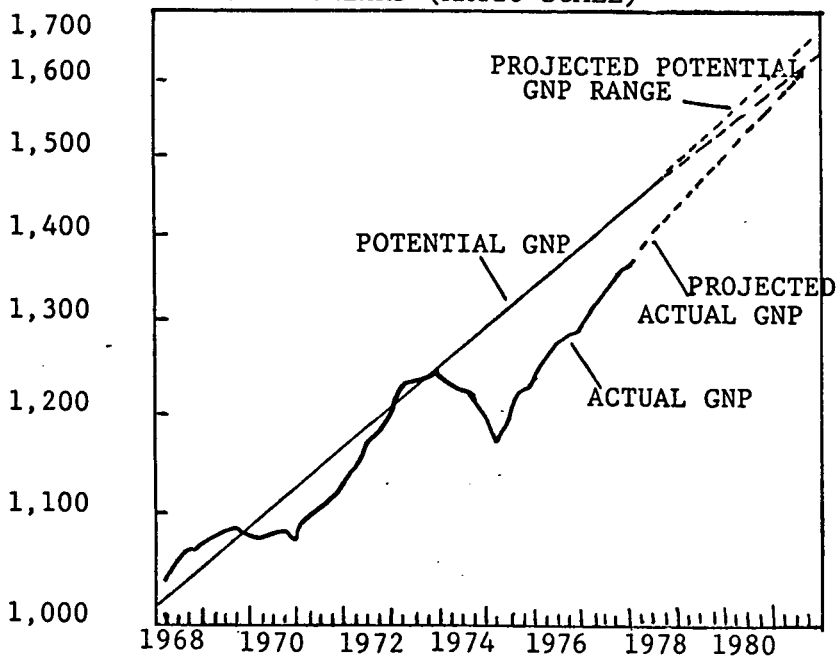
The life expectancy of the business cycle is also involved in the Administration's conclusion concerning capacity constraints. As mentioned previously, the average postwar upswing has lasted four years. In the present case, recovery has continued for three years, although there have been several hesitations. However, not all upswings will last the average length, and there is no convincing rationale for believing expansions must continue until full utilization of all sectors occurs. Recoveries have disintegrated in the past, even though some sectors had not yet reached their full capacity.

In addition to the shape of the current expansion so far, the outlook for policy changes for the rest of 1978 and 1979 is influenced by the size of the gap between actual and potential GNP. In their Annual Economic Report, the Council of Economic Advisers presented a chart

(shown below) that showed GNP growth to be within a range of 3.3 to 3.8 percent through 1981. However, in the Outlook section, the Council of Economic Advisers maintained that a "seven-year growth path" for GNP of 5 percent per annum was both the best that could be done and the minimum necessary to meet the Administration's employment and budget goals. This implies that the expected actual growth rate on a long-term basis (i.e., seven years) is faster than the potential rate—an event impossible by definition—at the same time it is supposedly impossible to reach potential GNP for the next five years! Clearly, the concept of potential GNP—which was never too sharp—is becoming steadily more confused.

CHART II-1.—Actual and potential gross national product

BILLIONS OF 1972 DOLLARS (RATIO SCALE)



Sources: Department of Commerce and Council of Economic Advisers.

Potential GNP is an estimate of what the economy could produce at high rates of utilization of the available factors of production—labor, capital, and natural resources. It follows that the factors of production must be present in order to be utilized or fairly accurate estimates of future availability must be made. It can be argued that because of the severity of the last recession, the level of the capacity of the U.S. economy was permanently lowered. (As an illustration, the line in the chart representing potential GNP should be shifted downward so the line is more nearly parallel to actual GNP from 1974 to pres-

ent.) Because the capital base required as underpinning for the projection of potential GNP over the next several years (as shown in the chart) was simply never put in place as a result of the last recession, current estimates of the level of potential GNP must be lowered, and therefore the size of the gap must be smaller.

If the projection of the level of potential GNP is shifted downward, it suggests an entirely different situation than the 3.3 to 3.8 percent range proposed by the Administration. (The CEA has assumed that the track for potential GNP remained the same even after the 1974-75 recession.) More properly, the projection should have a lower starting point and a faster rate of increase—according to the Council itself, something very close to 5 percent. Using the chart again as an illustration, the line for potential GNP should be lower, but its slope should be steeper. Without this adjustment, one is inclined to ask just what the potential line represents for 1978, 1979, and 1980? If we cannot reach the potential level for at least several years, but we can grow faster than potential for more than five years, just what is the Council's concept of potential GNP growth? Is it something more properly called "unattainable potential"?

The implications of the two perspectives concerning GNP potential are significant. The capacity limitations for the economy may be much closer than is presently assumed, and perhaps resources, other than labor, are being utilized more heavily. If there is not as great a gap between actual and potential GNP, inflationary pressures may be an even more imminent problem. If the growth rate of potential GNP over the next five to seven years is not between 3.3 and 3.8 percent, but closer to 5 percent, policymakers should take extreme care to tailor the economic stimulus to the real needs of the economy. Excessive short-term stimulus could exacerbate inflation very quickly, yet insufficient longer-term stimulus would allow the gap to widen even more than portrayed under the current projection. Specific policies to deal with this potential anomaly are discussed in the following chapters.

anticipates. If wages can be encouraged to grow, revenues will rise without a tax rate increase.

The Minority believes that it is far better to increase real wages by 50 percent more than the Social Security planners predict, than to impose a 50 percent increase in the tax rate on currently expected real income. An increase in the annual U.S. growth rate by only 0.6 percent would produce such a wage increase within the 70-year planning period. We urge that steps be taken (as described below) to bring about the needed increase in the rate of economic growth.

SAVINGS AND GROWTH

Anyone hoping for more rapid economic growth must be concerned with savings. Only that part of national income which goes into savings is available to cover investment and the government deficit.

Once the government chooses a deficit, the only way to get more investment without expanding our foreign debt is to raise savings. The ratio of investment to GNP basically determines the country's growth rate. Only by increasing savings can the real growth rate be raised. This is especially true in the face of a massive diversion of investment to non-growth uses, such as pollution control and the coal conversion portion of the Energy Program.

The government could help growth by reducing government spending to lower the deficit. However, a tax increase to reduce the deficit would also reduce saving by reducing the after-tax return to saving and would be counterproductive.

As described below, one way of encouraging saving is to lower personal income tax rates across the board. This would allow every taxpayer to keep a higher percentage of the *additional* interest or dividends earned from *additional* saving, and thus, would make saving more attractive.

Another approach would be to tax income only when it is spent, thereby not taxing net savings. A tax deduction for savings would be created. For savings accounts, the deduction would be interest plus deposits minus withdrawals. For stocks and bonds, the deduction would be purchases and reinvested dividends minus sales. (Net withdrawals or sales would be negative deductions and would be added to taxable income.)

Other nations have out-saved and out-grown the U.S. by wide margins over the years. Table III-1 shows the results of the relatively low saving rate, which the Energy Plan, and higher social security and income taxes, threaten to make worse.

TABLE III-1.—WAGE INCREASES, INVESTMENT, AND SAVING

	1965-75 percent change in real wages and fringe benefits ¹	Investment as percent of GNP—Averages, 1960-73		Household savings ratios, 1976 estimate (percent)
		Total	Total minus homebuilding	
United States.....	15.7	17.5	13.6	6-8
Canada.....	48.5	21.8	17.4	10-12
Japan.....	138.9	35.0	29.0	24-26
France.....	77.4	24.5	18.2	16-18
Germany.....	78.1	25.8	20.0	14-16
Italy.....	116.4	20.5	14.4	22-24
United Kingdom.....	53.9	18.5	15.2	12-14

¹ Includes pension programs and other fringe benefits.

Sources: Bureau of Labor Statistics, OECD.

III. ECONOMIC GROWTH: WHY AND HOW

THE NEED FOR GROWTH

The United States is about to experience its first year of a \$2 trillion GNP. It could have been \$3 trillion.

Since 1950, the average annual growth of the U.S. economy in real terms has been 3.7 percent. Many other major industrialized countries have grown at annual real rates averaging in excess of 5.5 percent, and some have averaged more than 6 percent. If the United States had grown on average 1.5 percent faster each year since 1950, at a rate of 5.2 percent, its GNP would now be \$3 trillion.

With a \$3 trillion economy, incomes would be 50 percent higher than at present. Jobs would be plentiful. Federal revenues this year would be \$200 billion higher, enough to provide for a balanced budget, welfare reform, national health insurance, and unquestioned military pre-eminence, with enough left over to let us reduce payroll and income taxes instead of raising them. Of course, price stability would have been another spin-off of the growth of real output and the balanced budget.

The Minority does not mean to cry over spilt milk. Our purpose is to illustrate the power of compound interest, and the benefits to be had within a generation from faster economic growth.

Faster growth, higher incomes, and plentiful jobs are exactly what the unemployed, the underprivileged, and the minorities of this country have been seeking for many years. It is no accident that the greatest gains in income, jobs, and dignity for minority workers have come during periods of rapid economic expansion. In recent weeks, the NAACP has issued a clear call for a return to rapid economic growth and the creation of real jobs in the private sector. Bitter experience with unproductive, dead-end public jobs programs has convinced many black leaders that young people need the skills which can be learned and benefits which can be earned in the production of goods and services.

The social security tax increases just enacted are drawing sharp criticism even before they go into effect. In fact, these tax increases are but the tip of the iceberg.

Benefits currently promised will require increases in social security taxes by 50 percent, from 12 percent of payroll to 18 percent of payroll, over the next 70 years, if real wages grow only as rapidly as the Social Security Administration predicts (1.75-2 percent per year). It is widely assumed that the next generation will be unwilling to pay such taxes, either in the form of payroll taxes or sharply higher income taxes. Recent polls already show a decline in public support for the Social Security System. For these reasons, some have suggested reducing benefits or raising the retirement age to 68 for workers just entering the System. But this assumes that nothing can be done to get income to rise more rapidly than the Social Security Administration

PRODUCTIVITY AND SAVINGS

Once saving is stimulated, it must be put to work creating capital investment and jobs.

A higher rate of investment is necessary in the short run to bolster our current economic expansion. But in the long run as well, we need massive capital outlays. Various studies in recent years have pointed to the huge volume of capital investment needed over the next decade—trillions of dollars—to expand, replace, and modernize our production facilities to accommodate economic growth, to help us reach full employment, to achieve greater energy independence, and in general, to raise our standard of living. (Even for those who advocate “zero economic growth” as a way of enriching our overall quality of life, huge amounts of capital formation are still essential in order to develop new products and new processes of production which are more economical in their use of resources and less damaging to the environment.)

Increased productivity (output per unit of input) is the key to economic growth and more jobs. Over the past 25 years, improvement in labor productivity has accounted for more than two-thirds of the growth in the real gross national product.

From 1949 to 1968, private non-farm productivity increases averaged about 2.6 percent per year. From 1968 to 1977, productivity rose by only 1.4 percent per year. This slowdown in the growth of output per worker hour is one of our most serious economic problems. Without faster gains in productivity, inflation is aggravated, and improvement in real incomes, if it comes at all, comes to some at the expense of others.

Productivity depends on: (1) increases in the amount of physical capital per worker; (2) technological innovation that brings more output from each unit of resources, capital, of labor; (3) qualitative improvements in the labor forces through better education, motivation, and manpower training; (4) improved mobility of labor and capital, permitting resources to shift from low productivity sectors to high productivity sectors; and (5) management innovation to improve the way labor and capital are used.

Of the factors listed, increased and improved capital per worker is one of the most potent forces for productivity and economic growth. From 1949 to 1968, the capital-labor ration grew at an annual rate of about 3 percent. Over the last decade it has grown much more slowly, about 1 percent a year. If capital required to meet government-imposed pollution and abatement regulations is deducted, the capital-labor ratio growth is even less.

The slower growth of the capital-labor ratio in the past decade is at the root of our recently reduced rate of productivity increase.

We must turn our productivity trends around through large-scale investment in new business plant and equipment. This can best be accomplished by direct tax rate reduction to increase the after-tax return to saving and investment. Tax rate reduction, plus measures to reduce the risks associated with the regulatory climate, can promote the expansion of business plant and equipment spending needed for economic growth.

FISCAL POLICY AND GROWTH

Demand or Supply Problems

Every administration witness to appear before the Joint Economic Committee discussed proposed tax changes in terms of aggregate demand, or total spending. Herbert Stein has questioned this approach, asking how demand can be stimulated by a tax cut if the Government does not reduce its spending. What the Government gives away with the tax cut, it must take back with increased borrowing to fund the spending.

Other economists have pointed out that the Administration approach fails to take account of the impact of tax rates on aggregate supply. For example, in every year without a tax rate reduction, inflation pushes people into higher tax brackets, even when they have no increase in real income. Their *average tax rate* rises, which means that their tax burden rises faster than inflation, and they have less to spend. However, there is an additional effect which demand theorists tend to overlook.

Inflation raises the average tax rate by raising the *marginal tax rate*. It is marginal income, the last few hundred dollars of the taxpayer's earnings, which falls into higher brackets and is taxed at a higher rate. The Government takes a larger slice out of the last few hundred dollars of each person's wages, profits, interest, and dividends. These higher rates also apply to any increase in wages, profits, interest, and dividends which could be earned by working longer, saving more, or investing more.

The problem of higher tax rates resulting from inflation is not a minor matter. Inflation is producing real tax increases of \$7 to \$9 billion per year on individuals. Millions of workers have seen their incomes taxed in higher and higher brackets.

Furthermore, the change in marginal tax rates can affect behavior. At the margin, leisure might be substituted for labor, because the reward to labor has fallen. Consumption could tend to replace saving and investment because the reward to saving and investment falls. On the other hand, higher real tax rates will tend to force workers to ask for higher pay increases than might otherwise have been the case, in order to compensate for their lowered real after-tax incomes. In any event, these shifts in behavior cause real GNP, investment, and job creation to drop, even if the Government spends the money to keep nominal demand constant. Nominal demand cannot offset the shift away from productive activity as taxes reduce the rate of return to labor, saving, and investment.¹

This adverse effect on GNP occurs whenever a tax is imposed. For example, a payroll tax reduces the after-tax wage of labor, and raises the after-tax cost of labor to the firm. The supply and demand for labor fall. So do employment and GNP.

Similarly, a tax on the use of oil and gas reduces the after-tax receipts of the producers, and raises the after-tax prices of goods and services to consumers, which reduces the value of their wages. Output of gas and oil falls. The supply of labor falls. Employment and GNP fall.

¹ See the discussion of marginal tax brackets in the additional views of Senator Javits.

This drop in output will occur even if the energy taxes are handed back to consumers in some fashion unrelated to work effort. Demand may be maintained, but the supply disincentives remain. Furthermore, we know all too well that when money is poured through Washington, a substantial amount of it, in effect, "sticks to the funnel." There is considerable waste in any such income transfer. For this reason, the Administration is wrong to think that the proposed energy taxes and energy rebates will have no net impact on economic activity. Consequently, netting these tax changes out in the presentation of the budget gives a misleading picture of the budget's economic impact.

The inability to take account of the supply of productive effort is the biggest failure of demand management economics. Unfortunately, this shortcoming is shared by most of the major econometric models used by policymakers.

INFLATION AND GROWTH

Personal Taxes

In the short run, the impact of inflation on personal income taxes can destabilize the economy. Many economists believe that the higher personal income taxes generated by inflation between 1972 and 1974 contributed heavily to the recession of 1974-75. In a study prepared for the Joint Economic Committee, Thomas Dernburg concluded that the tax code should be adjusted (indexed) annually for inflation to keep tax rates from rising without an open debate and vote by the Congress. He suggests that "an indexed personal income tax would have helped to avert the collapse of 1974, that it would tend to stabilize the level of economic activity, that there is little presumption that it would contribute to inflation, and that it might, indeed, do the opposite if it relieved cost and supply pressure."

The reason that inflation is a tax problem is that the tax system treats every increase in income as if it were real income. The tax system does not take into account the fact that a worker's real income has increased less than his or her nominal income—the entire nominal income gain is taxed. Thus, with the sustained high inflation of recent years, workers have had wage increases reduced not only by inflation but also by the higher taxes that must be paid as inflation pushes incomes into higher tax brackets.

As high inflation continues, as marginal tax rates remain high, and as decreasing productivity gains reduce the real component of wage increases, the economic effect on taxpayers becomes more severe. James T. Lynn, former Director of the Office of Management and Budget, estimates that during this decade inflation-induced taxes will take \$82 billion from the American taxpayer, if Congress does not take compensating action.

In the long run, inflation has another effect, a subtle but devastating influence on saving. Inflation acts through the tax system both to reduce personal saving, and to misdirect what saving is done into inefficient, even unprofitable investments, thereby reducing economic growth.

It is not commonly realized that inflation and the tax changes since 1964 have had the effect of raising marginal tax rates in spite of the fact that average tax rates have been held fairly steady. Increases in the standard deduction, and adoption of the general tax credit, have

held down effective tax rates, while increased nominal income has been taxed at higher marginal rates.

Economists have long warned that a broad tax base with low tax rates is less disruptive of economic growth than a narrow base with higher rates. Unfortunately, the tax system has been moving in the wrong direction since 1965.

It begins to pay a taxpayer to look into the use of tax shelters when his income rises to the point where it is being taxed at marginal rates a bit in excess of 30 percent. The number of taxpayers in those brackets has risen dramatically in the last 12 years. In 1965, less than 2 percent of taxable returns reached brackets above 30 percent. By 1974, 7 percent of returns were in that category. This year, the figure is nearly 10 percent. Taxpayers in these brackets have incomes roughly three times the median income. Thus, the share of national saving done by these taxpayers is likely to be at least three times higher than their share of the number of taxable returns filed would indicate. The percent of total personal saving which potentially could be lured into tax shelters has risen from perhaps 10 percent to about 30 percent since 1965.

At the present time, less than \$3 billion is collected in tax revenues on existing taxable income by having marginal tax rates in excess of 50 percent. Much of the potentially taxable income in these brackets has been sheltered or simply not earned. To increase the taxes on this income group will only result in a lower tax take, as more of their income would be shifted to non-taxable forms of income.

The amount of income actually being directed into certain types of tax shelters has risen several hundred percent in the last few years. Many brokerage houses are finding it harder to interest customers in common stock, while finding it very difficult to keep up with the demand for tax exempt bonds and tax exempt mutual funds and unit trusts.

It is very likely that marginal tax rates have risen to the point where they are causing a substantial reduction in this country's growth rate. There is even a reasonable possibility that marginal tax rates are so high that they have actually reduced Federal revenue. The Minority strongly urges the Treasury and the Joint Economic Committee to investigate these possibilities.

Corporate Taxes

Inflation depresses the growth of business activity, job formation, and wages by interfering dramatically with depreciation. The tax code only permits a tax deduction of the historical cost of plant and equipment. When inflation increases the cost of new plant and equipment, the firm finds that the money it has set aside for replacement is inadequate. It must use taxable income to supplement its depreciation allowances just to maintain its productive capacity—just to stand still. Thus, actual economic depreciation is understated, and corporate profits are overstated. Inflation "disallows" the deduction of a real cost of doing business, increases the firm's tax liability, and reduces its ability to grow.

The Bureau of Economic Analysis regularly reports a data series designed to show the true value of corporate profits after allowance

for real depreciation and the cost of replacing inventory. The goal is an accurate measure of business health. Reported profits are reduced by the "capital consumption allowance adjustment" and by the "inventory valuation adjustment." What remains are true "economic profits." These may be reduced by corporate tax payments to produce "economic profits after tax," or set out in constant dollars to produce "real economic profits."

Treasury Secretary Blumenthal has been quoted as saying, "I can't explain the stock market. I didn't understand the market when I was in business, and I don't understand it now." Yet, there is nothing mysterious about the behavior of the stock market. The broadly-based Standard and Poor's 500 index, expressed in real dollars, shows that stock prices have been accurately matching changes in real economic profits for years. After-tax real economic profits are well below the levels of 1965 to 1968. The stock market is reflecting that fact.

TABLE III-2.—ECONOMIC PROFITS OF DOMESTIC CORPORATIONS
[Calendar years in billions of dollars]

	Current dollars	1972 dollars
1960.....	44.7	65.1
1961.....	44.6	64.3
1962.....	52.3	74.1
1963.....	57.0	79.6
1964.....	63.9	87.8
1965.....	73.8	96.3
1966.....	79.8	104.0
1967.....	76.3	96.5
1968.....	82.6	100.0
1969.....	77.7	89.6
1970.....	64.1	70.2
1971.....	72.6	75.6
1972.....	87.2	87.1
1973.....	92.2	87.1
1974.....	74.0	63.8
1975.....	93.1	73.2
1976.....	119.9	89.6
1977.....	129.8	91.8

The market is also reflecting a sharp rise in the effective corporate tax rate, defined as taxes paid divided by economic profits. Two tax rate series are presented. One is based on economic profits, as described above. The other is based on a profit series with one further adjustment. The capital consumption allowance adjustment estimated by the BEA appears to many observers to be too small. Recently, the SEC was empowered to require large corporations to file a special report on the cost of replacing their existing equipment. The results of the survey suggest that the BEA allowance may be only half the proper amount. Profits in the second series have been adjusted accordingly, by doubling the capital consumption allowance adjustment.

Either way one looks at the depreciation allowance, one sees a sharp rise in the effective tax rate on pre-tax economic profits. The rate increased from roughly 40 cents on each dollar, after the tax cuts of 1962 and 1964, to roughly 50 or 60 cents by 1977. These are increases of 25 to 50 percent over the 1965 rate.

The stock market is reflecting real factors and will continue to be depressed as long as real economic profits are expected to remain at very low levels. The expected increase in energy taxes, social security

TABLE III-3.—EFFECTIVE TAX RATES ON U.S. CORPORATIONS BY FISCAL YEAR¹—FEDERAL, STATE, AND LOCAL

	Tax collections (percent)	
	NIPA profits ²	Adjusted economic profits ³
1960.....	49.5	52.4
1961.....	53.1	55.8
1962.....	44.1	44.5
1963.....	42.7	41.5
1964.....	41.2	39.6
1965.....	40.4	38.5
1966.....	40.9	39.0
1967.....	46.8	44.6
1968.....	39.4	37.6
1969.....	48.4	46.3
1970.....	52.6	50.7
1971.....	44.9	44.3
1972.....	46.3	45.6
1973.....	45.4	44.2
1974.....	52.2	52.0
1975.....	64.7	72.5
1976.....	42.6	48.7
1977.....	50.8	58.8

¹ Courtesy of House Republican Research Committee Economic Task Force.

² NIPA profits are pretax economic profits—national income and products accounts domestic corporate profits after inventory valuation and capital consumption allowance adjustments.

³ Adjusted economic profits equal NIPA profits less an adjustment to the capital consumption allowance adjustment implied by the new SEC replacement cost data. The added annual "adjustment" equals 100 percent of the old adjustment.

taxes, and underdepreciation over the next few years are sufficient to explain the market's continued pessimism.

Minimizing the Damage

The best way to end the damage which inflation is doing to the economy is to move toward price stability. This will require a gradual reduction in the rate of growth of the monetary aggregates over many years.

In the meantime, other steps should be taken. The Congress should reduce marginal personal income tax rates and should examine the tax code annually to make sure that increases in nominal income do not expose taxpayers to increasing marginal tax rates in the future. On the corporate side, replacement cost depreciation should be considered, to allow firms to set aside sufficient funds to maintain and modernize our stock of productive capital. These two steps would go a long way toward guaranteeing rapid increases in jobs and after-tax wages.

IV. MONETARY POLICY: DOMESTIC AND INTERNATIONAL

Great concern has been expressed in many quarters that monetary policy has not been easy enough in recent months to produce rapid economic growth. This concern has intensified since the beginning of the year, when the Federal Reserve moved to strengthen the dollar in relation to foreign currencies.

The Minority feels that this concern is unwarranted. Indeed, rising inflation at home and reduced demand for the dollar overseas indicate that the dollar is, if anything, in excess supply. The recent very modest increases in interest rates are clearly signs that the public expects a rise in the rate of inflation. The increases in interest rates are due to a rise in the inflation premium, not to an incipient credit crunch.

RECENT HISTORY

During 1977, M1 (the narrowly-defined money stock consisting of currency plus demand deposits) grew at a rate of nearly 7½ percent. This rate was even higher, in excess of 8½ percent, for the first three quarters of the year. In the last 13 weeks, M1 has grown at a 4 percent annual rate. Judging from other figures, this lower rate may be an aberration.

Also during 1977, M2 (a broader money measure made up of M1 plus time deposits at commercial banks) grew 9 percent. Since the turn of the year, M2 has grown at an annual rate of about 6½ percent. Historically, M2 has moved more closely with GNP than has M1.

While M1 and M2 rose rapidly in 1977, they have occasionally grown faster, though not often. At the same time, the monetary base (bank reserves and currency, the base on which bank credit, M1, and M2 are built) was setting growth records. It rose about 9 percent in 1977, and its major component, Federal Reserve credit, rose at least 10 percent on the year, and at a 12 percent rate in the last half. Since the turn of the year, the monetary base has grown at a 15 percent annual rate. This too is an aberration due to a short-term surge in reserves in January, but it does indicate that no great tightening of monetary policy has occurred.

In fact, continued expansion of the monetary base and Federal Reserve credit at 1977 rates would be contrary to the Fed's announced intention to reduce the rate of growth of the monetary aggregates in order to curb the rate of inflation and to halt the decline of the dollar on the foreign exchange markets.

There are other reasons for believing that the monetary aggregates are growing rapidly enough to sustain the economic recovery. Liquidity can be assured through a variety of means:

(1) Velocity of circulation may rise. It has proven to be flexible in the past, usually rising with inflation and interest rates as people try to shift out of money into interest bearing assets.

(2) Many foreign governments, especially those with heavy oil revenues, continue to be large buyers of U.S. government securities, recycling petrodollars and shifting investment money to the U.S., the most rapidly growing major Western nation. Admittedly, how much longer these countries will hold American securities is problematical if the dollar continues to decline.

(3) Many private holders of dollars have reduced their demand for the dollar as it has declined in value. Multinational firms and foreigners can transact business in a wide variety of currencies. When the dollar appears unsettled, they can and do go elsewhere. This frees large sums for use in the U.S. money markets.

MONEY AND INVESTMENT

The Administration hopes that new management at the Federal Reserve will produce an easier monetary policy. It hopes to lower short-term interest rates to stimulate investment. If recent history is a guide, this policy will not work.

Nominal short-term interest rates have little to do with real long-term investment in plant and equipment. Real long-term interest rates are the rates relevant to investment decisions.

Easy money will generate inflationary fears which will raise nominal short-term interest rates. Eventually, nominal long-term rates will rise as well. The effect on real long-term interest rates (nominal interest rates minus the expected inflation) is unclear.

Inflation increases uncertainty and raises the tax burden on individuals and businesses. It understates depreciation and reduces the real return on all forms of business individuals into higher tax brackets, reducing their after-tax return on stocks and bonds. Whatever all this means for real interest rates is immaterial, since it also implies less saving and less investment regardless.

In testimony before this Committee, Joseph Kasputys of Data Resources, Inc., presented DRI's comparison of two methods of inducing a given amount of investment. One method was to reduce the corporate tax rate or alter the investment tax credit. The other was to increase the money supply in an effort to reduce interest rates.

The tax reduction method resulted in a drop in the rate of inflation by nearly 1 percent over a five year period, compared to the baseline forecast. The easy money method raised the rate of inflation by between 1 and 2 percent.

Clearly, tax policy is a far less inflationary way to increase investment than is monetary policy, even assuming an easy money policy could work. In fact, a moderate monetary policy may be used to curb inflation (a move which would also help investment) while a properly designed tax policy could simultaneously increase investment and real growth.

INTERNATIONAL CONSIDERATIONS

The Administration's faith in an easy money policy may be misplaced for still another reason. Such a policy would conflict with

the Administration's international economic goals of a strong dollar, stable exchange markets, and a coordinated economic recovery of allied and Third World countries.

Easy money would produce a declining and erratic dollar. A declining and erratic dollar would wreak havoc with all nations' exports, imports, and employment in the short run, and with the U.S. rates of inflation in both the short term and long term. A falling dollar hurts U.S. consumers and does not produce jobs for American workers. A falling dollar does threaten worldwide trade disruption and recession.

The Administration has decided not to intervene to support the value of the dollar in relationship to other currencies. The President has recently restated the position that the U.S. will intervene in the foreign exchange markets to offset disorderly conditions, but not to affect basic trends. The success or failure of this policy depends upon a clear understanding of the processes at work.

Many observers apparently believe that the Federal Reserve has raised interest rates to support the dollar by attracting an inflow of investment funds. These observers fret about the impact of the higher interest rates on the domestic economy. Other observers feel that the Federal Reserve can buy dollars on the foreign exchange markets to support the exchange rate, while creating dollars in the U.S. to hold down short-term interest rates. Both views are off the mark.

Interest rates have not risen by more than expected increases in inflation. This has produced no added drawing power for foreign funds. Strengthening the dollar is done by restricting the supply of dollars on the world market, not by raising interest rates.

The market for dollars is worldwide. The world supply of dollars and the world demand for dollars determine the value of the dollar in terms of other currencies. All transactions impact on the exchange rates—trade and capital flows affecting demand, creation of dollars and other currencies affecting relative supplies. There is no rigid segmentation of the market into domestic and foreign sectors.

Two types of operations affecting the world supply of dollars are carried out by the Federal Reserve Bank of New York. Through the Foreign Exchange Desk, the Bank can engage in swap arrangements with foreign central banks, acquiring foreign currency with which to buy dollars on the foreign exchange markets. These purchases reduce the world supply of dollars and support the dollar's value. Through the Open Market Desk, the Bank increases or decreases the quantity of dollars by buying or selling Treasury securities. This is how monetary policy is normally conducted.

A dollar is a dollar is a dollar. It would make no sense for the Bank to be reducing the world supply of dollars through the Foreign Exchange Desk while increasing the supply through the Open Market Desk. Consequently, the two Desks are under one management. Their activities are coordinated. The Foreign Exchange Desk, dealing in terms of a few hundred million dollars, has been used on a day-to-day basis to smooth out disorderly conditions in the exchange markets. However, such sums are dwarfed by the billions of dollars which are created or destroyed each week at the Open Market Desk. Only as the Fed moves gradually to slow the growth of the monetary aggregates through its open market operations will the basic trend in the value of the dollar be altered.

EXCHANGE RATE POLICY

International economic policy, and especially exchange rate policy, are intimately connected with monetary policy.

In 1977, the U.S. had a trade deficit on the order of \$30 billion. However, there is more to the balance of payments than the trade account. The trade deficit was partially offset by a surplus in services of approximately \$9 billion. The remaining current account deficit was covered by earnings on foreign assets and by capital inflows (borrowing or sale of equities) from abroad. Stocks, bonds, and government securities are, in a sense, our biggest "export."

The dollar has not fallen simply because of the U.S. trade deficit. The U.S. had a trade deficit every year from 1776 to 1914. However, because this was a rapidly growing country with great investment opportunities, capital inflows covered these deficits. Foreign lenders knew that their investment would be backed by increased real output, and they had no hesitation in buying American bonds.

Over the past 10 years, excessive dollar creation has generated inflation, lower real profits, higher taxation, and higher real costs of production in the U.S. The reduced after-tax returns have led to savings and investment rates that are the lowest in the developed world, and our long-term growth prospects are poor. These facts and prospects are a direct threat to our ability to fund our trade deficit with "exports" of commercial paper, bonds, and government securities.

The U.S. current account deficit is largely the result of the growth of the U.S. economy at a time when other nations are in recession or are growing only slowly. Many of our largest trading partners, including Canada, Germany, Japan, Britain, France, and Italy, suffered falling real output in one or more quarters of 1977. Consequently, our purchases of their products grew normally, while their purchases of our exports lagged. As the world economy recovers, the U.S. deficit will fall.

To use the current trade deficit as the primary reason for passage of the Administration's energy proposals is faulty logic from two perspectives. First, only one-third of our increased import bill since 1975 is due to oil. There is an energy problem in our balance of payments, but it is clearly not the only problem, and its resolution will not resolve the trade deficit. Second, the heavy taxes proposed in the energy plan will raise U.S. production costs, reducing our competitive position. Furthermore, the plan's emphasis on energy conservation rather than production will result in more oil imports than strictly necessary. Congress should not be pushed into hasty action on the energy program.

Over the last year, the dollar has slipped in value approximately 5 percent relative to other currencies, on a trade-weighted basis. This drop has increased the rate of inflation in the U.S. Robert Solomon, a recent witness before the Committee, has stated that the recent drop in the dollar has already added about 1.2 percent to the U.S. price level.

A falling dollar is far more inflationary than is commonly realized, and far less likely to improve trade balance than is commonly supposed.

The devaluation theory which has been dominant since the 1930's had no real test until the collapse of the Bretton Woods system of fixed exchange rates in the currency disorders of the late 1960's. This theory held that a devaluation would discourage imports by raising their price and make exports relatively cheaper for foreigners to buy. If domestic and foreign buyers reacted strongly enough to the price changes, the trade balance would eventually improve.

The theory predicted a rise in prices generally limited to imports. Thus, we see calculations that a 5 percent fall in the dollar will raise prices on the 7 percent of our spending which goes for imports, with a price level impact of \$0.35 percent (0.35×0.07). Spillover effects on other prices are assumed to be minor.

In fact, the situation is more complicated.

When the dollar declines, about 60 percent of any price adjustment occurs in the U.S. and about 40 percent in the rest of the free world. (The adjustment burden is distributed inversely with the sizes of the economies involved. The U.S. has roughly 40 percent of free world GNP. A very small country, with little impact on world prices, would bear nearly the entire burden of adjustment.) The 60-40 ratio means that a 5 percent decline in the dollar will cause world prices of traded goods to rise about 3 percent more than normal in terms of dollars and about 2 percent less than normal in terms of other currencies. These changes will have spillover effects which will help to increase U.S. prices generally by the same 3 percent over a two year period, while helping to reduce general inflation in other countries by about 2 percent.

First, both U.S. import and export prices will tend to rise by about 3 percent in dollar terms to the new world price. Why would exporters charge less than the going world price? Then prices of close substitutes for imports, and of products similar to exports, will also rise. For example, wheat bound for Boston and wheat bound for Bombay sell for the same world price in Chicago. Domestic steel and auto prices will firm in response to higher prices on imports. All tradeable commodities, whether exported, imported, or produced and consumed domestically, will trade at the world price.

These predictions are firmly grounded in the law of markets and in historical observation. Efficient, centralized markets with modern communications bring all world buyers and sellers into contact. Then the law of one price dictates that identical products sell for identical prices at any moment in time.

Once basic commodities and large numbers of manufactured goods rise in price, cost of living allowances and wage negotiations bring matching wage increases and extend the price increases into the service sector. With raw materials and wages rising, costs catch up with prices, and any initial stimulus to exports, or disincentive to imports, is undone.

Most of a devaluation is uselessly spent in raising domestic prices and costs, with little improvement in our competitive posture or trade balance.

The price impact from the recent fall in the dollar is already well in excess of the predictions of traditional theory. The price increases following the U.S. devaluations of the early 1970's also tend to support the

modern view. Another recent case in point is the substantial Mexican devaluation, which was quickly followed within a year by a 32 percent rise in Mexican prices.

Debasement of a nation's currency is not a cure for fundamental policy errors. Nations cannot enrich themselves at their neighbors' expense. A declining currency increases inflation, raises taxes, reduces saving and investment, and weakens a country's economy internationally and domestically.

Strengthening the economy requires another approach. A drop in Federal spending as a percent of GNP would permit substantial personal, payroll, and business tax reduction. This would result in a drop in the real costs of production in the U.S. It would help the trade balance, increase our growth rate, restore confidence in the U.S. economy and the dollar, and make it easier to sell our bonds to cover any residual deficit.

V. TAX POLICIES

EFFECTS OF SOCIAL SECURITY INCREASES ON TAX POLICY

The President has stated that his tax cut would offset the higher social security taxes and the effects of inflation on the progressive income tax system. These two effects have a serious impact on the taxpayers of this country.

The social security tax increases were proposed as a solution to the financial instability of the social security system. The bill the President signed into law is, in essence, a "tax solution." This piece of legislation increases the tax burden on the public by almost one-quarter of a trillion dollars by 1987.

The new social security legislation will increase both the tax rate and the maximum wage base that can be taxed. The tax rate (to both employers and employees) increases from 5.85 percent to 7.15 percent by 1986. The tax rate is boosted dramatically in 1981 and 1985, which will present the winners of the 1980 and 1984 national elections with growing taxpayer resentment.

Under the new legislation the wage base will increase very rapidly by 1981. In 1977, the wage base was \$16,500 and indexed by the rate of wage increase. The new legislation will increase the wage base to \$17,700 this year, \$22,900 next year, \$25,900 in 1980, and \$29,700 in 1981. After 1981 the wage base will then again be indexed by the wage rate. The rate and base increases will greatly increase the tax take from social security participants. Over the next 10 years, the new social security legislation will amount to approximately \$227 billion in increased taxes on payrolls.

The increase in social security taxes will have its largest effects on taxpayers in the next three years because of the boost of the tax rate by 0.8 percent (on both employer and employee) and the lifting of the base by \$13,200. And the brunt of the new Carter taxes falls in the same old place—on the middle-income taxpayers. The President's plan assures this heavy burden on the middle-income group by increasing the maximum wage base to levels that are in the middle-income range. Consequently, as the rate increases, the middle-income people will be hit the hardest because theirs will be the highest salaries below the maximum wage base. Conceivably, a social security tax of any level could be acceptable, if presented as a purchase of a good: one's pension. The more generous the pension, the larger the tax. However, the Social Security System is more in the nature of a simple income transfer program; wage earners currently pay social security taxes for today's, not tomorrow's, annuitants. Policy should therefore concentrate on how this burden should most equitably be spread.

The Minority does not believe that the wage base should be increased to higher levels to redistribute the tax burden. The Minority seeks to reduce the Carter tax burden for *all* taxpayers, not to increase

it for a few taxpayers. The Minority is particularly concerned with reducing that burden on the middle class because the new social security taxes are especially harmful to them.

The following table shows how the middle class will be affected by the new legislation signed into law by President Carter. It is safe to assume that a social security taxable income of \$13,000 would be in the middle-income range. If we assume that the median wage will increase by 8 percent per year between 1977 and 1981, we can determine the effect on this middle-income group in the near future.

TABLE V-1

	1977	1978	1979	1980	1981
Tax rate.....	5.85	6.05	6.13	6.13	6.65
Wage ceiling.....	16,500	17,700	12,900	25,900	29,700
\$13,000 covered income.....	13,000	14,040	15,163	16,376	17,686
FICA tax/\$13,000.....	760	849	929	1,003	1,176

Notice that the tax on this income level increases by 55 percent. While this is bad enough, we must consider that the income range of the middle class has a much higher limit than the \$13,000 in covered income. Most experts would include an income of \$20,000 (in covered income; in 1977 dollars) in the middle group. Because a portion of their salary was exempt from social security taxes before the new legislation, this middle-income level has even larger percentage increases in their tax.

Table V-2 shows that the social security tax increases by 88 percent between 1977 and 1981 for an income of \$20,000 indexed at an 8 percent annual wage increase. The new legislation is very harmful to those middle-income individuals who had a portion of their income exempt from OASDI taxes or those middle-income individuals who through pay increases would have moved above the maximum wage base. The latter would include a large number of the middle-income group.

TABLE V-2

	1977	1978	1979	1980	1981
Rate.....	5.85	6.05	6.13	6.13	6.65
Wage ceiling.....	16,500	17,700	22,900	25,900	29,700
\$20,000.....	20,000	21,600	23,330	25,194	27,209
FICA tax/\$20,000.....	965	1,070	1,403	1,544	1,809

The social security tax is shared equally by employer and employee. Each group will seek to recoup their share of the \$227 billion of their wages or profits lost to these higher taxes in the next 10 years. The employee will demand higher wages which will be paid by the employer partly out of higher prices. The employer will also have to offset his higher labor costs with higher prices. While the tax reduction offered by the President (and still pending in Congress) will help to ease the pressure on prices, by 1979 the pressure will increase as a majority of the taxpayers will experience an increase in taxes.

The employment effects of the large increases in social security are of major concern to the Minority members of the Joint Economic Committee. As the social security tax that the employer must pay on

each employee increases, the employer will be less willing to keep present employees or to hire additional workers. Also, as the employee's social security tax increases, he will experience a drop in the reward to work. Because the incentive to work has been reduced, the employee may seek not to work at all and rely on government aid, or he may seek compensation in the form of leisure (such as longer vacations).

These effects on inflation and unemployment caused by the social security tax increases should not be taken lightly. The Committee has heard testimony supporting this belief from a wide range of experts both in and out of the Administration.

THE CARTER TAX PACKAGE

While the Carter tax plan offers a net aggregate tax reduction in 1979, there are serious deleterious effects on specific income groups.

In truth, the Carter tax plan is a tax *increase* for many persons in our economy who are sacrificed to reduce the taxes of other taxpayers. It is structured around the erroneous belief that to provide tax relief for some Americans and to pay for bloated government expenditures, the Government must increase the tax burden on other Americans. While it is important to identify those who will have their taxes increased, the Minority feels that at this time any increases in taxes for anyone in our society is wrong. In addition, it is an ill-founded belief that increasing the taxes on the upper-income groups will result in vast tax revenues that can then be "returned" to lower-income groups in the form of new government programs or tax reductions. The fact is there is just not that much money in the higher income brackets because there are not that many people earning these high incomes.

Size of the Package

Most economic forecasters have been warning for more than a year that some form of additional economic stimulus will be needed if the economy is to remain strong through 1980. Significant tax cuts are necessary if social security and inflation-induced tax increases are to be offset and if the tax burden, as a percent of GNP, is to fall. The tax cut must be larger still to offset the major energy taxes proposed by the President and modified by the Congress become law.

Unfortunately, the Administration's tax package does not offset the tax increase that will be occurring over the next several years. The Administration promises that there will be further tax cuts several years down the road. Nonetheless, most individuals and businesses face substantial tax increases by 1980. These tax realities outweigh vague promises in the formation of consumer confidence and business investment plans.

The accompanying table compares the impending social security, inflation-induced, and energy tax increases with the net tax cuts in the Carter tax package. Compared with fiscal year 1977 tax rates, the President's package will increase taxes by \$0.8 billion in 1979, \$7.4 billion in 1980, \$21.4 billion in 1981, \$21.6 billion in 1982, and \$18.4 billion in 1983.

The size of the Carter tax package does not appear to be adequate to keep the economy moving. This is a serious problem. The economic

TABLE V-3.—TAX CHANGES¹

[In billions of dollars]

	Fiscal year—					Total
	1979 ²	1980	1981	1982	1983	
Pending tax increases:						
Social security.....	9.5	12.7	24.2	32.6	35.3	114.3
Inflation ³	13.4	9.0	10.4	12.1	13.8	58.7
Energy taxes ⁴	2.9	12.3	15.4	7.7	4.2	42.5
Total.....	25.8	34.0	50.0	52.4	53.3	215.5
Carter tax package:						
Tax cuts.....	30.4	37.1	41.9	46.4	52.4	208.2
Tax increases.....	5.3	10.4	13.2	15.6	17.5	62.0
Total.....	25.0	26.6	28.6	30.8	34.9	145.9
Pending increases minus Carter net tax cuts:						
Tax increase.....	25.8	34.0	50.0	52.4	53.3	.....
Tax cut.....	25.0	26.6	28.6	30.8	34.9	.....
Total tax increase.....	.8	7.4	21.4	21.6	18.4	.....

¹ Prepared by the staff of the Joint Committee on Taxation.² Includes fiscal 1978 increase of \$7,200,000,000 and fiscal 1979 impact of \$18,600,000,000.³ Estimate based on 5- to 6-percent inflation rate.⁴ Based on energy tax bill passed by House.

indicator which has historically given the longest warning time of approaching recession is formed by dividing the BEA index of coincident indicators by the index of lagging indicators. That ratio has turned down. It peaked in April of 1977. Many observers believe that a recession, or at least a serious reduction in economic growth, is likely by mid-1979. The economy cannot wait until 1980 for a second tax bill to remedy the shortcomings of the first.

The President has stated that the Federal Government must reduce the size of its tax take, as a percent of the gross national product. We agree with that view.

Shape of the Package

The size of the Carter tax package is merely inadequate. The shape of the package is actually harmful.

Across tax brackets, the package discriminates against middle-income taxpayers and especially those covered by social security. Within tax brackets, it discriminates against taxpayers with large families, households with two workers, workers dependent on overtime to make ends meet, and taxpayers in the middle or top portions of many of the brackets.

Average Tax Burdens

Treasury Secretary Blumenthal told the Committee that all but a handful of taxpayers would benefit from the Carter tax package. Unfortunately, this is true only if the analysis is restricted to the income tax. Social security tax increases will completely offset the benefits from the income tax cuts for most workers with income above \$25,000 by the end of 1978 and above \$20,000 by 1979. Even more amazing, when the effect of inflation on the tax rates over the next two years is added in, we find that families earning only \$17,000 in 1979 will be paying a higher real tax than they do today.

[JOINT COMMITTEE PRINT]

ERRATUM

The following table, which appears in Chapter V of the Minority Views of the 1978 Joint Economic Committee Report, is amended to present the cumulative impact of inflation on tax rates from the base year instead of the year-to-year increments incorrectly reported in the original table. This change affects lines labeled "Inflation", the first "Total", and "Total tax increase".

TABLE V-3.—TAX CHANGES¹

[In billions of dollars]

	Fiscal year—					Total
	1979 ²	1980	1981	1982	1983	
Pending tax increases:						
Social security.....	9.5	12.7	24.2	32.6	35.3	114.3
Inflation ³	13.4	22.4	32.8	44.9	58.7	172.2
Energy taxes ⁴	2.9	12.3	15.4	7.7	4.2	42.5
Total	25.8	47.4	72.4	85.2	98.2	329.0
Carter tax package:						
Tax cuts.....	30.4	37.1	41.9	46.4	52.4	208.2
Tax increases.....	5.3	10.4	13.2	15.6	17.5	62.0
Total	25.0	26.6	28.6	30.8	34.9	145.9
Pending increases minus Carter net tax cuts:						
Tax increase.....	25.8	47.4	72.4	85.2	98.2	-----
Tax cut.....	25.0	26.6	28.6	30.8	34.9	-----
Total tax increase.....	.8	20.8	43.8	54.4	63.3	-----

¹ Prepared by the staff of the Joint Committee on Taxation.

² Includes fiscal 1978 increase of \$7,200,000,000 and fiscal 1979 impact of \$18,600,000,000.

³ Estimate based on 5 to 6 percent inflation rate.

⁴ Based on energy tax bill passed by House.



TABLE V-4.—EFFECT OF INCOME AND FICA TAX CHANGES ON EFFECTIVE TAX RATES, 1977 LAW TO PROPOSED 1979 LAW (4-PERSON FAMILY, 1-EARNER)

[Money amounts in dollars]

1979 income level	1977 taxes ¹					1979 taxes					Change in tax		
	Equivalent 1977 income ²	Income tax ³	FICA tax ⁴	Total tax	Combined effective tax rate (percent)	1979 income	Income tax ³	FICA tax ³	Total tax	Combined effective tax rate (percent)	Combined tax liability with 1977 effective tax rate	Amount	Effective tax rate (percent)
\$5,000.....	4,440	-356	260	-96	-2.16	5,000	-300	306	6	0.12	-108	⁶ 114	2.28
\$10,000.....	8,800	259	519	778	8.76	10,000	134	613	747	7.47	876	-129	-1.29
\$12,000.....	10,656	567	623	1,190	11.17	12,000	502	736	1,238	10.31	1,340	-102	-.85
\$15,000.....	13,320	1,070	779	1,849	13.88	15,000	1,072	920	1,992	13.28	2,082	-90	-.60
\$17,000.....	15,096	1,345	883	2,228	14.75	17,000	1,430	1,042	2,472	14.54	2,509	-37	-.20
\$20,000.....	17,759	1,788	965	2,753	15.50	20,000	1,910	1,226	3,136	15.68	3,100	36	.18
\$25,000.....	22,199	2,603	965	3,568	16.07	25,000	2,830	1,404	4,234	16.94	4,018	216	.86
\$30,000.....	26,639	3,503	965	4,468	16.77	30,000	3,910	1,404	5,314	17.71	5,032	282	.94
\$40,000.....	35,519	5,606	965	6,571	18.50	40,000	6,630	1,404	8,034	20.08	7,400	634	1.59

¹ Tax law in effect Dec. 31, 1977.

² Deflated by expected increase in CPI from 1979 levels shown in col. 1.

³ Assumes itemized deductions equal to 23 percent of gross income in 1977 and 20 percent of gross income under the proposed 1979 law.

⁴ Calculated under 1977 wage base (\$16,500) and tax rate (5.85 percent). Employee share only.

⁵ Calculated under 1979 wage base (\$22,900) and tax rate (6.13 percent). Employee share only.

⁶ Under the administration's welfare proposal, taxpayers in this income class will have a net tax reduction from the liberalized earned income credit.

Source: Office of the Secretary of the Treasury, Office of Tax Analysis.

Median family income in 1978 is estimated to be between \$15,000 and \$16,000 (the last precise figures available from the Census Bureau are for 1976). By 1979, median income will be somewhere between \$16,500 and \$18,000. This means that by 1979, the majority of American families will be paying a higher percent of their income in Federal taxes than they do today.

The picture is even worse if we look only at taxpaying families. People in roughly the bottom fifth of the income distribution pay no income tax. The median income of taxpaying families is about \$3,000 higher than median family income. Thus, the majority of taxpaying families will earn more than \$18,000 or \$19,000 in 1978 and more than \$19,500 or \$21,000 in 1979.

Well over half of all taxpaying families will experience a real increase in their tax burdens by 1979, even with the Carter tax package. The exceptions (allowing some leeway for differences in family size) will be those approximately \$14,000 to \$15,000 (less if single) and those not subject to social security taxes.

Thus, it is apparent that the Carter tax package fails dramatically when it comes to providing tax relief for middle-income families, especially those who pay social security taxes.

Tax Rates on Future Income

Whatever one thinks of the desirability of greater income redistribution, the move to a more steeply progressive tax schedule poses certain problems. It increases the rate at which any given level of inflation pushes people into higher tax brackets. In fact, with many people being dropped from the tax rolls, and with government spending still growing, many taxpayers must, of necessity, be pushed into higher brackets to pay the bill. While the rates in each tax bracket will be reduced under the President's proposal, inflation will soon move millions of taxpayers into higher brackets and higher tax rates than they have ever paid before.

Thus, while it may appear that the reduction in marginal tax rates in each bracket by 1 to 4 points proposed by the Administration will raise the after-tax reward to greater work effort and saving by a substantial amount, inflation, plus the rise in progressivity in the tax plan, will work to offset this effect.

Progressivity is increased by the proposed switch from the \$750 personal exemption to a \$240 credit. While the \$240 credit would lower the tax burden for most taxpayers below the 32 percent bracket, it would also eliminate the \$750 deduction from taxable income. In many cases, this would move families into higher tax brackets.

For example, elimination of \$3,000 in deductions for a family of four which used to have \$2,500 in taxable income, would raise that family's taxable income to \$5,500. The \$2,500 in taxable income is now taxed at marginal rates of 16 percent. The \$5,500 taxable income, now taxed at a 19-percent marginal rate, will only be taxed at an 18-percent marginal rate under the President's plan. Nonetheless, 18 percent is higher than the original 16 percent. For this family's marginal tax rate, the move to a higher tax bracket more than offsets the proposed rate reduction in that bracket. Their average tax rate and total tax

TABLE V-5.—MARGINAL TAX RATES, JOINT RETURNS, AFTER RATE REDUCTION AND CHANGEVER TO \$240 CREDIT

Current taxable income (1)	Marginal rate		Family of 2		Marginal rate	Family of 4		Marginal rate
	Present law	Tax proposal	Taxable income after loss of \$1,500 exemption			Taxable income after loss of \$3,000 exemption		
0 to \$500.....	14	12	\$1,500 to \$2,000.....		2 14	\$3,000 to \$3,500.....		2 17
\$500 to \$1,000.....	14	12	\$2,000 to \$2,500.....		2 16	\$3,500 to \$4,000.....		2 17
\$1,000 to \$2,000.....	15	14	\$2,500 to \$3,500.....		16/17	\$4,000 to \$5,000.....		2 18
\$2,000 to \$3,000.....	16	16	\$3,500 to \$4,500.....		17/18	\$5,000 to \$6,000.....		2 18
\$3,000 to \$4,000.....	17	17	\$4,500 to \$5,500.....		2 18	\$6,000 to \$7,000.....		2 18
\$4,000 to \$8,000.....	19	18	\$5,500 to \$9,500.....		2 18/19	\$7,000 to \$11,000.....		2 18/19
\$8,000 to \$12,000.....	22	19	\$9,500 to \$13,500.....		19/20	\$11,000 to \$15,000.....		19/20
\$12,000 to \$16,000.....	25	20	\$13,500 to \$17,500.....		20/23	\$15,000 to \$19,000.....		20/23
\$16,000 to \$20,000.....	28	23	\$17,500 to \$21,500.....		23/27	\$19,000 to \$23,000.....		23/27
\$20,000 to \$24,000.....	32	27	\$21,500 to \$25,500.....		27/32	\$23,000 to \$27,000.....		27/32
\$24,000 to \$28,000.....	36	32	\$25,000 to \$29,500.....		2 32/36	\$27,000 to \$31,000.....		2 32/36
\$28,000 to \$32,000.....	39	36	\$29,500 to \$33,500.....		2 36/39	\$31,000 to \$35,000.....		2 36/39
\$32,000 to \$36,000.....	42	39	\$33,500 to \$37,500.....		2 39/42	\$35,000 to \$39,000.....		2 39/42
\$36,000 to \$40,000.....	45	42	\$37,500 to \$41,500.....		42/44	\$39,000 to \$43,000.....		42/44
\$40,000 to \$44,000.....	48	44	\$41,500 to \$45,500.....		2 44/48	\$43,000 to \$47,000.....		2 40/48
\$44,000 to \$48,000.....	50	48	\$45,500 to \$49,500.....		48	\$47,000 to \$51,000.....		48
\$48,000 to \$52,000.....	50	48	\$49,500 to \$53,500.....		2 48/51	\$51,000 to \$55,000.....		2 48/51
\$52,000 to \$54,000.....	53	51	\$53,500 to \$55,500.....		51	\$55,000 to \$57,000.....		51
\$54,000 to \$62,000.....	53	51	\$55,500 to \$63,500.....		51	\$57,000 to \$65,000.....		2 51/54
\$62,000 to \$64,000.....	53	51	\$63,500 to \$65,500.....		2 51/54	\$65,000 to \$67,000.....		2 54
\$64,000 to \$76,000.....	55	54	\$65,500 to \$77,500.....		2 54/57	\$67,000 to \$79,000.....		2 54/57
\$76,000 to \$88,000.....	58	57	\$77,500 to \$89,500.....		57	\$79,000 to \$91,000.....		2 57/60
\$88,000 to \$90,000.....	60	57	\$89,500 to \$91,500.....		2 57/60	\$91,000 to \$93,000.....		2 60
\$90,000 to \$100,000.....	60	60	\$91,500 to \$101,500.....		2 60	\$93,000 to \$103,000.....		2 60
\$100,000 to \$110,000.....	62	60	\$101,500 to \$111,500.....		2 60/62	\$103,000 to \$113,000.....		2 60/62
\$110,000 to \$120,000.....	62	62	\$111,500 to \$121,500.....		2 62	\$113,000 to \$123,000.....		2 62
\$120,000 to \$130,000.....	64	62	\$121,500 to \$131,500.....		2 62/64	\$123,000 to \$133,000.....		2 62/64
\$130,000 to \$140,000.....	64	64	\$131,500 to \$141,500.....		2 64	\$133,000 to \$143,000.....		2 64
\$140,000 to \$150,000.....	66	64	\$141,500 to \$151,500.....		64/65	\$143,000 to \$153,000.....		64/65
\$150,000 to \$160,000.....	66	65	\$151,500 to \$161,500.....		65	\$153,000 to \$163,000.....		65
\$160,000 to \$175,000.....	68	65	\$161,500 to \$176,500.....		65/66	\$163,000 to \$178,000.....		65/66
\$175,000 to \$180,000.....	68	65	\$176,500 to \$181,500.....		66	\$178,000 to \$183,000.....		66
\$180,000 to \$200,000.....	69	66	\$181,500 to \$201,500.....		66/68	\$183,000 to \$203,000.....		66/68
\$200,000 and over.....	70	68	\$201,500 and over.....		68	\$203,000 and over.....		68

1 The zero bracket is not shown in this table. To include the zero bracket, increase all taxable incomes shown by \$3,200.
 2 The \$240 credit eliminates tax for returns with total taxable income falling in this bracket.

3 Brackets in which many taxpayers could experience either no reduction, or an increase, in marginal rates.

will be lowered by the switch to the credit. But any additional earnings acquired by working overtime, or having both spouses work, will be taxed more heavily at the margin.

For as many as one-half of all taxable joint returns, the switch to the credit will cause a rise in taxable income sufficient to push the family into a higher tax bracket. In perhaps half of these cases, one-quarter of the total, the new tax rate in the new bracket will be as high or higher than the old tax rate in the old bracket. This effect is less pronounced for single taxpayers, and more pronounced for larger families than for smaller families.

The Administration could have avoided most of this mess, while still helping lower-income taxpayers, if it had kept the exemptions while raising the minimum value of the general tax credit by an appropriate amount. If it had, the incentive effects of reduced marginal tax rates would not have been lost in such a peculiar fashion for so many taxpayers.

It is particularly unfortunate that the failure to reduce marginal tax rates begins to be especially pronounced in the 32 to 42 percent tax bracket, exactly the region in which people start to profit by switching into tax shelters. To remedy the problem, the Minority recommends that, if the \$240 credit is adopted, families be allowed the option of retaining the current \$750 exemption or switching to the Credit.

Business Tax Changes

The Administration has proposed net tax cuts for business valued at \$5.7 billion in 1979, \$7.2 billion in 1980, and \$6.7 billion in 1981. These involve a reduction of 4 points in the corporate tax rate, and an expansion of the 10 percent investment tax credit (now limited to equipment) to cover structures and to offset a larger share of taxes. The reductions will be partly offset by a reduction in DISC export subsidies, elimination of deferral of taxes on foreign source income, reduced business entertainment deductions, elimination of the minimum tax deduction for ordinary taxes paid, and other tax reforms.

Unfortunately, the tax cuts being promised are more than offset by increases in social security taxes and proposed energy taxes. Business can expect an additional burden of more than \$6 billion in 1979, \$20 billion in 1980, and \$27 billion in 1981 in these new taxes.

Thus, business is facing net tax increases of a few hundred million in 1979, \$13 billion in 1980, and \$20 billion in 1981. This comes on top of the severe erosion of the value of depreciation allowances by inflation described above.

Business tax relief should be larger than that proposed by the Administration. Replacement cost depreciation and deeper corporate tax rate reduction would be most helpful in spurring productivity, reducing unemployment, and raising wages.

Investment Tax Credit

The extension of the investment tax credit to structures, and to offset larger percentages of profits, is possibly an inefficient use of tax reduction dollars, compared to deeper cuts in the corporate tax rate.

The investment tax credit as a tool for promoting growth is viewed with suspicion by some economists. The credit is not a reduction in

marginal taxes on production and does not act directly to stimulate output. It is equivalent to a lump sum payment to the firm for employing a particular type of input.

Milton Friedman has pointed out that the quantity of investment depends on the amount of investment funding available. The ITC does little to increase national savings. Thus, the primary effect may well be a shift of investment from ineligible to eligible equipment, from structures, inventory, and added manpower training to new machinery.

Norman Ture has compared the ITC with corporate tax rate reduction and finds the reduction in the marginal tax rates to be a far more effective stimulus to output and job creation.

Chase Econometrics reaches similar conclusions. The ITC is of little effect at low rates of capacity utilization, while a reduced corporate tax rate raises the rate of return to production at all levels of output. In addition, businesses surveyed to Chase appeared to view the credit as too changeable to be relied upon in investment planning.

Furthermore, urban development experts are concerned that the extension of the ITC to structures will make it more attractive for firms to build from scratch in the suburbs rather than remodel older buildings in depressed urban areas.

Deferral of Taxes on Foreign Income

The proposal to eliminate the deferral of taxes on foreign source income is ill advised. Foreign subsidiaries of American firms are an important source of export orders. It is unwise to put these firms at a competitive disadvantage overseas.

Furthermore, the Treasury may end up losing money on this reform. If U.S. subsidiaries repatriate foreign earnings, they will face higher foreign taxes on remitted dividends. This will increase amounts claimed under the foreign tax credits. Alternatively, if U.S. firms try to pay the U.S. taxes out of domestic income, they will have less money available for domestic job formation.

Alternative Tax on Capital Gains and Elimination of Deductions for Regular Taxes

Current law allows a deduction from preference income subject to the minimum tax of an amount equal to regular taxes paid. The Administration proposes to end this deduction, as well as the alternative tax on capital gains. The chief impact will be to raise further the tax burden on capital gains, which are a large part of preference income. This can only serve to reduce economic growth.

Capital gains are already overtaxed. They are not ordinary income, and we should not be trying to tax them as if they were.

Capital gains occur when the price of an earning asset rises. The price increase is generally caused by a perceived increase in the future earnings of the asset. Those future earnings will be taxed when they occur. To tax the rise in the asset's value as well as the future earnings is to double tax those earnings. For this reason, no major nation treats capital gains as ordinary income.

Any move to increase taxes on capital gains will worsen the existing double taxation of saving, as compared with consumption spending. Income is taxed as it is earned. It may be spent or used to

purchase an income earning asset. Ideally, the tax system would be neutral between the choices. However, if income is spent, only a small sales tax is levied. But if it is saved, a substantial share of the earnings are taxed. If the saving is in the form of a fixed dollar asset, such as a bond or savings account, inflation erodes the principle. If not, any gain in price, whether due to inflation or a real increase in value, is taxed as a capital gain. The tax code discriminates against growth activities in favor of consumption.

Budget Totals, Taxes, and Rebates

The Administration has placed much emphasis on the small rise in real terms of Federal outlays for 1979. The real increase is roughly 2 percent. Unfortunately, the full impact of the President's budget proposals is not reflected in the budget totals.

One glaring example of the problem is the netting out of the energy tax and rebate proposals before they appear in the budget totals. The Administration proposes to increase taxes on energy production and use by some \$8.3 billion. They also propose to provide rebates and credits on the order of \$7.2 billion. All that appears is a net increase in receipts of \$1.1 billion.

While it is technically correct to subtract the rebates and credits from the receipts column, it is also true that the economic impact of a tax and transfer program is the same whether the transfer is effected by outlays or credits. The tax burden on producers of energy and industries which use energy still results in less energy production and higher product prices. The transfer of money to consumers of heating oil or the buyers of coal-burning equipment does not undo this impact, whether it is done by tax rebates or by Federal check.

Thus, the budget looks as if it has revenues of \$439.6 billion and outlays of \$500.2 billion. In fact, the budget behaves as if it has receipts of \$446.8 billion and outlays of \$507.4 billion.

When off-budget items and the true economic impact of the proposed energy tax credits are factored into the budget totals, we see little evidence of a firm hand on expenditures, and no sign that the much-heralded zero-based budgeting concept has produced any results to date.

TAX POLICIES AFFECTING SMALL BUSINESS

Small business provides employment for over half of the workers in the private sector and contributes 43 percent of our GNP. Thus, small business is an important contributor to the economy; if small business is healthy, it is a major boon to the health of the economy as a whole; if small business is sick, it is a drag on the economy.

The one overriding problem facing small business in the United States is external financing, especially equity financing. This is a problem for business as a whole but especially for small business. The cost of floating securities is prohibitively higher for small firms compared to large firms. Security offerings by small firms may be so unusual as to require a separate market mechanism. Small businesses are perceived as being, ipso facto, more risky than large businesses, and therefore, risk premiums are higher. And finally, what external financing is done is usually in the form of debt rather than equity—

for several years now the stock market has presented a nearly impossible environment for raising capital via new equity for small businesses.

At the same time that external financing is a difficult problem for small businesses, especially new companies. Internal funds from after-tax earnings are becoming more difficult to achieve due to increasingly big bites of corporate income and other taxes. Our tax laws have methodically eroded traditional incentives for investment. For example, the 1969 Tax Reform Act increased capital gains taxes from 25 percent to a 35 percent maximum. In addition, the minimum tax provisions have raised the potential capital gains tax to 49 percent. At the same time, the risk of any investment has been doubled by permitting only a 50 percent write off of capital losses.

Increasing the differential between the tax rate on realized capital gains (by eliminating or reducing the capital gains tax), and that paid on ordinary income, would be one solution—this would encourage companies to retain and reinvest their earnings in new plant and equipment rather than paying them out in dividends.

But the best route to stimulate small business capital formation and provide the necessary internal financing for other business purposes is substantial reduction in the corporate tax rate. Moreover, the small business exemption should be raised from the current \$50,000 to a minimum of \$150,000 of taxable income.

Although such a reduction would help all corporations, it especially would help small companies that do not have large incomes and must rely heavily on retained earnings.

Other tax provisions that would help small business are:

Adjust depreciation schedules to reflect replacement costs of assets, with carry-forward provisions to aid firms that are not yet profitable.

Defer capital gains taxes if the proceeds from an investment in a qualified small business concern are reinvested within a limited period of time in another small business concern.

The foregoing proposals would be helpful to small business and, in turn, would contribute to the health of the whole economy. Cost estimates for these proposals have not been developed, but they would not cost as much as the Carter tax package, and they would be more helpful in stimulating long-run economic growth and employment. As discussed in a previous section, the Minority members of the Joint Economic Committee also strongly recommend an across-the-board reduction in the marginal rates of personal taxes, which also would aid unincorporated small businessmen.

One serious problem facing all business, but which small business may find especially hard to deal with, is the heavy cost of Federal regulation. We note the study on Federal regulation being prepared by the Senate Governmental Affairs Committee. We urge that particular consideration be given to the impact of regulation. We note the study on Federal regulation being prepared by the Senate Governmental Affairs Committee. We urge that particular consideration be given to the impact of regulation on small business, and to the comparative disadvantage of small business in contesting unreasonable agency rulings.

VI. EMPLOYMENT

THE EMPLOYMENT SITUATION IN 1977

Over 1977, employment grew by 4.1 million, or 4.7 percent, marking the largest numerical 12-month gain ever reported in the post-World War II period. Employment for adult men grew by 1.8 million, for adult women by 1.7 million, and for teenagers by nearly 650,000. Employment in blue-collar and service work grew relatively more than other occupations.

Accompanying this substantial increase in employment was a correspondingly large increase in the civilian labor force, which ended the year at 98.9 million persons. The 12-month rise was nearly 3 million. The labor force participation rate in December eased back to 62.8 percent, just below the all-time high of 62.9 percent in November.

Because of the large labor force growth, the numbers of unemployed dropped by only 1.1 million, and the unemployment rate was 6.4 percent, a decline of 1.4 percentage points from December a year ago. Over the year, jobless rates dropped markedly for white men, women, and teenagers, and black adult men, while no downtrend was evident among black women and teenagers.

These statistics underscore some of the concerns expressed at the White House Conference on Balanced National Growth and Economic Development. Vernon Jordan of the National Urban League maintained that a large part of minority unemployment, especially for minority youth, still is due to discrimination. Statistics show that even with the same amount of education, blacks suffer disproportionately higher unemployment rates than whites.

Another graphic illustration of the variance of employment opportunities for blacks is the situation in the Sunbelt regions. Although many new industries, and consequently new jobs, have settled in those areas, black unemployment remains very high in that region. This has happened even though minorities represent a larger share of the population. Unfortunately, they also constitute the isolated rural poor, the least skilled, and the most poorly educated.

The evidence that minorities and youth have not participated as freely as have other groups in the jobs created by the expansion of the economy over the last several years does not come as any real surprise. These are precisely the groups with characteristics that make them harder and more costly to absorb into the ranks of the employed workers. What does cause concern among black leadership occurs in the discussion surrounding policies to achieve full employment.

The first point of concern is that the full-employment-unemployment rate will be set so high that it will be virtually meaningless as an

appropriate goal. Some of these fears were sharpened by the Council of Economic Advisors' acceptance of the benchmark unemployment rate at 4.9 percent in 1977 (compared with 4.0 percent in 1955) after adjustment in the age-sex composition of the labor force. There is no doubt that a fixation upon one number can be misleading and result in misdirected policies.

What may be more important, however, is the possible relaxation of public policy once a politically acceptable number is reached. For example, once the unemployment rate reaches 5.0 percent, just how much pressure will be put on government to achieve a lower rate, particularly if meeting that goal might induce additional inflationary pressure?

POLICIES FOR FULL EMPLOYMENT

While debate still rages about the specific target for the unemployment rate under conditions of full employment, agreement on the necessity for a double-pronged attack to reach full employment has gradually evolved. This involves: (1) A high enough rate of economic growth to absorb the growing number of entrants in the labor force and to reduce the present high number of unemployed, (2) structural programs that target on groups with specific unemployment problems such as minorities, youth, and older workers.

Although economic expansion is a crucial element in the movement of disadvantaged groups in the labor force into jobs, the purpose of this section on employment policies is to treat structural problems exclusively. Suggestions on structural programs have come from witnesses before the Joint Economic Committee and from the White House Conference on Balanced National Growth and Economic Development. One theme stressed repeatedly was that the structural programs must involve a high degree of local initiative and authority. In addition, structural unemployment programs should be incorporated within other regional and urban strategies.

Another element was the involvement not only of large firms but small businesses. The latter have many of the added job opportunities, particularly in the fast expanding service sector. John Burns, from the Committee on Economic Development, pointed out that half of the jobs in this country are in firms with a hundred employees or less and that three-quarters of the jobs are in firms with fewer than five hundred employees.

Not much emphasis was placed on the development of new initiatives. It was more of a commitment to use tools already established in a more flexible framework. A wider dissemination of information about workable programs, a concerted effort to involve business leadership on local and national levels, and the use of intermediate organizations that would serve as liaisons between businesses and the disadvantaged were recommendations to better implement training and education programs.

Beyond a grass roots approach, effective incentives for employers to participate in these programs can be created by tax credits and subsidies from the Federal Government. These incentives can suit various alternative purposes:

(1) Tax credits to encourage business to locate in central cities. In the Administration's tax program, the investment tax credit is available both for the construction of new utility and industrial structures and the rehabilitation of existing structures so the proposal will have no anti-urban bias. If the investment tax credit spurs rebuilding in central cities, jobs will flow to the areas of concentrated high unemployment. It has been suggested that the investment tax credit be channeled more narrowly by limiting it to areas with high unemployment rates. However, the more restriction and consequently, more expensive paperwork, put on the use of such a credit, the less businesses will be disposed to take advantage of the credits.

(2) Employment tax credits. These have been directed to youth, the hard-core unemployed, and minorities. An example is S. 2436, proposed by Senator Javits, which provides a refundable tax credit to business, equal to one-half of the increase in unemployment insurance wages over a base period. This credit is applicable to youth aged 16 to 19 who have been either unemployed 15 weeks or longer or enrolled in a CETA employment or training program for at least 15 weeks.

(3) Wage subsidies. One of the assumed effects of the increased minimum wage is that the marginal productivity of many new entrants into the labor force, especially youth, does not equal their marginal cost for businesses. A wage subsidy would allow businesses to recoup part of the wages paid and, thus, encourage employers to hire youth.

(4) We continue to believe that a viable system of local labor-management-government committees as described in the section on urban policy action can have a favorable impact on the amount of structural unemployment.

Participants in JEC hearings and in the White House Conference made it clear that a training element must be associated with all tax incentive and subsidy programs or the employment gains would prove illusory in the long run.

There is a brick-and-mortar policy aspect that national, State, and local government bodies also must undertake. Businessmen pointed out that while tax and subsidy incentives were very important, a basic and suitable infrastructure had to be available to encourage the relocation of business to a new area. The necessary infrastructure would include a transportation network, adequate housing for workers, effective police, fire, and sanitation support, and effective insurance at reasonable rates.

VII. AGRICULTURE

Some of America's farmers are hurting. In fact, grain farmers and farmers in several other sectors of agriculture are desperate. Live-stock and poultry farmers, dairymen and fruit and vegetable farmers had a pretty good year in 1977, but these bright spots in agriculture do not offset the overall negative atmosphere in the farm sector.

Net farm income (including net inventory change) has dropped from a peak of \$33.3 billion in 1973 to \$20.6 billion in 1977. Of course, 1973 was a good year for farmers and perhaps an unfair base year comparison. But, even with that perspective, farmers are restless.

The squeeze comes in prices received by farmers for their products versus the prices paid by farmers for costs of production and household operations. For example, the Prices Received index (1967=100) rose sharply in 1973 and averaged 179 that year; it rose further to 192 in 1974. The Prices Paid index, on the other hand, averaged only 144 in 1973. Since then, the relative position of these indices has painfully reversed itself, with Prices Received dropping to 183 in 1977 and Prices Paid rising very sharply to an index of 202 last year. In 1973, the parity ratio, adjusted for government payments to farmers, stood at 94. By January 1978 it had dropped to 67, the lowest level in 45 years.

The problem is that commodity surpluses have depressed prices, leaving many wheat and feedgrain farmers in financial difficulty. For many, especially some new farmers, debt-to-equity ratios are reaching precarious levels, threatening both their financial stability and the stability of those financing them.

The plight of farmers has brought forth many proposals for solving the problems—some good, some bad, some drastic. Some call for making it illegal to sell any agricultural product below 100 percent of the parity price. Others call for a return to high price supports, set-asides, and the controls of the 1950's and 1960's.

In the interests of farmers, consumers, and taxpayers, we should be careful to avoid policy mistakes like those made after World War II. Farmers don't want the government again to become the dominant force in the market. The policies and programs of the 1950's were primarily concerned with attempting to assure fixed returns to farmers, but they had the effect of insulating agriculture from the need to adjust to changing conditions. This only delayed the time when adjustments had to be made. One of the adjustments was that thousands of small farmers went out of business.

Small bureaucratic errors in program formulation during that era resulted in substantial costs to taxpayers and also damaged the Nation's pre-eminent position as the world's greatest agricultural exporter.

Holding prices at levels that are inconsistent with the underlying demand and supply situation creates excess capacity and requires strict controls on the amount produced. This leads to all kinds of mischief, loss of freedom, inefficiencies and frustrating farm policy administration. Farmers should be free to control their own operations and permit market prices to play their traditional role in directing production and consumption.

Within this concept, there is a role—but not a dominant one—for government. Government should be responsible for placing a floor over the pit of disaster, but beyond this, government should devote itself to improving the functioning of the marketplace. Examples of useful government services are negotiation of sales abroad, market supervision, supervision of grades and standards, outlook information, relatively low loan levels and target prices that would permit prices to fluctuate freely most of the time, and overseas food aid, such as Public Law 480.

Market-oriented agricultural policy would involve less government involvement than we had in the 1950–70 period. But within that market concept, there are specific things that can be done to bolster farm incomes:

(1) Let farmers intelligently choose the proper level of output of their products, in keeping with supply/demand conditions and relatively free market prices.

(2) Develop and strengthen marketing organizations, structures, and programs for both domestic and foreign farm product sales.

(3) Expand agricultural exports.

(4) Bolster agricultural credit programs to help deserving farmers meet current financial crises.

(5) If we hope to help agriculture or any other sector of the economy, we must control the overall rate of inflation.

In the following paragraphs we elaborate on some of these points:

LEGISLATIVE PROPOSAL IN KEEPING WITH THE FREE MARKET CONCEPT

The current set-aside program is not working well because the incentives don't attract many farmers. On the other hand, increasing the incentives too much would pose the danger of excessive government involvement in commodities. One possible compromise has been proposed which deserves careful debate and consideration. Under this proposal, S. 2481, the government would establish a flexible schedule of prices and production set-asides that would permit an individual farmer to choose his own target price, up to parity: however, the higher he went up the price scale, the lower his permitted production would be. Thus, farmers would have a flexible mechanism whereby they could voluntarily control their production, and each individual could reflect the target level and set-aside that was best for his farm operation, based on the sliding scale.

Under this type of program a farmer could achieve parity without corresponding price increases to the consumer and with only relatively modest outlays from the Federal Treasury.

ENHANCED MARKETING

Government can do more than it has been doing to aid farm marketing. We need better information, research, and regulatory services.

Through their organizations, farmers must develop the capacity to understand the market system, to manage their production, and to form associations to negotiate contracts with handlers in advance of production.

Agricultural cooperatives can be a dynamic force in farm marketing in keeping with the preservation of our competitive enterprise system. These cooperatives can provide business units large enough to compete effectively with other enterprises. Government should not intrude into the operation of cooperatives.

EXPAND COMMERCIAL EXPORT MARKETS

The expansion of commercial exports is the key hope for prosperity in American agriculture.

U.S. agricultural exports have increased for seven consecutive years now, reaching \$24 billion in 1977. However, indications are that exports will trail off slightly in 1978, to about \$23 billion.

Our highly efficient agricultural system enables us to compete for export markets in spite of the fact that many U.S. exports are subject to some form of restriction in foreign countries. But what we have done so far is not good enough. We must do more to expand our foreign markets. We slipped badly in grain exports last year (ending June 30). While Canada, Australia, and Argentina increased their wheat shipments by 3.7 million metric tons, U.S. wheat exports fell by 5.8 million metric tons. Fortunately, 1978 looks much better, and we should substantially regain the ground lost in 1977.

There is an urgent need to increase sharply our promotional efforts. The \$23.5 million that the U.S. will spend this year to promote some \$23 billion of exports is an investment of only one-tenth of 1 percent. Our competitor, Australia, by contrast, will invest ten times as much on a proportional basis. A recent House Agriculture Committee study shows that U.S. export promotion expenditures totalled \$16.8 million in 1970. The \$21.4 million spent in 1977 is only \$13.6 million in 1970 dollars, a real dollar reduction in effort.

Actually, farmer organizations have been much more aggressive in promoting and marketing American farm products than has been the government itself. Export promotion by co-ops and organization of "Unitrains" to carry carloads of a single commodity direct from farm areas to export ports have helped keep American agriculture moving abroad.

One thing we should *not* do is rely on a declining dollar to stimulate export sales. As the dollar declines in value, it raises inflation and inflationary expectations in the United States. Energy prices, materials prices, and wages build upward momentum as inflationary expectations continue even after the initial devaluation of the dollar, eliminating any benefit to farmers from the farm price increases a devaluation may bring. Therefore, in the long run there is no benefit to farm-

ers from a weaker dollar. What is needed is a direct drive on export promotion by the government, without regard to the status of the dollar on world markets. (See other observations on this point in the section on International Considerations.)

Specifically, the Minority members of the JEC recommend the following six-point program to help sell American agricultural products abroad:

- (1) Liberalize restrictive trade barriers which limit the flow of agricultural exports. Emphasize to importing countries that we can guarantee them a dependable supply of farm commodities.
- (2) Provide short- and intermediate-term government credit (through the Commodity Credit Corporation) to other countries for the purchase of U.S. farm products.¹
- (3) Expand Export-Import Bank financing of loans for farm commodity exports commensurate with agriculture's share of total U.S. exports.
- (4) Implement existing legislation that permits foreign nations to purchase our grain and store it in the U.S. for subsequent export.
- (5) Push for steady and regular annual export sales over long periods, rather than huge bulges from year to year.
- (6) Expand our agricultural trade missions.

THE FARMERS' HEAVY COSTS

Rising farm costs in the face of falling prices received by farmers are putting a squeeze on many otherwise sound farm operations. It now costs more to process, transport, and distribute food each year (\$58 billion) than to produce the food itself on the farm (\$56 billion). Food processors, marketing firms, and distributors—the middlemen in the agribusiness world—receive a bigger share of the food dollar than do the farmers. And while the farmer has recently been subject to falling profits and profit margins, profits earned by middlemen continue their upward trend. Like the farmer, the middleman faces higher costs for labor, energy, materials, construction, and government regulation. But unlike the farmer, the middleman is able to pass along his higher costs to the consumer.

For example, in 1977 the average family paid \$41 more for its domestically-produced food than it did in 1976. But \$39 of that increase went to the processors and other middlemen, not to the farmers.

Thus, the villain in the farm economy is inflation. Increases in the minimum wage, huge jumps in social security taxes, and proposed energy taxes will create even larger costs for farmers and middlemen alike.

¹ Representative Clarence J. Brown recommends that we permit these OCC loans to totalitarian economies such as the People's Republic of China, the Soviet Union, and the Eastern European nations. In addition, Mr. Brown recommends that we adjust our tariff policy to provide most favored nation tariff status to certain countries, including some communist countries (although not such countries as Cuba, North Vietnam, or North Korea until other disputes are settled). Such sales can help pave the path for peace by increasing the dependence of these nations on America for their food. Moreover, these sales agreements should comport with recommendation five (5) below.

It is better to raise parity for farmers by reducing prices paid by farmers than to raise prices received by farmers.

In this regard the Minority emphasizes a major item in the cost of food production and distribution, i.e., the cost of over-regulation by government. The GAO has estimated that the annual tax cost of government regulation of the food industry is nearly \$1 billion. At least 75 Federal agencies have the power to control rural Americans in some way or another. The need for "sunset" legislation in the agriculture and food industry is obvious.

The goal for U.S. farmers is rising real income. This can best be accomplished in an atmosphere of freedom, which admittedly has its fluctuations, but allows for real gains over the long run. Prices must not be dictated by government. This stance, combined with aggressive export promotion and government policies that attack, rather than promote, inflation are the sure path to prosperity for American agriculture.

VIII. URBAN POLICY ¹

The near bankruptcy of New York City in 1975 and the prospect of another New York City crisis this year underscore an unfortunate aspect of our political life—that the United States lacks a national urban policy.

By virtually every statistical measure, America's larger—and especially her older—cities display the symptoms of economic waste and stagnation. As the following analysis shows, the problems of urban areas have been building up for several decades. Furthermore, the problems are not confined simply to the so-called northern tier states but instead can be found in cities of all sizes in virtually every part of the country.

Most of the problems of society, from ancient times on, have been the problems of cities. "Congestion" is really urban congestion; air and water pollution is usually urban pollution; crime rates in urban areas are higher than in rural ones. Ironically, the rising expectations of our affluent society have generated accelerating demands for services which many cities, given their relatively fixed tax base, cannot afford. Cleaner air, better education, modern medical care, efficient transportation systems, and an effective police department able to cope with modern society's problems are typical of the expensive demands which we place on governments; yet each of these examples is also typical of the items with which mayors must deal in making up their own budgets.

There was a time when economic trends could have kept up with these aspirations of modern urban society more easily than they can now. Urban development during the 19th century was relatively well balanced, and our cities as a whole continued to grow vigorously into the 1920's. During this time, growth in the cities was faster than growth in the United States as a whole. This was the period when our urban industrial centers attracted millions of foreign as well as displaced domestic agricultural workers. The growth sectors in our geography were urban, and not suburban.

According to Census Bureau figures, suburban growth had begun to outpace growth in central city areas by 1930, and this trend has accelerated up to the present day. The disparities became so great that cities such as New York, Chicago, Philadelphia, Detroit, and Pittsburgh actually lost population during the 1950's. During the 1960's, according to Census Bureau statistics, 70 major core cities lost population. A greater consequence, the urbanized areas of the country—the New England and mid-east states—also lost in overall population during this period.

A breakdown of these population movements also reveals a disturbing pattern of income levels and employment. Fragmentary surveys indicate that core city areas in all parts of the country today are

¹Senators Hatch and McClure have additional views on urban problems.

showing fewer and fewer employment gains than suburban areas regardless of the overall level of economic activity at the national level. Rates of unemployment are also higher in central city areas than in the suburbs regardless of the city's size or its location; fragmentary data suggest that non-white unemployment in core city areas is also higher than non-white suburban unemployment. Finally, central city residents have lower incomes than their suburban counter-parts and a lower share of the higher-paying jobs.

As a result, many of the nation's cities, especially its central cities, are caught in a mire of stagnation, dragged down by high tax rates on an inadequate tax base on the one hand and by the lack of competitive public facilities on the other. As we have noted, these conditions are exacerbated by national population trends and by the economic principles which favor growth outside the central city areas.

Policymakers have not ignored these problems. Thus, the 1930's saw precedent-setting legislation in the field of housing, and the 1960's witnessed the growth of Great Society programs. With an increased emphasis on the fiscal problems of State and local governments per se, the early 1970's have produced the general revenue sharing program, counter-cyclical fiscal assistance, and several examples of grant-in-aid consolidation. Increases in aid to State and local governments, in fact, claimed approximately 40 percent of the Federal government's budget increases in the decade 1965 to 1975.

Most of this assistance has been in the form of categorical grant-in-aid programs, block grants, and revenue sharing (including countercyclical fiscal assistance). The common denominator to this assistance was money, whether in the form of grants, loans, or loan guarantees. Relatively little consideration has been given to urban policy per se.

We now see how shortsighted this approach has been; because in fact we have had a Federal "urban policy," a de facto urban policy which was well intentioned, but which has brought many central cities to where they are today.

Most urban economists acknowledge that Federal policies are in a large part responsible for the poor fiscal condition of many urban governments. For example, a Rand Corporation study cites Federal grants for sewage and water treatment facilities, the investment tax credit, the national highway program, mass transit, airport subsidies, pollution control, and the minimum wage as examples of Federal policies which either have or may have affected central cities adversely, in favor of suburbs. A recent study by the Urban Institute concludes that "directly or indirectly, provisions of the Federal tax code have tilted the terms of economic competition in favor of suburban development and development of new regions of the country, thereby accelerating the abandonment of central city housing, contributing to the deterioration of the existing urban capital infrastructure, and precipitating the decline of the central city tax base."

Federal macroeconomic policies have a major impact on local economies as well. The statistics on urban employment and business formation tend to correlate to the swings in the national economy. Furthermore, we are concerned that a national economic policy which fails to promote business confidence will also fail to promote the urban economy itself.

There have, of course, been some positive aspects of Federal urban policy. Transfer payments—i.e., social security, unemployment compensation, and SSI payments—have prevented the urban poor from becoming totally destitute. In some cases, the existence of a widespread system of transfer payment support has meant a significant difference in the overall health of the urban core economy itself. For example, a survey of personal income growth in five older cities between 1970 and 1975 shows that the largest gain in income during this time came from increases in transfer payments than from private sector wages, salaries, and other income. By extension, Federal aid other than cash transfer payments—such as medicaid, housing subsidies, food stamps—has also helped urban areas generally as well as the residents of these areas.

The thrust of recent Republican policy initiatives such as general revenue sharing, countercyclical fiscal assistance, and the grant consolidation proposals² contained in President Nixon's special revenue sharing program have all been directed at increasing the freedom of, and reducing the red tape associated with, the administration of local government. We still believe that greater progress in reducing the amount of Federal involvement in local decisionmaking is necessary.

In reaching our recommendations on urban policy, we take note of the following findings and conclusions:

(1) Federal urban policy is poorly coordinated and inadequately monitored. The fact that the Treasury Department administers the New York City program and that the Commerce Department has considerable urban development responsibilities indicates that urban policymaking is fragmented at best. The same fragmentation is reflected, though to a lesser degree, in the congressional committee structure. Furthermore, we do not know the effects on our urban areas of various Federal policies. The congressional statement of policy for the Department of Housing and Urban Development itself makes little distinction between the smallest community and the largest city. The New York City crisis is an example of a national issue which found the Federal government bereft of appropriate policies; the Seasonal Loan Program that was finally adopted has proved to be only a stopgap measure.

(2) Confusion in urban policy often arises from the failure to distinguish between income support programs and economic development activities. In our view, urban policy should avoid concentrating so much on income maintenance for urban populations as to become a means of perpetuating the urban poor.

(3) The urban economy is closely tied to that of the country as a whole. A recent study indicates that core city job levels were sustained during periods of rapid economic growth but fell during recessionary times. The same study indicates that industries showing rapid national growth also show more growth in cities. In other words, balanced and continued national economic growth is the single most effective urban policy we have today.

(4) The most important single factor affecting urban development in the past 10 years has been population shifts from urban

² Senator Javits states: "I support the efforts at grant consolidation, provided there is no tendency to reduce improperly the overall amount of support, under cover of grant consolidation".

to suburban areas and from the slower growing to the more rapidly growing regions of the country. Commerce Department statistics indicate a direct relationship between population growth on the one hand and growth in real personal income on the other. Those sections of the country with the slowest or with negative population growth, have also experienced the slowest rates of growth in per capita personal income. By contrast, the so-called "sunbelt" states, including the Rocky Mountain states, have had above average growth in both these categories.

The President's urban policy recommendations were being finalized as these views went to press. However, certain aspects of these recommendations have been in the public domain for some months, and the general outlines have been described by Administration spokesmen. In our view, the important aspects of a national urban policy are as follows:

The most effective and fool-proof urban policy is a sustained level of balanced economic growth. Therefore, our tax, fiscal, and monetary policy recommendations also constitute the chief recommendation of this urban policy section. We know that urban areas respond unevenly to changes in economic growth, and do not conform precisely to the ups and downs of the business cycle in the Nation at large. In other words, there are leads and lags in the response of cities in all parts of the country. However, a sustained period of growth helps urban areas regardless of size or location. Several specific tax proposals in these views would also help serve the needs of urban development. In particular, we cite the tax proposals with regard to small business and to reducing structural unemployment.

Urban areas are especially hard-hit by inflation. Therefore, an effective anti-inflation policy is a necessary component of a national urban policy. Because the urban tax base is relatively rigid and does not respond to sudden changes in the economy, the inflationary shocks of the past decade have been especially severe. For example, the real purchasing power of urban areas actually declined between 1970 and 1974, as fuel costs sky-rocketed and labor costs rose in an attempt by municipal unions to keep pace with inflation. The additional fuel bill for New York City alone in 1974 was estimated at \$250 million.

Municipal employees' salaries constitute the largest single item in any urban budget, and hence the biggest opportunity for savings. Nevertheless, there are not sufficient incentives for urban governments to resist unnecessarily large wage demands. We affirm that the appropriate salary level for municipal employees must be set through collective bargaining between the appropriate governmental body and the municipal employee union. We also accept the principle that differences in salary levels across the country will arise because of many factors, including the existence of different salary levels in private industry. However, we also believe that greater attention needs to be paid to the productivity of municipal workers and to the economic impact of the Federal and local regulations and programs which many of them have been hired to enforce.³

³ Senator Javits states: "While municipal employee salaries may possibly constitute an area for savings, they can be a shrinkage base where, as the New York City, major lay-offs have already been necessitated. Hence, other economies must be sought in those situations, as well as a buildup of municipal revenues themselves, preferably through enhanced business activity".

We believe that part of the problem of national urban policy is one of organization. Our government is poorly organized for making policy. Thus, we recommend that greater efforts be made to coordinate the administration of Federal urban policy.⁴

We do not know adequately the effects on our cities of legislation which may have been enacted in pursuance of widely differing policy goals. Therefore, we recommend that the President assess the impact which those legislative programs with major urban effects have made on our cities. We also recommend that major legislative proposals by the Administration carry an urban impact statement so that the unwanted effects of legislation can be avoided.

While we support the concept of welfare reform, we urge that welfare reform per se not be used as a substitute for a bold and innovative urban policy. Because welfare expenditures constitute a large percentage of urban budget, there will be a temptation to look upon welfare reform as the preferred means for helping out our cities. This route must be avoided. Otherwise, we consign our cities to the role of warehouses for the Nation's poor and frustrate any progress toward other meaningful reforms in urban administration and finance.

The distribution of Federal grants-in-aid and Federal procurement must be rigidly scrutinized and re-assessed with a view towards determining whether urban areas and the urban regions of the country have been unfairly discriminated against. There is ample evidence to support the view that military bases and Federal grants-in-aid favor those parts of the country which are already faster growing. On the other hand, several innovations have been made in recent years to introduce criteria into grant-in-aid distribution formulas which recognize the problems in older sections of the country and the problems of urban areas where prices are often higher. We urge that work be continued in developing suitable criteria for Federal spending that our urban areas not be shortchanged.

Above all, we believe that national urban policy must affirm the central role of private enterprise in developing and maintaining the economic base of our cities. This means that urban governments must actively cooperate with business and with non-municipal employee unions in developing strategies for growth which are appropriate to the peculiar conditions in the city at hand. While the Federal role in this process must necessarily be minimal, there is conceivably room for Federal assistance in developing city-wide business-labor-government councils to give this form of cooperation the high profile that it needs. Such councils should actively advise City Hall on means to attract and hold the high quality labor force—both professional and blue collar—that private firms must count on. Past experiments with municipal councils of this kind have shown that they can be instrumental in providing training programs, attracting new business, clarifying the needs of the business and labor communities, and improving the labor climate and business confidence in the area.⁵

⁴ Senator Javits and Representative Heckler recommend an Office of Urban Affairs in the White House in order to provide the requisite high-level coordination and support of a national urban policy.

⁵ Senator Javits states: "I support the concept of an Urban Development Bank. Such a bank should be a major vehicle for Federal loans and loan guarantees in promoting development in our cities. The bank should be equipped with the appropriate technical expertise for engaging in technical assistance in municipal development and finance."

ADDITIONAL VIEWS OF SENATOR JACOB K. JAVITS

Traditionally, the Minority report has served the valuable function of challenging the Majority's viewpoint and recommendations. Because of the grave dangers that I see on the international economic front in 1979, I feel compelled to assume that role.

The evidence of the problem is all around us: the weakness of the dollar; the lagging recovery and the relatively low level of capital formation in the industrialized countries; the problems of recycling the vast accumulation of financial resources in the hands of a small number of oil exporting countries of the Persian Gulf; and the persistent coupling of unacceptable unemployment and inflation in industrialized countries.

The choice of the solutions that the developing and developed countries make in solving these problems will determine the health and stability of the U.S. economy. Because of the interdependent economic relationships between the U.S. and the rest of the world, the U.S. and the other industrialized countries must provide the basis for the cooperation in chartering a course to establish a viable world economy rather than one which faces recession, even depression in the next few years.

My proposals touch several strategies—financial assistance and trade policy with separate elements for the developed and for the developing countries.

1. In spite of efforts by oil-importing countries to increase their exports to OPEC and Third World countries or to increase their international debt to finance their oil bills, OPEC's surpluses amounted to almost \$133 billion in 1974-76, with a surplus of an additional \$45 billion estimated for last year. OPEC countries have placed their investment funds largely in short-term assets, deposited in the industrialized world's financial intermediaries (mainly commercial banks). Because of the nature of short-term instruments, the "recycling of OPEC funds" has become a game of balance-of-payments accounting with every dollar of deficit being balanced by a surplus dollar. There is no guarantee that this money will be used for capital equipment investment to stimulate noninflationary and productive growth. If this type of investment does not take place, oil-importing countries will have no way to establish a higher growth rate and to build up their industrial capacity to pay off their debts.

Because of the danger of potential disruptions of world financial markets if OPEC managers rapidly shift these short-term assets, we must develop a large pool of capital using at least half of the reserves of Western currency—mainly dollar denominated—that are being held by the surplus OPEC countries. These funds must be converted from short-term assets to long-term investments.

However, governments of the industrialized countries must be prepared to meet OPEC's legitimate concerns for the preservation of

the value of their funds. A guarantee of a rate of interest reflecting expected inflation rates and a formula which allows the withdrawal of surplus funds in an orderly manner should ease any initial misapprehension of the OPEC nations.

This capital pool which should be about \$150 to \$250 billion (representing conservatively 50 percent of OPEC's surpluses over the next 10 years) should be used to stimulate investments in return for a pledge from developing countries to establish rational trade policies. Country criteria for investment funding should include evidence of high product demand and insufficient industrial capacity and the maintenance of a favorable investment climate.

2. In addition, we must increase on a bilateral basis all forms of our aid programs, international lending, direct private investment and bond financing. We must improve the delivery of the U.S. aid program, i.e., the International Development Cooperation Act of 1978, which I have cosponsored.

On a multilateral basis, we must provide greater capital to the international financial institutions such as IBRD and the World Bank. Also, the Congress should authorize immediately the \$1.7 billion requested by the Administration for the Witteveen Facility of the International Monetary Fund.

3. In addition to the aid mentioned above, we should help the developing countries increase their export earnings by providing economic opportunities in the developed countries. This can be accomplished by programs which seek to stabilize commodity prices. We should engage in specified commodity agreements, provide some financing of selected buffer stocks and underwrite some export earnings through economic programs similar to the Stabex Plan under the Lome Agreement. Some accommodation must be made with the developing countries on a "second window" that will provide soft technical assistance to commodity producers covered by the Common Fund. We should expand our system of Generalized Trade Preferences, which will permit the LDC's to increase their exports of manufactured and semi-manufactured products.

4. The spin-off to the U.S. from encouragement of productive investment and greater economic development to take place in the developing countries is the provision of expanded markets for U.S. and other industrialized countries' products.

I believe that one of the problems which impedes U.S. industrial growth is the lack of sufficient overseas markets for U.S. products. The Administration must develop a serious export expansion program and create greater interest on the part of U.S. industry and agriculture in exporting.

The Government especially should encourage small- and medium-sized firms with no prior international experience to explore the overseas market potential for their products.

Because I believe that the Administration should improve business confidence through tax policy, I do not favor the elimination of DISC (Domestic International Sales Corporation) and the ending of tax deferral on undistributed profits earned abroad by affiliates of U.S. businesses.

DOMESTIC ECONOMIC SITUATION

I applaud the key points made in the Minority Report that greater productivity resulting from increased investment is needed to finance our economic growth. Unless we, as a Nation, maintain our competitive edge by improving productivity, U.S. business will be unable to take advantage effectively of the growth of foreign markets for its products. Investment in human capital is the cornerstone in achieving productivity growth. As an added bonus, increased productivity, combined with substantive growth in technological development, can counter the erosion of business profits through inflation.

As my legislative record makes very clear, I have sponsored Labor-Management Committees and pushed profit sharing and pension reforms in order to involve workers in the mainstream of corporate activity. The Human Resources Committee, on which I am Ranking Minority Member, continues to examine these proposals for Labor-Management Committees and expects to act on them in the 95th Congress. Not only will advantages accrue to the business community, but the human needs of workers also can be satisfied. It is the marginal worker, the one who needs to develop skills, that we want to incorporate into the ranks of productive employment.

On the issue of the Minority Report's recommendations for social security, I must separate myself from my colleagues. The Minority is opposed to increasing the wage base for social security. If there is a change to be made, the wage base should be increased, not decreased. This opinion stems from my fundamental belief that the increases in social security taxes were legislated after congressional realization that the cost of higher benefits must be paid by the recipients of those benefits. Increases in the wage base will mean ultimately larger benefits to the workers on retirement. We could not continue to legislate a system that permitted higher and higher benefits without recovering the costs.

We must consider the plight of the low- and middle-income taxpayer. In February of this year, I cosponsored S. 2503, a bill which would have substantially eased the burden of social security taxes on low- and middle-income taxpayers. This proposal would have removed the disability insurance and hospital insurance (Medicare) programs from payroll tax financing and, instead, funded these programs from Federal general revenues. Payroll taxes would continue to finance old age and survivors benefits.

S. 2503 will reduce the payroll tax burden by almost one-third; make the Social Security System actuarially sound for the next 75 years; re-establish a 100 percent reserve fund to protect beneficiaries from inflation and recession; and return the system to its original design as a retirement program.

As a result of my position on social security financing, I would rearrange some of the incremental components of the Administration's Tax Reform Package. Inflation has boosted taxpayers' incomes into higher marginal tax brackets without a corresponding increase in real living standards.

While I believe that some of the tax cuts should offset this phenomenon, the rest of the package should be shifted largely to busi-

ness tax cuts. As explained in my earlier section, we desperately need more business investment. Personal consumption has not lagged in this recovery, but investment spending has. We need to cut corporate tax rates, increase the investment tax credit, accelerate the depreciation rate, and give incentives which stimulate further increases in research and development. Business means jobs, and while government programs can aid the structurally unemployed as well as maintain adequate levels of economic activity, there is no substitute for private sector initiatives.

In addition, I cannot agree with the doctrine put forward by supply-side economists. It is conceivable that high marginal tax rates could encourage some to substitute "leisure for labor," because the reward to labor has fallen, as the Minority Views point out. I would even add that this phenomenon is more likely to take place in affluent countries where people can more easily afford to forego the small amounts of additional real income they would receive from working for extra earnings at these high marginal tax brackets. But it is just as possible that a worker whose real after-tax income falls might be forced to work harder—perhaps at a second job—in order to keep up with inflation, the mortgage payments, the new car, etc.

With regard to savings and consumption being affected by marginal tax rates, I am not sure that the relationship is all that simple. The incentives from a combination of inflation and high marginal tax rates could be just as strong to change one's pattern of saving (e.g., municipal bonds, real estate, etc.) as to substitute consumption for saving. Ultimately I am concerned that the real after-tax incomes of workers have fallen substantially over the past 10 years. High marginal tax rates have prevented workers' pay increases from keeping pace with inflation. It is this fact, in my view, which underscores a basic failing in our economic policy.

As a final note, I would urge additional consideration of the need for planning with regard to an urban policy, balanced national growth, structural unemployment, and other domestic issues. The White House Conference on Balanced National Growth and Economic Development emphasized repeatedly that meeting national employment and unemployment goals could only be made within the context of national, regional, and local planning. It has become absolutely apparent to me that our problems cannot be solved on an ad hoc basis, but instead must be interwoven in order to gain maximum results for the time, money, and involvement put into their development.

JACOB JAVITS.

ADDITIONAL VIEWS OF REPRESENTATIVE CLARENCE J. BROWN

Noting the importance of timing in making decisions designed to affect the economy, I feel that it is already too late to avoid the sequence of inflation and recession over the next two to three years. This all-too-familiar cycle of the past decade is the result of the routinely high rates of inflation which have affected the U.S. economy as a result of the steadily growing Federal deficits since the beginning of the Vietnam era. Federal tax and spending policies still predicated on the experiences of the Great Depression should have been changed a decade ago when it became apparent that inflation had become endemic to the United States and other deficit-ridden national economies. Germany and Japan—even Great Britain and France—have faced up to the need for spending restraint and, as a result, their currencies are showing more relative strength than ours. Our economy and our dollar would be even weaker but for the fact that we are still the largest and the most self-contained of all the world's major trading nations.

The evidence of wrong-headed policy is all about us and hardly needs to be emphasized: The Administration's energy proposals, the growth of Federal regulation, the growing real tax burden, the impact of two severe winters, the coal strike, the lack of competitiveness in many major industries (the ones whose under utilization pull down total plant capacity utilization figures), the rising wholesale prices, and the lack of investment, and on and on—many of which have been dealt with in this Report.

Exacerbating the present situation is a growing sense of drift produced by an absence of decisiveness in national leadership. This same situation (for different reasons) worsened the slide of 1974.

Psychological factors can be significant to economic change. Disillusionment and frustration with the ability of government to cure all "the heartache and the thousand natural shocks that flesh is heir to" has been evident for some time. And very few things have happened in the year since the last of these annual reports was published to offer any reasons to change that perception. However, I am confident that traditional American self-reliance will pull us through whatever lies ahead. At the very least, a government that cannot help should not be permitted to hinder.

CLARENCE J. BROWN.

ADDITIONAL VIEWS OF SENATOR WILLIAM V. ROTH, JR.

I concur generally with the views expressed by the Minority, but I believe the need for substantial and permanent tax rate reductions, and for strengthened international economic policies deserve further emphasis.

As the Minority Views correctly point out, the President's proposed tax package will not offset the increased social security taxes and inflation-induced tax increases. In addition to being too small, the President's tax proposals will soak the middle-income taxpayers of this country. In particular, his proposal to replace the \$750 personal exemption with a \$240 tax credit and his proposed changes in itemized deductions will substantially increase the tax burden on middle-income taxpayers.

LARGER TAX CUTS NEEDED

The President's claim that 96 percent of all taxpayers will benefit from his tax cut proposal is simply not true. By failing to take into account the impact of inflation and the social security tax increases, every family of four now earning more than \$17,250 will be paying higher taxes under the President's proposal. By 1980, every family of four now earning \$10,000 or more will be paying higher taxes under the President's proposal.

The following table shows the net impact of the President's tax program on families of four at various income levels whose income merely kept pace with the Administration's own inflation estimates of 5.9 percent in 1978, 6.1 percent in 1979, 5.7 percent in 1980, and 5.2 percent in 1981. The figures represent tax cuts (-) and tax increases (+).

IMPACT OF CARTER TAX PROGRAM

1977 income	1979	1980	1981
\$8,000.....	-98	-61	+51
\$10,000.....	-100	+16	+111
\$15,000.....	-37	+25	+157
\$17,500.....	+14	+92	+257
\$20,000.....	+186	+270	+449
\$25,000.....	+247	+458	+848
\$30,000.....	+377	+663	+1,110
\$35,000.....	+549	+960	+1,389
\$40,000.....	+710	+1,129	+1,661

As the table shows, middle-income taxpayers face substantial tax increases over the next three years under the President's tax proposals, and the President is misleading the American people by claiming they will be paying lower taxes.

The following table compares the Administration tax cut claims with the actual tax cuts (-) or tax increases (+) which will occur next year. As the table shows, the Administration has overestimated the impact of its tax cuts for virtually every income level.

COMPARISON OF CARTER TAX CUT CLAIM AND ACTUAL TAX CUT/TAX INCREASE

Income.....	Administra- tion claim	Actual tax cut/tax increase
\$8,000.....	-98	-98
\$10,000.....	-284	-100
\$15,000.....	-216	-37
\$17,500.....	-186	+14
\$20,000.....	-150	+186
\$25,000.....	-22	+247
\$30,000.....	-24	+377
\$35,000.....	+24	+549
\$40,000.....	+80	+710

As the figures show, the President's tax cuts are not large enough to offset the social security and inflation-induced tax increases. We need a tax cut which will both offset these tax increases and substantially reduce the total tax burden on the working taxpayers of this country.

THE TAX REDUCTION ACT

The Roth-Kemp Tax Reduction Act (H.R. 8333; S. 1860), which I have introduced with Congressman Jack Kemp, is expressly designed to restore incentive to the economy by increasing the after-tax reward for work, production, and investment. This bill, which is cosponsored by 163 Members of Congress, would provide substantial tax relief to all Americans, and its adoption would stimulate economic growth and create millions of new jobs in the private economy.

The Tax Reduction Act would provide across-the-board tax rate reductions for both individuals and businesses, phased-in over a three-year period.

For individuals, the bill would reduce tax rates by an average of 33 percent, reducing the present tax rates which range between 14 and 70 percent to rates ranging between 8 and 50 percent.

For businesses, the tax rates would be reduced from 48 to 45 percent and the small business surtax exemption would be increased from \$50,000 to \$100,000.

The immediate adoption of the Tax Reduction Act would assure the type of long-term economic growth needed to create jobs in the private economy. The principal obstacle to strong economic growth is the excessive tax burden imposed on the American economy. The high rates of taxation now imposed on the economy are strangling economic growth, increasing inflationary pressures, and choking off private initiative, investment, and the creation of jobs. An across-the-board tax reduction is the best way to remove these restraints on economic growth.

The Tax Reduction Act is modeled after the legislation proposed by President Kennedy in the early 1960's to get this country moving again. Kennedy realized then, as we should realize now, that the largest single barrier to a higher rate of economic growth is the heavy drag of Federal income taxes. The Kennedy tax rate reductions reduced individual tax rates from a range of 20 to 91 percent to the present range of 14 to 70 percent, and reduced corporate tax rates from 52 to 48 percent. These across-the-board tax rate reductions stimulated a five-year period of unprecedented economic growth, low inflation, and high employment.

The Tax Reduction Act would provide substantial relief to all taxpayers, with the largest percentage tax cuts going to lower- and middle-income taxpayers. When fully effective, the bill would reduce the tax burden on a family of four earning \$8,000 by 90 percent, reduce the tax burden on a family of four earning \$10,000 by 50 percent, and reduce the tax burden on a family of four earning \$15,000 by nearly 40 percent. Those earning more than \$20,000 would have this tax burden reduced by about 33 percent.

The economic impact of these across-the-board tax reductions would be enormous. By reducing the tax burden on the economy, the cost of working and producing would be reduced, and production, employment, investment, and wages would increase substantially.

According to one econometric projection, the Tax Reduction Act would increase this country's gross national product by \$43 billion and result in the creation of 1.2 million jobs by the end of 1978. By 1985, the bill would increase GNP by \$240 billion and create 5.5 million jobs.

Although critics contend these tax reductions would increase the budget deficit, history proves otherwise. In every tax rate reduction enacted since 1946, the estimated revenue losses have not occurred, and in fact revenues have increased because of the tax rate reductions. This is because tax rate reductions expand the economy, create tax-paying jobs, reduce Federal spending on unemployment benefits, and expand the Federal tax base. In the case of the Kennedy tax rate reductions, the Treasury Department estimated a six-year revenue loss of \$89 billion. But the tax reductions stimulated the economy so much that revenues actually increased by \$54 billion.

As President Kennedy said 15 years ago, we must free up the private sector to give consumers, workers, and employers the opportunity to get this country moving again. Instead of relying on increased government spending, we should reduce the tax burden on the private sector. The massive increases in government spending, and the budget deficits we have experienced for 18 out of the last 19 years, have drained resources out of the private economy, resulting in higher taxes, higher prices, and higher levels of unemployment. The American people do not want a bigger government with bigger government deficits. They want less government spending and lower taxes, and tough controls are necessary to reduce the growth of Federal spending. Working Americans need this kind of relief, and the American economy needs it in the interests of jobs, equity, and real economic growth in the private sector.

INTERNATIONAL TRADE POLICIES

Turning to international economic policy, I believe that the United States will be facing much tougher international competition in the coming years. International economic policy has become much more complex, but at the same time, there are increased opportunities for the United States to create jobs and promote sound growth through the sale of American industrial and agricultural goods and services.

I am deeply concerned that the United States is not properly organized to cope with a rapidly changing international economic environment much less to take advantage of the great opportunities in

that environment. We have seen that in a few short years, the Japanese can virtually destroy an American industry, but we have paid very little attention to how to forecast such dangers, to give our industries early warning, and to provide them with the kind of protection or help they need to make appropriate adjustments.

Time and time again, U.S. effectiveness in the international economic arena is sapped by bureaucratic turf fights. This kind of wrangling can only weaken our ability to bargain effectively with foreign countries. As Harold Malmgren, a former Deputy Special Trade Representative, recently testified:

In fact, my own negotiating experience is that if the man across the table senses divisions behind the U.S. negotiator, he will exploit them. He will try to bring one U.S. agency into conflict with another, if he can. If he senses a way to peel away one issue from another, he will.

I believe that in addition to strengthening coordination on broader international economic policy issues, we should consolidate into a single Department of International Trade and Investment the many existing offices and agencies dealing with foreign commercial and investment policy issues. The International Trade and Investment Reorganization Act, S. 1990, which I have introduced together with Senator Ribicoff, would create such a Department by joining together the Special Trade Representatives with the international, commercial, and investment functions of the Departments of State, Treasury, and Commerce. The statistical functions of the International Trade Commission would also be placed in the Department, and the Export-Import Bank and Overseas Private Investment Corporation would be semiautonomous elements of it.

This Department would reduce duplication and streamline decisionmaking on international trade and investment issues. It would join the trade negotiating and the retaliatory functions, thus strengthening U.S. bargaining leverage in trade negotiations. By consolidating the offices and people who collect trade and investment statistics and make analytical studies, it should help develop improved forecasting of potential trouble areas and the development of intermediate and long-range strategies for avoiding serious adjustment problems and taking advantage of new market opportunities for U.S.-produced goods and services.

I firmly believe that if the United States is going to have a first-rate foreign economic policy, we need a first-rate governmental apparatus for developing and implementing those policies. Like the other major economic powers, we should have a single agency for helping promote U.S. exports, protecting U.S. industry from unfair competition, and negotiating with foreign countries.

W. V. ROTH, JR.

ADDITIONAL VIEWS OF SENATOR JAMES A. McCLURE AND SENATOR ORRIN G. HATCH

ECONOMETRIC MODELS

We are in strong agreement with the Minority Views on supply problems and taxes and on the need for economic growth. We want to express our concern that policymakers are reducing job opportunities, living standards, and the growth of the economy by relying on an economic policy that neglects the economics of supply.

The econometric models used in the formulation of public economic policy assume that the levels of GNP and employment and the rate of economic growth are demand-determined. Following the view that the greater the spending, the greater that GNP and employment will be, economic policy focuses on increasing aggregate demand. Policymakers are preoccupied with shifting the aggregate demand schedule along the aggregate supply schedule, largely through the use of fiscal policy.

Policymakers have ignored the fact that fiscal policy produced shifts in aggregate supply in addition to shifts in aggregate demand. Fiscal policy affects the tax burden and produces incentive or disincentive effects that affect aggregate supply. For example, if marginal tax rates are changed, two important relative prices that affect output are altered. One is the price that governs the choice at the margin between additional current income or additional leisure. The other governs the choice between additional future income (savings) or additional current consumption. The higher the marginal tax rates, the less after-tax reward there is to saving and work, and the less that additional leisure and current consumption cost in terms of foregone after-tax current and future income.

A fiscal policy that raises tax rates reduces work effort and the supply of savings for investment and reduces the level of aggregate supply. Thus, it is possible for fiscal policy to retard production even as it increases aggregate demand. If the real tax burden is, as Milton Friedman and other distinguished economists say, equal to total government spending, a fiscal policy designed to increase government spending may shift the supply schedule backward as it shifts the demand schedule forward. This would explain why fiscal policy in recent years has increasingly worked to raise the price level rather than to raise the real output of goods and services.

A fiscal policy that reduces tax rates would increase the likelihood that aggregate supply would respond to an increase in aggregate demand. Traditional multiplier analysis ignores the supply-side effects of fiscal actions. As a result, it does not give an accurate comparison of the effects on the economy of increases in government spending and reductions in personal income tax rates.

Traditional economic policy has a problem of transition from the short run to the long run. In the short run, policymakers try to maximize demand. According to a recent report by the Congressional budget Office, a savings rate in excess of 7 percent of consumers' disposable income is bad for the performance of the economy ("Closing the Fiscal Policy Loop: A Long-Run Analysis," December 1977). According to the CBO report, which purports to be a long-run analysis, the economy will be strong if the savings rate is less than 6 percent.

The problem with this view, if carried to its logical conclusion, is that if all income is spent in order to maximize demand, there cannot be savings to finance the investment that increases the productivity of labor and makes the economy grow. More attention to supply-side economics may let policymakers escape the short-run treadmill in which business will not invest unless consumer demand is strong, and strong demand means a savings rate below 6 percent and few real resources for investment.

The neglect of supply-side economics is best illustrated by the forecasts in recent years by two of the three big commercial econometric models of the result of a reduction in corporate income taxation. According to the econometric simulations, the result of increasing the after-tax profitability of business investment would be a *decline* in investment and GNP! This bizarre prediction illustrates the pitfalls in an economic theory based on the assumption that output is demand-determined. It is this kind of misguided theory that has led to big spending, big government, and big trouble.

URBAN POLICY

Whereas we agree with the statement that "urban policy should avoid concentrating so much on income maintenance for urban populations as to become a means of perpetuating the urban poor," we believe that most of current and proposed policy perpetuates the urban poor and the financial plight of urban centers.

Many economists believe that our large cities are becoming warehouses for the poor because political entrepreneurs saw opportunities to build their spending constituencies and acted upon them. Politicians and welfare bureaucracies have been successful in causing migrations of poor to their constituencies by offering a higher living standard in terms of welfare benefits and leisure than could be obtained by working in lower income areas from which they came. Once there, handouts are traded for votes, and the political machine rolls on. As the machine rolls on, it rolls over the productive citizens and the taxpayers, and they respond to the rising tax rates and deteriorating police and educational services by removing themselves from the machine's jurisdiction. As the Minority Views point out, "a survey of personal income growth in five older cities between 1970 and 1975 shows that the largest gain in income during this time came from increases in transfer payments rather than from private sector wages, salaries, and other income."

The other part of the machine's constituency has been municipal employees. As the Minority Views point out, "municipal employees' salaries constitute the largest single item in any urban budget . . . Never-

theless, there are not sufficient incentives for urban governments to resist unnecessary large wage demands." Of course there are not, because politicians in pursuit of their self-interest trade benefits in the form of current salaries and future pensions for the bloc vote of a large and well organized group.

Strangely, the Minority Views suggest that the urban problems of escalating budgets and declining tax base are a result of affluence which has generated accelerating demands for services such as "cleaner air, better education, modern medical care, efficient transportation systems, and an effective police department." The question is: Has affluence made our cities poor by generating demands that they could not afford, or have politicians made our cities poor by building their spending constituencies and securing their political future at the expense of the economic viability of the cities? Are some cities in trouble because they have provided quality educational and police services, or because increasingly their budgets have been allocated to their spending constituencies and not to their taxpaying constituencies?

A first principle of economics is that subsidies increase the supply of that which is subsidized. If we subsidize with Federal bailouts the political behavior that has contributed to the plight of some of our cities, then we can expect an increase in this kind of behavior. If we make it pay, it will spread to additional cities. If we establish incentives that will generate this behavior nation-wide, we will succeed in ruining the entire country. As the Minority Views point out, "increases in aid to state and local governments, in fact, claimed approximately 40 percent of the Federal government's budget increases in the decade 1965 to 1975." And things got worse. Obviously, by subsidizing the growth of political spending constituencies, the Federal government insured that they continued to grow.

We should not make it pay for cities to conduct their financial affairs in irresponsible ways nor help them keep large numbers of people in welfare-dependent positions. Unfortunately, under current policy, when cities succeed in getting into financial difficulties, Federal money is their reward. This policy means success for urban politicians and ruin for the country.

The Minority Views point out that the older urbanized areas of the country are losing population from their privately-employed and tax-paying ranks, but the Minority Views fail to relate these facts to the taxing and spending policies of these urbanized areas. Instead, it is suggested that the loss of working population is the result of some "economic principles which favor growth outside the central city areas." If the relative decline of central city areas is not related to the taxing and spending policies of those areas, and if the relative growth of suburban areas is due to some inherent economic advantage that makes them more efficient in the use of resources, then to adopt a policy that would interfere with the shift of resources out of urban and into suburban areas would reduce the overall economic performance and rate of growth of the national economy. We believe that our urban areas are more likely to be restored by reestablishing in them incentives for financial and political discipline than by underwriting on the Federal level the kind of incentives that have led them to their present plight.

ORRIN G. HATCH.
JAMES A. McCLURE.

COMMITTEE AND SUBCOMMITTEE ACTIVITIES IN THE PAST YEAR

Public Law 304, 79th Congress (the Employment Act of 1946), directs the Joint Economic Committee to report to the Congress by March 1 each year on the main recommendations of the President's Economic Report. The Committee's 1978 Economic Report is submitted in accordance with that requirement. Due to the late filing of the President's Economic Report, the Joint Economic Committee's filing date was extended to March 31, 1978. It is intended to serve as a guide to the several committees of the Congress dealing with legislation relating to economic issues.

Under the Congressional Budget Act (Public Law 93-344) the Committee is also required to submit reports to the Budget Committees each year setting forth the Committee's view of the economic outlook and recommendations regarding relevant economic policies and to supply to the Congress an annual economic evaluation of the President's Current Services Budget estimates.

In addition, the Committee is required by the Employment Act to make a "continuing study" of the economy and to report to the Congress in midyear and at other times when deemed necessary.

In fulfillment of the Committee's responsibilities, the work of the full committee and its subcommittees for the past year is summarized below.

FULL COMMITTEE

1977 Joint Economic Report

The Committee conducted nine days of hearings during January and February 1977 in its annual review of the President's budget and economic report.

Testimony was received from spokesmen for the new Administration, including the Chairman and a member, as well as a former Chairman of the Council of Economic Advisers; the Chairman of the Board of Governors of the Federal Reserve System; the Director of the Office of Management and Budget; and the Secretaries of Commerce, Labor, and Treasury. The Committee also heard from representatives of business, management, and the academic community.

The 1977 Joint Economic Report was filed with the Congress on March 15, 1977.

Prices and Profits of Leading Retail Food Chains, 1970-74

The Committee held two hearings in late March and early April in relation to a study analyzed at the University of Wisconsin over a two-year period and based on confidential company records dealing with food chain store profits and prices. Also discussed were mergers between food chains and market concentration. Testifying were spokesmen from the University of Wisconsin, Harvard, and the Vir-

ginia Polytechnic Institute. Contributing to the discussion were representatives from the Department of Agriculture, the Bureau of Competition of the Federal Trade Commission, the Food Marketing Institute, and the Consumers' Union.

The study on which the hearings were based, "The Profit and Price Performance of Leading Food Chains," was released on April 12.

The Economics of Solar Energy

Hearings were held in early April based on a study dealing with the economics of solar energy development and investigating the state of the art and recommendations relating to the ability of the United States to achieve widespread solar utilization.

Prior to the hearing, the Committee released a study entitled "The Economics of Solar Home Heating." The study was prepared by researchers at the University of New Mexico and revealed that Minnesota and the Northern United States are currently the most feasible, practical locations for solar energy use. The economic feasibility of solar space and water heating on a State-by-State basis under a variety of assumptions regarding energy price control and deregulation was reviewed. In summary, the study contends that solar energy is more practical, economically, in the colder northern portions of the United States.

Issues at the Summit

In late April the Committee held three consecutive days of hearings on many of the issues to be discussed by the President with foreign heads of state in London at an upcoming Summit Conference. A Japanese economist, an adviser to the German Government, the Director of the New York office of the United Nations Conference on Trade and Development (UNCTAD), and the Secretary General of the Commonwealth Secretariat, London, testified, along with academicians and American spokesmen for Business and labor, as well as representatives from the banking and investment communities.

Bipartisan views and recommendations on a number of economic issues likely to be discussed at the summit conference were sent to the President in early May. Additional and supplementary views were also submitted by several of the Committee's Minority Members.

The Economics of the President's Proposed Energy Policies (May 20 and May 25, 1977)

The two hearings held in late May reviewed the specific goals and provisions of the President's program to see how they fit together as a national energy policy. The program's effects on income, employment, prices, how it would influence the economy's structure between now and 1985, and alternate schemes for rebating the massive energy taxes the President proposed were also examined.

The first hearing's witnesses included: an Assistant to the President, the Secretary of the Treasury, and representatives from Data Resources, Inc., the Brookings Institution, MIT, and the University of Southern California. The Chief Executive of Middle-South Utilities, the Chief Executive of Kaiser Aluminum, and representatives from Resources for the Future, the Environmental Defense Fund, and FEA presented testimony at the second hearing.

The 1977 Midyear Review of the Economy

The Committee held four days of hearings on the Midyear Review of the Economy in June and July. Testimony was received from the Director of the Office of Management and Budget and representatives of academia and the Brookings Institution.

The Midyear Report was filed with the Congress on September 26, 1977, and focused on the long-run outlook for investment, on Federal budget policy and inflation. It contained additional and Minority views.

Five-Year Budget Projections: Fiscal Years 1979-83 (December 5, 1977)

The Director of the Congressional Budget Office testified before the Committee in December to present CBO's Five-Year Budget Projections. The hearing marked the beginning of congressional evaluation of the budget for fiscal year 1979 and the following four years.

Employment-Unemployment (Monthly)

The Commissioner of the Bureau of Labor Statistics continued his monthly testimony before the Committee in its review of the unemployment situation. In addition to the Commissioner's appearances on January 12, February 4, March 4, April 1, May 6, June 3, July 8, August 5, September 2, October 7, November 4, and December 2, a Professor of Economics from Yale University testified on his report, "The Wholesale Price Index: Review and Evaluation" on August 5, and the Chief Economist with the Department of Commerce testified on the Department's statistical programs and procedures on November 4.

Special Studies

Economic Planning in Five Western European Countries: An Overview

In early January, the Committee released this study involving France, The Netherlands, Norway, West Germany, and Great Britain. The study is a handy review of the successes as well as the disappointments that Western European countries have experienced in developing workable government planning.

The Federal Reserve System

A comprehensive study was released in January relating to the Federal Reserve System. Initiated by the former JEC Chairman, the late Wright Patman (D-Texas), the study reflects many years of study of the central banking system and traces the history of the Federal Reserve System from its establishment in 1913 to the mid-1960's.

The Impact of Macroeconomic Conditions on Employment Opportunities for Women

The recession cost women 1.8 million jobs, according to this study released in late January by the Committee. It examines the extent to which the state of the overall economy affects the success of women in the labor market. Written in two parts, the first deals with what happened to women in the labor market since the start of the recession in late 1973. The second examines their employment prospects through

the remainder of the decade under alternative assumptions about overall economic conditions and about women's own interest in participating in the labor market.

Some Questions and Brief Answers About the Eurodollar Market

The Committee released this staff study on February 11th which deals with commonly asked questions about the Eurodollar market.

U.S. Economic Growth From 1976 to 1986: Prospects, Problems, and Patterns

During the year the Committee released four more volumes in this series of studies discussing the factors and processes which will shape long-run U.S. economic growth. This is an effort by the Committee to provide a comprehensive view of the U.S. economy from many perspectives.

The volumes released this year include:

Volume 9—Technological Change (January 1977)

Volume 10—The Quality of Economic Growth (May 1977)

Volume 11—Human Capital (May 1977)

Volume 12—Economic Growth in the International Context (May 1977)

Youth and Minority Unemployment (July 6, 1977)

Four Republican Members of the Joint Economic Committee released this study reviewing some of the current literature on the effects of minimum wages on youth unemployment. Adverse employment effects from market control by unions, the Davis-Bacon Act, job discrimination, licensure, inadequate education skills, and present manpower policies are also surveyed by this study.

The Macroeconomic Goals of the Administration for 1981: Targets and Realizations (August 5, 1977)

This study was prepared by Committee staff to supplement the Committee's midyear hearings on the state of the economy. It examines the Carter Administration's budget goals to determine if they are consistent and attainable. It concludes that reaching all of the goals simultaneously in 1981 is not possible, and confirms the views expressed by several of the hearing witnesses that the key to continuing recovery lies in more expansive monetary policies.

East European Economies: Post-Helsinki (August 1977)

A factual and interpretative assessment of the policy and performance of the East European economies, this compilation of invited papers is designed to meet the interests of the Committee and the Congress by providing an up-to-date body of data and comment on the domestic and foreign economic relations of the countries of Eastern Europe. These countries include: Bulgaria, Romania, Hungary, Czechoslovakia, Poland, the German Democratic Republic, Albania, and Yugoslavia.

Recent Experiences With National Planning in the United Kingdom (September 16, 1977)

This study was prepared by a professor at the University of California for the Committee. It examines the different planning exercises undertaken in the United Kingdom since 1962 and concludes that while

successful intermediate-term comprehensive planning is probably not yet feasible, there has been success in providing a hospitable environment for government officials, leaders of private industry, and labor to meet, share information, and cooperate in planning their future activities.

Work, Welfare, and the Program for Better Jobs and Income (October 14, 1977)

The Committee released this study prepared by professors from Brandeis University which concentrates on the labor market implications of the Administration's welfare reform proposals, particularly the work requirement, job creating, and work incentive components.

The Program for Better Jobs and Income—A Guide and a Critique (October 17, 1977)

Written by professors from the University of Wisconsin for the Joint Economic Committee, this study discusses the strengths and weaknesses of both the present welfare system and the Administration's welfare reform proposal. It also reviews some of the key economic issues which should be considered in a discussion of welfare reform.

SUBCOMMITTEE ACTIVITIES

In early March the Chairman of the Committee announced the reorganization of the Subcommittees and subcommittee membership. The number of Subcommittees was reduced from nine to five, and three of the Subcommittees are now headed by cochairmen. The Subcommittees on Economic Progress, Economic Growth, and Consumer Economics were merged into the Subcommittee on Economic Growth and Stabilization; the Subcommittees on Fiscal Policy and Urban Affairs were merged into the Subcommittee on Fiscal and Intergovernmental Policy; and the Inter-American Economics Subcommittee was merged with the Subcommittee on International Economics.¹ A list of subcommittee membership follows this section on Committee Activities.

SUBCOMMITTEE ON FISCAL AND INTERGOVERNMENTAL POLICY

Financing Municipal Needs

Testimony was received by the Subcommittee in late July, jointly with the Subcommittee on Economic Growth and Stabilization, on financing municipal needs. The hearing focused on the proposed National Development Bank, which would provide long-term, low-interest loans to municipalities as well as to certain private businesses. Witnesses included representatives from three research organizations and the academic community.

Studies

The Current Fiscal Condition of Cities: A Survey of 67 of the 75 Largest Cities (July 28, 1977)

At the Subcommittee hearing mentioned above, the Subcommittee released the results of a Joint Economic Committee survey on the

¹ The Subcommittee on Priorities and Economy in Government and the Subcommittee on Energy remained the same.

fiscal health of U.S. cities. The survey found, among other things, that capital needs in the surveyed cities are extensive, the combined service budgets have increased by only 5 percent, and the aggregate level of municipal employment has remained relatively constant between fiscal years 1976 and 1977.

Members of the Subcommittee: Representatives Richard Bolling and William S. Moorhead, Cochairmen; Representatives Henry S. Reuss, Otis G. Pike, Clarence J. Brown, and John H. Roussetot; and Senator James A. McClure.

SUBCOMMITTEE ON ECONOMIC GROWTH AND STABILIZATION

Economic Problems of Rural America

In mid-June the Subcommittee held two days of hearings focusing on the major economic problems that rural communities across the country face and what Congress and the Administration can and should do to foster balanced growth in rural areas. Witnesses included the Chairman of the U.S. House of Representatives' Rural Caucus, another Member of Congress, representatives from the Department of Agriculture, two national "rural" organizations, the academic community, and several local officials.

Assessment of Public Opinion and Public Expectations Concerning the Government and the Economy

In hearings in mid-June, the Subcommittee received a comprehensive report on what the American public thinks is right and wrong with Federal economic and energy policies and programs and what it expects and wants in these areas from the Government and the private sector. Representatives from six prominent polling organizations testified at this hearing.

The Role of Federal Tax Policy in Stimulating Capital Formation and Economic Growth

Simplification of the Internal Revenue Code and the effect of proposed tax measures on the levels of saving and investment were discussed, among other subjects, by the Subcommittee in four hearings held in mid-July. Three former Commissioners of the Internal Revenue Service, and representatives from the academic community, private industry, and national associations testified at these hearings.

American Women Workers in a Full Employment Economy

A hearing held by the Subcommittee in mid-September focused on the theme of a compendium of papers released by the Subcommittee under the same name, listed below. The hearings highlighted the basic economic and social facts about women's participation in the labor force as well as those factors responsible for changing the role of women in the work force.

Witnesses at this hearing included representatives from several national organizations, the academic community, and private industry.

Joint Small Business and Joint Economic Committee Hearings

In June and July joint hearings of the Subcommittee with the Small Business Committee's Subcommittee on Government Regulation and Small Business Advocacy were held to discuss, particularly S. 1726, The Small Business Economic Policy and Advocacy Reorganization Act of 1977, introduced by Senators Humphrey and McIntyre. The first hearing consisted of testimony from representatives of na-

tional and regional small business organizations, and the second heard from Administration witnesses, with invited comments requested from the Council of Economic Advisers and the Departments of Labor and Agriculture.

Conference on Measuring Progress in Participation by Minority and Female Contractors in Federal Procurement

In late September the Subcommittee sponsored a conference which focused on problems of measuring the share of total Federal purchases fulfilled by minority and female firms which, as a result of past discrimination and other barriers, are today socially disadvantaged. Federal procurement officials representing most major departments and agencies of the Government and a selected panel of individuals with research or advocacy interests in the field participated in the conference.

Studies

Foundations for a National Policy to Preserve Private Enterprise in the 1980's

A study prepared for the use of the Subcommittee and released in early April was based on the premise that the survival of the free enterprise system depends on the volume and vitality of small business in the next decade. The author's findings and recommendations are aimed at providing an improved climate for small business in terms of capital formation and government regulation.

Toward a National Growth Policy: Federal and State Developments in 1975

In mid-May the Subcommittee released a study documenting significant actions taken in 1975 that have an effect on national growth and development. By relating these actions to one another and to the various elements of a national growth policy, the report is intended to provide an information base that should be helpful in developing coherent and comprehensive policy governing the future growth and development of our Nation.

In addition, the report contains a very extensive annotated bibliography, broken down by policy area, covering books, articles, research papers, and other major works published during 1975, as well as a list of research projects under way in 1975.

American Women Workers in a Full Employment Economy

A compendium of 17 papers, released by the Subcommittee in mid-September, draws on leading authorities in the private sector and academic circles to provide an analysis of the past, present, and foreseeable job roles of American working women and potential workers. Among other findings, the compendium concluded that there is still a wide gap between the goal of job equality between men and women, and its fulfillment, and that the lack of career-oriented education and training is one of the strong root causes of women's inability to establish themselves in upwardly mobile careers.

Recent Developments in French Planning: Some Lessons for the United States

The Subcommittee released, in mid-December, a study prepared for its use which reviews the most significant developments in the evolu-

tion of French national planning and suggests several conclusions for planning in the United States. One of the study's conclusions is that U.S. planning should be restricted to fundamental questions of economic development, rather than the intricate general equilibrium approach of setting total demand equal to total supply, by sector.

Members of the Subcommittee: Senators Hubert H. Humphrey and Lloyd Bentsen, Cochairmen; Senators Abraham Ribicoff, Jacob K. Javits, and William V. Roth, Jr.; and Representatives Richard Bolling, Lee H. Hamilton, Garry Brown, and Margaret M. Heckler. (Senator McGovern joined the subcommittee following Senator Humphrey's death in 1978.)

SUBCOMMITTEE ON INTERNATIONAL ECONOMICS

Recent Development in Mexico and Their Economic Implications for the United States

During two days of hearings in mid-January the Subcommittee focused on the major economic developments in Mexico, the broad outlook under the new administration in Mexico, and its effect on the areas of the United States along the Mexican border, including the agricultural situation.

Witnesses included Senator Lloyd Bentsen (D.-Texas), a JEC Committee Member; the Governor of Arizona; representatives from the Mexican Government, from the State of New Mexico, and the academic community.

Issues in North-South Dialog

The Under Secretary of State for Economic Affairs testified before the Subcommittee in mid-June on the results of the Conference on International Economic Cooperation (CIEC). Among the issues discussed at the Conference were proposals to stabilize commodity prices, financial and debt problems of the developing countries, proposals on international economic assistance, and the continued discussion of international energy issues, particularly OPEC's prices.

The Trade Deficit: How Much of a Problem? What Remedy?

The implications and impact of a growing United States trade deficit were the subject of a Subcommittee hearing in mid-October. Among other subjects, the witnesses discussed the outlook for the U.S. trade balance in 1978 and 1979, the impact of OPEC and other foreign nations' investment in the United States, and what, if anything, the United States should do to reduce the trade deficit.

Witnesses included a member of the Council of Economic Advisers, representatives from the Departments of Treasury, Labor, and Commerce, research groups, and the banking and academic community.

Studies

The United States Response to the New International Economic Order: The Economic Implications for Latin America and the United States

In early March the Subcommittee released a study which reviewed the key economic issues between the United States and Latin America in the context of the New International Economic Order, a program

put forward by the developing countries. The study describes the background of the demands being made by the developing countries, analyzes the issues, and sets out the position adopted by the United States.

Living With the Trade Deficit

A report on the trade deficit, based on a hearing held in mid-October on the same subject, was released by the Subcommittee in mid-November. The report recommended, among other things, that other industrial countries with trade or current-account surpluses stimulate their economies, that major industrial countries adopt a "clean" floating exchange rate regime and permit rates to adjust promptly in response to market forces, and the adoption of an energy policy that would be effective in halting the growth of oil and natural gas imports.

Members of the Subcommittee: Representatives Henry S. Reuss and Gillis W. Long, Cochairmen; Representatives William S. Moorhead, Lee H. Hamilton, Margaret M. Heckler; and Senators Abraham Ribicoff, John Sparkman, Hubert H. Humphrey, William V. Roth, Jr., and Jacob K. Javits.

SUBCOMMITTEE ON PRIORITIES AND ECONOMY IN GOVERNMENT

Allocation of Resources in the Soviet Union and China

During two days of hearings in late June, which were Executive sessions, and one day of open hearings in early July, the Subcommittee discussed how much the United States knows about the state of the economy in the Soviet Union, the principal gaps in our information, the prospects for Soviet economic growth and development, and the economic effects of the U.S.-U.S.S.R. arms control agreements. Excerpts of the Executive sessions were later released by the Subcommittee Chairman.

Witnesses included the Directors of the Central Intelligence Agency, Defense Intelligence Agency, and the Arms Control and Disarmament Agency, as well as representatives from the Library of Congress and two research organizations.

The Role of Women in the Military

The present policies of the military regarding women was the subject of two days of hearings, one in late July and the other in early September. Representatives from the Departments of the Army, Navy, and Air Force testified on such subjects as new job classifications for women, recruitment, retention, promotion, and efforts to eliminate discrimination. Other witnesses included representatives from several women's organizations and the American Civil Liberties Union.

Strategic Mobility and Military Airlift to Europe

Representatives from the Department of Defense and the General Accounting Office testified before the Subcommittee in late December concerning the development of information about the budgetary and economic consequences of current and alternative strategic mobility requests.

Shipbuilding Claims Against the Navy

The Subcommittee held a hearing in late December to consider the backlog of pending claims against the Navy by private shipbuilders as well as problems in the management of the Navy's shipbuilding pro-

gram and potential financial losses for the shipyards and the Government. Three representatives from the Department of the Navy testified at the hearing.

Studies

Soviet Economic Problems and Prospects

In early August the Subcommittee released a study, prepared for its use by the Central Intelligence Agency, which presented a comprehensive assessment of current trends and future prospects of the economy of the Soviet Union. The study concluded, among other things, that the Soviet economy faces unusually serious strains in the decade ahead, including a sharp decline in the rate of the growth of the labor force and a shortfall in crude oil production.

Members of the Subcommittee: Senator William Proxmire, Chairman; Senators Lloyd Bentsen, Edward M. Kennedy, and Orrin G. Hatch; and Representatives Otis G. Pike, Garry Brown, and John H. Rousselot.

SUBCOMMITTEE ON ENERGY

Energy Independence or Interdependence: The Agenda with OPEC

The Subcommittee, during two days of hearings in mid-January, heard testimony from representatives of the energy industry, academia, and research groups on the future of the Organization of Petroleum Exporting Countries (OPEC) and U.S. policy choices with respect to energy independence or interdependence.

Impact of the President's Energy Plan on the Northeast

The impact of the President's energy plan on the Northeast region of the country was the subject of a hearing held in Boston by the Subcommittee in mid-May. Because New England was harder hit than most other regions by the rise in energy prices brought on by the OPEC price rise, and is expected to bear an additional burden because of the proposed conversion of utilities' and industries' energy systems from oil to coal, New England seemed a suitable place to begin the Subcommittee's deliberations as a laboratory of how the economy might adjust to the higher prices envisioned in the President's plan.

The Administrator of the Federal Energy Administration led off the hearing and was followed by representatives of regional and local community groups, regional energy industries, and the Federal Reserve Bank of Boston.

The Economics of the President's Proposed Energy Policies

In mid-May the Subcommittee held two days of hearings to examine the feasibility of the President's energy plan and its consequences for various sectors of the economy. In particular, cogeneration and the proposed conversion of industry from oil to coal were discussed.

The first witness was the Secretary Designate of the proposed Department of Energy, followed by representatives of industry, research, and environmental groups.

Industrial Energy Conservation

In late July the Subcommittee held a hearing to consider road-blocks to improved conservation of energy in industry, a sector of society which accounts for 40 percent of energy consumption. Institutional, technical, and financial impediments, as well as improved means of reporting on energy use, were discussed by the witnesses who included a U.S. Senator from Colorado, and representatives from the Federal Power Commission, private industry, and the academic community.

*Studies**Achieving the Goals of the Employment Act of 1946: Thirtieth Anniversary Review. Volume 2—Energy—Paper No. 2. Energy and Economic Growth*

According to this study, released by the Subcommittee in mid-September, the Nation can continue to enjoy "a robust economy" while cutting energy consumption growth substantially by 1985. The authors who submitted the paper for the use of the Subcommittee claim that two trends, slower population and labor force growth, and a long-term shift from energy-intensive primary production toward greater dominance of less energy-intensive fabrication and service industries, will cut the annual growth in energy use from its historical level of 4 percent from 1960 to 1973 to 2.3 percent from 1985 to 2000.

The Economics of the Natural Gas Controversy

A staff study, prepared for the use of the Subcommittee and released in mid-September, was highly critical on economic grounds of proposals to deregulate natural gas prices. Among other things, the report reiterates the conclusion that natural gas reserves in the United States are limited, and that total gas production is likely to decline in the future under any price scheme.

Members of the Subcommittee: Senator Edward M. Kennedy, Chairman; Senators John Sparkman, William Proxmire, James A. McClure, and Orrin G. Hatch; and Representatives Gillis W. Long and Clarence J. Brown.

STAFF PARTICIPATION IN MEETINGS WITH OUTSIDE GROUPS

In addition to conducting formal studies and arranging hearings for the Committee and Subcommittees, the staff participated in discussions of economic problems and research techniques with outside groups. The following list illustrates the nature of the groups in whose activities the staff took part in 1977:

American Economic Association Convention, New York City
 American Enterprise Institute
 American University Washington Seminar
 Atlantic Richfield Company
 Brookings Institution
 Center for Integrative Studies
 Central Intelligence Agency
 Chase Econometric Outlook Seminars
 Chemical and Engineering News

Conference Board Conference
 Conference on National Energy Plan
 Conference on Tax Policy and Economic Growth, sponsored by National Journal
 Congressional Tax Group Seminars
 Cornell University, School of Industrial and Labor Relations
 Council on Foreign Relations
 Data Resources Outlook Conferences
 Department of the Treasury
 DuPont Company
 Federal Staff Seminar—Georgetown University Center for Strategic and International Studies
 Harvard University
 Hill and Knowlton
 International Management and Development Institute
 International Monetary Fund
 Kansas State University
 LBJ School of Public Affairs
 Life Cycle Planning for Full Employment Conference
 Mount Holyoke College
 National Association of Business Economists
 National Economists Club
 North American Conference on Labor Statistics
 Oberlin College
 Overseas Development Council
 Participation, Profit Sharing and Employee Stock Ownership Conference
 Philip Morris
 United Nations
 Urban Institute
 U.S. Conference of Mayors
 Wharton Econometric Forecasting Associates Conference on the Economic Outlook
 World Bank
 The Executive Director and other professional staff members addressed or presented papers to a number of groups including:
 Alternatives to Growth Conference
 American Association for the Advancement of Science, annual meeting, Denver
 American Studies Program
 Aspen Institute for Humanistic Studies Seminar
 Atlantic Richfield Company Annual Corporate Planning Division Meeting
 Council on Trends and Perspectives, U.S. Chamber of Commerce
 George Washington University
 National Forum on Jobs, People and Money
 St. Olaf College
 Taylor University
 University of Chicago
 University of Missouri
 U.S. Civil Service Seminar Center, Oakridge, Tennessee and Kings Point, New York

The International Forecasting Seminar in London was attended by a member of the research staff in May. On the same trip, the staff member consulted with representatives of the Organization for Economic Cooperation and Development in Paris and with government officials in London.

The Committee had a staff member representing it in early September at the International Economic Association meeting in Tokyo.

Economic development and resource allocation in the Soviet Union were the topics of discussion for a staff member visiting France, Belgium, the United Kingdom, Sweden, and West Germany in midyear.

Government officials and private experts were consulted relating to economic trends in Asia, including the People's Republic of China, by a staff member visiting Taiwan, Hong Kong, and Tokyo in late 1977.

The Executive Director, while on personal travel in Europe in the fall, visited Brussels, Basel, and Paris and conferred with economic and finance officials regarding long-range policy issues.

A staff member traveled to Europe in late 1977 to attend the OECD Youth Employment Conference in Paris. While on the Continent, he discussed employment issues with British business, labor, academic, and government experts and conferred on economic growth and trade issues with EEC officials in Brussels.

A staff member visited the European Communities as their guest in May and was briefed on methods used by the Communities to coordinate the national energy policies of their member states. Also, discussions were held with German officials regarding the prospects for the German economy. The cities visited were Brussels, Strasbourg, Bonn, Paris, Amsterdam, London, and Copenhagen. Consultations were held with government officials and members of the business and academic communities concerning issues of mutual concern.

CHANGES IN COMMITTEE MEMBERSHIP

During early 1977 Senator Percey (R-Ill.) left the Committee membership, and Senators McClure (R-Idaho) and Hatch (R-Utah) joined the Committee membership.

CHANGES IN COMMITTEE STAFF

During 1977, several staff members left the Committee to work in the new Administration, including: Lucy Falcone Hamachek, research economist, presently Deputy Assistant Secretary of Commerce for Policy Development and Coordination; Sarah Jackson, international economist, presently Deputy Assistant Secretary of Energy for International Policy Development; John Karlik, international economist, presently Deputy Assistant Secretary of Treasury for International Economic Analysis; Ralph Schlosstein, economist, presently Associate Director of the Domestic Policy Staff in the White House, and Courtenay Slater, senior economist, presently Chief Economist at the Commerce Department.

Also leaving were administrative staff members Elaine Allen, Christal Blakely, Melissa Chambers, Beverly Mitchell, Vicky Ramos, and Robin Stein, secretaries; Libby Gotschall, receptionist; Michael Runde, administrative assistant; and Martha Vinograd, research assistant.

William Buechner, staff economist, left the Committee to join the staff of the Small Business Committee.

The following joined the staff in 1977: Margaret Akra, David Battey, Carole Geagley, Linda Maisel, Eileen Murray, Michael Nardone, Patricia Ormond, Jody Reed, and Mary Sutton, administrative staff; and Thomas Dernburg, senior economist; Imogene Holmes, executive secretary; Kent Hughes and Deborah Norelli Matz, staff economists; Edward Jacobs and William D. Morgan, Professional Staff Members.

In mid-1977, Congress created as part of the Joint Economic Committee the Special Study on Economic Change. The new staff members are Charles S. Sheldon II, Research Director; Robert Wallace, Assistant Research Director; Albert Sayers and Paula Dobriansky, research assistants; Lorren Roth, secretary; and Cathy Pennock Runde, clerk.

DISTRIBUTION OF COMMITTEE PUBLICATIONS

In 1977 the Joint Economic Committee distributed over 150,000 copies of current and previous years' publications to individuals, libraries, and organizations the world over.

Since the time of our last Annual Report, the Committee has released 28 committee prints and has held 23 sets of hearings, (59 days).

§ Economic Indicators, which are sold by monthly subscription through the Superintendent of Documents, were received by 12,000 subscribers and distributed through the Committee to 1600 persons.

In addition, committee prints, released by the Joint Economic Committee, are mailed to over 700 depository libraries throughout the country by the Government Printing Office.

**SUBCOMMITTEE MEMBERSHIP, 95TH CONGRESS,
1ST SESSION**

FISCAL AND INTERGOVERNMENTAL POLICY

REPRESENTATIVES	SENATORS
Mr. Bolling, Cochairman	Mr. McClure
Mr. Moorhead, Cochairman	
Mr. Reuss	
Mr. Pike	
Mr. Brown of Ohio	
Mr. Rousselot	

ECONOMIC GROWTH AND STABILIZATION

SENATORS	REPRESENTATIVES
Mr. Humphrey, Cochairman	Mr. Bolling
Mr. Bentsen, Cochairman	Mr. Hamilton
Mr. Ribicoff	Mr. Brown of Michigan
Mr. Javits	Mrs. Heckler
Mr. Roth	

INTERNATIONAL ECONOMICS

REPRESENTATIVES	SENATORS
Mr. Reuss, Cochairman	Mr. Ribicoff
Mr. Long, Cochairman	Mr. Sparkman
Mr. Moorhead	Mr. Humphrey
Mr. Hamilton	Mr. Roth
Mrs. Heckler	Mr. Javits

PRIORITIES AND ECONOMY IN GOVERNMENT

SENATORS	REPRESENTATIVES
Mr. Proxmire, Chairman	Mr. Pike
Mr. Bentsen	Mr. Brown of Michigan
Mr. Kennedy	Mr. Rousselot
Mr. Hatch	

ENERGY

SENATORS	REPRESENTATIVES
Mr. Kennedy, Chairman	Mr. Long
Mr. Sparkman	Mr. Brown of Ohio
Mr. Proxmire	
Mr. McClure	
Mr. Hatch	