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THE 1971 MIDYEAR REVIEW OF THE ECONOMY

REPORT

OF THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

TOGETHER WITH

SUPPLEMENTAL AND MINORITY VIEWS

AUGUST 16, 1971

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JOINT ECONOMIC COMMITTEE

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WILLIAM PROXMIRE, Wisconsin, *Chairman*
WRIGHT PATMAN, Texas, *Vice Chairman*

LETTER OF TRANSMITTAL

AUGUST 16, 1971.

To the Members of the Joint Economic Committee:

Transmitted herewith for the use of the Joint Economic Committee and other Members of Congress is the report of the committee entitled "The 1971 Midyear Review of the Economy" together with supplemental and minority views.

This report is issued pursuant to hearings held in July on the state of the economy. The committee believes that the serious problems confronting our economy warrant an analysis of the issues and recommendations for policy action at this time.

WILLIAM PROXMIRE,
Chairman.

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THE 1971 MIDYEAR REVIEW OF THE ECONOMY

INTRODUCTION AND SUMMARY

At the midpoint of 1971, it is clear that the economic goals set forth by the Administration at the beginning of the year are not being met. Unemployment has not been reduced, and without immediate new policy actions, there is little hope that it will be reduced during the remainder of this year. We entered 1971 with a 6 percent unemployment rate, and given present policies, there is every expectation that we will enter 1972 faced with very much the same distressing situation.

The continued high level of unemployment has been accompanied by a higher rate of inflation than had generally been anticipated. The Administration now takes the position that high unemployment must continue to be tolerated for a time because any effective action to reduce unemployment might further aggravate inflation. Other approaches to containing inflation, including either mandatory price and wage controls or comprehensive voluntary incomes policies have been rejected, because, in the judgment of the Administration, they would not be effective.

The members of this Committee share the Administration's concern over the persistence of inflation, but we emphatically reject the "do-nothing" response which constitutes present policy. In this Report we set forth a carefully considered alternative to present policy; an alternative which would, in our judgment, both effectively control inflation and significantly hasten the return to full employment.

Our proposals are by no means revolutionary. Indeed, given the enormous human costs of unemployment and underemployment presently being experienced, they are quite modest. Resources capable of producing over $70 billion worth of goods and services per year are presently idle. The actions we propose would put these

NOTE.—Senator Fulbright states: "While other responsibilities have not allowed me to fully participate in the Committee's deliberations which have led to the conclusions in this Report, I would like to express my approval of certain specific recommendations endorsed by the Committee. I refer particularly to the recommendation that Housing and Urban Development funds now impounded by the Administration be released immediately. The effect of such action on the overall budget can be more than offset by significant defense expenditure reductions with no danger to the national security. I, also, am favorably disposed toward the Committee's request for voluntary price and income guidelines or other suitable machinery designed to combat inflation pressures, as well as the recommendation that our monetary policy be conducted in such a way as to reduce long-term interest rates.

As to the other recommendations, I prefer to reserve judgment for the reason previously stated."

NOTE.—Due to the pressure of other responsibilities, Representative Bolling and Representative Griffiths could not participate fully in the midyear hearings and the preparation of this Report. They therefore reserve judgment on the recommendations made in this Report.

idle resources back to work. Because of the low level at which the economy is presently operating, and because we would couple expansionary policies with a vigorous incomes policy, the actions we propose would not create strains on productive capacity that might lead to new inflationary pressures. We believe our recommendations are responsible and conservative. Above all, these recommended actions are essential. The social costs of high unemployment are too great to be borne any longer.

The Committee's principal recommendations are summarized below. They are explained in greater detail in the body of this Report.

- The personal income tax reductions presently scheduled for 1972 and 1973 should be made retroactive to January 1, 1971.
- The increase in the social security tax base presently scheduled for January 1972 should be postponed. The additional increase in the tax base and the increase in the tax rate contemplated under H.R. 1 should be instituted on a gradual basis beginning no sooner than January 1973.
- The level of expenditure for emergency public service employment should be increased to double the $1 billion for fiscal 1972 and $1.25 billion for 1973 authorized by the recently enacted Emergency Employment Act.
- At least $1 billion of the funds already appropriated for housing and urban development but presently impounded by the Administration should be released immediately.
- The Federal Government should adopt a system of payments to State and local governments to compensate these governments for the shortfall in their own tax revenues caused by high unemployment. The amount of such payments should be related to the unemployment rate, and such payments should cease when the unemployment rate no longer exceeds an agreed upon figure such as 4½ percent.[1]
- A comprehensive policy of voluntary price and income guideposts should be instituted at once. The President should establish a price and incomes board, or other suitable machinery, to collect and publicize price and income data and to administer the guideposts.
- Monetary policy should be conducted in such a way as to reduce longer-term interest rates at least to the levels which prevailed in January and February of this year.

[1] Senator Bentsen reserves judgement on this recommendation, which he feels was not fully explored during the Committee's hearings.

I. A COORDINATED FISCAL AND MONETARY POLICY TO RESTORE FULL EMPLOYMENT

The Need To Set Clear Employment Targets

For well over a year now the United States has been experiencing an unusual, and totally unsatisfactory, combination of high unemployment and persistent inflation. The continuation of this situation has surprised and discouraged most observers, and it has caused many to question whether our traditional goal of combining full employment with reasonable price stability is still achievable.

For several years this Committee has held the position that the Nation's long-term objective must be an unemployment rate no higher than 3 percent.[1] In our Annual Report last March, we stressed the importance of a firm national commitment to work toward a combination of an unemployment rate of no more than 3 percent and an annual rate of price increase, as measured by the gross national product deflator, of no more than 2 percent. We reiterate our conviction that this is both an achievable long-term goal and an essential aim of current policy.

We recognize that achievement of this goal will require an extended period of concerted policy efforts. Interim goals which represent progress toward our desired position must be set. Such interim targets have been set before at times when unemployment has been clearly too high. In the early 1960's, the Council of Economic Advisers set a 4 percent unemployment rate as an interim goal. In January of this year, the present Council of Economic Advisers set the "4½ percent zone" as an interim unemployment target to be reached by mid-1972. A gross national product (GNP) of $1,065 billion was established as the output target because this was estimated to be consistent with the employment target. Although the vague nature of the employment target was somewhat unsatisfactory, even the "zone" of 4½ percent would have represented clear progress from the 6 percent rate that has prevailed since late 1970.

The hoped-for vigorous economic recovery has not materialized. Unemployment remains in the neighborhood of 6 percent. Rather than adopting additional policies designed to reach their "4½ percent zone" goal, the Administration has now chosen to abandon the goal. This was made clear in the testimony of the Chairman of the Council of Economic Advisers before this Committee during our midyear hearings in July:

> There is a danger that if money GNP were now to rise, or be pushed up, to reach the targets previously put forward that would revive inflation or at least seriously delay its abatement. This is because to regain the original path from the present apparent starting point of money GNP would require a steeper rise of money GNP than was originally contemplated and because the rate of inflation has been very persistent.

[1] Senator Bentsen states: "I agree that this is a worthwhile and important objective. However, the difficulties involved in reaching this target should not be minimized."

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Even more disturbing is a recent statement by the Secretary of the Treasury that casts doubt on the commitment of this Administration even to a long-term goal of full employment:

> We talk in terms of a norm of unemployed being 4 percent. This is a myth, it has never happened, it has never been on an annual basis unemployed at the rate of 4 percent save in wartime, not in the last quarter of a century.
>
> So 4 percent is not the norm. We have never achieved it except in wartime. I don't think the American people are willing at this point in time to continue the war or continue all that that means in order to try to achieve a 4-percent rate of unemployment.[2]

Peacetime full employment with reasonable price stability has long been an unquestioned bipartisan goal in the United States. Indeed, a commitment to this objective is required of both the Executive and the Legislative Branch under the Employment Act of 1946. The Chairman of the Council of Economic Advisers recognized this commitment during his testimony at our annual hearings last February when, in regard to, the $1,065 billion GNP target, he stated:

> It is the target of government policy because it describes the path that would reduce unemployment as rapidly as is consistent with reduction of the inflation rate. In this sense the target is required by the Employment Act of 1946. We should not aim for less.

The Administration should immediately reaffirm its commitment to the goal of restoring peacetime full employment with reasonable price stability. The appropriate officials should specify the Administration's definition of full employment. Interim targets which represent measurable progress toward full employment should be established at once and policies designed to achieve these targets should be adopted.[3]

The Present Employment Outlook

The consensus among the economic experts who testified before this Committee during our midyear hearings was that no significant decline in unemployment is to be expected during the remainder of 1971. The year is expected to close with unemployment still in the neighborhood of 6 percent. The improvement in employment during 1972 is expected to be, at best, very gradual. Many forecasts place the unemployment rate still at 5½ percent or more at the end of 1972.

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[2] Senator Bentsen states: "I very much regret that this statement by the Secretary of the Treasury has been misinterpreted in this Report. The Secretary has made his total commitment to peacetime full employment abundantly clear on numerous occasions."

[3] Senator Humphrey states: "I heartily endorse this recommendation. In developing employment targets, full account should be taken of the extent of hidden unemployment. In the first half of 1971 there were 746,000 people identified in the official employment statistics as not looking for work because they believed no work was available. These persons were not officially counted as unemployed. If they had been, total measured unemployment would have risen by nearly 15 percent. Even this would give only a partial measure of hidden unemployment. I urge the Labor Department to collect additional data on hidden unemployment, and to include this information in the monthly press release on employment and unemployment."

It may seem puzzling that unemployment has remained so high while GNP has grown substantially in dollar terms. Current dollar GNP increased by $45 billion in the first half of this year, an unusually large increase. Three factors are important in explaining why this GNP growth has not been accompanied by a reduction in unemployment. First, part of the growth of GNP represented a catch-up from the auto strike that took place late in 1970. Second, more than half of the dollar growth of GNP was simply inflation and thus did not represent any increase in the real volume of goods and services produced, nor in the number of job opportunities available. Third, the labor force is growing and productivity is increasing.

The rate of growth of output that can be achieved through labor force growth and productivity gains is referred to as the potential growth rate of the economy. The unemployment rate will fall only if the actual growth of output, after adjusting for price increases, exceeds this potential growth rate, which is estimated to be between 4 and 4½ percent per year. As shown in Table 1, growth of real output over the past year has not been sufficient to prevent unemployment from increasing. Only during the "catch-up" from the auto strike during the first quarter of 1971 did the growth of real GNP exceed 4 to 4½ percent. The average growth rate during the four most recent quarters was only a little over 2 percent and unemployment rose from 5.2 percent in the third quarter of 1970 to 6 percent in the second quarter of 1971. If the rate of growth of real output remains below 4 to 4½ percent, unemployment must be expected to rise further.

TABLE 1.—SELECTED ECONOMIC INDICATORS

[All data seasonally adjusted]

	1969 (quarter)		1970 (quarter)				1971 (quarter)	
	3d	4th	1st	2d	3d	4th	1st	2d
Real GNP (billions of 1958 dollars; annual rate)	727.8	725.2	719.8	721.1	723.3	715.9	729.7	736.3
Percent change in real GNP (annual rate)	+2.0	−1.4	−3.0	+0.7	+1.2	−4.1	+7.7	+3.6
Index of industrial production (1967=100)	111.6	110.6	107.7	107.5	107.2	103.6	105.5	106.7
Percent change in index of industrial production (annual rate)	+4.3	−3.6	−10.4	−0.8	−1.1	−13.6	+7.2	+4.4
Business expenditure for plant and equipment (billions of 1958 dollars; annual rate)[1]	67.3	66.8	66.2	67.2	67.9	64.1	64.3	[2]66.5
Housing starts (thousands; annual rate)	1,429	1,357	1,252	1,286	1,512	1,768	1,813	1,951
Index of retail sales, adjusted for price increase (1967=100)[1]	102.49	102.06	101.90	102.24	103.43	101.01	104.59	107.02
Total civilian employment (thousands)	78,089	78,570	78,992	78,533	78,520	78,568	78,625	78,701
Rate of unemployment	3.6	3.6	4.2	4.8	5.2	5.9	5.9	6.0
Gap between potential and actual GNP (billions of 1970 dollars)	+4.9	+18.1	+36.0	+44.9	+52.8	+73.7	+66.2	+68.7

[1] Computed by the Joint Economic Committee staff from Department of Commerce, Department of Labor, and SEC data.
[2] Anticipated.

Many observers expect the growth of GNP to be less in the second half of this year than it was in the first. Production during the first half was boosted by the catch-up from last year's auto strike and by increased steel production as steel users built up their stocks in anticipation of a strike. Neither of these factors will be repeated in the second half.

Moreover, little strength can be found in other sectors of the private economy. Unless choked off by rising interest rates, the level of housing starts can be expected to remain fairly high during the second half (although still far below the housing goals set by Congress in 1968). However, no further large increase in the real level of residential construction can be expected. After adjustment for price increase, business expenditures for new plant and equipment are expected to decline slightly in the period ahead. Consumer behavior is always difficult to anticipate, but the latest surveys indicate that consumers remain cautious in their buying plans, suggesting that no surge of consumption expenditure is to be expected. The only real strength in the economy during the second half of this year would appear to lie in the government sector, primarily in the continued growth of State and local spending. Given present policies, Federal purchases of goods and services are expected to remain about level.

In light of these various factors in the outlook, growth of real output in the second half is not likely to be sufficient to achieve any significant reduction in unemployment. In short, the economy is still in a recession, in the sense that no progress toward restoring full employment is presently being made.

It should be stressed that the above assessment is based on the assumed continuation of present economic policies. Although the return to full employment cannot be immediate, it can be significantly accelerated by appropriate changes in government policy. In the remainder of this chapter, we outline what we believe to be appropriate fiscal and monetary policies to hasten the return to full employment. These policies should be accompanied by an active and comprehensive incomes policy to contain inflation. This aspect of policy is discussed in chapter II.

A Fiscal Policy To Hasten Full Employment

Federal tax receipts in fiscal 1971, the fiscal year just ended, were more than $25 billion below what they would have been if the economy had been at full employment. This shortfall in receipts more than accounts for the $23 billion deficit in the unified budget in fiscal 1971. Similarly, almost all of the expected deficit in the unified budget for fiscal 1972 will be the result of a revenue shortfall. Thus, despite the large deficits in the unified budget, neither the 1971 nor 1972 budgets should be regarded as particularly stimulative. If the economy had been at full employment, there would have been a small surplus in the unified budget for fiscal 1971. As presented by the Administration, the unified budget for fiscal 1972 also showed a small surplus at full employment. On a national income accounts basis, the basis commonly used for economic analysis, the budgets for both years showed somewhat larger full employment surpluses.

Since Congress has not yet completed action on the 1972 budget, it is not possible to say what the net change from the President's budget may be. Congressional actions such as the increase in social security benefits, the postponement of the social security tax base increase, and the Emergency Public Service Employment Program will add to the deficit. But, these increases could be partially or entirely offset by cuts in defense spending, by the elimination of the SST, and by other cuts in the President's budget recommendation.

In our view, the actions we recommend below can responsibly be accommodated in the 1972 and 1973 budgets. All of the tax and expenditure changes which we are recommending are temporary and designed to phase out as full employment is restored. We recognize that future demands on the budget will be very heavy relative to available resources. A program of economic stimulus which committed resources far into the future regardless of the level of employment would be short-sighted and ill-advised. None of our suggested measures would have this effect. None of them will damage our ability to responsibly finance vital Federal programs in the future.

Tax Policy

We recommend two changes on the tax side of the budget:

The reductions in personal income taxes presently scheduled to occur in 1972 and 1973 should be made retroactive to January 1971.

The increase in the social security tax base presently scheduled for January 1972 should be postponed until January 1973. The further increase in the tax base and the increase in the tax rate presently being considered by Congress as part of social security and welfare reform legislation (H.R. 1) should be instituted on a gradual basis, beginning no sooner that January 1973.

Our first recommendation, the speed-up of the personal income tax cuts already provided for under existing law, has been widely discussed. We regret that the Administration did not see fit to recommend this action earlier. We continue to hope that such a recommendation may yet be forthcoming. At this point, it would not appear that such an action could be made effective before the beginning of the fourth quarter of 1971. However, the tax cut could be made retroactive to last January, with part of the cut being realized through reduced tax withholding in the fourth quarter and the remainder through tax refunds in early 1972. Since the tax cuts we are discussing will take place in 1972 and 1973 anyway, a speed-up will have only a temporary impact on the budget. It will provide the economy with an immediate temporary boost at a time when this is clearly needed.

Our second recommendation, the postponement of social security tax increases, has been less widely discussed. The magnitude of scheduled and contemplated social security tax increases may not be generally recognized. An increase in the social security tax base from $7,800 to $9,000 is already scheduled for January 1972, as a result of action taken by Congress last spring postponing this tax increase from the January 1971 starting date originally recommended by the Administration. This Committee supported that postponement. January 1971 was not an appropriate time to raise taxes. The continued sluggish performance of the economy makes it highly probable that January 1972 will be an equally inappropriate time to raise taxes. Therefore we believe that this increase in the tax base should be postponed for an additional year.

The social security and welfare reform legislation presently being considered by Congress (H.R. 1) contains, as presently formulated, a further increase in the social security tax base from $9,000 to $10,200 and an increase in the social security tax rate from 10.4 to 10.8 percent, both scheduled to take effect in January 1972. Coupled with the tax base increase already legislated, these provisions would result in one of the largest social security tax increases in history and would exert a significant and most unfortunate restraining effect on the economy. Therefore, we believe that these further tax increases should be put into effect gradually, with none of them beginning any earlier than January 1973. The social security trust funds presently contain a large surplus. Even without the tax increases, this surplus will grow by some $7 to $8 billion in fiscal 1972. Thus, postponement of these tax increases does not present any danger of impairing the sound financing of the social security system. There was virtually unanimous agreement among our witnesses, however, that the whole system of Social Security taxation raises increasingly serious questions of equity and that major reform should be given high priority.

Expenditure Policy

We recommend three areas where Federal spending should be temporarily increased:

The level of expenditure for emergency public service employment should be increased to double the $1 billion for fiscal year 1972 and $1.25 billion for fiscal 1973 authorized by the recently enacted Emergency Employment Act.

At least $1 billion of the already appropriated funds for housing and urban development projects, presently impounded by the Administration, should be released immediately.

The Federal Government should adopt a system of grant payments to State and local governments to compensate such governments for the shortfall in their own tax revenues caused by high unemployment. The amount of such payments should be related to the unemployment rate, and such payments should cease when the unemployment rate no longer exceeds 4½ percent.[4]

In order to keep total expenditures within appropriate limits, some part of these recommended increases should be offset by reductions in other areas. The largest potential for expenditure reduction is in the defense area. As we have stated in the past, substantial cuts in defense expenditures can be achieved with no damage to our national security.[5]

All of the expenditure increases which we are recommending are of the type which should create a maximum number of employment opportunities per dollar of Federal expenditure.

The Emergency Public Service Employment program works directly to create additional jobs in State and local government. The enactment of this program by the Congress and its acceptance by the President represent an important forward step toward a full employment economy. But the amounts authorized under this program are small, relative both to the total number of unemployed and to State

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[4] Senator Bentsen reserves judgement on this recommendation, which he feels was not fully explored during the Committee's hearings.

[5] Senator Bentsen states: "While there is always room for greater efficiency in Federal spending, I cannot agree that substantial cuts in defense spending beyond those already recommended by the Senate Armed Services Committee are realistically possible at the present time without damage to our national security."

and local public service needs. A program at least double the presently authorized $1 billion for fiscal year 1972 and $1.25 billion for 1973 is clearly needed and would not be too large to be established quickly and administered efficiently.

Since this program is temporary and tied to the unemployment rate, with no further funds to be authorized once unemployment falls below 4½ percent, this program will phase out as full employment is restored. The Emergency Program does not, therefore, take the place of the comprehensive program of manpower training and public service employment, passed by Congress in the last session but vetoed by the President. Enactment of a comprehensive manpower program designed to meet longer-term structural employment problems rather than temporary cyclical needs continues to be a high priority task.

Every year some funds are appropriated by the Congress which the Executive Branch, for various reasons, impounds and does not allow to be spent. At the present time the cumulative total of such funds is about $12.1 billion. Since the Congress presently lacks an adequate procedure for determination of overall spending totals consistent with the needs of economic policy, it is important that the Administration have some discretion over the release of appropriated funds. Otherwise, budgetary control would be difficult indeed. However, at the present time, the total size of impounded funds is disturbingly large and, in our judgment, the Administration has in many cases shown poor judgment with respect to the best places to cut spending. We are particularly concerned that over $1 billion in funds for housing and community development remain impounded. We urge that these funds be released at once. These funds could be put to work quickly on projects that have already been planned. Jobs would be created and some of the desperately necessary work of community renewal presently being held up for want of funds could proceed.

The third of our expenditure proposals, a counter-cyclical payment to State and local governments, would go directly to the heart of one major element in the present State and local budget crisis. As mentioned earlier, the Federal Government is experiencing a revenue shortfall, due to high unemployment, at a rate of over $20 billion dollars per year. State and local governments are also experiencing a large revenue shortfall, perhaps in the neighborhood of $7 billion per year.

We feel that the Federal Government should assume responsibility for economic stabilization policy. When unemployment is high, States and localities should be compensated for the amount by which their own tax revenues (at existing tax rates) are below what they would be at full employment. Such a policy would allow States and localities to count on stable growth of their total revenues. They would not be forced to raise taxes at a time when this would exert undesirable restraint on the economy. Nor would they be forced to cut back on services at a time when public service needs increase—as, of course, they do during a recession.

The total amount of the counter-cyclical payments to be distributed should be based on the amount of excess unemployment. We suggest that such payments should begin whenever the national unemployment rate exceeds 4½ percent in any calendar quarter and should continue, with the amount varying with the excess of the unemployment rate over 4½ percent, until such time as unemployment has again fallen below 4½ percent for a quarter. The distribution of this total payment among States should be based on population, on the severity of unemployment within the State, and on the degree of dependence of each State on progressive taxes such as the personal income tax. This latter factor is important because progressive taxes are most sensitive to changes in the rate of personal income growth. Consequently those States with the most progressive tax systems are the most severely affected when unemployment rises.

The counter cyclical payment we are proposing would remove one major cause of current State and local budgetary problems. It would not by itself provide the complete solution to State and local financial problems. Another major problem is the poor distribution of income, and of tax resources, among and within States. This inequality of income distribution is not a cyclical problem, but a longer-term structural problem. It needs to be attacked by a major Federal effort to change the distribution of Federal aid programs so as to bring this distribution more in line with the distribution of need. The cyclical problem and the longer-term structural problem are different both in their cause and in their cure. We believe they must be attacked by two separate programs rather than by a single "cure all" such as the Administration's revenue sharing program. Unless the separate causes of State and local budget problems are understood, the cures will not be appropriate.

A Monetary Policy To Support Recovery

During the first half of 1971 the money supply increased at the unusually rapid rate of 10½ percent per year. Yet, since April interest rates have been rising. This combination is puzzling. More importantly, the rise in interest rates is disturbing, because it could choke off activity in the only two sectors of the economy that presently seem at all strong, residential construction and State and local government.

Several factors may help explain the rise in interest rates in the face of such monetary growth, although they are not complete explanations. First, business demands for credit have been heavy, as business has been striving to correct the very tight liquidity positions into which they were drawn during the tight money period of 1969 and early 1970. Second, inflation is a factor in interest rates. As long as there are expectations of inflation, interest rates will be higher than they would otherwise be. Third, several of our witnesses pointed to the difficult seasonal adjustment problem in the money supply estimates. It may well be that when the data are revised we will learn that the money supply has been growing somewhat less rapidly than the preliminary figures indicated.

The Joint Economic Committee has previously suggested that in normal times a rate of monetary growth somewhere between 2 and 6 percent per year is desirable, and we have requested that the Federal Reserve supply this Committee with an explanation whenever the rate of growth of the money supply departs from this range during any quarter. Past statements of the Committee's view have made it quite clear that we recognized there would at times be exceptionally difficult periods when it would be desirable for monetary growth to be outside our suggested range.

The present situation is certainly exceptionally difficult. In order to restore full employment the rate of growth of real output must for a time exceed the "potential" rate of growth of the economy. That is, real output must grow in excess of 4½ percent per year until full employment has been restored. The growth of the money supply must be adequate to accommodate this growth plus some increase in the price level. What the exact rate should be cannot be determined in advance, but it might well continue to exceed the range recommended by the Committee for normal times. In any event, it is essential that Federal Reserve policy be based on present needs and not on any effort to balance the very rapid monetary growth of the first half by very slow growth in the second.

An important objective of policy must be to arrest the present rising trend of interest rates, and, if possible, to reduce longer-term rates at least to the levels of the first quarter of this year. Some witnesses at our recent hearings expressed a concern that large increases in the money supply would lead to further inflation and therefore to higher rather than lower interest rates. We do not feel this has to be the case. As discussed in chapter II of this Report, many observers expect that given present policies, inflation will continue serious. But if the incomes policy recommendations we make in chapter II are adopted, we believe that a significant reduction in the rate of inflation can be achieved. Most importantly, expectations of future inflation—an important factor in interest rate determination—can be sharply dampened by an effective incomes policy. If this is done, fears of inflation need not deter the monetary authorities from adopting policies designed to produce lower interest rates. Certainly these policies should include adequate growth of the money supply.

During the remainder of this year monetary policy should be conducted in such a way as to prevent further increase in interest rates and to gradually reduce longer term rates at least to the levels which prevailed during the first quarter of the year.

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II. AN EFFECTIVE POLICY TO CONTROL INFLATION

Persistent Lack of Progress Against Inflation

The inflationary problem that has persisted during the past 3 years has proved much more stubborn than had generally been anticipated. When the present Administration took office the unemployment rate was 3.4 percent, and the inflation rate measured by the GNP deflator was 4.5 percent. At the time it was believed that excess demand could be eliminated and inflation checked without causing unemployment to rise much above 4 percent.

Experience has demonstrated that this estimate was far too optimistic. Unemployment has exceeded 4 percent for the past 18 months, and it has averaged about 6 percent for the past 8 months, yet the rate of inflation is not noticeably less today than it was in the first quarter of 1969. After 2½ years of a conscious effort to fight inflation by holding economic activity below the full employment level, the Chairman of the Council of Economic Advisers made the following progress report to this Committee at our midyear hearings:

> First, at a minimum the rate of price increase, which had been rising, has stopped rising.
>
> Second, some important measures indicate that there has been a significant decrease in the rate of inflation.
>
> Third, although the evidence is less clear on this, the rate of wage increase has probably also stopped rising.

We agree that during the first half of this year the rate of inflation was somewhat less than the peak rate reached in early 1970. We hope this improvement will continue. Unfortunately, examination of the major price indexes does not offer any evidence of a continued slowing of the rate of inflation. Table 2 shows, for each of the latest 8 months available, the percent increase in three principal price indexes compared to the same month one year earlier. It can be seen that the Consumer Price Index improved through April, but the sharp increases in May and June have reversed this trend: The Wholesale Price Index worsened steadily through June, then improved in July due to a sharp drop in farm prices. The important industrial component of the Wholesale Price Index showed no change in its rate of increase through June but accelerated sharply in July. From February through July wholesale industrial prices showed the sharpest 6-month rise since 1957.

TABLE 2.—SELECTED PRICE INDEXES

Percent increase during 12 months ending—	Consumer Price Index	Wholesale Price Index	Wholesale industrials
December 1970	5.5	2.3	3.6
January 1971	5.2	2.3	3.6
February	4.8	2.8	3.5
March	4.6	2.8	3.6
April	4.3	3.1	3.7
May	4.4	3.4	3.6
June	4.5	3.6	3.7
July	(1)	3.3	4.1

[1] Not available.

It is clear that the Council of Economic Advisers still regards inflation as a serious danger, for the Chairman also stated in his testimony:

> The Administration's rejection of a policy of further economic stimulation reflects the belief that we cannot temporize with the inflation problem * * *.

The Chairman of the Federal Reserve Board was even more pessimistic about the price outlook. He summarized the situation this way:

> I wish I could report that we are making substantial progress in dampening the inflationary spiral. I cannot do so. Neither the behavior of prices nor the pattern of wage increases as yet provides evidence of any significant moderation in the advance of costs and prices.

Many of the private witnesses who testified at our recent hearings expected that the rate of inflation would still be between 4 and 5 percent in mid-1972. Thus, despite the enormous costs we have paid in terms of output and employment, the rate of inflation is just about where it was 2½ years ago, and only modest improvement, at best, is anticipated during the next year.

The Need for a New Approach

Since a policy of reducing inflation by increasing unemployment has now been attempted for more than 2½ years—at such enormous cost and with such meager results—we are puzzled that the Administration continues to advocate more of the same. The Administration recommends no further action to increase employment because to take such action would, in the Administration's view, interfere with progress against inflation. The Joint Economic Committee emphatically rejects this "do nothing" approach. Other policies to control inflation are available. They should be tried.

> **The effort of the past 2½ years to control inflation by increasing unemployment has been a failure. Such an approach, by itself, offers no hope of success in a modern economy characterized by large areas of monopoly and imperfect competition. Monetary and fiscal policy should be conducted in a way that quickly restores and then consistently maintains a full employment level of economic activity. Simultaneously, inflationary psychology must be broken and price increases brought under control by the immediate adoption of a vigorous and comprehensive incomes policy.**

An Incomes Policy Is Essential

The Administration has candidly admitted their concern over the danger of continued inflation. Both official and private witnesses have especially stressed the role of inflationary expectations in driving up interest rates, discouraging business investment, and weakening consumer confidence. Yet the Administration continues adamant in its refusal to adopt the one policy approach which, in our judgement, would dampen inflationary expectations and create an atmosphere in which full employment could be restored without creating new inflationary pressures.

In a modern full employment economy reasonable price stability can be consistently maintained only if the Government assumes responsibility for specifying the rates of price and wage increase that are in the public interest and for insuring that these rates are not exceeded. We do not believe that compliance with such a policy will necessarily require legal compulsion. That is, we do not believe compulsory wage and price controls are necessary. If price and income guideposts are applied fairly and on a comprehensive basis, labor and management will cooperate. An informed public opinion will exert a powerful influence to help achieve compliance. In addition, the Government, through its important role in the economy as a regulator and as a purchaser of goods and services, has a great deal of existing power to encourage compliance.

We do not mean to imply that there will be no difficulties in establishing a comprehensive incomes policy or that results will always be perfect. Of course there will be mistakes and setbacks. It may be many years before we fully succeed in combining price stability and full employment. But the Nation will be much better off with an incomes policy than without one. Such a policy can make an immediate, significant contribution.

We are fully aware that one can easily find historical cases where incomes policy has not worked. The historical record in this country and abroad is valuable. We should study it carefully and attempt to learn from past mistakes. We stress that one can find successes as well as failures. Guideposts served this country well in the early 1960's. They should not have been abandoned in 1967. The country has paid dearly for their abandonment and for the failure of two successive administrations to reinstate them.

In short, we reject the Administration's contention that incomes policies "won't work." It is the policies presently being followed which are a failure. Monetary and fiscal policy, unaided by incomes policy, cannot come to grips with inflation. Effective incomes policies can and must be established. The alternative is to abandon our goal of combining full employment with reasonable price stability. Obviously that alternative is not acceptable.

As we have repeatedly recommended, specific quantitative price and income guideposts should be established, and a board should be created to collect and publicize price and income data and to administer the guideposts. This should be done without further delay.[1]

[1] Senator Humphrey states: "An independent anti-inflationary price and wage board should be created to set guideposts. We should call this board exactly what it is: The Anti-Inflation Board. This board should not only publicize price, wage, and profit increases that are inflationary, but should, when necessary, recommend to the President the imposition of selective freezes on profits and wages in particular industries or sectors."

If, in the President's judgment, a temporary price-wage freeze would facilitate the introduction of a comprehensive guidepost policy, Congress has given the President clear authority to impose such a freeze.

Much valuable time has already been lost. As the Chairman of the Federal Reserve Board told this Committee:

> * * * I think a wage and price review board, had it been instituted a year or two ago, would have been more effective than it is likely to be today * * * but I will still try it. I think the effort is worth making. Then, we know where we stand.

As a result of this delay in establishing an effective incomes policy, an important lesson has been learned. There is now widespread recognition that incomes policy must be a regular part of overall economic policy. Business, labor and the public are ready to support such a policy because they recognize its necessity. There should be no further delay.

SUPPLEMENTAL VIEWS OF VICE CHAIRMAN PATMAN

Because of my duties as Chairman of the House Banking and Currency and Defense Production Committees, I have been unable to attend the Midyear Review hearings. I am, however, in complete agreement with the findings of the review and, in an overall sense, I endorse its recommendations to reduce unemployment and dampen inflation.

The need for decisive action along these lines recommended in the review is of critical importance. In my estimation, the Nation is much closer to a depression than it is to achieving a full employment economy and significantly reducing inflation.

The suggestion that the Federal Government adopt a system of grant payments to State and local governments to compensate for lost tax revenues during periods of high unemployment obviously raises questions regarding implementation. Are such compensation payments to be on a no-strings-attached basis? If not, what requirements will be imposed on the expenditure of grant money by State and local governments? Should a system of priority investment areas be established? The questions do not reflect a negative attitude toward compensating grants. Rather, they are being stated to indicate the need for thorough study of the entire concept as it goes to the responsibility of Congress and the Administration regarding expenditure of such funds.

Doubling the level of expenditures for emergency public service employment and immediate release of impounded housing and urban development funds, as recommended in the review, constitute effective ways of providing short-range economic improvements. At the very least, these recommendations should be immediately executed. At the same time it should be recognized that long-range approaches to unemployment and the lack of adequate funds at reasonable cost for priority areas of the economy should be devised. Compensating grants may be one approach. Creation of a national financial institution to serve such priority areas as public works and facilities, location of new industry and business and improvement of existing business and industry to provide job training and employment opportunities in chronically depressed urban and rural areas, and the funding of low and moderate income housing can be another method of helping to provide vital financial resources for these sectors, which are the constant victim of cyclical downturns in the economy.

It is my conviction that such a vehicle—a National Development Bank—must be established to serve as a source of credit for public works and facilities, small and medium size businesses and industries and to produce low and moderate income housing when loans for such purposes are not available from conventional lending institutions or are being made available at unreasonable interest rates. Certainly the Nation's economic history of the past 3½ years had dramatized the necessity for a Development Bank which could provide credit at reasonable cost through direct loans for both the public and private sectors.

The need for a Development Bank is constant, regardless of whether we achieve a full employment economy on a national basis or not. With or without a full employment economy, depressed urban and rural areas will continue to exist and require special effort. For the most part, the private financial industry has failed to meet the requirements of such areas and, without a new mechanism to provide incentive, they will not make an effective commitment to this problem in the future.

Despite improved market conditions, State and local governments continue to face the prospect of finding themselves virtually unable to sell their bonds because the yields are not high enough to be competitive under tight money-high interest rate conditions. Moreover, the penalty imposed by high interest-tight money conditions is one that will be shouldered by generations of taxpayers. For example, a 20-year, $2 million bond issue carrying an interest rate of 5 percent will have a total cost of $3.1 million. But a bond issue of the same size and maturity carrying an 8 percent interest rate, which was paid during the tight money period of 1969–70, will have a total cost of more than $4 million—more than double the funds actually raised for investment in public works and facilities.

The need for a National Development Bank is apparent despite lower interest rates and increased availability of funds. As the Midyear Review points out, unemployment remains at an intolerable level and there is no end in sight for the prevailing inflation. Every reasonable effort must be made to create and sustain employment and job training opportunities, especially in those areas in which the rate of joblessness far exceeds the present national level of 6 percent. In some of these areas, like Seattle and Southern California, the problem is characterized by large numbers of jobless engineers and technicians. Utilization of the National Development Bank resources to provide industrial capital in such areas could serve not only to create employment opportunities but technological innovations and diversification of industry as well. In this way, new product areas can be explored and the economic base of these communities can be significantly moved toward stabilization.

Finally, the existence of a National Development Bank can be a permanent bulwark protecting the Nation's low and moderate income housing market. Full recognition should be given to the current high rate of new housing starts. But it should also be recognized that mortgage interest rates have begun to climb back toward the high levels that recently all but crippled the housing industry. If the rate continues to climb, hundreds of thousands of families will find themselves unable to purchase homes. Again, a National Development Bank would stand ready to provide mortgage funds both for the construction of new housing and permanent mortgage financing of new and existing housing for low and moderate income families.

Despite all of its great potential, our free private enterprise system is an imperfect structure which often fails to reach into areas of greatest need. Methods to overcome this fault without damaging the system itself must be adopted.

To a large extent, the National Development Bank concept outlined here resembles the Reconstruction Finance Corporation which played a highly significant role in sustaining the Nation's economy by providing credit at reasonable cost when it was not available from conventional lending institutions. Since the RFC was repealed in 1953, businesses and industries have had to rely far more heavily, if not entirely, on commercial banks to obtain loan funds necessary to remain competitive and otherwise continue operations. Invariably, dependence on large commercial banks, especially the large New York City banks which do not compete with each other in any meaningful way, has made business and industrial entities the victims of exorbitant, usurious interest rates during tight money-high interest rate periods. The devices utilized by large commercial banks to obtain totally unfair profits include demands for unconscionable yields on tax exempt State and municipal bonds. As indicated above, this has frequently resulted in school districts paying the price of two schools in order to finance only one. The cost of such practices ultimately falls on the taxpayer and the consumer.

SUPPLEMENTAL VIEWS OF REPRESENTATIVE REUSS

I heartily agree with the Committee's stress in this report on the need for immediate adoption of a vigorous and comprehensive incomes policy to break the present inflationary psychology that is driving up prices and wages at an inordinately rapid rate despite an unemployment rate which has averaged 6 percent this year. But, I am convinced that it is too late for a mere voluntary or "jaw-boning" approach to work effectively. Imbalances between the various wage rates and prices are now so extensive, and accumulated pressure on business managers and union leaders so strong, that only compulsory guidelines having the force of law can break the spiral of inflationary expectations at this time.

The President should immediately make use of the authority delegated to him by the Congress a year ago to freeze all wages and prices, and to set up a regulatory agency to carry this out.

Such firm action will not only bring a halt to inflation, it will also permit expansion in the dollar volume of demand for goods and services to express itself in real output and employment, rather than in further inflation. It will bring about fuller employment and production in three ways:

1. As I pointed out in the Committee hearings, one of the impediments toward a rapid expansion of output and employment in the economy is the extraordinarily high level of interest rates. These high interest rates reflect to a substantial degree inflationary expectations. A wage and price freeze, by leveling off inflation and killing expectations of further inflation will produce lower interest rates. This will mean more home building, more demand for furnishings for those homes, and more demand for other goods and services where the demand is stimulated by lower interest rates.

2. A large factor responsible for the 6 percent unemployment rate for the past 6 months has been weakness in consumer demand and a high savings rate. I am convinced that stablizing prices will instill consumer confidence, leading to additional consumer purchases and a reduction in the high rate of savings that consumers have maintained over the last year and a half.

3. Stopping inflation will also lead to a higher real level of business investment. During his testimony on June 30, Dr. Arthur F. Burns, Chairman of the Board of Governors of the Federal Reserve System, agreed with the above two points, and added a third:

> You spoke of an enhancement of the confidence of consumers. I think that an incomes policy would also serve to enhance the confidence of businessmen and financiers.

> A typical businessman these days, as he looks to the future, sees wage costs rising and rising sharply. He anticipates that higher price as well on his products. But he is fearful that he will be unable to raise prices as much as his wage costs go up.
>
> A typical businessman these days knows that his profit margins are low; in fact, they are almost at the lowest point that they have been at since the end of World War II. He fears a further shrinkage in those profit margins.
>
> Fearing inflation, he is hesitant about making those long-term capital investments on which this country's economic growth is going to depend very heavily.
>
> In this expansion, business capital expansion, business capital investment has lagged. In real terms, it has actually gone down, whereas typically business capital investment is the driving force of economic recovery. Therefore, to conclude, I accept your analysis, Mr. Reuss. But, I also add the confidence factor as far as the business community is concerned.

If the President will proceed vigorously and at once to use the powers he now has to stabilize prices and wages, I am convinced we can begin to move toward full employment without inflation. We would then, within a year, begin to decontrol without the danger of renewed inflation.

It is too early to provide further stimulation to the economy by additional fiscal and monetary measures. Until we have tried stabilizing wages and prices, accompanied by programs of residual public services employment, we will not need additional stimulus.

The January Budget suggested a full employment budget that was approximately balanced. Since that time, according to Dr. Paul McCracken, Chairman of the Council of Economic Advisers, the Budget has been shifted towards a deficit by approximately $7 billion. Actions taken since January have reduced revenues by almost $2 billion and increased outlays for fiscal year 1972 by about $3 billion. Further increases in uncontrollable outlays for public assistance, medicaid, veterans benefits and farm price supports will apparently add almost $2 billion to what had been anticipated. Meanwhile revenues will fall far short of the original estimate, with the result that the deficit for the current fiscal year is now estimated at about $23 billion, a large figure.

In addition to the budget stimulus, the money supply has been increasing at a rate averaging about 11 percent over the first half of this year. It is widely argued that this rate of increase should be reduced.

Under these circumstances, I think it advisable to postpone further monetary and fiscal stimulus until a trial of an incomes policy with teeth produces evidence of its effectiveness. If stabilizing prices and wages produces the needed recovery to full employment, then we will not need further fiscal and monetary stimulus. If a strong and well-enforced incomes policy does not produce the necessary results, then we shall have to review the situation again, to see what monetary and fiscal measures may be appropriate.

MINORITY VIEWS ON THE 1971 MIDYEAR REVIEW OF THE ECONOMY

VIEWS OF REPRESENTATIVE WIDNALL, SENATOR PERCY, REPRESENTATIVE CONABLE, AND REPRESENTATIVE BROWN

The U.S. economy is recovering. Total output has risen since its low point at the end of last year and the rate of unemployment has declined. At the same time the rate of inflation has stopped rising and shows signs of declining.

In the evidence presented to us there was general agreement that the economy would continue to recover, with output and employment rising further. The recent strength of retail sales, the high level of housing starts, the rapid increase of State and local expenditures, the expensiveness of the Federal budget and the large increase in the money supply during the past year all point in this direction. On the inflation side the prospects are less certain. There is little reason to think that the inflation rate will start rising again, if we follow reasonable policy, but opinion is more divided about how confidently we can expect a significant slowdown in the rate of inflation.

We want to emphasize that early in the current administration government policy was designed to stop the acceleration of the inflation, keep the slowdown moderate and initiate a steady, non-inflationary recovery and it had those results. That fiscal and monetary restraint was continued through 1969 in the face of skepticism and opposition. Both fiscal and monetary policy turned from restraint to support around the beginning of 1970, before the slowdown had proceeded very far. In the middle of 1970 the Administration announced its policy of keeping expenditures within the revenues that would be yielded at full employment. This policy had the merit of avoiding the depressing effects of trying to balance the budget by cutting expenditures or raising taxes when the economy was below par. Of course, it implied actual deficits under existing circumstances, deficits which would be an appropriate part of a program to keep the slowdown moderate.

Fiscal and monetary policy have both become more expansive than was contemplated in the Administration's policy at the beginning of this year. Deferral of Social Security rate increases and other charges of taxes have reduced by $2 billion the expected revenue in fiscal 1972. At the same time various legislative actions and growth of some existing programs have increased expected outlays by about $5 billion. Also, whereas there had been a common expectation that the money stock might rise at an annual rate of about 6 percent during 1971 the actual rate of increase in the first seven months was about 10.5 percent. These policies of expansiveness contribute to our confidence that the economy will continue rising through 1971 and 1972.

The issue of current economic policy is often discussed as if the question were whether policy should be expansive or not. This, of course, is not in controversy. We now have an expansive fiscal and monetary policy. The question is how expansive that policy should be. The answer to that question is not "more," despite the fact that unemployment is now higher than anyone would like.

We currently have a two-sided problem in the current economy. We have the remains of the inflation problem left over from the irresponsible policy of 1965–68 along with the unemployment that has come and was inevitable when it became necessary to curb the runaway inflation resulting from that ill-advised policy. If we now neglect the inflation side of our problem we will throw away the gains that have been achieved in the past 2 years and will invite a renewed burst of rising inflation. One has only to look at foreign experience, for example in the United Kingdom, to see the heights to which inflation can soar if all questions of economic policy are resolved on the side of more expansion.

The necessary course today is to try to bring about as rapid expansion of the economy as is consistent with reasonable confidence that the rate of inflation will decline. This is the objective of the Administration. Although no one can be sure of the precise combination of policies that will yield this objective, we see no reason to think that the policies now under way are inadequately expansive. After 7 months in which the money supply grew at a rate of 10.5 percent, after a fiscal year in which the actual deficit was $23 billion and entering a fiscal year when there will be a deficit of several billion dollars even on a full employment basis—to ask for more expansionism is reckless. Expansive policies do not operate instantaneously. If we persist in piling expansive measures on top of expansive measures as long as the economy is below par we will surely have a great inflationary blow-off when all these measures begin to work.

Our first and basic recommendation is that Congress should exercise self-restraint and discipline about its appropriations and the budget. We are in circumstances where every member of Congress can tout every increase in expenditures and every reduction in taxes he has always wanted as a measure to promote economic expansion and full employment. If we all do this the result will be chaos—not only galloping inflation but also growth of the already massive Federal debt to unbearable size.

Congress should stay within the President's budget for fiscal year 1972 as revised by actions already taken and reestimates already made of the costs of ongoing programs. Even this budget will result in a deficit of several billion dollars at full employment. We should not allow the deficit to go beyond that. If Congress decides to increase some programs beyond the budget it should also decide to reduce others.

Second, we commend the intention of the Federal Reserve to slow down monetary expansion from the rate of the early part of this year. We recognize that the rapid expansion in early 1971 compensated for slower growth in late 1970, which resulted in an average 1970 rate of about 8 percent rather than the 10.5 percent rate so far this year. But we observe no disagreement with the proposition that a reduction from the 10.5 percent rate is necessary.

We believe that the recommendation of the majority that monetary policy should be so managed as to reduce long-term interest rates at least to the levels of January–February 1971 is extremely dangerous.

The recommendation implies that there is a policy of monetary expansion which will achieve this result. Yet it is important to note that the recent rise of long-term interest rates occurred during a time of extremely rapid monetary expansion. In fact the monetary expansion may have accelerated the rise of interest by intensifying inflationary expectations. If this is the case the only route back to lower interest rates is a policy of fiscal and monetary restraint which will generate confidence in the restoration of price stability.

Even if a specific monetary policy could produce a certain interest rate objective, to commit monetary policy to that limited purpose would be to prevent its use for the more important ambition of achieving an orderly, noninflationary expansion. Surely the basic lesson of experience during the period of bond price supports from 1945 to 1951 was that monetary policy could not simultaneously serve a fixed interest rate objective and an economic stabilization objective. This Committee thoroughly analyzed that problem at the time. It would be a great irony if we should be the agent for putting monetary policy into that straitjacket again.

Proponents of more expansive policy commonly try to escape from the inflationary implications of these programs by recommending what they call an "effective" incomes policy. There are two important things to be said about that:

1. The most that can be claimed for incomes policy is that it *may* help to slow down the rate of price and wage increases when there is not a strong inflationary pressure. It will not withstand inflationary demand pressure. The untested (or, rather, frequently and unsuccessfully tested) possibilities of an incomes policy are not a justification for pumping up demand and should not be passed off as such. *If* we have an incomes policy, and *if* it proves effective in reducing inflation, we can then consider its implications for the desirable rate of expansion.

2. While many members of Congress, including the majority of this Committee, and many other people, have recommended an incomes policy there have been no extensive hearings on the subject in Congress and no one has tried to answer specifically the operational questions that are critical for the workability and effectiveness of an "incomes policy." The public is continuously bombarded by suggestions that there is an easy but undescribed way out of our difficulties, but the public cannot judge the validity of these suggestions without more information about what is intended. If "incomes policy" is to be more than a political stick with which to beat responsible officials, Congress needs to make a serious effort to discover whether the ingredients of a policy can be specified which will be effective and command the support of the public and the Congress.

Therefore we recommend that an appropriate legislative committee initiate a study and hearings as background for considering the drafting of legislation. The subject should not be "Is Inflation Bad?" or "Is an Undefined Incomes Policy Good," but "How Would an Incomes Policy Be Managed?" Among the questions to be considered are:

1. Should there be a board representative of interest groups or a public-only board?

2. Should the policy cover only prices and wages or also interest, rents, profits, dividends, professional fees, taxes, etc.?

3. Should notification of any income change be required before it is made, or only after?

4. Should notification be required from everyone or only for cases exceeding a specified size?

5. Is positive approval required or only the absence of disapproval?

6. What would be the criteria for approving wage increases? Would previously negotiated deferred increases automatically be approved? Would increases be allowed to catch-up with past cost-of-living increases, past productivity increases, past increases of comparable wages, etc.?

7. What would be the criteria for price increases? Would there be a profits standard? What would it be?

8. Would there be penalties if prices, wages or other incomes were raised after disapproval? What would they be?

These questions are not raised as intellectual conundrums. Upon the answers to these questions, and others like them, will depend the workability of an incomes policy. Let us now make a serious effort to discover whether there are satisfactory answers to them. When we have done this we shall all know much better how to proceed.

VIEWS OF SENATOR JAVITS

Stripped of their rhetoric, the Majority Views recommend measures to stimulate the economy while holding down inflationary price and wage increases. On the other hand, my Republican colleagues caution against piling so many expansive measures on top of one another while pointing out—quite legitimately—the economic policy gains which have already been made by the Administration.

My differences with both sets of views are basically differences of priority. I believe the chief aim of economic policy at this crucial time must be to build up confidence in the recovery which may well be already underway while ensuring that our hard won gains on the inflation front do not erode and that the force and quality of the recovery are adequate to the needs of our nation. Econometric analysis and common sense as well as eminent testimony tell us that a restoration of confidence would be the single most beneficial factor in bringing the economy back to its proper growth rate.

To bring about these goals we must embark immediately upon a new and effective incomes policy. Such a policy would not only help build up our progress against inflation, but also bring a new confidence into business and consumer decisions that their spending plans will not be frustrated by inordinate price increases.

Recently I joined with twelve other Republican Senators in proposing a National Commission on Wages and Prices, which would establish the guidelines for noninflationary price and wage behavior. Our proposal was constructive, and I note that the President has welcomed Congressional debate on the issue. I believe the establishment of such a commission—with the power to publicize, to require advance notice of price increases, and to recommend further actions—is an essential first order of business for restoring confidence and controlling inflation.

The second major economic initiative which needs to be taken at the present time concerns productivity improvement. America's productivity in the past two years has been the worst of our entire postwar history, and our recent productivity figures compare unfavorably with every other industrial country. This performance shows up in many ways, being heavily responsible for the inflationary situation at home, for the noncompetitiveness of many American products abroad and for the rapid growth of certain imports.

Indeed, our productivity experience is both a symptom and a cause of an erosion of worker morale in our country. Conversely, experience during World War II has shown us that a major drive to improve productivity can have a major influence on increasing productivity and invoking patriotism.

The United States needs such a major drive now. At a minimum we must strenghthen the President's Commission on Productivity and encourage a nationwide system of factory level productivity councils such as we had during World War II. Considering the price we have had to pay for declining productivity, we cannot afford to do less than place productivity improvement on the highest levels of economic policy priorities.

It is my strong feeling that the two measures I have described are essential if a better balance is to be brought to our troubled national economy and if the spirit of the American people is to be renewed.

VIEWS OF SENATOR MILLER AND REPRESENTATIVE BLACKBURN

The Economy in Perspective

All of us share the concern over unemployment and inflation. However, there are different ways of looking at these problems. One is the pessimistic way—looking at the unfavorable indicators, overlooking the favorable indicators, and neglecting to put these problems in perspective with previous recessions when the unemployment peak was considerably worse and when it was not aggravated by large cutbacks in defense and space contracts and a reduction of 1,200,000 in the armed services. Even worse, perhaps, is to draw hasty conclusions from short-term statistics and to engage in premature action which would lead to a short-term gain and a long-term disaster.

Another way is the realistic way—balancing the favorable indicators against the unfavorable ones, putting the problems in perspective, understanding that a "steady as you go" (to quote economist Milton Friedman) improvement in the economy is better for our society than a jerky up-and-down performance, and recognizing that those in control of the Congress have far more to say about fiscal policy than the Executive Branch of our government. The following observations take this approach.

The Deficit

Early this year, during the testimony on the President's "full employment" budget deficit, I secured agreement from both the Chairman of the Council of Economic Advisers and the Chairman of the Federal Reserve Board that their projections rested on certain assumptions. One of these was that those in control of the Congress would adhere to the Administration's budget spending limits or, if they exceeded them, they would pass tax increases to offset the increased spending. To date, the budget spending limits have been exceeded by $5 billion, and there has been a shortfall in revenue estimates of $2 billion. This would raise the deficit estimated by the budget from $11.6 billion to $18.6 billion—and there are several large appropriations bills yet to be enacted—with indications that these will further exceed the budget spending limits. But there has been little talk in the Congress about tax increases to offset the increased spending; and, instead, some Members are talking about tax cuts. All of which, I fear, will impede efforts to solve the inflation problem.

Inflation

Another assumption was that there would be reasonable stability on the domestic scene—for example, no major strikes such as the auto industry strike of last fall. This assumption hasn't been borne out very well. Also, there have been a number of wage settlements which have considerably exceeded productivity increases. Resulting price increases tend to make our domestic goods more vulnerable to imports and less competitive in overseas markets. Our once favorable trade balance now shows a deficit. The "inflation factor" is again receiving more weight in the determinition of interest rates.

Although the inflation rate for the first 6 months of 1971 was down to an average annual rate of 4.1 percent compared to 5.3 percent for 1970 and 6 percent for the fiscal year July 1, 1969, to June 30, 1970, progress is slower than many of us had hoped for. Recent increases in the wholesale price index (which usually are reflected in the retail price index later on) suggest that we will continue to have an inflation problem for some time—granted that it is continuing to subside. (Some key government economists say that the inflation rate would be around 10 percent had not certain restrictive policies been adopted 2 years ago!)

Unemployment

The national unemployment rate has dropped from a high of 6.2 percent to 5.8 percent but there is some question whether this lower rate can be sustained for the next few months. Peak unemployment during the most recent recessions of 1949, 1954, 1958, and 1961 *averaged* 6.9 percent and these occurred without the heavy impact of cutbacks in defense and space contracts and a 1,200,000 reduction in the armed services which have been responsible for much of the present problem. For example, if the reduction in the armed services had not taken place, our unemployment rate would be 4.2 percent instead of 5.8 percent.

No one should minimize the undesirability of a situation where there are people able and willing to work but who can't find jobs. However, unlike previous recessions, a large proportion of those presently unemployed represents individuals who are *not* the main earner in a family. Among married men, the peak unemployment rate was 3.4 percent (within the high of 6.2 percent), and the current rate as 3.1 percent (within the current 5.8 percent).

The Pluses

The overall job total in the Nation has not exactly been standing still. There are 78.5 million people working today (total personal income $855 billion) compared to 78.3 million (total personal income $804 billion) a year ago, and 77.7 million (total personal income $741 billion) 2 years ago. Personal savings are at an all-time high. The gross national product increased by $32 billion in the first quarter of this year (an 8 percent *real* dollar increase over the previous quarter) and by $20 billion in the second quarter (a 3.7 percent *real* dollar increase). The large first quarter resulted considerably from the "catch up" following the auto industry strike. Retail sales have been strong, and, since there has been little expansion of inventories, rebuilding of inventories is expected. Housing starts are going to push near the 2 million mark for the year. In short, the economy is moving along well enough to prompt this statement from one of the Nation's leading economists, Leif Olsen (Reader's Digest, August 1971): "* * * it seems to me that all the indicators point in one direction: toward moderating inflation, lessening unemployment, and a steadily growing economy."

"Incomes Policy"

There has been considerable confusion over what is meant by an "incomes policy." Chairman Arthur Burns of the Federal Reserve Board, in his testimony before the Joint Economic Committee, advocated a wage and price review board which would have no enforcement powers, but could initiate inquiries into specific wage adjustments or into specific price adjustments and would evolve guidelines for wages and prices. This suggestion does not appear to differ essentially from the wage-price guideposts of the Johnson Administration which failed simply because both labor and management refused to adhere to them.

Conclusion

The hearings record before the Committee makes it clear that the Administration's policy is to seek a simultaneous, continued lowering of *both* the unemployment rate and the inflation rate. It does not wish to over-emphasize one problem at the cost of aggravating the other, because it recognizes that the two are inextricably intertwined—certainly over the long run.

This policy is working. The concern is over the fact that everyone wants to see it work faster. As former Secretary of the Treasury David Kennedy so well observed: "We are paying for our past sins." and the price is painful. Compared to previous recessions, this recovery has, in fact, been more rapid. Therefore, I think we should be patient for a few more months before reaching conclusions and making decisions that deviate materially from the course we are following. Needless to say, cooperation from those in control of the Congress will be vital.

VIEWS OF SENATOR PEARSON

An incomes policy, including comprehensive wage and price guideposts, would, at this stage of the game, serve primarily as a signal to business that prices must be held down. The major wage contracts have been settled—steel, copper, railroads, construction—with awesome implications for creating a wave of inflationary pressures. But this is a fact of life. We cannot improve the situation by taking the attitude that the government's role has been played out in this area. In most cases, industry has moved quickly to recoup its wage position by announcing price increases, as in the case of steel recently. Now is the time in my opinion for a strong step on the part of government to create the machinery that can halt the spiral of wage/price increases.

Profits during the first two quarters of this year have been strong and certainly there is little question that if we intend to stabilize economic expansion, the government must take a position of reasonable intervention into the present cycle of events. I am inclined to believe that mandatory wage and price controls, instituted for a limited period of time, would have a good effect if begun within the next six weeks.

While this proposal is directed towards the struggle against inflation and its burden on those who have a source of income, however limited or fixed, we must also consider those who have no job at all. In the city of Wichita, Kansas, for instance, unemployment has reached 11.8% after hovering at the 10% level for almost a year. Yet when one visits the city, he sees that signs of economic disaster are simply not there yet. People are hanging on. They are hoping for a better turn. I think the confidence of these people in the future of the American economy could be greatly increased by federal job-creating programs directed towards areas of high unemployment. This is just what the Emergency Employment Act would do, and I think the recommendation for increased authorizations under that act is a good one.

Of course, the real question now is how much we can appropriate. But even with an enormous effort to create public service jobs, we have to recognize that government programs simply cannot be expanded enough to employ all the jobless in any area.

The President has rejected the idea of economic stimulus through the construction industry. I agree. The inflationary impact would be devastating. But the man without a job in a city like Wichita or Seattle or Bridgeport or Boston or Los Angeles is waiting for his government to respond to his problem, and he knows there are resources enough in the nation to help him. He is no different in that regard from the black or Mexican American who lives below what we glibly call the "poverty line."

I have introduced legislation to develop a program of economic transition from wartime to peacetime, and I look on this as the basic challenge facing our national policy. But in order to have the time we apparently need to make this transition, the Congress needs to look carefully at legislation to attack unemployment where it is concentrated—through the private as well as the public sector. As an advocate of tax incentives for the development of jobs in rural areas, I would have no problem with proposals using this method. Admittedly, we would be working in an area where little experience is readily available, but I think the unemployed aircraft worker in Wichita, Kansas, would welcome an opportunity to test out this course of action. It is one which the Congress could initiate and carry forth through legislation and the appropriations process, and it would not reduce the Presidential prerogatives to use fiscal and monetary policies for the benefit of the national economy as a whole.

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