Notes for Ways and Means Markup Session on Debt Limit Bill, October 24, 1973

(originally scheduled to be closed, but committee voted to open to public)

Introduction

The debt limit was last reviewed by Congress in June of this year.

At that time, the Congress set a temporary debt ceiling of $465 until November 30, 1973, and retained a permanent debt limit of $400 billion. Under existing law, the debt limit will revert to $400 on December 1.

Secretary Shultz recently testified before this Committee that the public debt subject to the ceiling stood at $462.4 at the end of September.

He further testified that the debt ceiling will need to be raised before the final week of November if severe pressure on the Treasury's cash balance in late November is to be avoided.

The facts presented to this Committee by Secretary Shultz are, I believe, incontrovertible.

His recommendation to this Committee that the temporary debt ceiling be raised to $480 for fiscal 1974 is prudent, expenses an urgent need. I fully support it, and I am entirely confident that your Committee, whether or not it accepts every detail of the Secretary's recommendation, will act in sufficient time to prevent financial embarrassment to the Treasury.

As a practical matter, there is little else that this Committee can do.

II I take it that a major purpose of these Hearings, as in the past, is not only to review the debt ceiling, but also -- and more fundamentally -- to appraise the condition of our Federal finances.

Everyone of you, I am sure, is deeply concerned about our nation's fiscal position.

Every member of this Committee, knows that our economy is in trouble, that the rise of the price level which commenced in 1964 has lately accelerated.

That we are now in the midst of the most serious inflation since the Korean War and that, while the inflation that is plaguing our economy has many and complex causes, our Federal fiscal policies have contributed to the inflationary pressures which are causing economic hardships for many millions of our people.

III. Let me review some salient facts of recent Fed history

(a) In 1954, Fed. exp.

1954	\$71 billion	)	+ 48
1964	119 "	)	
1966	135 "	)	+151
1974	270 "	)	

(b) These gigantic increases in Federal spending have

[At the end of fiscal 1963: public debt : \$311
1973: " " 459

(c) Since 1961, the unified federal budget has reported a deficit in every years except 1969.

(d) In three of the past six fiscal years, the deficit has approximated or actually reached $25 billion.

(e) During the last fiscal year -- a year of rapidly advancing prosperity -- the deficit exceeded $14 billion.

(f) Nor is this all. Since 1969, the borrowing by federal agencies has been excluded from the unified budget. The borrowing by these agencies has been growing rapidly.

If we take total of Treasury and agency borrowing: Fiscal 1970 - $15 billion; 1971 - $24 billion; 1972 - $28 billion; 1973 - $33 billion.

IV. These fiscal developments have played their part in the great inflation and the upward trend of interest rates since 1964.

They go a considerable distance in explaining the underlying inflationary trend of our economy.

The explosive increase of the price level during the past year (September - September wholesale prices - 17%; consumer prices, 7 1/2%) cannot, however, be laid solely or even mainly at the door of our fiscal or monetary policies.

Nor can we blame the trade unions, which in other years-- notably between 1969 and 1971 -- exercised a powerful upward push on costs and prices.

Let me take two or three minutes to sketch the special and extrapolating developments in the price sphere during the past year.

(1) The first fact to notice is that the inflation this past year has been on a world-wide scale.

Consumer price level	
Germany	7%
France	8%
Canada	8%
Gt. Britain	9%
Italy	2%
Japan	12%

similar of smaller countries.

(2) This world-wide inflation reflected a world-wide economic boom --

Usually, economies of individual countries trace out divergent trends.

Now and then, however, all or most industrial countries find themselves in the same phase of the business cycle.

Such an unusual coincidence of economic expression occurred last year.

Now, in the course of an economic boom,

people are more willing to use the money they have,

money turns over more rapidly -- the consequence

inevitably is that shortages soon appear in different sectors of the economy, and prices go up this happens even when fiscal and monetary policies are entirely neutral.

(3) Another complicating factor during the past year was the accident of bad harvests -- crop failures -- in many countries.

The result has been an run-up of farm prices and food prices.

(4) Still another complicating factor was the restricted capacity of raw material producing industries in our country -- paper, wood pulp, steel, aluminum, man-made fiberts, etc. -- to expand production.

This was a result of low investment in these industries in recent years, which in turn was due to abnormally low profits from 1966 to 1971.

(5) There were till other complicating factors --

the developing shortages in the energy field, reflecting among other things -- the exercise of monopoly power by foreign producers;

more important still, the depreciation of the dollar in foreign exchange markets which caused sharp advance in the prices of all imported goods;

and this advance spread out to domestic substitutes, to products fabricated from foreign materials -- across the board.

(6) In view of the powerful special factors that I have noted, and the cyclical expansion of our economy, a sharp advance in our price level would have been practically inevitable this year. There was not much that we could have done about it.

But our governmental policies have also not dealt vigorously enough with our underlying inflationary problem.

(a) First, a word about monetary policy

Began moving toward restraint in March 1972.

In retrospect, degree of restraint should have been somewhat greater.

This situation has now been fully corrected.

Dec. 1972-Sept. 1972: 4.2%; Sept.-Sept. 5.4%

(b) As for fiscal policy,

energetic support by Administration, with cooperation of the Congress, to restrain expenditures,

nevertheless, fiscal policy was not restrictive enough --

Budget deficit in fiscal 73 of over 14 billion dollars, and borrowing of 33, clearly inappropriate in a year of economic boom;

(c) As for wage and price controls,

they were eased too suddenly last January,

and -- worse still -- the relaxation was widely interpreted to mean that controls had virtually come to an end;

(d) And our governmental farm programs until early this year had been aimed at limiting production instead of encouraging production.

V. The accelerating pace of inflation this year is bound to have consequences over the next year or two -- if not longer --

The special factors that caused a price explosion this year are likely to be on the wane.

(1) Agricultural production increasing -- this country and abroad.

(2) Industrial capacity of national productivity indicators is beginning to expand.

(3) Depreciation of dollar -- encouraging developments.

However, the rise of consumer prices, and the strong continuing demand for labor, threaten an escalation of wage demands.

Wage rate advances are already creeping up.

Hourly earnings: September 1972-September 1973 - +6.6%

March 1973 - September 1973 +7.3%

This substantially exceeds the prospective increase of prices.

I am not hopeful that the rate of inflation can realistically be expected to fall below a 4-5 % range during 1974.

VI. To do that well, or no more poorly, will require scrupulous care in the exercise of our monetary and fiscal policies.

I emphasize monetary and fiscal policies, because I believe that the effectiveness of wage and price controls is quickly eroding. I do not expect much help from this quarter.

As for monetary policy, it is entirely clear to me that while the expansion of monetary and credit must continue, the expansion must be kept within very moderate bounds -- so that new forces of inflation are not released.

The Federal Reserve Board is firmly resolved to do this. I assure you that this will be done.

As for fiscal policy, the need for greater prudence and restraint than we had is clearly essential.

In June, the Treasury estimated Federal expenditures for this fiscal year at 268.7 billion.

This estimate was raised by Secretary Shultz last week to 270 billion, and that estimate did not allow for the increase in military spending that is likely to result from ominous foreign developments of recent weeks.

The balanced budget that Secretary Shultz presented to this Committee therefore looks very fragile to me.

To prevent the release of new inflationary forces fromfiscal side, it is vital thtat the Congress proceed with all possible speed to reform its budgetary procedures -- a subject to which this Committee, and particularly your Acting Chairman, are devoting much constructive thought and effort.

A reform of our budgetary procedures which would put an end to the fragmented consideration of expenditures and which would place a firm ceiling on total expenditures, and

which would relate these expenditures to prospective revenues and the nation's economic needs -- has become an absolute necessity.

If such a reform is accomplished this year, our country will finally be in a position to put an end to the inflation that has been plaguing our economy.

Effective budgetary reform is by far the most important contribution that the Congress can make to the soundness of our economy and the economic welfare of our people.

I also hope that this Committee, once it has disposed of the trade bill and the debt ceiling, will carefully consider ways and means of using tax policy as an instrument of economic stabilization, so that we will not need to rely -- as heavily as we have in the past and as we are now doing -- on monetary policy.

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