THE 1967 ECONOMIC REPORT OF THE PRESIDENT

HEARINGS

BEFORE THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

NINETIETH CONGRESS

FIRST SESSION

FEBRUARY 7, 8, AND 9, 1967

PART 2

Printed for the use of the Joint Economic Committee

U.S. GOVERNMENT PRINTING OFFICE

75-314 WASHINGTON : 1967

For sale by the Superintendent of Documents, U.S. Government Printing Office
Washington, D.C. 20402 - Price 65 cents

JOINT ECONOMIC COMMITTEE

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

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

SENATE	HOUSE OF REPRESENTATIVES
JOHN SPARKMAN, Alabama	RICHARD BOLLING, Missouri
J. W. FULBRIGHT, Arkansas	HALE BOGGS, Louisiana
HERMAN E. TALMADGE, Georgia	HENRY S. REUSS, Wisconsin
STUART SYMINGTON, Missouri	MARTHA W. GRIFFITHS, Michigan
ABRAHAM RIBICOFF, Connecticut	WILLIAM S. MOORHEAD, Pennsylvania
JACOB K. JAVITS, New York	THOMAS B. CURTIS, Missouri
JACK MILLER, Iowa	WILLIAM B. WIDNALL, New Jersey
LEN B. JORDAN, Idaho	DONALD RUMSFELD, Illinois
CHARLES H. PERCY, Illinois	W. E. BROCK 3D, Tennessee

JOHN R. STARK, *Executive Director*
JAMES W. KNOWLES, *Director of Research*

ECONOMISTS

WILLIAM H. MOORE
JOHN B. HENDERSON
GEORGE R. IDEN
DANIEL J. EDWARDS

DONALD A. WEBSTER (Minority)

CONTENTS

STATEMENTS

February 7, 1967

February 8, 1967

February 9, 1967

EXHIBITS AND ADDITIONAL INFORMATION

CHARTS

DEPARTMENT OF LABOR

DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE

FEDERAL RESERVE SYSTEM

DEPARTMENT OF COMMERCE

TABLES

DEPARTMENT OF LABOR

DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE

DEPARTMENT OF COMMERCE

THE 1967 ECONOMIC REPORT OF THE PRESIDENT

TUESDAY, FEBRUARY 7, 1967

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

The joint committee met at 2 p.m., pursuant to recess, in room S-228, the Capitol, Hon. William Proxmire (chairman of the joint committee) presiding.

Present: Senators Proxmire, Ribicoff, Javits, Symington, Miller, and Percy; and Representatives Reuss, Griffiths, Moorhead, Curtis, Widnall, Rumsfeld, and Scheuer (visitor).

Also present: John R. Stark, executive director, James W. Knowles, director of research, and Donald A. Webster, minority economist.

Chairman PROXMIRE. The committee will come to order.

We expect to vote in the Senate in 5 or 10 minutes and Senator Javits and I will have to leave. Before we do, however, I believe Senator Javits would like to make a statement. Senator Javits?

Senator JAVITS. I would like to make my statement now because it is not directed to this particular Secretary who is to be our witness today, but to the Secretary of the Treasury, who testified yesterday. Mr. Chairman, I rise to a point of personal privilege in this matter. The outburst of the Secretary of the Treasury yesterday with respect to me personally was both intemperate and injudicious and not warranted by the facts which were clearly before him.

He apparently needed a scapegoat for what I considered to be a serious mistake in administration policy and he chose me. I am honored because it was a serious mistake and I repeat it.

Now, Mr. Chairman, what apparently aroused the Secretary's ire is that as the senior Republican present in the absence of my beloved colleague, Congressman Curtis, I read the unanimous statement of the minority taking exception to various policy decisions which had been made by the administration in the preceding year and the word used by the Secretary quite gratuitously was to challenge my qualifications to speak "purportedly" for the minority. This is baseless and untrue. The minority statement is before the Secretary, it is unanimous. Indeed it has been unanimous, Mr. Chairman, for the last 5 years. It was unanimous in 1966. I joined them in it then and it had been unanimous for some years before. I read it because of the absence of Congressman Curtis. I hardly think that any other appellation but intemperate can be applied to an attack which he made from the theory that I "purported" to represent the minority when I read its unanimous statement, as it was my duty to do.

I was the senior Republican present. I am sorry about this incident. Secretary Fowler, I thought, has been a friend of mine for many years and I really deplored, terribly, this outburst. I will forgive him, but I see no excuse for it and it did not help his case.

Now, as to the merits—as long as he did challenge me—the fact is that I have stood with the minority on this committee for years and perhaps it might be of interest that an analysis of the 2 years during which I have been the ranking Republican member on Labor and Public Welfare indicates that the minority was never more together there than it is now and has been for the past 2 years. Many of the things I advocated, my party has been against, many they have been for. That is the fate of everyone. I guess it is the fate of every Senator or Congressman including the chairman of this committee, and I honor them for it. I would not pick on them for it.

I do think that a case was made of the kind of personal sort, and it seems to be almost an attempt to divert attention from the merits. I had my say on that and I hope neither of us will bring the question up again, although I will be happy to debate it ad infinitum if Secretary Fowler desires it. If he does that is fine with me.

The allegation that the Republicans had a position different from mine on a tax increase is simply untrue. The fact is that though there was evidence to that effect in the House, the Senate minority leader was for a tax increase and I call attention to the President's press conference on February 26 where the President of the United States was asked this question: "What is your reaction to Senator Dirksen's statement earlier this week that a 5-percent tax increase is in the offing?" Then in July we have again in the Congressional Quarterly a flat statement that Senate Minority Leader Everett Dirksen urged the President to increase taxes to dampen inflation.

As Secretary Fowler admits, this view was backed by the leading experts at the time. The Council on Economic Advisers itself was pretty much bound by the administration. They seemed to me at least hearing their testimony last year, to lean toward tax increase and there was a tremendous body of opinion for it.

Now, finally, and I shall not deal with the matter beyond that, I would like to make just one other statement.

It seems to me that the primary economic explanation the Secretary gives for the apparent contradiction that interest rates this year are going down while last year they were going up—which he claims justifies the policy which I assume was his, he espoused—is that this year the demand for credit is softer, whereas last year interest rates were pushed up by too many conditions which could have been abated by a better fiscal policy.

The Federal Reserve Board had to use its muscle because the administration was not using its muscle in the form of a tax increase. This resulted in a disastrous burst of inflation which is now leading us to an economic softening as witnessed by the drop in housing starts—probably the single most deleterious economic fact which developed in that time.

Now, Mr. Chairman, I think the Secretary had better think pretty coolly and not let his anger run away with his reason. The administration is putting forward a tax increase proposal with all this heat, whereas the Council of Economic Advisers sat here the other day and told us, "Take 90 days to think it over and watch the economy, it is not all that hot."

The most persuasive argument on behalf of the minority statement is the fact that interest rates last year reached their highest levels in 40 years, and that the economy was threatened with a serious financial crisis in late summer of 1966. The tightness of monetary policy last year was dramatic proof that fiscal policy did not adequately restrain the economy, whatever the Secretary or other administration spokesmen may now claim.

The Federal Reserve in December 1965 raised the discount rate—2 months later than it wished to do so—after becoming convinced that the administration was not pursuing, and had no intention of pursuing, a sufficiently restrictive fiscal policy. Subsequent events bore out that judgment.

To be sure, the administration did take some restraining actions, but they were not adequate to cool down the booming economy and moderate the excessive demand for credit throughout the year. Interest rates rose in response to market forces which could have been restrained only by an appropriate fiscal policy. Had the Federal Reserve supplied adequate reserves to meet the extraordinary demand for funds without an increase in the level of interest rates, prices would have gone through the roof. Even with a tight money policy, price increases were sharp and—as stated by the administration—we have not yet seen the end of the inflationary road.

Secretary Fowler chides the minority for being Monday morning quarterbacks on the question of advising a tax increase for 1966. The record shows that the minority members of the Joint Economic Committee, last March, unanimously said that the administration's fiscal policy was not adequately restraining and that monetary policy would have to carry too heavy a burden. We said that reductions in nonessential Federal expenditures would be preferable to a tax increase, but we clearly said a tax increase would be necessary in the absence of genuine expenditure restraint.

Expenditure restraint was not forthcoming. 1967 administrative budget expenditures are now estimated to be $14 billion higher than the estimate made by the administration in January 1966.

Nor was the minority alone in calling for further fiscal restraint during the year. Walter W. Heller, former Chairman of the Council of Economic Advisers and the architect of the "New Economics," said repeatedly that a tax increase was needed. That recommendation was echoed by Arthur F. Burns, Chairman of the Council under President Eisenhower, and Otto Eckstein of President Kennedy's Council of Economic Advisers. A number of eminent witnesses who appeared before the Joint Economic Committee at its annual hearings last year said that restraint in the administration's fiscal program was more apparent than real. Chairman Ackley of the Council of Economic Advisers, told this committee just last Thursday that the question of a tax increase in 1966 was "a close question" throughout the year.

It is beyond my comprehension how the Secretary can now say fiscal policy was perfect last year when all the signs point the other way. Does he mean to suggest that the high level of interest rates was a plot by the Federal Reserve and had nothing to do with underlying economic forces? Does he suggest that the break in price stability which began in 1965 would have occurred even if fiscal policy had been tighter? If fiscal policy was sufficiently restraining in the first half of the year, why did the administration ask for suspension of the investment credit in the second half?

Secretary Fowler tells us now that an increase in taxes early last year would have been a mistake because of "selective weaknesses" that were developing in the economy. These weaknesses, particularly in the housing industry, were the direct result of the administration's high-interest policy that was made so necessary by the absence of adequate fiscal restraint. It seems clear today, as it did all last year, that the policy mix was wrong and that spokesmen for the administration simply cannot bring themselves to admit the error of their policies.

After having derided the minority members of the committee for their support of greater fiscal restraint, not to speak of the many eminent economists who supported this position, Secretary Fowler now says that a tax increase is needed this year. What was wrong last year, when the economy was booming, has suddenly become right this year, when weakness is pronounced. The only explanation the Secretary can give for this apparent contradiction is that interest rates this year are going down, while last year they were going up. He misses the point entirely, which is that interest rates are going down this year because the economy and the demand for credit is softening, whereas last year, interest rates were pushed up by boom conditions which could have been abated by a better fiscal policy.

Last year the administration relied too heavily on monetary policy and not enough on fiscal policy. This year it seems determined to rely too heavily on fiscal policy and not enough on monetary policy. Last year the result was serious inflation, a recession in housing and other "selective weaknesses" in the economy. This year the result could be a sharp slowdown in growth and a deepening balance of payments deficit.

So, as I love our country more than I care about any personal slight to me, Mr. Chairman, I urge the Treasury and the Secretary of the Treasury to divest himself of these petty, intemperate remarks and to get down to cases and to bring himself in line with the Council of Economic Advisers as to what the policy which he recommends really means as far as we are concerned.

Thank you, Mr. Chairman.

Chairman PROXMIRE. Our witness this afternoon is the Secretary of Labor, Willard Wirtz, and accompanying him is the Commissioner of the Bureau of Labor Statistics, Arthur Ross.

We are delighted to have both these extremely able representatives from the executive branch.

Mr. Wirtz, you have a concise statement; go right ahead.

STATEMENT OF HON. W. WILLARD WIRTZ, SECRETARY OF LABOR, ACCOMPANIED BY ARTHUR M. ROSS, COMMISSIONER, BUREAU OF LABOR STATISTICS

Secretary WIRTZ. Thank you, Mr. Chairman and members of the committee. It is a short statement.

Chairman PROXMIRE. Senator Javits and I are going to have to leave for a vote in the Senate but we will be back soon and Congressman Reuss will chair the meeting while we are gone.

(At this point Congressman Reuss assumed the chair.)

Secretary WIRTZ. Mr. Chairman, and members of the joint committee, the brevity of this statement marks my respect for the broad understanding the members of this committee have of the vitally important subject of these hearings, and my concurrence in the views other members of the administration have already presented to you, and I mean all of the views of the other members of the administration.

If there is a single point of particular emphasis in my own measurement of the condition of the economy it is this: It seems to me right to assert full employment (in the fullest sense of that term) at wages producing a decent standard of living for everyone as a first-priority national purpose.

I expect there is probably no disagreement about this—except as there may be differences of judgment about the operational relationship of the means of serving this purpose to the means of serving other purposes. I recognize these differences are important.

This testimony may also reflect another possible bias which should be made clear. Respecting a strong, continuing constantly expanding economy as the most important single element in the achievement and maintenance of full employment at adequate wages, it seems to me no less necessary to center a full employment policy on that type of unemployment which will not yield to overall economic growth.

We are today at that point where the most serious remaining unemployment is more personal than economic, where there are skill shortages, and where the primary need is to develop people's abilities so as to permit their using the opportunities that are available.

If the economy were to falter, this situation would worsen immediately. Continued economic growth is the essential condition of full employment at fair wages. But it is not, alone, enough.

This is the context for the following somewhat more detailed observations.

EMPLOYMENT

Employment increased in 1966 by a solid and phenomenal 1.9 million. This is *people in jobs.*

The civilian labor force increased by 1.8 million which is half a million more than would have resulted from population growth (and the continuation of normal trends) alone. (See chart 1, p. 253.) Most of the unexpected increased affected adult women and teenagers.

The "unexpected" additional workers were primarily adult women and teenagers.

The number of adult women (20 years and over) was expected to increase by about 470,000; it increased in fact by 740,000. Almost all of this extra gain of 270,000 was among women 20 to 34 years of age. This development is apparently associated with the recent decline in birth rates, especially in the number of children born to mothers in the 20- to 24-year age group.

Among teenage girls, the labor force increase was about 230,000 more than the trend expectation of 190,000. The employment opportunities provided by the expanding economy as well as the special youth program were the primary factors in pushing up the labor force participation rates for teenage girls as well as for the 16- and 17-year-old boys.

Despite this unprecedented expansion in the work force, unemployment was reduced by 400,000. The jobless rate for married men dropped to 1.9 percent, its lowest point since this series began in 1955. (See chart 2, p. 254.) On the average, only 1.1 million adult males were jobless and looking for work, compared to nearly twice that number in 1963.

Adult female employment rose by 900,000 to a record 23.5 million, while teenage employment recorded it largest annual gain on record, rising by 750,000 to 6.9 million. Three times as many teenagers found jobs in 1966 as in 1964.

There were three-fourths of a million more teenagers in the labor force in 1966 than there had been the year before. Due to the high level of economic activity and the concerted efforts on the part of governments, private industry, and community organizations, the number of unemployed in this group did not increase. It remains, however, too high.

Teenage unemployment has been one of the most troublesome manpower problems of the 1960's. Between 1963 and 1966, teenage unemployment remained at the 1 million level and as a result steadily made up a larger proportion of total unemployment. At the same time, the number of teenagers in the labor force increased by 1.5 million—more than during the entire 10-year period from 1953 to 1963. The generation of jobs kept this large increase in the teenage labor force from creating an increased level of unemployment, but the teenage jobless rate is still an unacceptable 12 percent. (See chart 3, p. 254.)

In 1966, the unemployment rate for Negroes dropped to a post-Korean low of 7.5 percent. At the same time, however, there was a slight slowdown in the rate of improvement for Negroes compared with that for whites.

If you look at the figures for teenage Negro boys and girls the improvement for their chance slowed up in comparison with the improvement of the employment situation as far as the white group is concerned.

The jobless rate for Negroes, which had declined steadily between 1963 and early 1966, moved upward toward midyear and failed to return to the 7.1-percent rate (seasonally adjusted) established in the first quarter. In 1963, the jobless rate for Negro boys (teenagers) was 1.8 times as large as that for white boys; in 1966 this ratio increased to 2.1. For Negro girls, the differential has moved from 2.4 to 1 in 1962, to 2.8 to 1 in 1966.

Manpower Programs and Policies

The Economic Report for 1967 contains this statement:

"Although precise targets cannot be set for the ultimate minimum levels of unemployment or the speed of the downward movement, it is clearly unnecessary and undesirable to accept 4-percent unemployment as a permanent objective of U.S. economic policy."

I agree with this suggestion—the first is that we must keep constantly in mind that the way we measure unemployment in this country limits it only to those who are looking for work and unable to find it. It does not include those who have given up or who are nonparticipants in the work force for one reason or another and does not include an undercurrent factor of which we are becoming increasingly aware and concerned.

Agreeing completely with this statement, I note three points:

First, as regards the concept of unemployment itself, a person is counted "unemployed" if he has no job and is actively seeking one. This omits significant factors of "nonparticipation in the work force," and underemployment.

Second, there is an enormous variation in the elements which are taken together to develop an "average" unemployment rate.

The rate of unemployment in the United States for 1966 was 3.9 percent.

It was only 1.3 precent for professional personnel, but 31.1 percent for Negro teenage girls.

It was only 1.9 percent for married men as a whole, but 21.2 percent for Negro teenage boys.

It was only 2.8 percent for skilled workers, but 7.3 percent for the unskilled.

The first two points preface the third: We are developing manpower policies and programs aimed directly at *hard core* unemployment.

This means not waiting for the unemployed to come to us, but going out to reach them with programs which will help motivate them, enhance their employability as well as their basic education, give them occupational training, develop and place them in jobs, and follow them up with support services so that whatever initial success is achieved with them "takes."

Employers are being much more active participants in the development of recruitment, referral, training, and work-training programs.

Two-thirds of the training slots available under the Manpower Development and Training Act are being allocated to the hard-core unemployed. The trainee population now includes much larger proportions than before of youth, minority group members, and long-term unemployed (table 1).

The remaining third of the training opportunities under MDTA are being used to help meet particular and serious skill shortages. During this fiscal year, about 82,000 trainees out of the projected total of 235,000 are being deployed explicitly in that direction. Special training programs are being set up for hard-to-fill occupations requiring only relatively brief periods of learning, such as nurses aids and hospital orderlies, and for some of the entry jobs in the repair and mechanic fields. Refresher training is also being provided for professional personnel for whom there are large unfilled demands. For example, refresher training for 10,000 professional nurses was authorized for this fiscal year, 10 times the corresponding number for last year. In 1966, more than one out of every four persons enrolled in MDTA courses (27 percent) received training for occupations in which personnel shortages had developed.

A 1966 amendment to the MDTA which permits adequate allowances for employed persons taking part-time training should help meet these manpower demands, by enabling persons to upgrade their skills while employed.

There has been a large increase in on-the-job training, so that it now takes equal rank with institutional training. Such on-the-job training has the advantages of lower average cost per trainee, greater specificity in learning content, the earnings it offers during the learning process, and a 90 percent job placement record.

Most of the OJT programs have been generated by industry and labor organizations which have served both as prime contractors and as providers of opportunities for this kind of training on their own sites.

WAGES

Hourly labor costs, including expenditures on supplementary benefits, rose more rapidly in 1966 than during recent years. Yet production and nonsupervisory workers' real take-home pay was lower at the end of 1966 than at the end of 1965 in most majority industry divisions.

The increase in hourly earnings and hourly labor costs in 1966 resulted from wage and fringe increases, a more rapid growth of unemployment in some of the higher wage manufacturing industries than in lower wage activities, and the increase in social security taxes (affecting employers' hourly labor costs).

The fall in real spendable weekly earnings was due to a decline in weekly hours worked, the rise in the consumer prices, and the employees' part of the increase in social security taxes effective in January 1966.

Analysis of major collective bargaining agreements concluded during 1966 indicates—for other than construction industries—we have given you the fairest figures—

(1) For key contracts, a median package (wages plus benefits) increase of 4.1 percent a year, assuming equal spacing of changes over the life of the contract. This compares with 3.3 percent last year.[1] (table 2).

(2) Considering wage rates alone, an increase of 3.7 percent a year as measured over the life of the contract, compared with 3.3 percent in 1965 and 3 percent in 1964.

(3) A median first-year wage adjustment of 4.4 percent, compared with 3.8 percent in 1965 and 3.2 percent in 1964. Negotiated adjustments were the largest since 1957. Despite the fact that the rate of unemployment in 1955, 1956, and 1957 was slightly higher than in 1966, first-year rate adjustments were larger in those years than in 1966. (See chart 4, p. 255.)

During 1966, settlements in the construction industry continued to be larger than those in other industries (table 3).

An unusually high proportion of workers in nonunion establishments received increases in 1966—about 80 percent as compared with a previous record (before 1965) of between 50 and 60 percent. About

[1] Limited to contracts of 5,000 or more in 1966 and 10,000 or more in 1965; other information refers to contracts affecting 1,000 or more.

half of the workers in nonunion factories received wage rate increases in both 1965 and 1966, where the previous experience was that they usually received rate increases about once every 2 years.

Labor cost developments in 1967 will be affected by the usual collective bargaining forces; the increase in the minimum wage under the Fair Labor Standards Act and the extension of this act to additional groups of workers; an expected smaller rise in the CPI during 1967 than during 1966; the fact that deferred increases under long-term contracts will be somewhat smaller on the average this year than they were in 1966; and the social security tax increase which became effective at the beginning of the year (but which represents a smaller change than did the 1966 increase).

The most clearly identifiable factor is the extension of the Fair Labor Standards Act and the increase there results in the increase in the hourly labor cost of the economy as a whole.

It is estimated that the direct effect of the increase in minimum wage rates under the Fair Labor Standards Act and its extension to additional groups of workers will be to increase the hourly labor costs for the economy as a whole by approximately three-tenths of 1 percent. The effect in certain industries will, of course, be larger.

PRODUCTIVITY

In both 1965 and 1966, productivity in the private economy rose at a rate of about 2.8 percent, compared with the long-term (postwar) trend of 3.2 percent, and with a 3.5-percent average annual rate during the most recent 5-year period (tables 4 and 5, p. 249).

Usually, some slowing down in the large rate of increase in output—such as is anticipated in 1967—is accompanied by a decline in the rate of productivity growth. Other factors in the economy may tend, however, to run counter to this pattern and stimulate rather than retard productivity growth. Foremost among these factors is the high level of investment in new plant and equipment which has been growing at an unprecedented rate since 1963. In each of the last 3 years, nonresidential fixed investment rose by at least 10 percent. Just as investment in capital which incorporates technological innovations serves to stimulate productivity growth, investment in human resources, through the manpower development programs and other training programs, will also serve to stimulate productivity growth.

Unit labor costs in the private economy rose by 3.7 percent in 1966. This was the largest increase in over a decade and was twice the average annual rise for the entire postwar period (tables 6 and 7). This increase represented a sharp break in the pattern, which had developed since the beginning of the current expansion, of unit labor cost increases averaging about one-half of 1 percent per year from 1960 to 1965 and with only small year-to-year fluctuations.

Prices

The December, 1965 to December, 1966 increase in the Wholesale Price Index was 1.7 percent. The increase in the Consumer Price Index was 3.3 percent. (Tables 8 and 9 and chart 5, pp. 251, 252, and 256.)

(At this point Senator Proxmire assumed the chair.)

The details set out in table 8, 9 and chart 5, and I call your attention to it because you get quite different figures depending whether you take a December through December approach or whether you take an average for one year or the other. Both are set out in the accompanying tables and charts.

Over one-third of the average family spending is on services, and they caused half of the total 1966 increase in the Consumer Price Index. (Table 10 and chart 6, pp. 253, 257.) Pressures in this area will continue, although with perhaps some moderating influences, as, for example, in connection with mortgage interest costs. But since service industries are still low paid, there will be likely wage movements required to obtain and keep competent employees; and since wages in these industries constitute a large element of operating costs, these increases are apt to be passed on. The increasing demand for medical care services, stimulated by a growing population, higher income levels, group insurance plane, and the medicare program, will also mean continuing upward pressures on service costs in this area.

So far as other sectors of the economy are concerned, agricultural supply and demand during 1967 are expected to be more nearly in balance; pressure on industrial capacity probably will lessen; few, if any, raw material bottlenecks are expected; and the more moderate pace of economic advance that is anticipated should further diminish inflationary pressures.

The Guideposts

Committee members have inquired of earlier witnesses about the guideposts. I summarize my own position on this very briefly, and only as a basis for whatever questions the committee may have.

First. The guidepost principle, that unless prices and wages stay in line with productivity for the economy as a whole there will be inflationary pressures, is clearly sound.

Second. This is one principle that should guide price and wage determinations in particular cases. There are also others.

Third. This productivity principle had been too little recognized and understood prior to the Council of Economic Advisers' statement of it in its 1962 report, and in subsequent reports. It is not yet fully understood, and it should continue to be developed and emphasized.

Fourth. The only real question is what governmental procedures or methods should be followed in trying to influence the economy as a whole, or to influence particular price and wage determinations, so that this principle will be followed as far as is practicable. My judgment on this is:

> That legislative enactment of wage and price controls would be a mistake;

That the adoption, by statute, of new procedures for reviewing wage and price developments in the economy warrants consideration, but is not required by present circumstance;

That there should be continuing efforts by the administration and by everybody informed and concerned to press the common interest reflected in the guidepost principle; and

That these efforts will be more successful if it is not attempted to develop a specific guidepost figure for prices and wages. There aren't such figures which take proper account of the applicability of the productivity principle to present circumstances, and its necessary relationship to other operative facts and principles.

I commend to the committee's consideration the unanimous report of the tri-partite President's Advisory Committee on Labor-Management Policy, dated August 18, 1966. It seems to me to state the key and relevant facts and considerations here exceedingly well. I attach copies for this committee's convenience.

(The document referred to follows:)

PRESIDENT'S ADVISORY COMMITTEE ON LABOR-MANAGEMENT POLICY

REPORT SETTING FORTH THE COMMITTEE'S VIEWS ON THE GUIDEPOSTS FOR NONINFLATIONARY WAGE AND PRICE BEHAVIOR, AUGUST 18, 1966

I. Introduction

A. The purpose of this memorandum is to provide the President with the Committee's views on what are referred to in the 1962 Annual Report of the Council of Economic Advisers and subsequent reports of the Council as "guideposts for non-inflationary wage and price behavior."

B. In our judgment the 1962 report of the Council relative to the guideposts is of particular significance. A copy of the relevant portions of the 1962 report is attached. We desire to emphasize the following portions of the report:

1. "Productivity is a *guide* rather than a *rule* for appraising wage and price behavior for several reasons. First, there are a number of problems involved in measuing productivity changes, and a number of alternative measures are available. Second, there is nothing immutable in fact or in justice about the distribution of the total product between labor and non-labor incomes. Third, the pattern of wages and prices among industries is and should be responsive to forces other than changes in productivity."

2. "These are not arbitrary guides. These describe—briefly and no doubt incompletely—how price and wage rates would behave in a smoothly functioning competitive economy operating near full employment. Nor do they constitute a mechanical formula for determining whether a particular price or wage decision is inflationary. They will serve their purposes if they suggest to the interested public a useful way of approaching the appraisal of such a decision."

3. "These are advanced as general guideposts. To reconcile them with objectives of equity and efficiency, specific modifications must be made to adapt them to the circumstances of particular industries. If all of these modifications are made, each in the specific circumstances to which it applies, they are consistent with stability of the general price level. Public judgments about the effects on the price level of particular wage or price decisions should take into account the modifications as well as the general guides."

C. Consistent with this approach we have agreed on the recommendations that follow.

75-314—67—pt. 2——2

II. Recommendations

A. That in the near future and at least once a quarter thereafter an objective evaluation should be made of the economy by the Council of Economic Advisers to determine the extent to which the economy as a whole is achieving the goals reflected in the guideposts.

B. That if the evaluation indicates that the overall economy is falling short of the goals reflected in the guideposts, the following steps be taken:

1. The Council of Economic Advisers should identify the nature and apparent chief causes of the major problems or shortcomings.

2. To the extent that the causes may relate to matters within the purview of the President's Advisory Committee on Labor-Management Policy, representatives of that Committee and the Council of Economic Advisers should discuss those problems to determine whether any appropriate corrective action can be recommended.

3. The President's Advisory Committee on Labor-Management Policy should submit to the President a report identifying the problems or shortcomings and including recommendations for corrective action.

III. Conclusion

A. We believe that it is essential to the continued economic growth and health of the country that the present inflationary trends be stopped, and that maximum efforts should therefore be made to restrain, through voluntary procedures, unjustified wage or price behavior.

B. We believe that the goals reflected in the guideposts as set forth in the 1962 report of the Council of Economic Advisers providing for the alignment of wages and prices with productivity in the economy as a whole need and deserve support.

C. We believe that the procedures set forth in the section headed "Recommendations" will assist in providing such support in that they will help to develop a more general understanding of why voluntary restraints serve both the national and private interests.

D. We also believe that it is impractical if not impossible to translate the goals reflected in the guideposts into formulae for application to every particular price or wage decision.

E. We believe that in a free society any policy to achieve price stability will be acceptable and effective only if it bears equitably on all forms of income.

TABLE 1.—*Characteristics of persons enrolled in MDTA courses, calendar year 1966*

Characteristics	Institutional program, estimated total enrollment			On-the-job program, estimated total enrollment		
	Total	Male	Female	Total	Male	Female
Total	165,000	[1] 93,390	71,610	80,000	[1] 61,360	18,640
Percent	100.0	56.6	43.4	100.0	76.7	23.3
	Percent distribution					
Total	100.0	100.0	100.0	100.0	100.0	100.0
Family status:						
Head of family or household	55.7	62.7	46.6	54.7	64.6	22.2
Other	44.3	37.3	53.4	45.3	35.4	77.8
Education, grade:						
Less than 8th	6.4	8.7	3.4	3.6	3.4	4.2
8th	9.8	12.6	6.2	6.9	6.6	7.8
9th to 11th	36.0	38.2	33.0	26.3	23.8	34.6
12th	41.4	35.1	49.5	53.0	55.4	45.2
More than 12th	6.4	5.3	7.9	10.8	10.9	8.3
Years of gainful employment:						
Less than 3	35.5	27.5	46.0	33.6	29.9	46.0
3 to 9	38.7	39.5	37.7	38.6	40.4	32.4
10 or more	25.7	33.0	16.3	27.8	29.6	21.6
Number of dependents:						
0	47.2	40.9	55.3	45.3	37.7	70.0
1	14.9	13.3	17.1	17.0	18.0	13.8
2	12.5	13.3	11.5	13.8	15.7	17.4
3	9.4	11.0	7.3	11.2	13.5	3.8
4	6.5	8.2	4.2	6.3	7.5	2.7
5 and over	9.5	13.2	4.6	6.4	7.6	2.3
Wage earner status:						
Primary	69.6	78.8	57.6	69.3	81.3	30.0
Other	30.4	21.2	42.4	30.7	18.7	70.0
Eligibility for allowance:						
Yes	70.5	80.0	56.6	13.9	15.9	8.0
No	29.5	20.0	43.4	86.1	84.1	92.0
Type of training allowance for which eligible:						
Regular	50.3	52.1	46.5	65.9	64.9	71.7
Augmented	31.3	32.6	28.6	28.3	29.9	19.6
Youth	18.4	15.3	24.9	5.8	5.3	8.8
Unemployment insurance claimant status:						
Yes	14.5	19.3	8.2	7.3	8.5	3.5
No	85.5	80.7	91.8	92.7	91.5	96.5
Public assistance status:						
Yes	11.8	9.0	15.5	1.3	1.0	2.4
No	88.2	91.0	84.5	98.7	99.0	97.6
Prior employment status:						
Unemployed	87.0	87.7	86.1	61.7	59.7	67.7
Family farmworker	1.6	2.5	.3	.5	.6	.1
Reentrant to labor force	2.3	.7	4.6	1.9	.8	5.0
Underemployed	9.1	9.1	9.1	35.9	38.9	27.2
Duration of unemployment:						
Less than 5 weeks	32.2	36.6	25.5	46.0	51.9	30.7
5 to 14	23.5	26.6	18.8	22.4	24.8	16.3
15 to 26	13.4	13.9	12.7	10.6	10.5	10.7
27 to 52	10.9	10.1	12.1	7.4	5.9	11.1
Over 52	20.0	12.7	30.9	13.7	6.8	31.2
Prior military service:						
Veteran	17.5	29.8	11.1	25.6	32.9	.6
Peacetime service	8.1	13.9	.2	12.9	16.6	.4
Rejectee	4.4	7.6	.1	3.9	4.9	.1
Other nonveteran	70.0	48.8	98.5	57.6	45.5	98.9
Handicapped:						
Yes	8.7	12.1	4.3	3.5	4.0	1.9
No	91.3	87.9	95.7	96.5	96.0	98.1
Race:						
White	61.8	66.4	55.7	84.6	86.0	79.9
Negro	35.9	30.9	42.4	13.8	12.2	18.9
Other nonwhite	2.3	2.7	1.8	1.6	1.8	1.1

[1] Percent based on reports on approximately 68,000 trainees in institutional programs and 17,000 in on-the-job training programs, received through Nov. 30, 1966.

Source: U.S. Department of Labor.

TABLE 2.—*Estimated annual rates of increase in hourly cost of wage and benefit changes negotiated in key collective bargaining settlements, 1966* [1]

Annual rate of increase	Percent of workers affected.	
	Equal timing [2]	Actual timing [3]
Under 3 percent	5	5
3 and under 3½ percent	16	6
3½ and under 4 percent	20	12
4 and under 4½ percent	38	18
4½ and under 5 percent		17
5 and under 5½ percent	[4] (21)	20
5½ or more		22
Number of workers (thousands)	1,400	
Median increase (percent)	4.1	4.5

[1] Excluding construction, finance, and insurance. Estimates were prepared only for settlements affecting 5,000 workers or more.
[2] Based on estimated increase in hourly costs at end of contract period and assumes equal spacing of wage and benefit changes over life of contract.
[3] Takes account of actual effective dates of wage and benefit changes during contract period.
[4] Grouped to avoid disclosing estimates for individual settlements.

NOTE.—Because of rounding, sums of individual items may not equal totals.

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

TABLE 3.—*Estimated annual rates of increase in hourly cost of wage and benefit changes negotiated in key collective bargaining settlements in construction,*[1] *1966*

[Percent of workers affected—Equal timing [2]]

Annual rate of increase:	
Under 4½ percent	1
4½ and under 5 percent	12
5 and under 5½ percent	14
5½ and under 6 percent	6
6 and under 6½ percent	13
6½ and under 7 percent	22
7 and under 7½ percent	8
7½ and under 8 percent	3
8 and under 8½ percent	6
8½ and under 9 percent	8
9 and under 9½ percent	1
9½ and under 10 percent	2
10 or more	4
Number of workers (thousands)	310
Median increase (percent)	6.6

[1] Based on settlements affecting 1,000 workers or more.
[2] Based on estimated increase in hourly costs at end of contract period and assumes equal spacing of wage and benefit changes over life of contract.

NOTE.—Because of rounding, sums of individual items may not equal totals.

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

TABLE 4.—*Year-to-year percent change in output, output per man-hour, man-hours, 1947–66* [1]

	Total private economy			Farm			Nonfarm		
	Output	Output per man-hour	Man-hours	Output	Output per man-hour	Man-hours	Output	Output per man-hour	Man-hours
1947–48	4.8	4.3	0.4	11.8	16.5	−3.9	4.4	3.1	1.3
1948–49	−.3	3.2	−3.3	−3.2	−2.6	−.7	−.1	3.9	−3.9
1949–50	10.2	8.2	1.9	5.4	14.0	−7.4	10.6	6.3	3.9
1950–51	6.3	3.0	3.2	−5.2	.5	−5.6	7.0	2.1	4.9
1951–52	2.4	1.8	.6	3.3	8.7	−5.1	2.5	.8	1.6
1952–53	5.1	4.3	.8	5.3	13.2	−7.0	5.1	3.0	2.1
1953–54	−1.3	2.3	−3.6	2.0	5.2	−3.0	−1.5	2.1	−3.7
1954–55	8.5	4.4	3.9	2.5	.8	1.6	8.8	4.5	4.2
1955–56	1.9	.1	1.7	−.5	4.3	−4.6	2.0	−.5	2.6
1956–57	1.4	3.0	−1.4	−2.4	6.0	−7.9	1.6	2.1	−.6
1957–58	−1.3	3.0	−4.2	2.5	10.4	−7.1	−1.5	2.6	−3.8
1958–59	7.0	3.6	3.2	1.4	1.7	−.4	7.3	3.4	3.7
1959–60	2.4	1.5	.9	3.8	5.6	−1.7	2.4	1.3	1.2
1960–61	1.9	3.3	−1.5	1.4	7.9	−6.0	1.9	2.8	−1.0
1961–62	6.8	4.7	2.0	−.5	2.3	−2.7	7.1	4.6	2.5
1962–63	4.2	3.5	.6	3.2	8.9	−5.4	4.3	3.0	1.2
1963–64	5.5	3.8	1.7	−3.5	.5	−3.8	5.9	3.7	2.2
1964–65	6.2	2.8	3.2	8.2	11.3	−2.7	6.1	2.1	3.8
1965–66	5.3	2.8	2.5	−5.0	4.7	−9.3	5.8	2.4	3.4

[1] Output refers to the gross national product in constant dollars; man-hours based primarily on establishment reports of the Bureau of Labor statistics.

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

TABLE 5.—*Average annual percent change* [1] *in output per man-hour and related data, 1947–66*

Item	1947–66	1961–66
Total private economy:		
Output per man-hour [2]	3.2	3.5
Output [2]	3.7	5.5
Employment	.9	2.0
Man-hours	.5	1.9
Farm:		
Output per man-hour	5.9	5.7
Output	1.4	.8
Employment	−3.6	−4.8
Man-hours	−4.2	−4.6
Nonfarm:		
Output per man-hour	2.6	3.1
Output	3.8	5.7
Employment	1.4	2.5
Man-hours	1.1	2.5

[1] Computed from least squares trend of the logarithms of the indexes.
[2] Output refers to gross national product in 1958 dollars; man-hours based primarily on establishment reports.

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

TABLE 6.—*Indexes of output per man-hour, compensation per man-hour and unit labor costs in the private economy, 1947–66*

[1957–59=100]

Year	Output per man-hour	Compensation per man-hour	Unit labor costs
1947	69.1	54.9	79.4
1948	72.1	59.9	83.1
1949	74.4	60.7	81.6
1950	80.5	64.9	80.6
1951	82.9	71.2	85.9
1952	84.4	75.4	89.4
1953	88.0	80.2	91.1
1954	90.0	82.5	91.7
1955	94.0	84.6	90.0
1956	94.1	90.0	95.7
1957	96.9	95.8	98.9
1958	99.8	99.8	100.0
1959	103.4	104.4	101.0
1960	105.0	108.5	103.3
1961	108.5	112.4	103.6
1962	113.6	117.3	103.3
1963	117.6	122.0	103.7
1964	122.1	128.2	104.9
1965	125.5	132.9	105.9
1966	129.0	141.6	109.8

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

TABLE 7.—*Average annual rates of change in output per man-hour, hourly compensation, and unit labor costs in the private economy, for selected years* [1]

Item	1947–66	1961–66
Unit labor costs	1.7	1.1
Output per man-hour	3.2	3.5
Compensation per man-hour	4.9	4.6
Real compensation per man-hour	3.1	3.0

[1] All rates computed from the least squares trend of the logarithms of the index numbers.

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

TABLE 8.—*Key wholesale price trends, 1964–66*

Wholesale price indexes	Quarterly percent changes, 1966				Year-to-year percent changes			
	December 1965 to March	March to June	June to September	September to December [1]	December to December		Annual averages	
					1965 to 1966	1964 to 1965	1965 to 1966 [1]	1964 to 1965
All commodities	1.2	0.3	1.0	−0.8	1.7	3.4	3.3	2.0
Farm products and processed foods	2.7	−1.6	3.5	−4.3	.2	9.6	6.7	4.2
Farm products	3.7	−2.4	4.3	−6.3	−1.2	11.1	7.3	4.3
Fresh fruits and vegetables	10.3	−2.0	10.7	−8.2	9.9	−6.8	.7	−1.4
Grains	.8	4.5	10.2	−3.0	12.7	0	8.6	−4.8
Livestock	3.6	−5.0	−.8	−10.3	−12.5	34.2	9.5	18.2
Fluid milk	4.4	−.1	11.4	−1.4	14.5	2.9	13.6	1.5
Eggs	.3	−23.3	40.8	−14.8	−7.8	38.6	15.4	3.0
Processed foods	1.9	−.8	2.9	−2.8	1.1	8.5	6.1	4.1
Cereals and bakery products	.9	1.6	4.3	−.8	6.1	2.8	5.9	1.1
Meats	.6	−3.7	3.0	−6.3	−6.5	29.3	9.0	13.3
Dairy products and ice cream	3.3	1.3	6.6	−1.5	10.0	2.2	9.3	.6
Industrial commodities	.8	.9	.3	.3	2.2	1.4	2.2	1.3
Crude materials	3.9	−.1	−3.5	−1.1	−.9	2.0	3.6	3.9
Hides and skins	11.7	8.9	−16.6	−18.6	−17.4	46.7	26.6	27.1
Nonferrous metals	3.1	[illegible]	−2.7	.5	2.8	3.7	5.0	8.8
Intermediate materials	.7	1.0	.2	0	1.9	1.6	2.1	1.3
Finished steel products	.5	.1	.6	.2	1.3	1.3	1.4	.5
Lumber	3.7	4.5	−2.2	−4.6	1.1	4.3	6.5	1.2
Finished: Producer goods	.8	1.0	.5	1.5	3.8	1.4	2.5	1.2
Nonelectrical machinery	1.0	1.3	.9	1.2	4.5	2.2	3.5	1.7
Electrical machinery	1.7	.6	.4	2.2	5.0	.3	2.3	0
Finished: Consumer nondurables	.4	.8	.5	.1	1.7	1.6	1.9	1.2
Apparel	.4	.1	.3	.5	1.2	1.2	1.3	.9
Gasoline	−1.8	6.8	.6	−2.5	2.8	5.3	5.8	2.9
Footwear	1.4	3.0	.2	1.0	5.7	4.4	6.8	2.0
Finished: Consumer durables	.1	.4	−.1	1.3	1.7	−.3	.6	−.3
Passenger cars	−.3	−.7	−1.0	2.4	.3	−.8	−.9	−.7
Household furniture	.5	1.6	.8	1.7	4.7	.9	2.7	.9
Household appliances	.3	.3	−.8	.6	.5	−2.0	−.1	−2.3

[1] December 1966 data preliminary.

Source: BLS, Office of Prices and Living Conditions, U.S. Department of Labor, Jan. 27, 1967.

TABLE 9.—*Key consumer price trends, 1964–66*

Consumer price indexes	Quarterly percent changes: 1966				Year-to-year percent changes			
	December 1965 to March	March to June	June to September	September to December	December to December		Annual averages	
					1965 to 1966	1964 to 1965	1965 to 1966	1964 to 1965
All items	0.9	0.8	1.1	0.5	3.3	2.0	2.9	1.7
Food [1]	3.1	−.2	1.1	−.3	3.8	3.5	5.0	2.3
Food away from home	1.1	1.3	1.5	1.4	5.3	3.4	4.6	2.3
Food at home [1]	3.4	−.4	1.2	−.7	3.4	3.6	5.0	2.4
Cereals and bakery products	1.2	1.0	3.2	.3	5.9	1.1	4.1	1.5
Meats [1]	7.1	−2.1	−3.5	−1.0	.1	13.5	9.3	7.5
Beef and veal [1]	5.6	1.0	−3.1	−.5	2.8	5.8	5.2	4.8
Pork [1]	8.9	−6.8	−4.7	−3.3	−6.4	28.7	14.4	13.8
Dairy products [1]	2.5	2.5	4.6	−.1	9.8	.5	6.5	.3
Fresh fruits and vegetables [1]	4.9	−1.2	6.4	−3.9	6.0	−6.0	1.8	2.1
Eggs [1]	6.7	−9.4	1.0	4.6	2.1	15.5	13.9	−2.3
Nondurables except food [1]	.6	.7	.6	.7	2.8	2.0	2.3	1.4
Apparel less footwear [1]	.8	.6	.8	.8	3.1	.9	1.8	.8
Footwear [1]	1.4	2.5	1.2	1.2	6.3	3.5	5.9	1.7
Gasoline	.4	.7	1.7	.5	3.4	4.0	2.2	3.8
Durable commodities [1]	−.1	.5	.3	0	.7	−1.0	.1	−.4
Furniture	.8	1.3	1.0	1.4	4.5	1.0	2.5	.6
Used cars [1]	−.7	−.7	1.6	−3.6	−3.4	−4.4	−2.5	−.7
New cars [1]	−.7	.5	−1.2	1.4	−.1	−2.9	−1.8	−2.2
Appliances	−.2	−.4	0	−.1	−.7	−5.1	−3.1	−3.2
Services	.7	1.6	1.2	1.4	4.9	2.7	3.8	2.3
Rent	.4	.3	.5	.5	1.6	1.0	1.4	1.0
Household services less rent	.1	2.7	1.1	1.5	5.5	2.4	3.8	1.9
Mortgage interest rates	.7	6.0	2.1	3.1	12.4	.9	6.4	.4
Transportation services	1.1	.5	1.9	.8	4.3	3.9	4.2	3.7
Local transit	.1	0	8.9	.1	9.1	1.8	4.4	2.1
Auto insurance	1.3	.9	1.6	.6	4.4	10.7	7.2	9.5
Medical care services	1.5	1.7	2.4	2.3	8.1	3.5	5.4	2.8
Physicians' fees	1.8	2.0	2.2	1.6	7.8	3.8	5.8	3.6
Daily hospital charges	2.4	2.1	5.1	6.0	16.5	6.6	9.6	5.8

[1] Seasonally adjusted, quarterly data only.

Source: BLS, Office of Prices and Living Conditions, U.S. Department of Labor Jan. 27, 1967.

TABLE 10.—*Price trends for selected consumer services, 1963–66*

Consumer price indexes	December-to-December percent changes			
	Total, 1963–66	1963 to 1964	1964 to 1965	1965 to 1966
All services	9.7	1.8	2.7	4.9
Rent	3.7	1.0	1.0	1.6
Transportation services	11.3	2.7	3.9	4.3
Auto repairs	5.6	.5	2.6	2.4
Auto insurance	23.7	7.0	10.7	4.4
Registration and license fees	12.8	2.3	−.1	10.3
Parking and garage rent	4.1	.8	2.2	1.1
Local transit	13.1	1.8	1.8	9.1
Taxicabs	11.4	3.6	2.1	5.3
Railroad fare, coach	.6	.6	.1	−.1
Airline fares	.5	.2	.5	−.2
Bus fares, intercity	6.9	3.0	1.6	2.2
Medical care services	14.9	2.6	3.5	8.1
Physicians' fees	15.3	3.0	3.8	7.8
Dentist's fees	10.8	3.1	2.7	4.6
Eye examination and eyeglasses	8.1	1.5	2.5	3.9
Hospital daily rates	29.9	4.6	6.6	16.5
Operating room charges	19.0	2.8	5.9	9.3
Household services	9.6	1.4	2.4	5.5
Mortgage interest	12.7	−.6	.9	12.4
Property taxes	10.6	2.1	4.5	3.7
Property insurance	18.2	5.5	6.8	4.9
Home maintenance and repair services	13.3	2.4	3.6	6.8
Gas	.4	1.1	−.4	−.3
Electricity	−.8	−.7	−.2	.1
Telephone	−2.0	−.2	−1.7	−.1
Domestic service	18.8	5.3	5.8	6.6
Baby sitters	11.0	.3	5.8	4.6
Day care	13.8	1.5	4.9	6.9
Laundry, flatwork	17.9	2.4	5.4	9.3
Other services	10.1	2.3	2.8	4.6
Laundry—men's shirts	11.4	1.2	3.6	6.3
Dry cleaning	10.0	1.1	2.6	6.0
Tailoring charges	7.4	.2	1.1	6.0
Shoe repairs	.9	.4	.4	0
Men's haircuts	15.8	3.9	3.5	7.7
Beauty shop	8.8	1.8	2.8	3.9
Movie admissions	24.3	6.9	7.6	8.0
Bowling fees	2.6	−.2	.4	2.4
Film developing	4.7	2.1	1.6	1.0
Funeral services	4.7	.4	1.8	2.4
Bank service charges	2.5	.8	−.1	1.8
Legal services	15.9	8.0	3.2	3.9

Source: BLS—Office of Prices and Living Conditions, U.S. Department of Labor, Jan. 27, 1967.

CHART 1

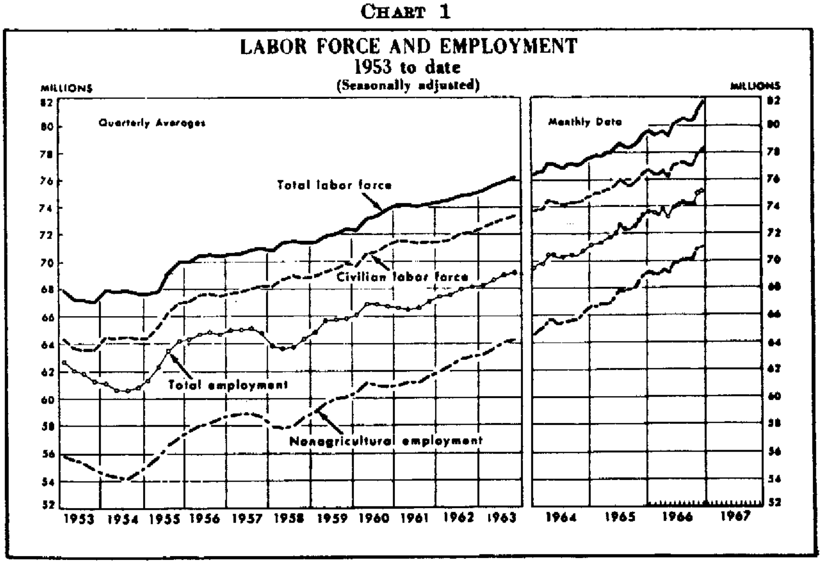


CHART 2

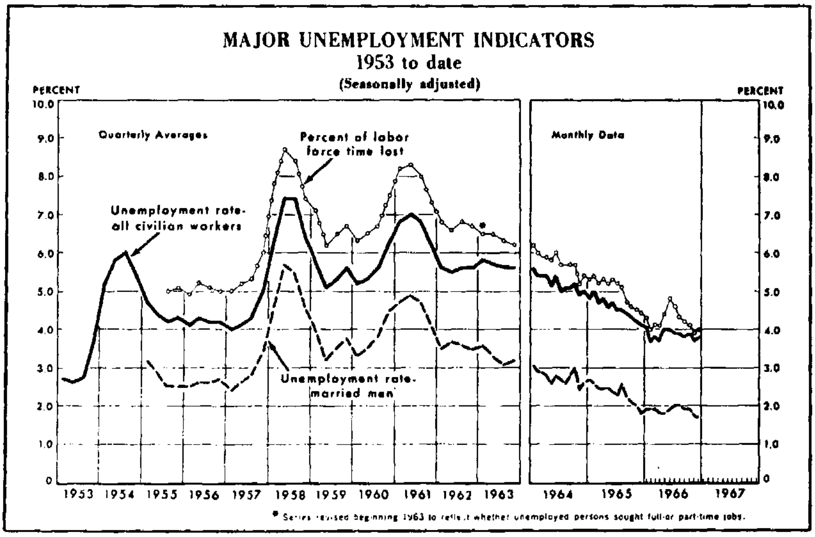


CHART 3

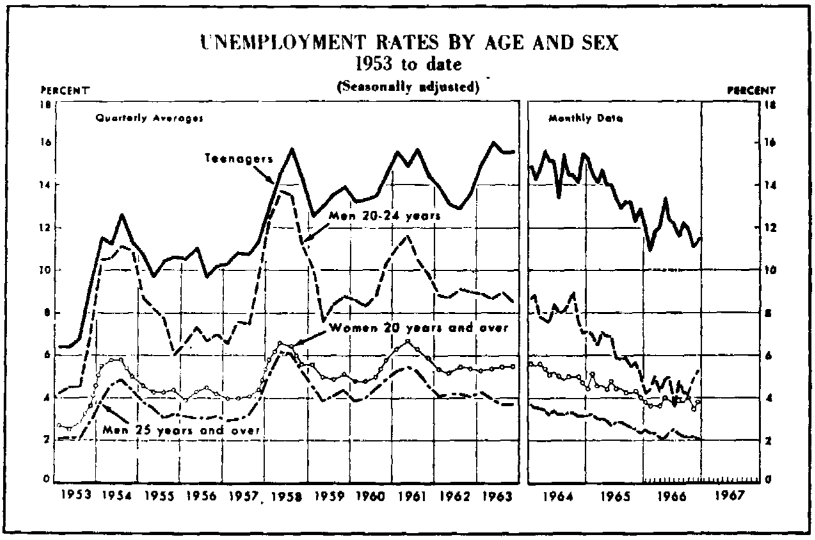
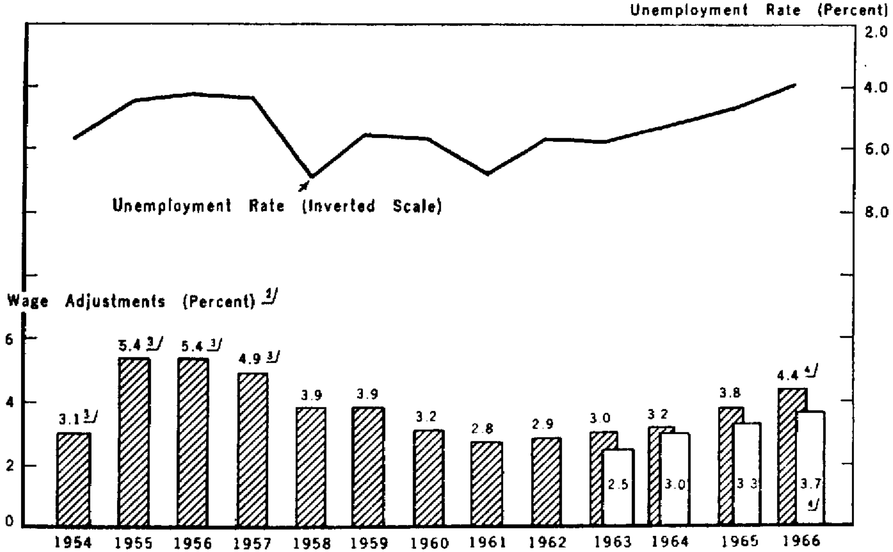


Chart 4 Negotiated Wage-Rate Adjustments 1/ and the Unemployment Rate, 1954 through 1966.



NOTE The striped bars represent the median first contract year wage adjustment. The white insert bars for 1963 through 1966 represent the total percentage wage increase during the life of each contract, converted to an annual rate.

1/ Median adjustments include no wage changes, decreases in wages, and increases in wages, but exclude the cost of fringe benefits.
2/ Percent of average hourly earnings, adjusted to exclude the effect of premium pay for overtime work.
3/ Estimated.
4/ Preliminary.

Chart 5. WHOLESALE AND CONSUMER PRICES BY MAJOR SECTORS

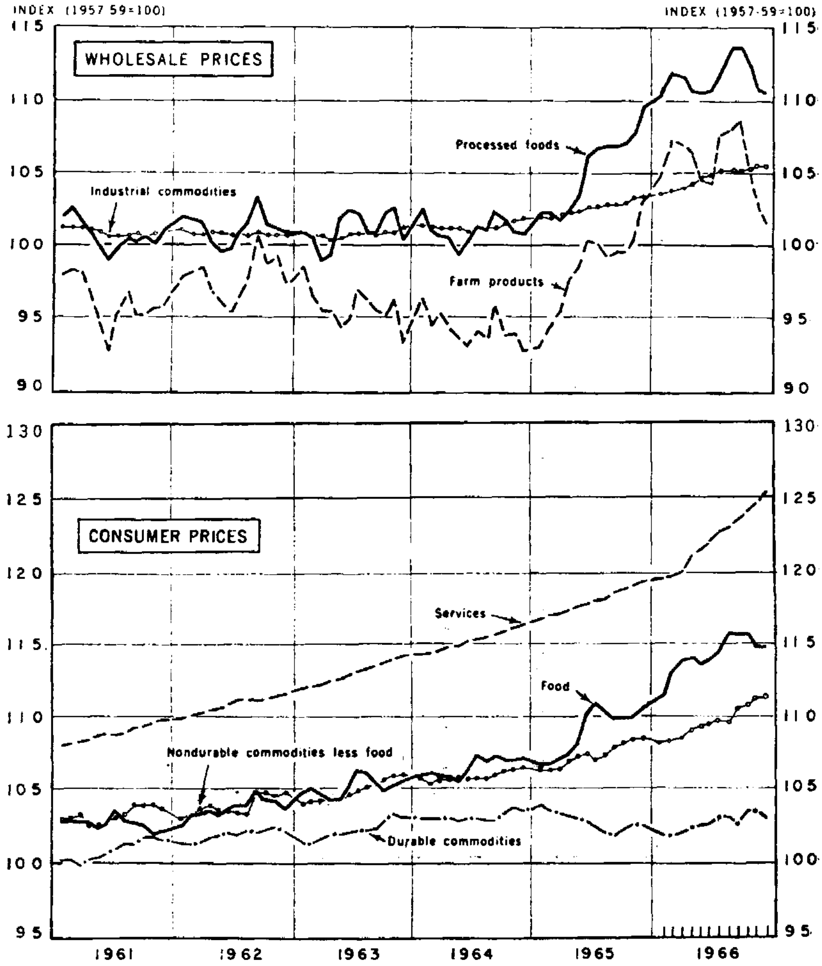
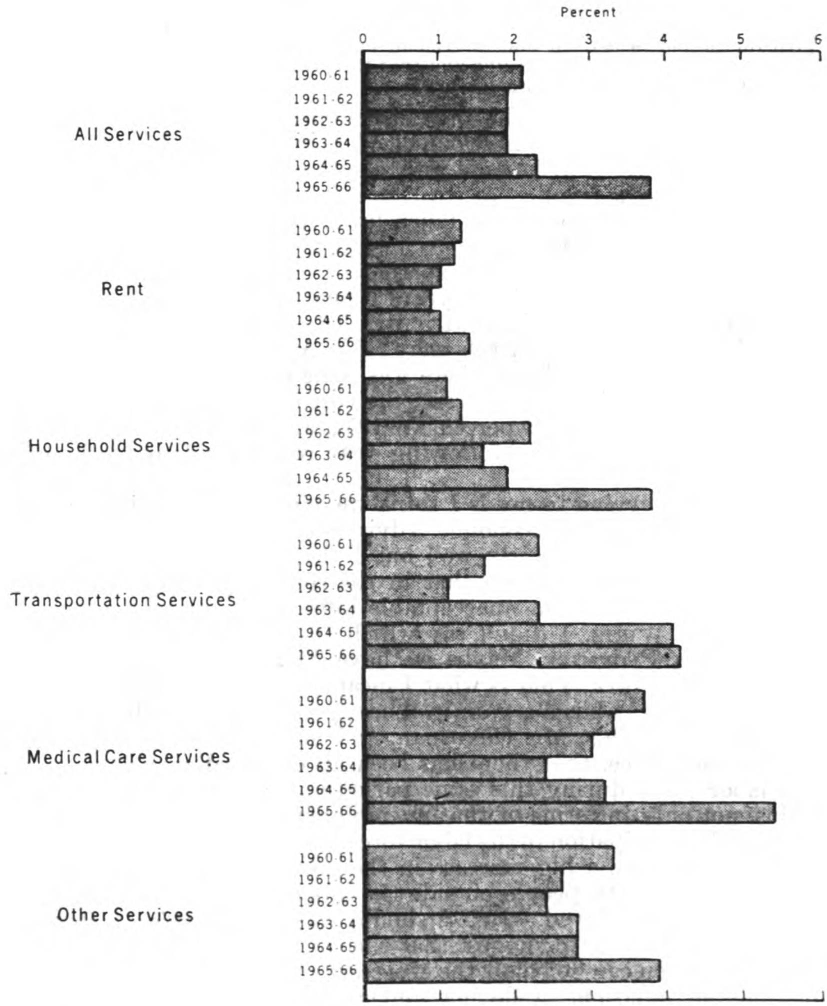


Chart 6. YEAR-TO-YEAR CHANGES IN CONSUMER SERVICE PRICES
(Percent changes in annual averages)



Secretary WIRTZ. I will be glad, Mr. Chairman, and members of the committee to respond as helpfully as I can to whatever questions you may have.

Chairman PROXMIRE. Thank you for a very fine statement, Mr. Secretary.

Remember, last year, Mr. Secretary, you made a very vivid impression on me and other members of the committee when you zeroed in on this 4-percent interim goal of unemployment and you said:

It will be very much the theme in my testimony here this morning that I point out that even as we stand now on what we have thought of as the interim goal for so long, 4 percent unemployment, we realize that it really isn't the goal at all. It is only the 10-yard line and that the problem left before us is to make the last 10 yards, which we propose to do.

It is now a year later, the December figure was 3.8 and for the year 1967 it is projected by the Council of Economic Advisers to rise to about 4 percent. It looks as if we are not making very much progress and of course the implicit or explicit reason is that there is a feeling that if we get unemployment much lower we are going to have a lot more trouble with inflation.

I call your attention to our experience in the years 1952, 1953, 1954, and 1955, especially the first 3 years I mentioned. In 1952 it was 3.1, in 1953 it was 2.9, and in 1954 it was 5.6. Credit controls came off in mid-1952 and price controls were off in April 1953. In spite of the fact that they came off and there was some pent-up demand and unemployment was below 3 percent, the cost of living rose only eight-tenths of 1 percent—2.2 percent in 1952, and only eight-tenths of 1 percent in 1953, and the following year rose only four-tenths of 1 percent.

What I am trying to say is I think we ought to have a better analysis in the Council of Economic Advisers than the Council has given us. They have done fairly well but I think we should pursue it a little further, of the notion that in the coming year we cannot get below 4 percent without unacceptable inflationary pressures.

Secretary WIRTZ. I didn't say which 10-yard line we were on.

Chairman PROXMIRE. Maybe we have 90 yards to go.

Secretary WIRTZ. That is what I mean. There has not been a very large advance, as large a gain in those terms as I would have hoped. I do point out this, Mr. Chairman, and members of the Joint Economic Committee, that there has been an extraordinary increase in the labor force during this same period and we ought to count our gains, not only in terms of that unemployment figure but also in the increased participation in the labor force.

There has been a big increase in the number of jobs and some of them have gone to people outside the labor force rather than those who were unemployed. But I should like to say this: I think it would be a mistake to suggest that there has been a basic difference on whether you can go below the 4-percent unemployment figure without having inflation. I do not understand the Council to take the position, which is taken by some economists, that there is an immutable Keynesian principle that you do not go below 4 percent on unemployment without having inflation. I don't understand that to be the Council's point.

I understand it to be, rather, when we get to that 4-percent figure, it is up to us to push it on down by increasing the manpower supply situation, by training those who are not presently trained and by making further use of the potential that we have.

I have no trouble with that approach and with the function of responsibility, not in personal terms, but in program terms for moving it on down below the 4-percent level through an affirmative manpower program. I go into this detail because I think there has been some misunderstanding. I know the Council does not take the position that we have to stop at that point.

Chairman PROXMIRE. I am sure they do not, but they do project 4 percent or expect this kind of unemployment at the end of the year. We have table 18 on page 109 of the Economic Report which shows 273,000 persons, number of trainees involved in manpower involvement and training in fiscal 1966 and fewer, 250,000 in 1967.

What is the projection on the present budget for fiscal 1968? What is the expectation of the number of trainees, taking manpower training in fiscal 1968?

(Table 18, from the Economic Report, is reprinted below:)

TABLE 18.—*Training opportunities, fiscal years, 1966–67*

Program	Number of trainees (thousands)	
	1966	1967 [1]
Manpower Development and Training Act program	273	250
Institutional training	160	125
On-the-job training and other	113	125
Job Corps	10	31
Neighborhood Youth Corps: [2]		
In-school	106	125
Out-of-school	55	60
Summer	209	165
Work experience	64	46
Adult work program		25
Special impact		8

[1] Estimates.
[2] Each position may be occupied by more than one person in the course of a training period, since trainees often do not occupy positions for the full period.

Source: Bureau of the Budget.

Secretary WIRTZ. About 275,000—250,000 to 275,000, depending on the mix.

Chairman PROXMIRE. So it has not changed much in the past 3 years?

Secretary WIRTZ. It is about the same.

Chairman PROXMIRE. Does not that indicate we do not have much of a drive to get down to the level of unemployment by the training programs?

Secretary WIRTZ. I answered your question, Mr. Chairman, perhaps not in the terms in which it is put—with reference to the Manpower Development and Training Act program. We must take into account the expectations of what can be accomplished through the other work training programs. Quite an arsenal of weapons has been developed which includes, as far as the youngsters are concerned, the Neighborhood Youth Corps program and Job Corps program.

Chairman PROXMIRE. This table includes the Job Corps and Neighborhood Youth Corps, work experience, special impact, adult work program, institutional training, on-the-job training.

Secretary WIRTZ. And the total was——

Chairman PROXMIRE. 273 in 1956, 250 in 1967, and you indicated it would be around that general figure in 1968.

Secretary WIRTZ. As far as MDTA figures are concerned. I think that last group of figures is too low, or putting it differently, it is conservative. But if your question is whether it is through the direct effects of government training, work-training programs, we will take sufficient strides toward the elimination of this last—I think in terms of about a million—the answer is no, and it will have to depend upon expansion of private training programs and on coordination of our public and private training programs.

I know what you are reaching for and perhaps I erred in suggesting to you that it is possible to do this with the present-day work training programs. If we can enlist the coordinated support of private industry, where we must look for these employment opportunities, or almost all of them eventually, we can do most of this job in the next 2 or 3 years and by the job, I mean moving in on that part of the remaining unemployment, which is susceptible to a work-training, public-private approach. I would hope, and this is obviously a risky statistic—I would hope that if the economy continues to do its part—we can train as a consequence of public and private effort in the next 2 to 3 years, approximately three-quarters of a million people. This would cut out most of the area which remains to be cut out. It is a rule of thumb.

Chairman PROXMIRE. Would you submit a comparison of how we are doing now as compared in the last 3 or 4 years, overall? The figures I asked about were only partial. You are giving me a more comprehensive one and I would like to have some comparison to see what progress we are making.

Secretary WIRTZ. I will give you the figures. You are right. What I have tried to project here is a more subjective judgment of what involves a fairly complicated—I hope sophisticated—estimate of how many people there are remaining who, as a result of progressive training programs, can be brought into employment.

(The table below was later submitted by the Department:)

Training opportunities, fiscal years 1964–68

Program	Number of trainees (in thousands)						
	Total in years	1963	1964	1965	1966	1967 [1]	1968 [1]
Manpower Development and Training Act	1,219	59	125	232	273	250	280
Institutional training	733	57	112	167	160	125	112
On-the-job training and other	486	2	13	65	113	125	168
Job Corps	41				10	31	
Neighborhood Youth Corps [2]	1,384			278	401	350	355
In school	463			102	106	125	130
Out of school	237			62	55	60	60
Summer	684			114	240	165	165
Work experience	110				64	46	
Adult work program	25					25	
Special impact	8					8	
Totals	2,787	59	125	510	748	710	635

[1] Estimates.

[2] Each opportunity covers a "full-time training period, although more than 1 person may undergo training in the position during the course of the training period.

Source: Office of Manpower Research, Manpower Administration, U.S. Department of Labor.

Chairman PROXMIRE. This is all related to the question raised by your "Projections 1970" which is, I think a wonderful study and did get proper support and praise in the press.

One of the most interesting statements in the study is as follows:

GNP would have to grow by about 4.3 percent a year between 1965 and 1970 to provide jobs for additional workers and to maintain the unemployment rate at 4 percent.

The expectation of the Council is that the growth rate in the coming year would be 4 percent—not 4½ percent or 4.3 percent. This means we are not going to make the kind of progress on unemployment, and it would suggest that perhaps our fiscal policy is too constrained and we could have more expansive fiscal policy—maybe we should not have the tax increase the President is talking about, and at the same time not have stringent monetary policy, lest it be easier than it has been in order to get at this 4.3 percent growth which the Council is not planning.

Secretary WIRTZ. I understand the analysis and you understand my response more in terms of operational possibilities and I do not pretend an independent mastery of the relationship of the fiscal policy to the unemployment figures. I have set myself to this extent—that I think that the rate of growth which the Council projects will probably result in an extension of about the present unemployment situation and that the gain on that has got to come from these other programs—I believe, Mr. Chairman, and members of the committee, that most of those who will be employed as a result of the expansion of the economy are employed and putting it this way, most of those who remain unemployed except for the frictional and seasonal unemployment—most of the others who remain unemployed will not be affected by an expansion of the economy. I know the point that you are making and can only say that I think as far as the effects of the expansion of the economy on unemployment is concerned, it will be maintained on the basis of the growth which the Council anticipates and that the remaining problem, of an affirmative program to reduce unemployment ought to be in this separate area.

Chairman PROXMIRE. My time is up.

Congressman Curtis?

Representative CURTIS. Thank you, Mr. Chairman.

Secretary WIRTZ. Could I add one other point because it is closely related?

Whatever I may have said just now about 1967 does not apply in the future, and I think that while my statement will stand, the projection for 1967 will cover that situation. I do not suggest that a continuation of a growth rate beyond 1967 would do the job because I don't think it would.

Rrepresentative CURTIS. Mr. Secretary, when you talk about productivity rates, you give us 2.8 percent and you project that in 1967 this will go down in the same degree. I note on tables 4 and 5, you apparently gave us fiscal years. Have we got the first half of fiscal 1967 available; namely, the last 6 months of calendar 1966?

Secretary WIRTZ. I wanted to check, Congressman Curtis—you mean the statement of productivity for 1967?

Representative CURTIS. The figure you give us is 2.8 percent. Really these are fiscal years in the table rather than calendar years, aren't they? What I want to known is what is the projection for the equivalent which would be 1966–67?

Secretary WIRTZ. Fiscal 1967–68?

Representative CURTIS. I am trying to correlate it with your own table. Your table 4 has these figures, and I presume they are giving fiscal years. I do not understand them otherwise. Maybe that is the first question.

Secretary WIRTZ. Table 4?

Representative CURTIS. Table 4. You have 1964–65, 1965–66. Maybe I am wrong. I interpret that to mean fiscal years.

Secretary WIRTZ. It is the average for 1 calendar year as compared with the average for the preceding calendar year.

Representative CURTIS. Then is 1966 actually 2.8 percent?

Secretary WIRTZ. Yes, sir, average for that year.

Representative CURTIS. Very Good. What do you anticipate this to be in calendar year 1967? You said it is going to decline, but have you made any estimate of what your rate of decline might be?

Secretary WIRTZ. On the suggestion of a decline, Congressman, I think you refer to what I said in my statement which notes that usually some of these factors are accompanied by a decline in the rate of productivity growth and I have gone on to point to what I confess to you is entirely secondhand information.

Representative CURTIS. You have no estimate?

Secretary WIRTZ. I am working operationally on the principle that it is likely to be about the same as it has been this year, perhaps slightly lower, but it is a complicated situation because the change in these factors resulting from this investment is such that there could be an increase in productivity which would be different from what we have experienced as a result of the change in the gross national product as we approached it in the past.

I am advised that there are factors at work which would mean a larger productivity increase this next year compared with the same expansion in the economy. But I cut through my own ignorance to say to you that for operational purposes and on the best advice I can obtain, I assume, I am expecting to see that productivity figure about the same in 1967 as it was in 1966, but possibly slightly lower.

Representative CURTIS. Most estimates I have seen are a lower figure.

Secretary WIRTZ. You hear 2.5 or 2.6; it is in that area.

Representative CURTIS. I wonder how much we might go further. You say unit labor costs in the private economy rose by 3.7 percent in 1966.

Have you got any estimate for 1967?

Secretary WIRTZ. That doubles the previous difficulty because I would have to add an explanation of what happens on wage costs as well as productivity and I frankly have not done this.

Representative CURTIS. Now, to the wage-price guidelines and the discussion there. I am quite pleased to see your statement because I think it is getting back to what the guideposts were when they were originally presented.

I always look at them simply as an economic exercise and a valuable exercise. But when the administration went through actually formalizing the guideposts and putting figures on them and working to obtain compliance, I thought it got way beyond that original purpose.

Now, I have heard you were quoted as saying a 5-percent wage guide possibility would be appropriate this year in view of inflation. Is this accurate?

Secretary WIRTZ. I thought it was accurate as reported originally. But time has eroded the accuracy of it, I think. It was with reference to the wage increases taking place this year, a good many of them which have been in the neighborhood of 5 percent.

My comment was to the effect that I did not consider that an unreasonable application of the various principles bearing on this situation, and so in general, I was quoted correctly.

Representative CURTIS. Many people feel we are developing a wage-cost push this year and with the large number of labor contracts that are due this year, this can be a very serious matter as far as Consumer Price Index. Will you comment?

Secretary WIRTZ. May I make it clear—I wanted to emphasize that in my previous statement it was a direction of what was happening and had happened and it was a comparative reasonableness of that and not a suggestion of a specific figure.

Representative CURTIS. I am trying to direct your attention to what might be the situation in this calendar year 1967 in respect to inflation. The experience I would say here is entirely too high level of inflation, and it looks like there is a real element of a cost-push situation. That is why I asked the question of your estimate on productivity increases which I myself think are going to go down. At the same time, mostly due to the inflation of 1966, and the wage contracts coming up, it looks like our wages are going to be pushed considerably beyond productivity.

Secretary WIRTZ. The point that you just made is vitally important. To whatever extent there is a carryover from previous experience, and that takes its most precise form in the extended contracts, that is one thing. And one about which I cannot do very much.

If, on the other hand we can say ourselves there is not an increasing head of steam on that, and that it may be decreasing, which I think to be the case, then we are in a more satisfactory condition. You are very right in suggesting there are some carryovers, cost-push effects.

Representative CURTIS. Some companies I understand have agreed to give the Council of Economic Advisers advance notice of proposed price increases. I wonder if any labor unions are going to give advance notification of their demands? Have they come to you in a comparable way?

Secretary WIRTZ. We all have a common experience that the advance notices are usually considerably higher than the final settlement, and if your question is whether I have any basis of knowing what the final settlements are going to be, I do not.

Representative CURTIS. I was very much interested in the process, of which a great deal was made last year by the Council of Economic Advisers, as to the techniques used by the administration in the area of wage-price guideposts. Frankly, I was a little bit alarmed. I thought they were somewhat extra legal.

If this is going to go on, and apparently the Council of Economic Advisers is going to continue discouraging industry price increases, I am trying to see whether there are any plans to go in the other direction, especially since it looks like we have some real momentum going toward a wage push beyond productivity increases, probably because of previous inflation.

Secretary WIRTZ. I am not quite sure as to the question.

Representative CURTIS. The question is: Whether or not you are going to try to use exhortation to get the labor unions to try to hold back on their wage demands in a way comparable to which the administration is going, to encourage industry to hold the price level?

Secretary WIRTZ. Let me answer you in different words and if they are not sufficient for an answer, come back and use your form of it.

There will be a stronger effort made to sell the general interest and the self-interest of restraint on the wage side as on the price side because you can't separate the two out.

Representative CURTIS. I appreciate that.

Secretary WIRTZ. I think the year's record ends up with a fairly complete public appreciation of the fact that even to the extent of going too far occasionally, we have tried to drive that home to everybody concerned during 1966. There were errors. There were errors of exhortation but they had a saving quality of evenness. They will in the future.

Representative CURTIS. In respect to the Manpower Training Act, what have you done this year to get the job vacancies statistics?

Secretary WIRTZ. You and I have talked about that over a number of years and I told you before that we haven't been able to get the appropriation from Congress, so we are postponing it. I can tell you now, in one way or another we have managed to get a pretty complete picture of that situation now through Mr. Ross' office, not only collecting, but publishing each month a quite comprehensive statement of the shortage situations. They are not statements that will satisfy the purest among the statisticians. They do jibe with general information, enough that there has not been much complaint about them. We are doing it on an occupation-by-occupation, area-by-area basis. I think I can say to you with confidence that that picture is now perhaps not statistically accurate, but practically sufficient.

Representative CURTIS. My time has expired.

Chairman PROXMIRE. Congressman Reuss?

Representative REUSS. Mr. Chairman, Mr. Secretary, your excellent presentation includes the disheartening fact that unemployment among Negroes, and particularly young Negroes, is trending up. That is unhappily true, is it not?

Secretary WIRTZ. Yes, sir. Trending up—not in absolute terms, but in percentages. We are just barely holding our own. The numbers are increasing but we are not pushing the rates down significantly.

Representative REUSS. The administration has recommended a 6-percent across-the-board tax increase to take effect on July 1. Will not this have some effect on increasing unemployment, and will not that effect bear very largely on Negroes and young Negroes in particular?

Secretary WIRTZ. I don't believe very much, Mr. Reuss. Because I think that it is particularly true of this group that was involved is perhaps less a shortage of opportunity than a completion of the requirements for taking advantage of it and that this is peculiarly a remaining area of unemployment which will not be remedied by an expanding economy and will require affirmative individualized concentrated attention. I think there will be only a small incremental effect.

Representative REUSS. I think every member of this committee would agree, it needs tailormade, ad hoc attention. It needed that all the way down from the 7-percent unemployment figure that we had a few years ago. But a moment ago you said that most of the current unemployed could be helped only by tailormade manpower training methods, not by general increase in demand. Is it not true that a substantial portion of the unemployed could be helped some by general increases in demand, and will not therefore the proposed tax increase, which means there will be less demand from the consumer to buy goods, and less ability of investors to invest—will not the effect of that tax increase be, on the margin, to deny a job to some Negroes, and particularly young Negroes, who would get a job were it not for that tax increase?

Secretary WIRTZ. I don't mean for a moment to avoid the obvious fact that there is a relationship between the tax increase and the rate of expansion of the economy, and that that has some relationship to jobs. But I can't help coming back to the fact that a third of our unemployment is among the youth and a lot of these are nonwhite.

But the point is, as far as I am concerned, they shouldn't be working, anyway. They ought to be in school or in training. So in terms of the problem you pose it does not seem to me that the answer lies in putting them into the jobs that an expanding economy would give them—most of them being dead end jobs that the machines are just waiting to take over. The answer to that problem lies in an extension of education and training programs rather than in increasing the number of jobs.

Representative REUSS. You do not think it lies in both?

Secretary WIRTZ. It does lies in both, of course, especially in the sense that if there should be a slipback in the economy, then that situation would worsen terribly. If the economy should fall back so that there would be an increase in unemployment, this would happen for the very reason that you are talking about. This situation would be exceedingly serious.

My point is that as far as an affirmative improvement is concerned, we have a lot bigger job in moving in on the personal aspects of it than is involved in the economic application.

Representative REUSS. I agree with that.

Let me now turn to the wage-price guideposts and call to your attention the very instructive and perceptive testimony you gave before the House Government Operations Committee last fall.

Secretary WIRTZ. I remember the occasion even with that description.

Representative REUSS. The Government Operations Committee following its hearings brought out a series of recommendations which are contained in its October 11, 1966 report[1] and I would like to ask unanimous consent that those recommendations be included at this point in the record.

Chairman PROXMIRE. It is so ordered.

The recommendations referred to appear below:

* * * * *

RECOMMENDATIONS

1. That the President continue the present practice of including wage-price guideposts in his Annual Economic Reports as required by section 3(a) of the Employment Act of 1946 and that he make comments on or revisions of such guideposts in supplementary reports he may transmit to the Congress under section 3(b) of the act.

2. That the Joint Economic Committee of the Congress continue its present practice of holding full public hearings on the President's Economic Report and that these hearings give special attention to the wage-price guideposts contained therein providing an opportunity for representatives of labor, management, and the public to give their views on the guideposts.

3. That the Joint Economic Committee, in its report to the Congress, specifically include its findings and recommendations on the guideposts. If the administration's guideposts are approved by the committee, this congressional action will strengthen their public acceptability. If the Joint Economic Committee's position on the guideposts differ from that of the President, it can be expected that the President would review them in the light of the committee's recommendations and that should result in greater public acceptance and, thus, opportunity of success. This is particularly important with respect to the forthcoming January 1967 guideposts since they inevitably must come to grips with the erosion in the cost of living which has occurred, with the problem of equity between different segments of our economy, and with the problem of the utilization of manpower.

4. We recognize that the application of the guideposts in specific wage or price cases is a different and a complex matter. Here we endorse the suggestions of Secretary of Labor Wirtz and the President's Advisory Committee on Labor-Management Policy for action by that advisory committee in specific cases. This would be consistent with section 4(c) of the Employment Act which permits the Council of Economic Advisers to constitute advisory committees and to consult with representatives of various groups as it deems advisable. Inasmuch as the Joint Economic Committee of the Congress is already authorized by law to hold hearings, we recommend that where the committee feels that it may usefully supplement the work being done within the administration on specific cases, it hold hearings on them and make its own findings and recommendations. We believe that such action on specific cases and when "crises" arise would help reconstitute and reinvigorate the guideposts in a manner designed to secure the greatest degree of public agreement and support. Thus, the essence of H.R. 11916 will have been obtained.

* * * * * * *

Representative REUSS. Have you had an opportunity to look at those?

Secretary WIRTZ. Yes, I have, Mr. Reuss, and I don't recall them in sufficient detail. I do remember the report.

Representative REUSS. They are here at this point in the record, and may I ask you to make your comment when you have a chance to review them? I strongly suspect from the testimony you gave that you will approve of every comma in those recommendations, but that is for you to say.

Secretary WIRTZ. I testified on the basis of my general recollection to that effect. I don't recall the detail.

[1] Strengthening Wage-Price Guideposts, 41st report by the Committee on Government Operations, H. Rept. 2231, 89th Cong., 2d sess.

Representative REUSS. Among the recommendations made were that this committee include its findings and recommendations on the guideposts, and if the administration's guideposts are approved by the committee, this congressional action will strengthen their public acceptability. If the Joint Economic Committee's position on the guideposts differs from that of the President, it can be expected that the President would review them in the light of the committee's recommendations and that should result in greater public acceptance and, thus, opportunity of success.

You might comment on that particular point.

Secretary WIRTZ. It makes good sense to me.

Representative REUSS. There have been expressions from members of this committee during these hearings—in which, incidentally, we are doing precisely the kind of review of the guideposts that the Committee on Government Operations had in mind—There have been expressions from members of this committee that the removal of numbers from the guideposts this year is not desirable, that it does not tell labor and management what their obligations are. There is a suggestion before this committee that meaningful guideposts next year in wages would be a particularization of the CEA's past guideposts, taking into account, perhaps, in addition to the productivity increase of 3.2 percent, about half of last year's cost of living increase, working out at something like a 5 percent wage guidepost, subject to all the "ifs," "and" and "buts" of the guideposts; and that the price guideposts should likewise follow the past productivity trend recommendations of the CEA, but with special emphasis this year on meaningful action to urge price decreases where the over-average productivity trend of the particular industry permits that.

I would like your comments on that proposal. Suppose the Joint Economic Committee thought it wanted to state something like that?

Secretary WIRTZ. One question to make my answer as helpful as possible. Does your question anticipate one figure which effects the productivity principle which was in the guideposts, or does it reflect one figure which represents the proposed application of productivity principle, costs of living, ability to pay—is it just the productivity point that is to be put in the single figure or would all of these be brought together?

Representative REUSS. The suggestion is that we use the same formulation in other years as the Council has given it, that is to say, in recent years like 1965 and 1966, but that we provide some partial reckoning of the cost-of-living increases, added to productivity, which would come to about 5 percent, and then on the price guideposts we would suggest about what the Council did in 1965 and 1966, with a little more meaningful public education on the ability of overaverage productivity industries to reduce their prices.

Secretary WIRTZ. I would respectfully disagree and be in complete opposition for these reasons. Starting from the one which is implicit in your last point—it will never be possible for this country to learn a price guideposts expressed in specific figures the way it learns a wage guideposts because of the difficulties of communication which attend the situation. It is one of the great misfortunes.

Representative REUSS. I did not suggest they should be.

Secretary WIRTZ. I am talking about the difficulty. It was easy for somebody to translate a single point affecting wages into a single percentage point, and by "somebody" I mean the American public, and to translate a principle into a decimal point—it was never done on the price side, not because of any lack of attempt, but because that message for interesting reasons just didn't get across and there is a lopsided reaction because the one was reduced to a decimal point and the other was not.

My first point is in answer to your question, unless that problem can be solved I think it would be a mistake to do it again.

My second point is, in the guideposts, 3.2 percent was intended to reflect the productivity element. It was interpreted as reflecting all elements. It was intended at least until 1966 to be a statement of general application to the economy as a whole. It was applied and interpreted in 1966 and the administration would share the responsibility for this as a result, for particular cases. I don't suppose we will ever get out of that habit. I don't think you could arrive at a single figure, given today's circumstances, which would represent a rational application of the productivity principle and the other relevant factors, and if you could, Mr. Reuss, and respectively I would point out that I think there is a built-in reaction in this country against being told that matters of the nature that we are talking about here should be reduced to a specific decimal point figure.

This country doesn't like being told "not to put beans up its nose" and that psychology was at work last year and it was 3.2 and this is the second time this country has learned that a specific figure—and, coincidentally, 3.2 is a poor translation of a broad set of principles in a particular point and so I don't think that another translation into a specific formula is recommended by present circumstances.

Representative REUSS. I would suggest to you that this country has not minded being told for a good long time that someone who reaches his 21st birthday is thus an adult and subject to all the legal consequences of being an adult.

Secretary WIRTZ. But the kids reject it.

Representative REUSS. And the day before he was not an adult, and I have not heard great outcries in this country for changing that rule and instead substituting one which says a person shall be an adult, and so considered for legal purposes, when he becomes rationally mature, because such a rule would be very difficult to apply.

Secretary WIRTZ. Your children are more mature than mine.

Representative REUSSS. It would be difficult for society to decide whether somebody was an adult or not. My big difficulty with having vague guideposts is that nobody can tell whether he is being a "good guy" or a "bad guy."

Secretary WIRTZ. I don't believe it is that simple any more than I could translate moderation into 3.2 in the 1930's. I don't think you can translate this situation into a decimal point figure. I have a good deal of sympathy with a member of my family who says, "How old do I have to be to be a member of this society, and why should I be denied all kinds of things just because I have not reached the age?". I think there's got to be a point where you have to have a specified limit at a fixed rate. Probably true of the age, although I have more trouble there. But when it comes to translating all of the subtleties—the sophistication, experience, wisdom, responsibility—of setting wages and of setting prices of this country into a single decimal point, I think we have a very good tradition from the one which we had in deciding how fast you could drive along the highway.

Representative REUSS. As a Milwaukeean, I recall I welcomed the 3.2 beer guidepost in the early 1930's, and I think in the recollection of most people who were around then it was a great thing.

Chairman PROXMIRE. Senator Javits?

Senator JAVITS. Mr. Secretary, what is the outlook for labor disputes this year and how will they affect the economic situation?

Secretary WIRTZ. I could answer you in terms of cases which are coming up which are significant of the portions which I think you refer to.

That list includes—and this listing is not exclusive or complete—the oil case which is already eventually settled. It includes the railroad case which gives promise of settlement right down to the last two or three or four issues. That was on a 5-percent basis. It includes the trucking case which is presently in active negotiation. There is another New York newspaper case shaping up and I don't know with what degree of concern it should be viewed. The meatpacking contracts are open this year, so are the nonferrous metals. Pulp and papers are coming up, and there are automobiles and farm implements, and if I didn't include rubber—the rubber industry—in that listing, I should have.

Those are the principal ones, and I can only expect our problems may come from one I haven't included at all. As nearly as we can anticipate the problems lie in those areas. I mean our prospects lie in those areas.

Senator JAVITS. That represents a large share of the U.S. economy, does it not? For example, trucking is absolutely based to the whole economy. Is that not correct?

Secretary WIRTZ. These are vital industries.

Senator JAVITS. What effect is this going to have on all these forecasts?

Secretary WIRTZ. The total in those industries would be about 3 million workers.

Senator JAVITS. Three million workers?

Secretary WIRTZ. Yes.

Senator JAVITS. What effect do you see the labor-management picture having upon the economy? Do you expect any big strikes this year?

Secretary WIRTZ. I can't answer that question.

Senator JAVITS. You just do not know?

Secretary WIRTZ. I just don't know.

Senator JAVITS. Does the administration have any feeling about any preparations it has to make to meet any such problems?

Secretary WIRTZ. Does it have any feelings about any preparations?

Senator JAVITS. Are there any preparations being made?

Secretary WIRTZ. The matter is, as it has been for some time, under serious consideration. You mean whether there should be some recommendation to the Congress, is that it?

Senator JAVITS. I was not really thinking about that.

Secretary WIRTZ. I am glad.

Senator JAVITS. Does the administration really expect to have a troublesome period of labor disputes this year which could be disruptive to the economy?

Secretary WIRTZ. I don't know how to answer that question helpfully. I hope I reflected it already. I have a feeling it is a matter that must be watched very carefully and it is being. It is surely being watched with the hope that every one of those cases will work out privately. But it is—we are not sitting back and assuming that nothing can happen.

Senator JAVITS. In the 1966 Economic Report, the statement was made as follows:

> The recent transit strike in New York City illustrates our helplessness in preventing extreme disruption of the lives and livelihoods of a city of 8 million people. I intend to ask Congress to consider measures that without improperly invading State and local authority, will enable us to deal with strikes that may cause irreparable damage to the national interest.

That was on page 17 of the 1966 Economic Report of the President. Now, in 1967, not a word about emergency strike legislation.

Will you tell us, Mr. Secretary, whether the administration thinks it is no longer necessary to consider what it proposed to consider in 1966 and if it does consider it still necessary what does it intend to do about it?

Secretary WIRTZ. I will answer the first question, that interpretation would not be permissible and I'm not in a position to answer the second, because it is a matter which, as I say, the administration has before it in a formal sense and you would appreciate my inability at this point to speak to that.

Senator JAVITS. When do you think we may expect an answer from the administration on this subject? Is there any time fixed?

Secretary WIRTZ. I couldn't without sparring with you by helpful on that and there is not a time fixed.

Senator JAVITS. Do you think we in the Congress would be right or wrong in trying to fix a time?

As you know, Senator Morse and I and many others have moved in this matter and I have no—personally I have no particular desire to press that resolution, which incidentally the Senate has passed three times in other legislation, but I would like to lay before you the proposition that we ought to know.

This is a critically important aspect of the U.S. posture to meet the contingencies of, let us say, a national trucking strike.

May I therefore ask, Mr. Secretary, with the Chair's permission, should the administration choose to make a statement upon this subject, and I hope and pray—I have no desire to do anything but find out what it has in its mind—I ask unanimous consent that should the administration choose to make such a statement that it may be made part of Secretary Wirtz' statement?

Chairman PROXMIRE. Without objection.

Senator JAVITS. Mr. Secretary, I agree with you, there is no use in sparring and I admire you for your frankness. Mr. Chairman, it is understood that I cannot hold up the printing of the record but I assume the administration will let us know and if they do not file, then certainly they do not want to.

Secretary WIRTZ. I will be glad to complete the record with any proposal which is available before the record closes.[1]

Senator JAVITS. I will do my best to give you notice.

One of the things we have been considering very seriously in the hearings on cities of the Government Operations Committee is some underlying replacement for the basic welfare idea and one of those concepts which has been underlying the replacement would be for the Government to act as an employer of last resort.

Do you, as a Secretary of Labor, have any views upon that subject—that is, the need to deal with the hard core unemployed and the need to put them into some form of useful community enterprise by making the Federal Government an employer of last resort?

Secretary WIRTZ. Yes, I do have a view; and it would be that, as this situation has worked out in its complete form, it may include something of that kind.

I think we are presently at a point where all of our available resources and all of our available personnel are to be put rather toward the development of the private employment very frequently as a result, as an end result, training programs which might be quite long and which might sometimes go on indefinitely, but not by design. With the economy working the way it is now, with as many potential private employement possibilities as there are, with as much to be done as needs to be done to complete the training of individuals for those, I think our emphasis should at this point be on that, rather than on the public employer of last resort point. But I am sure, Senator Javit, that eventually we will come to a recognition that there are about, as nearly as I can tell, a half of 1 percent of the people in the potential workforce who won't make it and eventually will get there. It is in terms of priorities. And I think these other things ought to come first.

Senator JAVITS. You do not care much for what we call the negative income tax, basic family payment, or what? Would you care to comment on that?

Secretary WIRTZ. Yes, I would.

Senator JAVITS. What is your position on it?

Secretary WIRTZ. I am in the minority as far as that view or the view of that group is concerned. I don't think it advances our present purpose in this country to be talking about a negative income tax. My logic tells me that there is nothing wrong with that proposition, but my practical good sense, or what passes for it, suggests to me that pushing along that line, at this point, probably slows up our progress in some of these other directions; and so I should like to see that item put down lower on the agenda, because I think it gets in the way, as far as the public is concerned, of doing some of these other things that we ought to do first.

Senator JAVITS. Let me recapitulate because my time is up. You are for government being the last resort in training?

Secretary WIRTZ. Yes, sir; and that's an important distinction.

Senator JAVITS. That you are all for?

Secretary WIRTZ. For the time being. Eventually it ought to be private, but for the time being.

[1] At time of publication of the hearings, no further information was available.

Senator JAVITS. Which would include stipends if necessary?

Secretary WIRTZ. Training allowances? Yes, sir.

Senator JAVITS. And, finally, your own individual sentiment is for the Government being the employer of last resort for the hard-core unemployed left beyond the training stage?

Secretary WIRTZ. But that we ought to postpone that and not let it get in the way of some of these more immediate things we like to do. I think the President's suggestion of a Commission to look at this set of problems or possibilities is a good one.

Chairman PROXMIRE. Mrs. Griffiths?

Representative GRIFFITHS. Mr. Secretary, you refer, in your statement, to the training slots allocated to the hard-core unemployed. How many are allocated to women, and how many to men?

Secretary WIRTZ. My recollection is that—and I think your question proceeds on the basis that it is about 35 percent women—between 30 and 35 percent women and 60 and 65 percent men.

Representative GRIFFITHS. In fact there are more women unemployed, am I right?

Secretary WIRTZ. I don't believe it is. I will have to check that.

(The following information was later supplied:)

1966 unemployment totals	2,976,000
Males	1,622,000
Females	1,354,000

Representative GRIFFITHS. If a young teenage woman draws ADC, does she go off the unemployed list? Does she draw unemployment?

Secretary WIRTZ. I am advised that it would depend not if she is getting payment, but if she is not actually looking for work. If she were actively looking for work she would be counted for unemployment.

Representative GRIFFITHS. If a young man draws welfare and is looking for work, I take it he is counted as unemployed. Would he be if he is not employed?

Secretary WIRTZ. He would not be counted as unemployed and would not be counted in the work force.

Representative GRIFFITHS. Are those women whose husbands are disabled, and who have several children and are drawing Social Security—are those women counted as unemployed?

Secretary WIRTZ. It would be the same answer.

Representative GRIFFITHS. Same answer?

Secretary WIRTZ. Yes.

Representative GRIFFITHS. How much success have you had with the relocation program?

Secretary WIRTZ. Very little. You mean the mobility?

Representative GRIFFITHS. Yes. Have you made any effort to relocate women as domestics?

Secretary WIRTZ. I will check, but unless I supplement the answer to the contrary, the answer is "No."

Representative GRIFFITHS. There are some jobs as domestics that are wonderfully good-paying jobs and many women certainly would enjoy having them. I know a woman who tried for weeks to hire one, at $75 a week, to cook only, 1 day off, and the employer would furnish a car, furnish the medical care and provide for social security payments, and the family would arrange a pension program. At the present time we are bringing women in from foreign countries for such jobs. They return to those foreign countries and draw social security payments. So you are hurting the balance of payments.

Secretary WIRTZ. I want to check about the social security.

Representative GRIFFITHS. I am sure this is right. I do not have any question about it at all. To my amazement we have substantial numbers of people even in Yugoslavia who do nothing but check on social security recipients and some of these people in some countries are women who have worked here as domestics. So it seems to me that it would be to our interests if you would move some of these women around.

(See pp. 366ff. for tables relating to above.)

Secretary WIRTZ. There is a very real question as to whether the American people are going to do this type of work.

Representative GRIFFITHS. If they know such jobs are available, I am sure they will respond. I came from a very poor area of this country, Mr. Secretary, and I know that a lot of these people have no idea that such work is available and that it pays these prices.

Do you or do you not have a group within your Department that is seeking equal pay for equal work?

Secretary WIRTZ. We do have.

Representative GRIFFITHS. How large is that group?

Secretary WIRTZ. I would have to supply that for the record. It is handled by the Wage and Hour people and I do not think that there is a large, separate group on it.

(The information requested follows:)

The Equal Pay Act was incorporated by the Congress into the FLSA so as to make possible a check on compliance with the equal pay standard in each investigation conducted under the Act. Originally the proposal considered by the Congress was for a separate equal pay act. As it now stands, a check on compliance with the equal pay standard was made in each one of the more than 57,000 investigations completed in the last fiscal year and in the more than 28,000 completed in the first six months of this fiscal year. It would be fair to say that the equal pay investigatory staff comprises all of the investigators of the Wage and Hour Division.

Representative GRIFFITHS. I have a letter from a woman in Pennsylvania who writes, "I have worked in a large factory near Pittsburgh for 15 years. In 1963 the company and union signed into the labor agreement a labor pool which included job class 1 through 4 which is common laborer. We worked in this pool. Now the union of which I am a member signed a new agreement which classified male and female jobs with the company.

"Now, instead of going into this pool I am laid off when the job is slow. The union said no woman will take the job. The company has gone right along with it. Can title VII of the Civil Rights Act of 1964 help us? There are about 50 of us women laid off and the company is hiring men to sweep and do common labor which we have done in the past." Can you help them, Mr. Wirtz?

Secretary WIRTZ. Yes, ma'am.

Representative GRIFFITHS. Will you do it?

Secretary WIRTZ. If you give me their names.

Representative GRIFFITHS. I have sent the letter to you, but what can you do for them?

Secretary WIRTZ. If the facts stand up as she suggested them to you, the complaint would seem to come clearly within title VII. Now, it is a gray area, but with the truth of those facts there would be a basis for recovery.

Representative GRIFFITHS. It is a phony classification.

In the city of Detroit, in some plants we have receivers and shippers. The shippers are women. They draw less than the men who are the receivers. The women have great responsibility. They can be suspended for an error where a man cannot be suspended at all.

Under any circumstances if you can enforce equal pay for equal work in our judgment, what would the effect be upon the economy?

Secretary WIRTZ. In dollars?

Representative GRIFFITHS. Yes.

Secretary WIRTZ. That will be a hard question to answer, but I think I could get an approximation of it, because we have made quite a study of it and I would like to suply it for the record. I do not have such figures here.

(The information furnished in answer to above follows:)

Since the Equal Pay Act went into effect, investigations have disclosed more than 10,000 employees underpaid under this provision. The amounts of underpayments involved were about 3¾ million dollars.

Representative GRIFFITHS. In quantitative terms how much is discrimination of Negroes costing the American economy?

Secretary WIRTZ. Against Negro workers? That figure has been estimated by the Council—the figure I have in mind is that an estimate was made in the range of $15 to $16 billion in terms of the gross national product, that being the price of discrimination. I will check that and correct it for the record and will try to supply copies of the figures as far as women are concerned.

Representative GRIFFITHS. Thank you. I would be very interested in seeing them.

(The information later supplied follows:)

The Council of Economic Advisers, in the 1966 Economic Report estimated that the annual economic loss to the Nation on account of discrimination amounts to $27 billion in terms of the gross national product.

Chairman PROXMIRE. I would ask Mrs. Griffiths to take over the Chair for a few minutes.

(At this point Mrs. Griffiths assumed the Chair.)

Representative GRIFFITHS (presiding). Senator Miller?

Senator MILLER. I understand we have a vote in the Senate.

Representative GRIFFITHS. Congressman Rumsfeld?

Representative RUMSFELD. Mr. Secretary, in your statement you indicate that on the average only 1.1 million of adult males were jobless looking for work and nearly twice that number in 1963.

Could you compare that with 1960? Do you have the figures for 1960?

Secretary WIRTZ. I can supply it, but I can bet it was about cut in half between 1960 and 1963 and then cut in half again between 1963 and 1966. So that would carry it to—my first figure may be a little high, but it won't be far off.

(See table, p. 275.)

Representative RUMSFELD. I believe you have indicated that it was only 1.3 for professional personnel, but 31.1 percent for Negro teenage girls. This is the rate of unemployment in the United States for 1966?

Secretary WIRTZ. Yes, sir.

Representative RUMSFELD. What was the figure for 1960 versus the other 31.1 percent for Negro teenage girls?

Secretary WIRTZ. I will supply it for the record and it will be lower than this figure. That figure has increased over that period of time.

Representative RUMSFELD. The percentage has increased as well as the number of individuals?

Secretary WIRTZ. No; the percentage has increased. The number of employed Negro teenage girls—employed has increased and the number of unemployed has increased, I think.

Representative RUMSFELD. I would like that figure for, say, 1960–63, and 1966.

Secretary WIRTZ. These are readily available.

(The information requested above and subsequently supplied follows:)

Adult males unemployed

	Thousands
1960	2,060
1961	2,518
1962	2,016
1963	1,971
1964	1,718
1965	1,435
1966	1,119

Employment status of nonwhite females, 14 to 19

	1960	1961	1962	1963	1964	1965	1966
Employed	202,000	193,000	191,000	184,000	197,000	200,000	231,000
Unemployed	58,000	70,000	75,000	91,000	87,000	85,000	104,000
Unemployment rate (precent)	22.3	26.6	27.2	33.1	29.6	29.8	31

Representative RUMSFELD. I would also like for the comparison with the 21.2 percent for Negro teenage boys.

Secretary WIRTZ. All right, sir.

(The table below was furnished in answer to above request:)

Employment status of nonwhite males, 14 to 19

	1960	1961	1962	1963	1964	1965	1966
Employed	340,000	324,000	323,000	314,000	341,000	378,000	406,000
Unemployed	96,000	106,000	84,000	107,000	104,000	111,000	109,000
Unemployment rate (percent)	22.2	24.8	20.9	25.3	22.9	22.7	21.2

Representative RUMSFELD. And for the 7.3 percent for the unskilled.

Secretary WIRTZ. Right.

(The information requested follows:)

Employment status—Nonfarm (unskilled) laborers

	1960	1961	1962	1963	1954	1965	1966
Employed	3,665,000	3,477,000	3,559,000	3,574,000	3,644,000	3,875,000	3,727,000
Unemployed	522,000	588,000	502,000	492,000	430,000	354,000	288,000
Unemployment rate (percent)	12.5	14.5	12.4	12.1	10.6	8.4	7.3

Secretary WIRTZ. On the first two the pattern will be the same, number of employed has increased, number of unemployed has increased, the unemployment rate has increased and that will be different for the third. That percentage has gone down.

Representative RUMSFELD. I suppose to make the number more meaningful it would be helpful for me to have the total number of individuals in each category in each of those periods, also?

Secretary WIRTZ. We can give you both that in the percentage and in absolute numbers. (See preceding table.)

Representative RUMSFELD. Fine; you also indicated that there has has been a large increase in on-the-job training?

Secretary WIRTZ. Yes, sir.

Representative RUMSFELD. Which, personally, I can say I am very pleased with. I feel that this is important and very valuable.

I would be interested to explore with you briefly some facts about what many Members of Congress in both Houses have talked of as the Human Investment Act. I have in mind that at one point you indicated you were not enthusiastic about the tax credit approach and I recollect that at some point subsequent to that you indicated that this might be a possibility. I feel very strongly that it would be a way to bring the private sector into this to a greater extent, and that, in keeping with your earlier remarks about the unemployment level and the problems of inflation, this might be a technique or mechanism whereby we could do this country a great service.

I would like some comment from you and hopefully a favorable comment about this concept and about the administration's possible position with respect to it?

Secretary WIRTZ. It is more operational than it is a point of policy. If there were some way of accomplishing the purpose, which we all seek, by a tax credit. I think there would be unanimity of reaction to it. The difficulty is in trying to work out a program which would subsidize, and I use that term in its sympathetic sense, the training of those who would not otherwise be trained. It would seem a mistake to subsidize training that would be done anyway. You could properly point out that that is true of the investment credit as far as equipment and machinery is concerned.

Representative RUMSFELD. I was about to do that.

Secretary WIRTZ. And that leaves this remaining problem. It doesn't matter what machinery and equipment somebody buys; it does matter that there is a social interest in trying to direct the training where it is needed most, which distinguishes these two situations.

The on-the-job training program, if properly administered does permit the sharing in that decision of the employer and the public. We have continued to proceed on the assumption that as we make the on-the-job training procedures more flexible, reduce the amount of redtape, diminish the number of restrictions upon it, be more flexible about it, and leave more to the employer's discretion, we perhaps move toward the same result that you are talking about in connection with the tax credit.

Now, you realize from what I have just said and from your proper reporting of the previous development I am by no means ready to propose to do away with that approach. I would go through with it—I would go through with the on-the-job training program. We would concentrate the subsidy on the cases which needed it most.

Representative RUMSFELD. Does the category of opportunity which you are referring to as on-the-job training program offer the same advantages as would a tax-credit incentive to the private sector in terms of seeing that the individuals once trained are trained for a job that does in fact exist? This is a problem. You were talking about statistical information with Mr. Curtis concerning what openings really exist. The knowledge, it seems to me, as to what is actually needed and available, exists in the private sector. And I am wondering if this apparent advantage in the tax credit mechanism—in addition to the on-the-job training, might be sufficient to swing you over.

Secretary WIRTZ. We are still proceeding on the assumption that if we perfect the on-the-job training there can be the full measure of the employer direction of the program and the particular training.

We are also hoping to meet this other situation. If you put a tax credit into effect and an employer has the possibility of on-the-job training, of Mr. A whom the employer is relatively sure he can make into a good working asset within 6 months, and Mr. B, who also requires some basic education, and who, therefore, probably will take 2 years to become a comparable asset, he will take A. We are hoping we can make arrangements which will encourage him to consider B if we supply the supporting services of one kind or another. But I didn't mean to take advantage of your question to answer another one.

I do think that the on-the-job training program can properly be administered with sufficient delegation, not in the constitutional sense, of authority to the employer, and can achieve the full purposes of the tax credit.

Representative RUMSFELD. You mention real take-home pay was lower at the end of 1966 than at the end of 1965. I would like to have those figures; and for 1960, also.

Secretary WIRTZ. We can give them—the figures are relatively complete for the production workers in the manufacturing industries and we can give you those. The tables are incomplete when you get outside of that. You want only the end round figures for production workers and manufacturing.

75-314—67—pt. 2——4

(The information below was subsequently supplied:)

Real spendable average weekly earnings, in 1957–59 dollars, for a worker supporting 3 dependents

	December 1960	December 1965	December 1966
Manufacturing	$76.09	$89.75	$88.13
Mining	87.89	102.32	101.20
Construction	92.03	111.77	112.35
Trade	[1] 62.26	64.63	64.17
Finance insurance and real estate	(2)	74.59	73.23

[1] Data for eating and drinking places are excluded in 1960, included in 1965 and 1966.
[2] Not available.

Representative RUMSFELD. May I ask another question? It is a bit remote, but of interest to me.

You have talked of the unemployment in the lower age groups, late teens and early 20's. In the event that it were possible for this country to recruit sufficient manpower for military purposes through a voluntary system and could elevate the compulsory system to fit on top of the voluntary system, to be activated and utilized only in the need of a major increase in military manpower, what effect might this have on the psychology of this age group and their employment rates? Does it seem to you that this question of the draft in this area causes some of the problems as far as placement, training, getting going from the young person's standpoint—the questions from management's standpoint as to their willingness to undertake training and take a chance on somebody who has his military obligation still facing him.

Secretary WIRTZ. Yes, sir, I think it would have an effect. When you find these young Americans as they did last Sunday, you are impressed and as long as your question is put in terms of psychological effect, there are some very important psychological effects on their thinking about the whole thing. I am sure that enters into their thinking.

Representative RUMSFELD. As the Secretary of Labor in command of this Department, have you communicated this to the President's Commission on the Draft with a view toward seeing if this administration might be willing to revise military personnel practices in terms of pay and other aspects of personnel policy so they might be able to recruit a substantially larger, if not all the military manpower required through a voluntary mechanism, rather than through the compulsory mechanism?

Secretary WIRTZ. I did testify before that group on the subject matter of this line of questions in October, I believe.

Representative RUMSFELD. Thank you, Mr. Secretary.

Chairman PROXMIRE. Senator Miller?

Senator MILLER. Thank you, Mr. Chairman.

Mr. Secretary, at the beginning of your statement, you say:

> It seems to me right to assert full employment (in the fullest sense of that term) at wages producing a decent standard of living for everyone as a first priority national purpose.

The Full Employment Act of 1946 states, and I am going to skip some parts of it: "The Congress hereby declares that it is the continuing policy and responsibility of the Federal Government to use all practicable means to promote maximum employment, production, and purchasing power."

I was wondering why you would not have used that language rather than what you used, or if as you see it there is any basic difference between the two policies?

Secretary WIRTZ. Senator Miller, you refer to that as the "Full Employment Act of 1946."

There is irony in the history which is that there was introduced to the Congress a full employment bill which Congress enacted as the Employment Act—they struck "Full" from the title of the bill and I think the point has relevance only to the psychology which has attended the subsequent development of our thinking in this area.

We have been afraid—too many of us—to say "full employment" and mean it. And so my answer to your question is that I would not be content with the philosophy of the full employment bill.

Senator MILLER. Why would you not seek to have Congress amend that act? It seems to me, as just one member of this committee, that if we are trying to promote maximum employment, we are trying to promote full employment in the best sense of the word.

Secretary WIRTZ. I don't think there is a shortage of legislation on this point. I think the Congress has responded to this problem in the enactment of the Manpower Development and Training Act in 1962 and in its subsequent amendments on four different occasions. Each time we have come up with needed additions developing a program which is still surely not complete. So I think it is a relatively good legislative picture. I think that the largest thing we need to do now is to further develop and integrate the efforts of government and of the private employer in this area.

Senator MILLER. Then would you agree that the Employment Act of 1946 objectives which I have read coupled with the subsequent legislation would indicate that the Congress intended by maximum employment the concept of full employment in the best sense of the word?

Secretary WIRTZ. Yes, I think that is right.

Senator MILLER. In addition to that is this word "purchasing power." Would you not consider that stability of the purchasing power of the dollar is an inherent part of that policy, not only the policy as set forth in the Employment Act of 1946, but the policy that you have stated in your statement?

Secretary WIRTZ. Yes, I would.

Senator MILLER. Then to the extent that you have indicated real wages went down last year, we have fallen short of attaining that purpose and policy, have we not?

Secretary WIRTZ. I think that's right.

Senator MILLER. How many employees—if you have the figures, fine—if you do not, I would like to have you supply them for the record—by year—how many employees are covered by escalation clauses in the United States?

Secretary WIRTZ. We can supply that figure. My offhand estimate would be 3 to 5 million. We will supply the specific figures.

(The information below was later supplied in answer to above:)

About 3 million workers were covered by cost-of-living escalation at the beginning of 1967, compared with 2.5 million at the beginning of 1966. In 1958 and 1959, when escalation was at a peak, the total was about 4¾ million.

Senator MILLER. It is going up each year as I understand it, is it not?

Secretary WIRTZ. Yes, it has gone up.

Senator MILLER. I understand that there is a demand for escalation clauses and there is a forecast for a number of potential renewals.

Secretary WIRTZ. That is correct.

Senator MILLER. If a guidepost is developed, should it not have a fluctuating factor, based upon the stability of the dollar, so that when there is an inflationary factor, that will be taken into account, so that there will be a real wage increase, rather than one that has been diluted by inflation?

Secretary WIRTZ. It presents a problem of terminology. If by guideposts we are meant to refer in what I understand to be the original, now almost in the classical sense, the phrase would apply only to the productivity factor in this equation and if it were taken in that sense, the answer to your question is that it would not be so effect. But surely the guideposts, that phrase has come to mean in the popular transfer, popular understanding, a net figure to be applied to wages or to prices, a net concept, and my answer would be that if that is what it means, it should reflect what has happened.

Senator MILLER. Do you think that is what it should reflect?

Secretary WIRTZ. You see my difficulty is that I am opposed to the attempt at this point to encompass all of these things in a single figure, so my approach would be to rather emphasize all of the subtle factors, and I could answer your question in these terms, too, and I would emphasize what has happened to the cost of living and real wages as one of the factors to be taken into account.

Senator MILLER. May I say that would be completely consistent with your answer to my question regarding your statement of policy at the beginning of your statement.

You have stated that employment increased in 1966 by 1.9 million people?

Secretary WIRTZ. Yes, sir.

Senator MILLER. If you do not have the figures, I would appreciate your supplying them for the record. I would like to know how many of the 1.9 million are represented by increased civilian Federal employees; how many are represented by additions to the Armed Forces and how many are represented by increases in defense plant workers?

Secretary WIRTZ. I don't have it on a year-by-year basis. I noticed your attention to this yesterday, Mr. Miller, and I did try to get the best figures we have and we do come out with a different set of figures from those. You were talking over a 5-year period. I can give you the answer to the question in terms of yesterday's question, but not in terms of today's.

Senator MILLER. I am not particularly bound by the years. I think it would be helpful, however, in the context of the statement, to have the additions in these particular three fields.

Secretary WIRTZ. I can give them to you off the cuff.

In terms of 5 years our figure shows 274,000 increase in Federal employment and 500,000 increase in terms of the production, the defense industries.

Those are somewhat different from the figures you used yesterday but I will complete the record if I may with those figures on a year-by-year basis over the last 5 years.

Senator MILLER. Yes, and further, if you would, define the term "defense workers."

Secretary WIRTZ. Yes, surely. I wonder if it would be helpful to include, because it has the same relevance in the economic trends, the employment of State and local governments because there has been a much larger development in that area than there has been in the Federal Government.

Senator MILLER. I would like to see a balanced picture. I think that would be helpful and meaningful, too. I am particularly interested in the impact of Federal employment, armed services and the defense plants' increase of workers.

Secretary WIRTZ. We will supply that.

(The table which follows was supplied in answer to the previous dialog:)

Employment

[In thousands]

	1966	1965	1964	1963	1962	1961	1960
Armed Forces	3,390.0	2,841.0	2,726.0	1,942.0	2,764.0	2,813.0	2,530.0
Defense industries (total)	2,127.1	1,849.3	1,670.4	1,756.9	1,794.6	1,702.2	1,617.5
Ordnance and accessories	268.1	233.7	225.1	266.2	271.6	252.9	235.9
Aircraft and parts	818.7	675.0	603.2	638.7	654.1	629.4	607.1
Ship and boat building	171.3	164.7	154.1	137.2	141.1	141.2	141.7
Electronic components	391.6	339.4	279.0	260.3	269.2	255.6	229.9
Communications equipment	477.4	436.5	409.0	424.5	458.6	423.1	402.9
Federal Government	2,769.0	2,543.0	2,483.0	2,482.0	2,492.0	2,510.0	2,506.0
State and local government	8,675.0	8,095.0	7,541.0	7,150.0	6,781.0	6,489.0	6,270.0

Senator MILLER. Mr. Secretary, there was quite a bit of conversation about saddling you with a child known as the Job Corps. I presume you have made some studies about the potential handling of the Job Corps if it were to be absorbed by the Labor Department. You have made some studies on that point, have you not?

Secretary WIRTZ. No, sir, I have not. It will be an unplanned parenthood, if that happens.

Senator MILLER. I wonder if you could have somebody on your staff give us a memorandum on this subject, analyzing the pluses and minuses?

Secretary WIRTZ. I should be a little hesitant, if you don't mind. That program is administered by another agency of the Government and whatever critique I might have in the form of a statement as to what would be involved—if it would be a part of the Department of Labor—would present possibilities of embarrassment. I should be glad to give you a statistical and financial reporting on it because those are matters within the purview of my responsibility as a member of the Council.

Senator MILLER. I certainly do not want to cause you any embarrassment, Mr. Secretary, and you know that.

Secretary WIRTZ. I do.

Senator MILLER. We may be faced with a problem in proposed legislation which will be submitted to your office for comment. This might anticipate something, but if you could do something which would give use some feasibility analysis, quite apart from your own evaluation, which might not be embarrassing, I think it would be helpful.

(No additional material had been received for inclusion in the record at time this volume went to press.)

Senator MILLER. Well, there has always arisen some concern over whether or not the minimum wage law applied properly to State employees. Have you made an analysis of that legal question?

Secretary WIRTZ. Yes; but I suppose I am not only entitled, but obligated, to repeat at this point and regret to say to you behind the defense that this is presently before the courts and the first case was instituted on January 17. This is litigation to which I am party defendant and I would regret that I cannot answer any specific questions on this.

Senator MILLER. Here again I would not want to embarrass you.

Perhaps this point was raised and an analysis made at the time of the minimum wage increase bill?

Secretary WIRTZ. That proposal was not in the administration bill. It came up, one part of it, in the House Ways and Means Committee and the other part came out of a conference and lacked the legislative history which you have so properly assumed it might have. I have checked that history and it does not include the kind of consideration to which you refer because it all came up in—as a matter of fact, it came up in the House committee and another part of it was added on the floor of the House. It went out in the Senate. It came back in conference. So it does not have the legislative history which includes an analysis.

Senator MILLER. Was there a recommendation by your Department?

Secretary WIRTZ. There was not.

Senator MILLER. To the extent you could give us a memorandum on this matter, would you, without embarrassing your position in connection with the litigation, I would appreciate it.

Secretary WIRTZ. I can easily describe the scope of the coverage. As a matter of fact, it is about 1.7 million employees. I think I should add that my impression, and I don't mean to suggest I haven't been interested in it, my impression is that it presents a quite, almost novel issue in the sense that there will be no exact precedent. So the various courts approaches to it will be almost a case of first impression. I will be as helpful as I can in giving you whatever background I can on it.

Senator MILLER. One further point. Is there anything, say in recent times, in the last 15 or 20 years, that has been gone into by the Labor Department on this point, and perhaps you could provide us something on that.

Secretary WIRTZ. I will check.

(The information requested follows:)

FEDERAL REGULATION AFFECTING STATE ACTIVITIES AND INSTRUMENTALITIES

The Department of Labor studied the legal issue of extending the Fair Labor Standards Act to employees of State schools when amendments for this purpose were under consideration in 1966. It was our conclusion that the Federal power to regulate interstate commerce supported the proposed amendment. We, therefore, saw no legal objections to the proposal. However, our opinion was not asked on this point and we made no specific recommendation to the Congress regarding this coverage. Cases upholding the applicating of Federal regulation to State activities under other laws include, *United States* v. *California*, 297 U.S. 175; *California* v. *Taylor*, 353 U.S. 533, *City of Tacoma* v. *Taxpayers*, 357 U.S. 320; *Parden* v. *Terminal Ry. of Alabama*, 377 U.S. 184 and *Oklahoma* v. *Atkinson Co.*, 313 U.S. 508.

Senator MILLER. Thank you, Mr. Secretary.

Chairman PROXMIRE. Senator Symington?

Senator SYMINGTON. Mr. Secretary, it is good to see you. I am sorry to be late, but we had a Space Committee hearing on the tragic accident.

In your statement you talk about Government procedures and the economy as a whole. In your second point you say, the adoption, by statute of new procedures for reviewing wage and price developments in the economy warrants consideration, but is not required by present circumstance.

What is the definition of "new procedures" to which you refer?

Secretary WIRTZ. That is perhaps too precise a reference to rather extended testimony which I submitted before the House Government Operations Committee on September 12 and I should be glad to supply that.

(The testimony referred to was subsequently supplied for inclusion in the record of these hearings and follows:)

TESTIMONY OF SECRETARY OF LABOR W. WILLARD WIRTZ BEFORE THE SUBCOMMITTEE ON EXECUTIVE AND LEGISLATIVE REORGANIZATION OF THE HOUSE COMMITTEE ON GOVERNMENT OPERATIONS, REGARDING H.R. 11916, SEPTEMBER 12, 1966

I testify in support of the proposal in H.R. 11916 for joint executive and legislative consideration of "price-wage guideposts which would, if observed, achieve noninflationary price and wage behavior." (Sec. 2(a) of H. R. 11916).

I would recommend further consideration, however, of the provisions in the bill which appear to contemplate the establishment of "guideposts" as operative *rules* (Sec. 2(b): "The price-wage guideposts . . . shall take effect upon transmittal . . ."), and the provision (in Sec. 3) establishing procedures for consideration by the Joint Economic Committee of particular cases.

The debate and controversy there has been about the "guideposts" set out in the last five Annual Reports of the Council of Economic Advisers has tended increasingly to conceal their unquestionable value.

In its 1962 Report, the Council ennunciated this principle: that *for the economy as a whole* price levels should remain constant and wages should increase only as productivity does.

This principle is essentially right, and its ennunciation was extremely important.

There isn't much general understanding of the "laws" of economics. As the society becomes more complex, and with increasing recognition of the role of public policy-making in the operation of these laws, this lack of understanding becomes increasingly significant. Identification of this relationship between productivity and prices and wages permits a more meaningful and discriminating expression of what is otherwise expressed only as the "public interest." It is at least a little like the value of the original identification of the implications of an apple's dropping from a tree.

An infinitely larger number of people in this country understand today that if either prices or wages or both move up faster than productivity warrants there is trouble ahead—or at least the possibility of it.

This has become a significant and meaningful part of the good sense which goes into private price and wage decisions in this country—even though it may not be articulated, or sometimes even recognized, in particular cases. A new factor has taken its proper place beside the previous recognized factors (taking wage decisions as an example) of "inequities," "ability to pay," costs of living," and so forth.

I support strongly the general provisions of H.R. 11916 because it will permit the fuller and more effective development of this principle of sound reason and good sense.

First, it will offer larger assurance that the right answers will be developed to some still unresolved problems about the productivity guidepost principle.

Second, it will work into this policy-formulation process an element of broader *participation,* which will increase the acceptability of the answers which are worked out. A good deal of the objection to the Council's formulation is that it seemed to constitute stabilization without representation.

Third, this proposed procedure may be expected to focus additional public attention on this matter and to increase public understanding—both of what guideposts are and of what they are not.

There *are* hard problems regarding the productivity guideposts which remain to be resolved. I mention some of them briefly here, but only for the relevance their identification has to the subject of the effectiveness of the type of governmental procedure proposed in H.R. 11916.

If the wage-price guideposts are to be more than statements of an ideal—and therefore unreal—set of facts, they have to include provisions for adjustment when the facts get out of kilter.

There is the problem right now of what to do when prices for food and services (and for goods in general) go up by more than the overall increase in productivity. For the guideposts assume that *real* wages will increase as productivity does—and this would require significantly more than 3.2% wage increases today.

What account is to be taken of the fact that wages have been traditionally—but irrationally—lower in agriculture and food processing and in a good many service trades than in most durable manufacturing industries? If these wages are to go up, by more than the productivity "par" for the economy as a whole, is this to mean lower increases for manufacturing workers—whose cost of living increases as a result of higher prices for food and services?

Is there a place in guidepost theory for the inevitable effect on wages and prices of a shortening of the supply of skilled workers in certain industries as unemployment rates drop—but still stay at about 4%? Does this theory contain some unarticulated or even unrealized assumption that a certain *unemployment* figure constitutes "full *employment*"—because anything below that will create upward price and wage pressures? If so, it is wrong.

There is also the practical question, obvious in the light of present circumstance, as to whether it is the more advisable public policy to press the guideposts in terms of a specific decimal point conclusion or in more general terms. They appear to have more utility right now as the basis for a defense in depth rather than as a Maginot line.

There are *hard* questions—that warrant the fullest possible consideration in a variety of forums.

There has been legitimate objection that the CEA's development of the productivity guideposts has included too little participation by those whose experience includes fuller participation in the functions of price and wage determinations. The point is made both in terms of the quality of the policy formulation and in terms of the pragmatics of general acceptance of the conclusions which are reached.

It could also be expected that the type of proceeding contemplated in Section 2 of H.R. 11916 would result in a much fuller public understanding than there is today of how the productivity guideposts actually operate in practice—and particularly of what is involved when they don't operate.

The general public impression today is that "the guideposts were broken" in a series of several specific cases, principally cases involving wage settlements. They were broken in fact (if that form of statement is permissible regarding the working of an over-all principle rather than a specific rule) when food and service prices went up so that the *real* earnings of workers were not advancing in line with increased productivity. The rest was inevitable. The importance of an understanding of this is that it affects materially the direction of the force of public opinion in connection with repairing the "breach."

All of these considerations point to the advisability of the kind of procedure proposed in Section 2 of H.R. 11916 for the participation by representatives of the Congress in the kind of policy development represented by the productivity guideposts.

More difficult questions arise in connection with *applying* the guidepost principles *to particular cases.*

During the past five years the *wage* guideposts have been applied consciously and meaningfully in collective bargaining and by employers unilaterally in a substantial number of specific wage cases. The 1965 maritime settlement is illustrative. There have been others. Particularly in the last year or so, the guideposts have affected materially the policies of the Federal Government in the making of wage adjustments for its own employees. It is more than *just* a matter of averaging, that the over-all wage movement in hard goods manufacturing industries over most of the period between 1962 and 1965 came out very close—just a little below—the 3.2% productivity increase figure.

There is less basis for evaluating the extent to which the guideposts have had a comparable effect on particular *price* setting practices during the past few years. To the extent—largely overlooked in public discussion—that the guideposts require price *decreases* where productivity goes up more than is true in the economy generally, that they have been paid exceedingly little respect—virtually none.

The hard problems are about the propriety and the effectiveness of the use of the guideposts principle *as a standard for the Government's influencing, in one way or another,* the price or wage decisions in particular cases; and these are the hardest problems that would arise under H.R. 11916 in its present form.

So far as the experience to date is concerned, it shows a variety of results virtually defying generalization. On the wage side, the experience ranges from the 1965 steel case (where the guideposts were an extremely important and constructive factor) to the 1966 airlines case (where they weren't). So far as prices go, the Administration has been effective in preventing and even pushing back certain increases, which couldn't be justified on guidepost principles; in other areas (particularly where small unit industries are involved) there have been no effective methods available to achieve these results; and here again it has proved impracticable to attempt to get *any* price *reductions*—even where this is what the guideposts indicated.

Consideration of the statutory formalizations of a process of "review" of particular situations—as contemplated in H.R. 11916—warrants the clearest thinking through of the implications of the Government's assuming responsibility in matters of this kind without establishing a basis for the exercise of authority.

The idea of "bringing to bear an informed public opinion . . ." with respect to "individual price and wage behavior" is appealing. But it may exaggerate both the public's desire to be advised and its willingness (or ability) to do anything if it is. The searing experience of years of representation of the public interest, especially in labor disputes, is that the public is an inconstant client who wants most of all not to be bothered any more than is absolutely necessary.

There is another factor here: There is a strong strain in the practice of government of caution about expressing *official* views in the absence of authority to back them up. And for good reason—part of it that the effectiveness of government is weakened whenever its expressed views are disregarded.

The judiciary has stayed almost completely away from this kind of practice, for a combination of constitutional and practical reasons. Advisory opinions are not issued, declaratory judgments resorted to sparingly, and obiter dicta counted as probably causing as much trouble as they cure. There is proper recognition that "the law" should speak authoritatively or not at all—for fear of weakening its authority.

The tradition of executive pronouncement designed to guide voluntary private action along the lines of the public interest is, on the other hand, more clearly established. Indeed the ability to lead is as important an element in the executive function as is the power to command. In scores of situations, many of them now so common-place as to go unnoticed, executive persuasion is relied upon as a desirable alternative to legislation. Yet here, too, sharp issues sometimes arise regarding the extent to which persuasion is appropriate without the authority to back it up if it gets into trouble.

So far as legislative action is concerned, there is a less clearcut tradition of either abstaining entirely from or entering freely into situations in which no authoritative action is contemplated. The recognized difficulties are reflected in the general rule of restricting legislative inquiry to situations in which such action is envisaged, at least as a possibility. But there have clearly been applications of this principle which would provide at least tangential precedent for the procedures suggested in H.R. 11916.

The question of legislative function is, however, more one of pragmatic than of either philosophical or constitutional considerations, and a certain presumptuousness attends any testimony I might offer here on this point.

I commend to the Subcommittee for its consideration the August 18, 1966 report to the President by his Advisory Committee on Labor-Management Policy, and attach it to this statement as Appendix I.

This Advisory Committee report reflects the *unanimous* conclusions of this tri-partite group regarding the validity of the wage-price guideposts as they were originally enunciated. It makes clear the important implications of the distinction between (i) guidepost statements of economic policy, and (ii) rules to be applied in every case. It suggests the constructive possibilities of broader participation in the further development of these policies. It also proposes what I would consider a more effective procedure for review of particular situations than the legislative review proposed in H.R. 11916. Indeed, it would perhaps be recognized generally that if the procedure outlined in the Advisory Committee report became operative, the original purpose of H.R. 11916—so far as the review of particular cases is concerned—would be substantially served.

In any event, the action of the President's Advisory Committee confirms the essential wisdom of the underlying proposal in H.R. 11916.

In short, I conclude that there is very real promise in the proposal in H.R. 11916 for the formulation of general guidepost policy as a basis for voluntary private decision-making and as a means for the public to make up its mind when it wants to; but that the provision for price-wage guideposts that "shall take effect" misconstrues their real nature; and that the proposal for formal determinations in specific situations warrants reconsideration.

I suggest, finally, that the future will testify to the foresight of the sponsor of H.R. 11916 in his recognition that by declaring our independence of the doctrines of economic determinism, and by asserting the human authority and ability to control economic as well as physical forces, we have assumed a responsibility to direct certain key economic actions on a much more rational basis than before. Recognition of the importance of sound public fiscal, monetary, and budgetary policy requires fuller realization than there is yet about the related necessity of "guiding" such decisions as those regarding wages and prices to some still undefined extent.

H.R. 11916 is a pioneering proposal for making the free economy work.

Secretary WIRTZ. It had to do with the bills which were then before the Congress involving the question of whether there should be established by legislative action special review procedures. The proposal at that time contemplated review procedures which would go into the fact of particular cases and also into the general economic implications of what was going on. My testimony was to the effect that I would oppose—would recommend against legislation which at this stage would go into particular cases. But would support or would recommend favorably with respect to a procedure which would involve any economic review of the situation. This is a reference to that.

Senator SYMINGTON. I understand, and will read that testimony with interest.

In your statement you also say that you believe we should do our best, voluntarily, both business and labor, to conform to the concept of the guidepost principle. Is that a correct interpretation?

Secretary WIRTZ. It would be.

Senator SYMINGTON. Your last point. In effect, you do not want to develop specific guideposts as to prices and wages, for the future; is that correct?

Secretary WIRTZ. That is right.

Senator SYMINGTON. That differs from what has been done in the past; does it not?

Secretary WIRTZ. As a practical matter, yes; I think it is a fair interpretation to be placed on the 1966 experience—was that the country and the administration did translate those concepts into a quite specific figure and the Council's report in the President's Economic Message did take a different approach.

Senator SYMINGTON. Now, let me ask you this question. If you increase labor rates you increase the gross national product; is that right?

Secretary WIRTZ. That would be right. I think that is out of my Department.

Senator SYMINGTON. I think it would be difficult to get you out of any department because of your experience. Now, some people justify the cost of the Vietnamese war on its percentage of the gross national product?

Secretary WIRTZ. Yes.

We got two gross national product measurements. We sometimes talk about it in price terms and sometimes in real terms. If we talk about it in price terms it would include all the factors to which you refer.

Senator SYMINGTON. The reason I ask is that, to me, the increasing cost of the Vietnamese war is a matter of grave concern. It is hard to get these costs together. The staff of the Senate Appropriations Military Committee estimates some $2.5 billion a month. But it is defended constantly on the grounds that it is the same percentage, or a less percentage, of the gross national product. If that is going to be the gage, I have a suggestion to make, being distressed to note the increasing fall in the private sector, of our excess of exports over imports. When you do have increases in the GNP that do not necessarily reflect increased productivity, you are liable to find yourself in a competitive jam as far as competing against other countries, are you not?

Secretary WIRTZ. Senator, you would understand by my previous answer, I wouldn't for a moment justify one single penny of expenditure for war or for anything else on the basis of gross national product permitting it by its gross. I think it is a matter of putting any figure of this kind in its context, but I don't think of that as a defense.

Senator SYMINGTON. I am delighted to hear you say that. When this question came up in another committee about 2 weeks ago, I said: "How long do you think this economy can stand the multi-billion-dollar cost of this war, which is steadily increasing?" The answer was, "Forever." It seems to me forever is a long time. This statement worried me a great deal. The next thing, you know, you will find people going back to the old Communist cliche, that capitalists promote war in order to have a more successful economy.

Secretary WIRTZ. I do think the analysis carries over to any expenditure which every simple purpose would like to see cut down as soon as it can be.

Senator SYMINGTON. I am glad to hear that.

This balance-of-payments problem. I have great respect for Dr. Heller, have just read his thoughtful new book in which the word "gold" in its relationship to currency reserves, does not appear. It seems to me, gold is currently one of the basic aspects of any fiscal or monetary consideration in government. I am not saying it is vital, do not know enough about it.

What worries me a great deal is that we keep saying it is a serious matter, and that we are going to correct it "next year." But we never do. In this balance-of-payments situation, we are getting to a point where we have to make some major decisions incident to our position with other countries, else we are going to have some real problems. Would you agree?

Secretary WIRTZ. Yes.

Senator SYMINGTON. The way I have it figured out is that we now have about 10 percent of free gold to pay off, if called our current obligations in foreign countries. I do not want to get you into a discussion of this very complicated subject.

Secretary WIRTZ. I do not, sir.

Senator SYMINGTON. But it worries me, continuing to use the percentage of the gross national product as a defense of the increasing cost of this war. I think the figure of the budget for defense this year is about $74 billion, with a $12 billion supplemental, total about $86 billion. We could use a lot of that money in many other programs, domestic programs you are vitally interested in. So I would hope that if the administration continues to defend the growing cost of this Vietnamese war on the grounds it is a lessening percentage of the gross national product, therefore a justified expense, all that would be looked at from a financial standpoint. I do not see, necessarily, any direct connection between a country's economic capacity, and its fiscal and monetary international position. Is that a fair observation?

Secretary WIRTZ. As far as I know. Let me say again, I don't believe anybody has every justified military expenditures on the basis that you do not need to worry about it as long as it stays within a certain percentage of the gross national product.

Senator SYMINGTON. For that answer I am grateful.

Chairman PROXMIRE. Congressman Widnall?

Representative WIDNALL. Mr. Chairman, Mr. Secretary. In your statement you say among teenage girls the labor force increase was about 230,000 more than the trend expectation of 190,000. To what extent did Government employment contribute to that?

Secretary WIRTZ. I don't know. We are trying to find out whatever we can. It would be a very small figure. There are not many teenage girls involved as far as Government employment is concerned. We will see what we can do about it.

Representative WIDNALL. Are there not a great number of people employed on an hourly basis in connection with some of the poverty programs?

Secretary WIRTZ. Let's see. If we called Neighborhood Youth Corps trainees Government employees, they would be a substantial group there. That would be the only area that I can think of with any substantial number. I just would have to check on that.

Representative WIDNALL. I would like to see the total figure of those employed.

Secretary WIRTZ. You would like to have whatever identification we can arrive at of the number of teenage girls and the increase in the number of teenage girls whose employment is with the Federal Government?

Representative WIDNALL. That is correct.

(In answer to the above request the Department supplied the following:)

Most of the young people participating in the Neighborhood Youth Corps' In-School, Out-of-School, and Summer programs are teenagers. (Table, page 260.) Approximately 1,384,000 young people have participated in the NYC programs since their inception, including the 355,000 projected in training during the 1968 fiscal year.

The Civil Service Commission and other Federal Departments and Agencies hire teenagers in conjunction with the President's Youth Opportunity Campaign. We have been informed by the Commission that data on this program and on the age and sex of teenagers hired by the Federal Government for the years 1965 and 1966 are not available.

Representative WIDNALL. As I understand you today, according to the major problems, one of the major problems of unemployment has to do with teenagers?

Secretary WIRTZ. Yes, sir.

Representative WIDNALL. I have several questions in mind with respect to that.

To what extent does the draft prevent employment of the teenager?

Secretary WIRTZ. It doesn't prevent it. It might reduce it some. I am not sure of the direction of your question. It is an interesting thing that we have still the largest unemployment in the age groups which are subject to the military draft.

Representative WIDNALL. There are many employers who do not want to employ a teenager with the hatchet hanging over his head, so to speak.

Secretary WIRTZ. We have paid considerable attention to that and are concerned about it and feel it is very unfortunate and have wondered whether we can undertake some educational program to try to diminish that effect but recognize it as exceedingly difficult.

Representative WIDNALL. From my own observation that would seem to be a great limiting factor and once we can firm up what a teenager is supposed to do with respect to his military and nonmilitary commitment to the Government I think we could solve a great deal of the problems within the teenage group, particularly with the male.

Secretary WIRTZ. It would help some and I did discuss that with that Commission. It is a problem. I think it is not a large factor, but it does contribute.

Representative WIDNALL. Also in this respect, one of the real handicaps in employment of the teenager is the restrictive labor laws. There are many that are thoroughly employable, thoroughly physically capable, but because of age limits that have been written into the law it is not possible to employ them when there are employment opportunities that go begging because no male adult will take the job. Do you think it would be wise to have a good look at some of these to see whether or not we could loosen up some of these labor laws?

Secretary WIRTZ. The first relates to your previous question.

The unemployment is higher among the girls than it is among the boys which is one thing that makes us think it is not of great magnitude.

The second one is—and February 1 the minimum wage law became effective applicable for the first time to school bus drivers and we found that a very large number, some 19 States employ 16- and 17-year-old boys as school bus drivers and we have that specific matter under particular study at the moment.

I am impressed, too, Mr. Widnall, that compulsory education in this country extends only to 16 and in some States below that, but we prohibit a considerable number of kinds of employment below 18 and so there is a kind of limbo period in there and I would agree. We are just starting an analysis of the relationship of those two.

Just one illustration. I suppose a good many years ago it was good sense not to let a child run an elevator because it was a hard operation. The same thing does not apply in elevator operation today. I agree with your point.

Representative WIDNALL. Another factor, too, you partly touched on, when you spoke about the minimum wage increase. It seems to me this has also been a limiting factor where people ought to pay the limiting wage that was going into effect, they will do their utmost to employ an adult rather than a teenager because they will feel they will accept more responsibility in handling the job. I have found that true locally in the metropolitan area, right as of today. Do you not think that there should be consideration of the minimum wage as it applies to teenagers?

Secretary WIRTZ. No, sir, I do not. I appreciate the problem. We have a congressional direction study every year under Section 4(d) of the Fair Labor Standards Act. This matter of whether the changes in the minimum wage law has affected employment with respect to the various industries, with respect to the various age groups—and we have reported each year to the Congress those results. They have never shown any evidence of the development to which you refer but I should add this. Every time there has been a change it has been on an upswing in the economy so there probably would have been an increase in employment anyway. So I don't know how to evaluate those two factors, but we find no evidence of its increasing youth unemployment.

Representative WIDNALL. There is one other phase of that that I would like to know more about.

It had to do with apprentice training programs of the unions. Does the teenager have the same opportunity to get into the apprentice training program as an adult does?

Secretary WIRTZ. I rather suspect that whatever problem there is there is less on the apprenticeship side than it is on the employer's side. We find an increasing practice in some industries to stay away from the young person, frankly, because of the education—the education isn't what it ought to be and we are talking very frequently about a nonwhite situation.

I will make a check, but I don't believe we have any evidence or basis to believe that the apprenticeship programs have shown an age bias. A good many of those programs have been on the father-son basis in the past which would neutralize that fact. I only testified to the best of my present knowledge. I don't believe the age factor to which you referred was a material factor in the administration of the apprenticeship program but I will ask our Bureau of Apprenticeship people about it.

Representative WIDNALL. Will you submit it for the record if you find it?

Secretary WIRTZ. Yes, sir.

(The information referred to follows.)

Teenagers have the same opportunity to enter apprenticeship programs as adults, provided they meet the qualifications. In general, 18 years of age is the minimum—in part because high school graduation is usually required and because hazardous working conditions are relatively common.

Evidence of the acceptance of teenagers in apprenticeship is shown by the average (median) age of apprentices already in training—22.9 years. Therefore, many of these apprentices would have started their training during their teens. In addition, a recent check on the ages of 2,495 beginning apprentices in the Washington, D.C. area showed 935 entrants under 20 years of age.

It is quite possible, however, that some employers might prefer older boys as apprentices, particularly in the light of the fact that younger ones may be subject to the draft at some time during their training.

Representative WIDNALL. The Council of Economic Advisers foresees a 4 percent growth of real output this year. Louis Paradiso of the Department of Commerce estimates the growth would have to increase 4½ percent to absorb all the new entrants into the labor force. If this is correct what will be the anticipated unemployment rate by the end of this year?

Secretary WIRTZ. There were different statements as to what is going to happen as far as productivity is concerned. We have all done our homework on that. I think all we can say to you from our various studies—Mr. Ross and his people in the Bureau of Labor Statistics have made the same approach. We all come out in a range of 4, 4½ percent for 1967 and I don't think any of us can be sure of the refined figures much more than that. Our own figure comes out in between those two as to the percentage that would be involved.

I think the important thing, at least to me, is that whatever we decide about 1967 that figure is going to have to be higher after 1967 and I would be very much concerned about the country settling back into thinking that 4 percent or 4-plus percent increase in the gross national product is going to carry us on through. There is doubt in all of our minds about the precise answer to your question for 1967, but we are all agreed that it is going to have to be higher than the identifiable factors we can see for this year in order to keep up with the expandable work force. That I can say to you with considerable certainty.

Representative WIDNALL. That is all, Mr. Chairman.

Chairman PROXMIRE. Thank you, Mr. Widnall; and since you leave off exactly where I want to begin, I would like to follow up along the same lines.

I understood when we were discussing this earlier, Mr. Secretary, you said most of those not now employed would not—or perhaps should not—be employed, that they ought to be either in school or in training rather than at work, and at least they would not be employed without further training. That was the impression I got. Was that correct or not?

Secretary WIRTZ. That would have been my thought with respect to those under 20 years of age.

Chairman PROXMIRE. We now have 2.7 million out of work. Some of them are teenagers and I am talking about the overall picture. I want to press on you the notion that perhaps we should try to get unemployment down, and that we can do it without a risk of substantial inflation this year.

Secretary WIRTZ. You would not need to press that, Mr. Chairman. I agree completely with you on it and I want to make quite clear there are a great many unemployed today who ought to be and can be employed and that figure should go down below 4 percent to someplace between 2½ to 3.

Chairman PROXMIRE. That answer seems to me has great implications for our fiscal and monetary policy.

Secretary WIRTZ. Yes, sir.

Chairman PROXMIRE. It would means if you followed that through that we should have a tax policy of probably no tax increase this year, a policy of more expansionary fiscal policy generally and lower interest rates.

Secretary WIRTZ. No; it is a much more complicated thing than that. I am afraid I overstated it.

First, I cannot be talking in terms of a single year.

Second, I am talking in terms principally of what I think can be done by training and educating, and qualifying the people who are not today trained, educated, and qualified.

Chairman PROXMIRE. You know far better than I know, Mr. Secretary, that most of the training is in private industry. You also know that when private industry trains they have a demand for manpower; when they can sell what they produce and they will go out and make an effort, they will train teenagers, train minority groups, train women, and they will do everything to get people into the work force. They will do everything they can to get people who are out of work at work; is that not correct? Doesn't demand pressure step this up more than anything else?

Secretary WIRTZ. That is true down to a point, and I think we are about at that point. I don't think that we will go any further into the hard core area, absent the pressures that we had in 1940 to 1946, which is the only time they did so.

I think that the next million will not be taken by private employers except as we help out in the training of it.

Chairman PROXMIRE. What is the difference between our situation now and our situation in 1952 and 1953 after the Korean war, especially 1953, after we had eliminated price controls? At that time—I am not talking about teenagers, experienced wage and salaried workers—the unemployment rate was 3.3 and 3.2 and now it is 3.5. For blue collar workers generally, it was then 3.6 and 3.4 and now it is 4.2. It would seem to me that there has not been that much of a change in the last 15 years in the nature of our economy, absent teenage problems which I am trying to separate out.

Secretary WIRTZ. I believe there has been and I appreciate your analogy. The point that you leave out is that the machines have had an extra 15 years of education, and that now the machines are so sophisticated that they can do more cheaply the work which was turned over to individuals at a period of comparable pressure heretofore.

Chairman PROXMIRE. Is there not—behind all this—an assumption that because prices did rise sharply in the first part, first 7 or 8 months of 1966, that the scarcity of labor had a lot to do with it? And when we analyze the nature of that price increase we find it was in food, No. 1, and in services. When you look at services increase, one-third of the rise in these prices was the very sharp increase in interest rates which went up 12 percent. When you look at that and consider the experience we had in 1952 and 1953, it does raise a question that we could probably push unemployment down below 3½ percent without necessarily having a serious inflationary problem.

Secretary WIRTZ. That is my view completely and that factor was exaggerated quite seriously last year.

Chairman PROXMIRE. The CEA tells us that we are going to be at 4 percent at the end of the year, not 3½ or 3.4 or 3.3 and there would be no progress. That is the Council's position. I take it you do not agree with that.

Secretary WIRTZ. I do not know where we will be and I think I have more confidence in what can be done on the affirmative manpower side than the Council does. They have the experience lessons to support their pessimism. I think we can do a good deal more on that side. I don't know what unemployment will be at the end of this year.

But on the analysis that you made concerning the wage rate factor, I couldn't agree more.

Chairman PROXMIRE. I appreciate that a great deal.

Secretary WIRTZ. May I add in fairness, we would both recognize there was a wage factor that had to do with the very low wage industries—services, food, and some of those—in which for independent reasons, because they were low wage industries there had been a slackening, a lowness of wage which had to be corrected. That factor I think was quite real and did bear on the service and the food industries. But I think the Nation, understanding that, would agree 100 percent that we had better push those wages up.

Chairman PROXMIRE. What evidence is there to indicate or measure the success of our manpower programs such as manpower development and training, the Job Corps, the Neighborhood Youth Corps, and work experience? Can we apply PPBS analysis to this?

Secretary WIRTZ. Several ways, and none of them satisfactory. It won't surprise you that I have sometimes wondered whether the Keynesians haven't taken too much credit for the gains we have made in the unemployment situation. I rather think that the manpower programs, training programs of the Government as well as private training programs have contributed quite significantly to the reduction in unemployment in this country.

The next set of evidence has to do with the numbers who have actually gone through these programs and with their subsequent employment record. Those figures are quite encouraging, but again it is hard to settle because of the argument that things were going quite well and they would have been employed anyway. I don't know how you prove that.

I am more interested, and I know you are, too, in the problem remaining to be done rather than what we have already accomplished and here the problem is painfully clear. We know a great deal more than we did before about the people who needed this help; who they are, where they are, and what the situation is. I could be quite specific about that. It is an area in which it is hard to measure your gains especially if you have to argue with the economists about whether it was the economy or the program. It is very hard to measure your gains but very easy to measure the jobs that are left.

Chairman PROXMIRE. I am not so sure the fiscal analysis is right. One of the big reasons they point out for the rise in personal compensation in 1966 is the movement of people off the farms, especially marginal farms where income is low, into industry where wages are high. I'm afraid this is too easily taken as evidence that wages are pushing up prices. This is not true at all. This means that the jobs were there and people left employment where they were not needed and you could produce much more efficiently and move into an area where they are producing more and earning more.

Secretary WIRTZ. The figure on this line is, that is so often left out, is the increase in the work force. We talk about unemployment ——

Chairman PROXMIRE. I'm talking about people working on the farm, leaving it and then working in a higher paid category.

Secretary WIRTZ. Yes, and they are moved from the lower paid to the higher paid category, the mix has changed, the number of people who have come into it has changed. All these things could happen. The standard of living in this country can go up substantially and the unemployment rate stays the same. It is an incomplete index and so often the answers to all these things we are talking about is that it has been a combination of factors.

When you ask me how do we measure our activities, all I can say is that it took both an expandable economy and a conscious manpower program.

Chairman PROXMIRE. Because of the analysis and nature of price increases and they are so important, I would like to ask Mr. Ross if he could supply either now or for the record an analysis of the proportions of the overall rise in the Consumer Price Index accounted for by its major components, for example, services, particularly interest rates, food, et cetera.

The table given by the Council is too big in my view to break it down to determine what are wage sensitive and what are not. It is difficult for the staff of this committee and for myself to make any kind of an estimate as to how inflationary fiscal policy is unless we have this kind of breakdown.

Mr. ROSS. We will supply that, Senator.

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

(The information requested, later supplied, follows:)

Percent change and contribution to total change, selected Consumer Price Index components, December 1965 to December 1966

Component	Percent change	Percent of total
All items	3.3	100.0
Food	3.8	25.8
Food at home	3.4	18.4
Food away from home	5.3	7.3
Housing	3.3	32.0
Shelter	4.1	24.7
Rent	1.6	2.7
Hotel and motel room rates	5.6	.6
Homeownership	5.0	21.4
Purchase	1.2	2.2
Mortgage interest	13.8	11.5
Taxes and insurance	4.2	2.8
Maintenance and repairs	5.5	5.0
Commodities	2.6	.7
Services	6.8	4.3
Fuel and utilities	.3	.4
Fuel oil and coal	1.5	.3
Gas and electricity	−.1	−.1
Telephone, water, and sewer	.3	.2
Household furnishings and operation	3.0	6.8
Textile house furnishings	3.2	.7
Furniture	4.5	1.7
Floor coverings	.6	.1
Appliances	−.3	−.1
Other house furnishings	2.7	.6
Housekeeping supplies	2.2	1.0
Housekeeping services	5.9	2.8
Apparel and upkeep	3.9	12.0
Men's and boys'	3.0	2.5
Women's and girls'	3.6	4.2
Footwear	6.3	2.8
Other apparel	3.7	2.4
Commodities	1.3	.3
Services	4.9	2.1
Transportation	2.0	7.9
Private	1.5	5.6
New cars	−.1	−.1
Used cars	−3.4	−2.3
Gasoline and motor oil	3.4	3.4

Component	Percent change	Percent of total
Transportation—Continued		
Private—Continued		
Tires	2.4	.5
Auto repairs	2.4	.7
Other auto expense	4.1	3.4
Public	6.4	2.4
Health and recreation	3.8	21.9
Medical care	6.6	11.4
Drugs and prescriptions	.2	.1
Professional services	6.3	5.0
Hospital services	16.5	1.9
Health insurance	9.0	4.4
Personal care	3.4	2.7
Toilet goods	1.5	.6
Barber and beauty shops	5.5	2.1
Reading and recreation	2.6	4.5
Recreation goods	.5	.4
Recreational services	4.6	2.2
Reading and education	3.8	1.9
Other goods and services	2.2	3.3
Tobacco products	3.5	2.0
Alcoholic beverage	1.2	.9
Personal expense	2.7	.4
Financing charges	3.4	.4
Commodities	2.5	49.7
Nondurables	3.3	46.3
Durables	.7	3.4
Services	4.9	50.3
Commodities less food	1.9	23.9
Nondurables less food	2.8	20.5
Apparel commodities	3.7	9.9
Apparel less footwear	3.1	7.0
Nondurables less food and apparel	2.3	10.6
New cars	−.1	−.1
Used cars	−3.4	−2.3
Household durables	1.7	2.7
Housefurnishings	2.2	3.1
Services less rent	5.5	47.7
Household services less rent	5.5	22.1
Transportation services	4.3	6.4
Medical care services	8.1	11.3
Other services	4.6	7.9

Chairman PROXMIRE. Now, I would like to ask this question before I yield to Mr. Curtis.

I would like to ask Mr. Wirtz if it is not true that the Government training programs, though very vital, are really very small in relationship to the problem?

Secretary WIRTZ. Yes, sir.

Chairman PROXMIRE. I think this is the one part of Government expenditure that is deflationary in the best and most constructive sense. You are taking people who are unemployable in some cases, people who in some cases do not have the motivation, and give them the opportunity to work in a Job Corps camp, where they can develop motivation and skill. These will be producers and not consumers. I cannot think of a better investment and the deflation effect is a matter of months in many cases. It is not a matter of years. Are we not really missing a good bet by not putting more into an area which seems to be so rewarding for the national interest?

Secretary WIRTZ. Senator, you know the easy answer for me to that question and it is, "Yes," put more money in. I am sobered by the realization of the extent to which this program has changed from year to year in our own administration, sobered to the extent of realizing that I am not certain that we could have economically and efficiently administered a larger program.

Chairman PROXMIRE. It is hard to get instructors and teachers?

Secretary WIRTZ. It is very hard. That is the single worst shortage. When I realize how rapidly we have shifted from institutional training to on-the-job training, I guess I would have to be cognizant of the fact that one of the implications is getting further action rapidly on institutional training. It has caught up with us so fast we might have been training people for jobs at that point which did not need to be filled.

There are expansions contemplated for this year. The biggest single point that makes me reluctant about answering your question the easy way is that I think as we move into this next period we are going to be shifting more and more of the responsibility to employers and picking up the marginal or submarginal costs. I have a strong feeling we can direct more and more of our money to work out the relationship between public training and private employment, so I cannot answer unhesitatingly your request about whether we should have an expansion now in terms of dollars.

Chairman PROXMIRE. I want to apologize, Congressman Curtis. I said I would yield. I have one other question to ask.

This relates to guidelines.

Mr. Secretary, you are Vice Chairman, as I understand it, of the President's Advisory Committee on Labor-Management Policy and the Secretary of Commerce is the Chairman. The report on the guideposts recommended quarterly reports from the Council to identify the nature and chief cause of major shortcomings and recommendations to correct any within the purview of the President's Commission.

Now, in view of the fact that the administration has decided to drop the figure which so many of us are concerned about, it would seem to me that this kind of report should certainly be made and I am informed by the staff that no report has been made, this recommendation was August 18, and this is February, 5 months later and not a quarter, not 3 months, and this is exactly the kind of study which, in the absence of a precise guideline figure would be most helpful.

Secretary WIRTZ. That report was not made formally, but was made by the Council on Economic Advisers to the Committee at its December 14 meeting. It was not a written report. It was an extensive full-day discussion on a sector-by-sector basis.

Chairman PROXMIRE. Would this not be invaluable to the members of this committee and the Congress if we could get this on a quarterly basis, absent the figures, the 5-percent figure or some other figure, to have this kind of information publicized and made known?

Secretary WIRTZ. I think so. That is what the position is some of us took with respect to the proposed legislation before the Government Operations Committee.

My answer would be an unqualified "Yes." That kind of quarterly reporting would seem to me all to the good to this committee, to the country.

Chairman PROXMIRE. Is there any prospect we can get that?

Secretary WIRTZ. It would lie within the province of the Council, but those conversations have been sufficiently complete I think and there would be great interest on the part of the Council in doing this. I answer subject to that consultation.

Chairman PROXMIRE. Congresman Curtis?

Secretary WIRTZ. We on our part, as far as the Bureau of Labor Statistics are concerned, would be doing that kind of quarterly reporting from here on.

Representative CURTIS. Let me commend you for that approach. That is where I think the value of the wage quidepost lies, and as I said, going back to 1962, I want to be sure it is clear, I do not share the view of Senator Javits or Mr. Reuss. When I was interrogating, I said I was rather pleased that you had gotten away from the actual figure. But, to give productivity information, yes, this is an economic exercise and it is the data that is needed. I might add, Mr. Chairman, I am pleased to have your emphasis on getting the data out and distributed widely.

As I understand your response, that is what you were responding to; am I correct?

Secretary WIRTZ. Yes.

Representative CURTIS. I probably do want to direct written questions to you on job vacancy statistics. I think you are aware of the fact that our Subcommittee on Economic Statistics, under our present committee chairman, went further into the job vacancy statistics, and the testimony we heard showed that there was only one person, representing AFL–CIO, who was against it. What I am fearful of is that the data you mentioned is not anywhere near what I thought we had in mind when we were talking about job vacancy statistics and what we were talking about in reference to the $2.5 million needed to get this kind of data. It seems to me that for manpower training programs to work we need as much data as we can add in this area of job vacancies. Would you care to comment on that?

Secretary WIRTZ. Yes, sir, my view would be the same as it was in the previous testimony, we would like to do it on the basis that we have been proposing over the years. I think it might be helpful if I were to transmit to you on a personal basis the set of reports for 1966 which we have been able to assemble and which represent in my judgment the best we can do with the material at hand.

Representative CURTIS. I would appreciate it. I have asked our staff to see if we could get those reports and possibly make an analysis of them and then see what we might have to do further on this. I think it is very important.

I think I understood what Senator Miller was asking in regard to the manpower utilization in the armed services, the civil service, as well as in the munitions industry. I am interested in getting some estimates of how much additional manpower utilization there is as a result of the Vietnam war. Do you have that? Have you attempted to get statistics on that?

Secretary WIRTZ. We will identify that in that report which Senator Miller has requested—we will identify it as far as we can, anything allocable to the Vietnam situation.

Representative CURTIS. Also, when the day comes when we end the war, we have the other side of the coin of what our problem might be in getting these people back into the labor market. I am just trying to get some idea of the size of the problem.

Secretary WIRTZ. I think of that not only as a problem but as a prospect.

Representative CURTIS. It is a problem. When we shifted from the Korean war, I recall all sorts of talk. Well, I identified a good deal of the unemployment then as a shift from a war economy to a peace economy, and we have now shifted to a degree from a clearly peace economy to one that is partially war. I want to see through the labor statistics, the extent of this.

During World War II we had a Manpower Utilization Board which, partly considered deferment cases for munitions industries and so forth. There is a similar board today or commission, is there not?

Secretary WIRTZ. No, it is a function that I exercise as Secretary of Labor with respect to occupations, and the Secretary of Commerce with respect to industries. The function is carried out but it is carried out in a line department basis. There is an interagency committee.

Representative CURTIS. That is what I thought. Has that been active in recent years—in the recent year and a half or two years?

Secretary WIRTZ. I can tell you exactly. As far as the occupations are concerned, and I answer because I am chairman of that committee, there have come up from the interagency committee several recommendations about deferments. I felt that the circumstances did not warrant any additional deferments, so there has been in terms of change—in the last 4½ years there really has been no extension of that.

Representative CURTIS. In other words, what deferments there are we might relate to peacetime kinds of deferments?

Secretary WIRTZ. Developed before 1963.

Representative CURTIS. Thank you very much.

Chairman PROXMIRE. Congressman Scheuer? Congressman Scheuer is not a member of the committee but he has an interest in this.

Representative SCHEUER. I am grateful to join you for a few moments. I have enjoyed your testimony very much, Mr. Secretary.

In your statement you emphasize the point that we are developing manpower policy and programs and in your remarks you emphasize the affirmative statement that you believe these are necessary.

What is your estimate of the total pool of unemployed persons in the country, somewhere between 2½ or 3 million that would make sense for us to develop these special manpower training programs, for training, educating, and qualifying these people, either in public or in the private sector?

Secretary WIRTZ. I am afraid I missed the specific form of the question, Mr. Scheuer.

In terms of occupations or in terms of areas?

Representative SCHEUER. You mentioned in your testimony that these programs to train, educate, and qualify people could be aimed at developing their talents in the private sector primarily, but also in the public sector, too. Of the pool of unemployed who presumably are structurally unemployed, what part of that polo or somewhere between $2\frac{1}{2}$ or 3 million persons do you think we ought to engage?

Secretary WIRTZ. I don't believe it is that large. I suggest merely—thinking in terms of a million who are clearly identifiable and who warrant this kind of intensive approach—we are out in a point where your monthly unemployment figure is about $2\frac{1}{2}$, $2\frac{3}{4}$ percent. I think this is what you have in mind—I think of a million and a half of that is being the so-called frictional employment, and including part of the seasonal unemployment and in answer to your question leaving about a mililon. That is a different million from month to month so that that figure could perhaps be enlarged on that basis, but just in round figures it is like that.

Representative SCHEUER. Would you say we ought to be developing programs to involve that?

Secretary WIRTZ. Yes.

Representative SCHEUER. How would you divide these programs where the Government would be the trainer of last resort, but would sluice or channel presumably a major portion of them into the private sector and the rest into public service employment?

Secretary WIRTZ. I would put into the area where there ought to be coordinated public and private operation everybody except for those who are without a basic education and some of those who have a serious handicap, an unusual handicap of one kind or another. And again, in round figures, if we are talking about a million, I would put three-quarters of that million into one category and a quarter of a million in the other.

Representative SCHEUER. Three-quarters ultimately in the private sector?

Secretary WIRTZ. In that area where we would be coordinating public and private jobs.

Representative SCHEUER. You would say three-quarters of a million ought to be trained—ought to be undergoing training, education, and qualifying that would enable them to participate in the public sector or private sector?

Secretary WIRTZ. Yes.

Representative SCHEUER. How would you define the three-quarters of a million?

Secretary WIRTZ. Ultimate gainful participation in the private sector. I do my thinking in terms of ultimate private employment. There was some discussion of that—that is an operational principle instead of a total principle because I know that if we got all of the rest of it done we would end up with a group which did not lend itself to that approach. I used the figure of half a million before. I am talking about a million with whom we can do something here—but to clarify the situation I work on the basis that there probably are close to half a million whom we are kidding ourselves about ever putting into private employment.

Representative SCHEUER. Even with training, educating, and qualifying them, they would probably never be appropriate for unassisted employment?

Secretary WIRTZ. That is right. That is not an idle figure. That arose during the war when there was pressure to use every person we could possibly move. It ended up with a half of 1 percent. In the other foreign countries, Western European countries and others where they have what they think of as full employment situations, it points in the same direction. So that you will get a figure some place around a half of 1 percent.

Representative SCHEUER. So of this million, roughly half of them could be trained and qualified and educated so that they could make it in the private sector?

Secretary WIRTZ. The figures got confused because you and I started talking about the unemployed. Now, another part of the group that we are both thinking about is not technically unemployed because they are not looking for work.

Representative SCHEUER. They are out of the statistical universe?

Secretary WIRTZ. That is right. That is why my last figures goes up again a half million.

Representative SCHEUER. I take it there would not be any doubt in your mind that as to the million who have—who could be constrained and qualified for private sector employment that our private enterprise economy could absorb them?

Secretary WIRTZ. Yes, sir; there is no doubt in my mind about that.

Representative SCHEUER. Do you have any doubt that as to the other half million who presumably would be trained for some kind of subprofessional or service job, that there is the need for them in public services?

Secretary WIRTZ. I have no doubt about that.

Representative SCHEUER. Do you feel that our economy at the present could afford the cost of educating and training and qualifying these million people?

Secretary WIRTZ. It will cost us less to do it than the cost after the second year if we don't do it.

Representative SCHEUER. How much do you feel?

Secretary WIRTZ. If I make my point clear——

Chairman PROXMIRE. Will you yield a moment? You are telling us that it will cost us less to do it than it would within 2 years in welfare costs, and so forth, if we do not do it?

Secretary WIRTZ. That is right. These are not idle figures.

Chairman PROXMIRE. You make that estimate based on a study?

Secretary WIRTZ. Yes; and one other thing——

Chairman PROXMIRE. Will you supply us with the data?

Secretary WIRTZ. Yes, sir. It is not exact or precise.

(The information requested follows:)

ON-THE-JOB TRAINING PROGRAMS

MEMORANDUM FOR THE PRESIDENT

You have stated that a major purpose of your Administration is to make the poor, the unemployed, and the disadvantaged taxpayers rather than tax eaters.

I am happy to report that Manpower Development and Training Act on-the-job training programs are doing just that.

These programs will repay their cost to the U.S. Treasury many times over. The average trainee repays in taxes the cost of his training in less than two years.

The programs are sound investments for the Nation, both in human and in fiscal terms.

The facts are these:

The average MDTA on-the-job trainee earns $57 a week during 14 weeks of training, and $73 a week as a fulltime worker after his training. Thus the average trainee earns $3,572 the first year.

The cost to the Government of regular on-the-job training averages about $500 a trainee. Some cost more, some less.

According to the Internal Revenue Service, income taxes on earnings of $3,572 range from $419 for the trainee with no dependents to $74 for trainees with three dependents.

More than 45 percent of the trainees are single; another 15 percent claim only one dependent; 14 percent have two dependents; 12 percent have three, and the remaining trainees have four or more.

Of the 182,000 on-the-job trainees approved since the program began in 1963, the incomes of nearly 163,000 are taxable, after deductions.

Of the 182,000 men and women who have had or are now being given on-the-job training, 163,000 are taxable, after deductions.

The Federal Government allocated $95.8 million for their training.

The Federal treasury has so far received back $50.5 million in taxes from these trainees, or better than 53 percent of what was spent on them.

An average on-the-job trainee in his first year repays the Federal Government over one-half of its total investment in him. Before the second year is over, the Government has been repaid in full.

And the Nation will continue to profit thereafter because the trainee becomes a productive citizen and a taxpayer who can carry his fair load.

On-the-job training programs are one of the soundest investments we can make. Trainees not only pay back the cost of their training, they add to the production and prosperity of the Nation.

These programs have been warmly received by American employers, who, in the long run, must provide the jobs for American workers. The business community along with American labor has cooperated in making MDTA on-the-job training one of the most exciting and successful aspects of our Manpower policy.

W. Willard Wirtz,
Secretary of Labor.

September 2, 1966.

Chairman Proxmire. It does not matter if you can supply us with the general data.

Secretary Wirtz. In 4 years it will be paid back in taxes.

Representative Scheuer. In 4 years after employment, after training?

Secretary Wirtz. Yes, sir.

Representative Scheuer. Could you give us the approximate cost of training involved?

Secretary Wirtz. Yes, sir; we work on the rules of thumb. The figure, and it cannot be precise, but it is this, if we are talking of a Neighborhood Youth Corps in a school situation, we are talking about $500 in round figures. If we are talking about on-the-job training, our experience pinpoints that to $800 and $1,000. This is to pull a person back to the point of where he can be self-supporting. On institutional training it is about $1,500 to $2,000. Until we get to the cases where there is a lack of basic education, at which point again, the need for greater support of services, it goes up to $3,500.

Representative Scheuer. What is the cost of your jobs?

Secretary Wirtz. That is only a 2-week brushup program.

Chairman Proxmire. There is a vote on the floor. Congressman Scheuer, will you take over until I return?

Representative Scheuer. Yes, Mr. Chairman; I would be happy to preside.

(At this point Representative Scheuer assumed the chair.)

Secretary WIRTZ. To answer your question, we are using present day figures of $400 and I think that has been lower, no doubt, and it would be a lot lower.

Representative SCHEUER. It might be helpful in the committee if you would submit some of the experiences that you have had with the on-the-job program.

(The material below was subsequently submitted for inclusion in the record:)

It is difficult to provide the average illustration. Programs vary from the most expensive, during which 52 weeks of training is provided, to those lasting only 3 weeks.

Some widely varied types of on-the-job training programs, illustrate, however, how they pay for themselves:

Tidewater Oil Company estimated that $567,000 will be paid in income taxes by 1,080 service station manager trainees while they are earning approximately $5,400,000 during 44 weeks of training. This program will pay for itself the first year.

Forsyth Memorial Hospital in Winston-Salem, North Carolina, said $22,353 will be paid in income taxes by 353 health care trainees who will receive a total of $159,665 in annual wages. Federal funds totalling $44,611 have been allocated. This is 50 percent repayment the first year.

Leverenz Shoe Company in Sheboygan, Wisconsin, estimated that $22,477 will be paid in income tax by 70 trainees who will earn $236,600 in annual wages. Federal costs of the program were $33,135. The first year's return on this program is about 68 percent.

Winzen Research, Inc., of Mount Vernon, Texas, said $10,374 will be paid in income tax by 42 trainees who will be paid $109,200 in annual wages. Federal funds of $3,970 were approved for the six-week OJT project. This program is making a 260 percent return in its first year.

Sixteen Fiberglass layup trainees at Ramco Manufacturing Company in Gainesville, Texas, will pay $4,446 in income taxes from their annual earnings of $46,800. Total Federal cost of the program was $3,836. The return on this program the first year will be more than 115 percent.

While these illustrations cover only some 1,500 trainees, they also would apply to the more than 63,000 on-the-job trainees approved during 1965.

Representative SCHEUER. It is a million and a quarter we are talking about, and three quarters of a million can probably end up in private sectors, and a half million will end up in the public sector if they get the training, education, and qualifying that you are talking about?

Secretary WIRTZ. Yes: we both realize we are using the best figure available for discussion purposes, and they are not statistically refined at all.

Representative SCHEUER. I am most impressed by the judgement that you gave that these costs would be returned in 2 years from, say, the welfare expenditures and 4 years out of tax revenues that these people would produce.

Secretary WIRTZ. Yes.

Representative SCHEUER. If that is true, and I am sure it is, is there any reason—and I think that is a rate of return that any corporation would feel is an extremely satisfactory rate of return on capital investment on its plant and equipment over the years or even workers.

Is there any reason why we should not gear up to such a national program right now?

Secretary WIRTZ. I think the limiting factor is personnel and the building up of experience with these programs. So there is a limiting factor of know-how and personnel.

Representative SCHEUER. No limiting factor as to ability of the factor to support these training and orientation programs or the ability of a need of the private and public sector to absorb these?

Secretary WIRTZ. To any extent—this is manpower. To the extent it has come from manpower agencies, it should alleviate this. There is no limitation.

Representative SCHEUER. From the point of view of general economic policy, the economy needs them, the economy can absorb them, and the cost of such a program would be paid in perhaps 2 years out of welfare expenditures; and, again, in the first 3 or 4 years of tax payments.

Secretary WIRTZ. Yes, sir.

Representative SCHEUER. Thank you.

(At this point Senator Proxmire resumed the chair.)

Chairman PROXMIRE. A very interesting line of questioning. You say the limiting factors are personnel and what else?

Secretary WIRTZ. Know-how.

Chairman PROXMIRE. What can we do to start moving as fast as we can in that area? What can we do about personnel in this tight market?

Secretary WIRTZ. That is very hard to answer, Mr. Chairman. I wish it could be answered more easily. The testimony this morning before the Government Operations Committee concerned social science research; and we ran into the same question there, with the same difficulty there. There just are shortages right now. We are trying to develop training programs of one kind or another. We tried, Mr. Chairman, 2 years ago, and the year before, to develop a summer training program of personnel; and it was called CAUSE. It was a program in which we took college graduates and put them through an intensive 12-week on-the-job training program. It didn't work too well. One, we were just that much ahead of the development of this program that we got them trained before the programs were ready to pick them up.

It was the year the Poverty Act passed, and so forth.

The other mistake we made was putting some questions on reactions and attitudes into a test which got us into all kinds of trouble.

We are trying very hard to present to the Congress an employment service bill which meets this problem where it is most serious, which is not in Washington, but in the State agencies of one kind or another. I do not believe there is any one single answer.

Chairman PROXMIRE. We also need some kind of priority system for training manpower, for the manpower that is capable of doing training, for teaching, who have been able to move in here so we can use at least the discretion of the Federal Government to make and break the bottleneck that way.

Secretary WIRTZ. Yes, sir. We are trying all varieties of ways. You have given us authority to authorize research in the colleges and universities and we are doing it frankly where they are not only getting research, but researchers.

Chairman PROXMIRE. All these programs are good, the Teacher Corps and so forth, and my colleague, Gaylord Nelson is one of the principal sponsors on this. It is a fine program, but it runs into this terrific shortage of teachers; and it would seem to me that some kind of priority system—do we have the available data on who are where, or where are the teachers, or who can be brought into the teaching picture, that kind of thing. Do we know that?

Secretary WIRTZ. I don't believe we do. Mr. Ross could respond to this. We can manufacture an answer to that in the affirmative but the real answer is no, there has not been a good job done.

Chairman PROXMIRE. Why would this not be desirable to do?

Secretary WIRTZ. It would. We have tried an approach to that in the establishment of the President's Committee on Manpower. We have that as a committee covering all of the agencies. It is a committee which has worked extraordinarily well together but which has had a good many energies directed toward the immediate problems but the committee hasn't functioned very well on the development of personnel in this field. I say this critically of the President's Committee on Manpower. There is a forum there, a forum for doing this. It also gets into the competition between this area and the whole area of the physical researchers. I suppose one of the things that has put as much push on this area is the development of the Medicare program.

Chairman PROXMIRE. If we cut a billion dollars out of the Space Program, say, let the Apollo program stand but cut a billion out of the non-Apollo space requests of a billion and a half dollars this would ease a lot of pressure on extremely able instructors in universities around the country not engaged in teaching, but engaged in space research. Would this kind of thing be helpful?

Secretary WIRTZ. You will understand my answering only that I would expect it would have some effect in loosening up that kind of personnel. I think that in order to answer your last question, we ought to pursue the preceding question. There ought to be some clearinghouse for information within the country—not just within the Government—and there ought to be some opportunity to analyze ways for making use of limited personnel.

Chairman PROXMIRE. One closing question. Gerhard Colm recommended the establishment of what he calls a high level unit in the Executive Office to assemble and analyze data concerning prices, productivity, inputs, and incomes. This is something that I understand Mr. Ross does now, does a very fine job and makes the information available to the Council of Economic Advisers. The staff of this committee wants it, but does not get it, the public in general does not get this information.

What prospects would there be that this could be opened up to the public?

Secretary WIRTZ. Information which is available to the Council and is within the Department but not available to this committee?

Chairman PROXMIRE. That is my understanding. Maybe I misunderstood my staff.

I am told that we had excellent cooperation from the Council. They give us whatever we ask for. But we think it would be helpful if the whole academic community throughout the country could get this and get it on a regular basis.

Mr. Ross. Senator, we have always tried to give the Congress everything we have been asked for and I am sure we will do that in the future. I don't know of any large body of information we give the Council that is not available to the Congress on the matter of prices. We have tried to set this out.

Chairman Proxmire. Prices, productivity, outputs, inputs.

Secretary Wirtz. Is it the projections or information on present data?

Chairman Proxmire. To assemble, analyze data concerning these things.

Secretary Wirtz. The only thing I can think of is, when we get into this business of the basis of projections which we make in a variety of ways and the predictions that are involved, I can see some sense there. Aside from that I do not see any reason that I could not explore any matter with you and with Commissioner Ross and with your staff.

That is the only exception I can think of offhand.

Chairman Proxmire. Well, Mr. Ross has been extremely cooperative.

I want to thank you gentlemen, very much.

This has been a wonderful afternoon for all of us.

Secretary Wirtz. I appreciate it.

Chairman Proxmire. We will convene tomorrow morning at 10 o'clock, weather permitting, to hear Wilbur J. Cohen, Under Secretary of the Department of Health, Education, and Welfare.

(Whereupon, at 4:55 p.m. the committee adjourned to reconvene at 10 o'clock, February 8, 1967.)

(The following material is made part of the record at this point by order of the chairman:)

U.S. Senate,
Committee on Banking and Currency
February 13, 1967.

Hon. W. Willard Wirtz,
Secretary of Labor, Department of Labor,
Washington, D.C.

Dear Mr. Secretary: I am very sorry that I was called away from the Joint Economic Committee's hearing on Tuesday afternoon, February 7, to answer a rollcall vote on the floor of the Senate. Because I was unable to ask you about a subject of interest to me, I would appreciate your answering the attached questions for inclusion in the hearings record.

Thanking you for your assistance in this matter, I am

Sincerely yours.

Charles H. Percy,
U.S. Senator.

Enclosure

QUESTIONS

1. (*a*) How many job vacancies now exist in our economy?

(*b*) How many persons are now participating in Federal job training programs?

(*c*) How many persons need job training or retraining and are not now in a private or public training program?

2. I am fully aware of the stress that you put on training programs and have noted that in your testimony before this Committee last year, you said, "training programs have become increasingly important."

I certainly agree with you, for I feel that our nation has a commitment to continually upgrade the skills of its workers. Therefore, I have cosponsored a bill to give private employers a tax credit to cover employee training expenses.

Feeling as I do that the tax credit approach is a good one, I was happy to see that in an address at Catholic University on November 29, 1966 you stated that essential to expanding job opportunities will be "social invention more than increased appropriations." And you went further in suggesting the use of tax credits to encourage enlarged employee training programs.

Secretary Wirtz, I assumed from this statement that this year you will lend your support to legislation such as the Human Investment Act which would provide tax credits for private employer training programs; and therefore, I would like to ask you:

(a) What caused you to reconsider your negative opinion on the tax credit approach as stated in February 1966 before the Subcommittee on Employment and Manpower of the Senate Labor and Public Welfare Committee?

(b) What is the Department of Labor doing to pursue the idea of a tax credit approach?

(c) Will you propose legislation?

3. I do not wish to suggest that the present Federal training programs should be replaced. In last year's hearings you stated that about half of the reduction in unemployment during 1965 was due to the effect of these programs. However, I also noted that you went into great detail (in response to a question from Congressman Curtis) to explain what the Department of Labor has done to attempt to coordinate the many existing federal training programs.

From the point of view of economy and efficiency would you not think it wise to begin to think in terms of a block grant program to the states for training programs? Do you think that a State administered program (funded with "no strings attached" Federal money) would be far more efficient and far more flexible in meeting the individual needs of each community?

U.S. DEPARTMENT OF LABOR,
OFFICE OF THE SECRETARY,
Washington, March 29, 1967.

Hon. WILLIAM PROXMIRE,
Chairman, Joint Economic Committee,
Washington, D.C.

DEAR MR. CHAIRMAN: Enclosed for the Committee's information is a copy of a letter which I have sent today to Senator Percy replying to certain questions to be forwarded to me after the February 7 hearing of the Joint Economic Committee.

Sincerely,

W. WILLARD WIRTZ,
Secretary of Labor.

[Enclosure]

U.S. DEPARTMENT OF LABOR,
OFFICE OF THE SECRETARY,
Washington, March 29, 1967.

Hon. CHARLES H. PERCY,
U.S. Senate,
Washington, D.C.

DEAR SENATOR PERCY: I am glad to make further response to your letter requesting information for the record in the recent hearings on the Joint Economic Report. Your questions and my answers follow.

Sincerely,

W. WILLARD WIRTZ,
Secretary of Labor.

[Enclosure]

1. (a) How many job vacancies now exist in our economy?

We do not at present have any figures on total job vacancies in the United States. Such information is now available only for about fifteen metropolitan areas, as part of a Department of Labor experimental program initiated several years ago. This pilot program, operated by the United States Employment Service and the affiliated State Employment Services in cooperation with the Bureau of Labor Statistics, provided one time job vacancy estimates for each of these areas for the fall of 1964, for April 1965, and for April 1966. Another such survey will be conducted in these areas later this spring.

The best available indication of vacancies now at hand is the monthly listings of unfilled job openings held by public employment offices throughout the country.

These total about 322,500 at the end of February (slightly less than the year-ago level of 344,400). Unfilled job openings generally range between a quarter and a third of the total vacancies in the areas included in our pilot program.

(b) *How many persons are now participating in Federal job training programs?*

In 1966 the number of trainees, in thousands, were as follows:

Manpower Development and Training Act program	273
Institutional training	160
On-the-job training and other	113
Job Corps	10
Neighborhood Youth Corps:	
In school	106
Out of school	55
Summer	209
Work experience	64
Total	771

(c) *How many persons need job training or retraining and are not now participating in a private or public training program?*

Any estimates we could make on this point would be highly tentative and speculative. We have requested $500,000 in our fiscal year 1968 manpower research budget to collect information about the adequacy, extent, and quality of training in the United States. With these funds we hope to find more statistically reliable answers to the kind of question you have raised.

2. *What are your views on the tax credit approach as a means for inducing private employers to increase their training efforts?*

It is clear that we are both very much interested in new methods which will induce private employers to increase the training efforts they now undertake.

The problem is one of finding suitable means. I have not given up the search for a suitable proposal which can operate through the tax system and would be very much in favor of one if we could find a practical approach.

Although we have examined carefully and sympathetically the bills which have been introduced by members of the Congress, we have not yet seen one which is not deficient in one respect or another. Some might involve great windfalls. Others would probably not reach the people who are the primary objectives of our manpower program or our public concern, or are deficient for other technical reasons that affect both the Nation's tax and manpower policies.

I do want to assure you, however, that we have not given up the search for an appropriate method. Members of our staff are in active consultation with representatives of the Treasury Department and are exploring a number of avenues involving both the tax system and other methods which can increase training.

I am confident that we will be able to find a method which we can recommend to the Congress.

3. *From the point of view of economy and efficiency would you not think it wise to begin to think in terms of a block grant program to the States for training programs?*

The Labor Department has explored block grant programs thoroughly. Our present grants to the States are based on their budgeted needs, subject to review by the Secretary of Labor for administrative efficiency. The States present to us their broad program requirements broken down by functions, and the grants are made on the basis of function. The Department is additionally moving in the direction of greater delegation of responsibility, to give the States greater authority to shift funds from program to program within the broad functional allocation within which they have evaluated their needs, and within which funds have been allocated.

The chief objection to the block grant is that it does not give the Department enough discretion to allocate among States by need, to assure efficient administration, and above all, to move in the direction of national (as compared with State) goals. The executive branch of the Government would be less than responsible if it did not maintain some flexibility in fund allocation to enable it to be most effective in meeting national needs and objectives, as well as sufficient control to protect the Federal purse.

THE 1967 ECONOMIC REPORT OF THE PRESIDENT

WEDNESDAY, FEBRUARY 8, 1967

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

The joint committee met at 10:05 a.m., pursuant to recess, in room S–228, the Capitol, Hon. William Proxmire (chairman of the joint committee) presiding.

Present: Senators Proxmire, Talmadge, Ribicoff, and Javits; and Representatives Reuss, Griffiths, Curtis, Widnall, Rumsfeld, Brock, and Scheuer (visitor).

Also present: John R. Stark, executive director; James W. Knowles, director of research; and Donald A. Webster, minority economist.

Chairman PROXMIRE. The committee will come to order.

Our witness this morning is the distinguished Under Secretary of Health, Education, and Welfare, Wilbur Cohen, an old friend of the committee, and he is accompanied by Robert Myers, who is the Actuary for the Social Security Administration.

The Department of Health, Education, and Welfare is responsible for the operation of the social security programs in addition to including the old-age and survivors insurance. It also contains a substantial portion of what we know as the "Great Society" programs. In addition, that agency has a major responsibility for the education and health programs of the U.S. Government, both of which represent very important sectors of the Great Society program.

I should say that from the standpoint of economic policy, this is an operation which can only be compared with the Defense Department. The figures that have just been given me by the staff is that altogether, counting HEW funds of $13 billion and trust funds of $27 billion, the total amount involved here is $40 billion. I might also add that we are always hopeful that the Defense Department expenditures decline; we want those to decline as rapidly as possible. We certainly expect them to be lower in the future. On the other hand, it is anticipated HEW-supervised expenditures will be constantly increasing, and the impact on economic policy is conspicuous and definite.

For this reason, the testimony this morning of the very able Mr. Cohen will be most useful to us. Mr. Cohen, you may begin.

75-314—67—pt. 2——6

STATEMENT OF HON. WILBUR J. COHEN, UNDER SECRETARY, DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE; ACCOMPANIED BY ROBERT J. MYERS, CHIEF ACTUARY, OFFICE OF THE ACTUARY, SOCIAL SECURITY ADMINISTRATION; AND MRS. IDA C. MERRIAM, ASSISTANT COMMISSIONER, OFFICE OF RESEARCH AND STATISTICS, SOCIAL SECURITY ADMINISTRATION

Mr. COHEN. Thank you, Senator. I am also accompanied by Mrs. Ida Merriam, who is the Assistant Commissioner for Research of the Social Security Administration.

I would like to add that in the difficulties yesterday of getting the statement prepared, I inadvertently left off one table, which I would like to have included in the record. It includes the monthly social security cash benefits under the present law and under the President's proposal, which supplements the tables I have in the testimony.

Chairman PROXMIRE. That will be done. Do you have duplicates of that table?

Mr. COHEN. No; I don't. I will be glad to give you that one copy.

Chairman PROXMIRE. Why don't you keep it with you for now, since you may need it for reference during questioning?

Mr. COHEN. All right.

(Table 8, referred to, appears on p. 333.)

Chairman PROXMIRE. In other words, you have given us the bad news here in the presentation, but not what we get for it.

Mr. COHEN. That is correct; and I don't know whether that was inadvertent or intentional, but when I looked at it this morning, I saw that it should have been the last table, which was left off.

Mr. Chairman and members of the Joint Economic Committee, it is a pleasure to participate in your consideration of the Economic Report of the President.

The health, education, and welfare of the American people are the Nation's greatest resources. Investment in these resources yields benefits to the individual and to the society. They are essential to individual fulfillment and to the economic growth and stability of the society. In turn, economic development also contributes to the development of these resources. Thus, the Department that I represent shares with you a deep interest in a healthy economy, with its resulting full employment and economic growth.

The singular objective of all the Department of Health, Education, and Welfare's programs is the development of the individual's capacities to their fullest extent. Programs are designed to prevent disease and improve health, to support and encourage education, to provide a strong social insurance system, and to seek ways through welfare programs to reduce dependency as well as reduce the causes and meet demonstrated need. Legislation enacted by the last several Congresses has reinforced the Department's efforts in carrying out its objectives.

President Johnson noted in his state of the Union message on January 10, that:

> We tried to meet the needs of our people. And we have succeeded in creating a better way of life for the many as well as the few. And now we must answer whether our gains shall be the foundations of further progress or whether they shall be only monuments to what might have been—abandoned now by a people who lacked the will to see their work through.
>
> I believe that our people do not want to quit.

In my testimony today I will discuss the Department's concern for reinforcing the gains that have already been achieved from the Nation's investment in human resources and some of the problems and needs in the years to come. In this respect I would like to review the areas in which we are developing proposals to expand the opportunities of the American people and to bolster the growth of the economy.

TOTAL PUBLIC AND PRIVATE EXPENDITURES FOR HEALTH, EDUCATION, AND WELFARE

At this point I would like to discuss the totality of public and private expenditures for health, education, and welfare, no matter what their source or what their method of payment, to give you a full picture of their impact on the Nation's economy as related to the gross national product.

The extent of the Nation's commitment to programs for strengthening human resources is clearly evident in the amounts spent in fiscal year 1966 on health, education, and welfare from both public and private funds. The combined expenditures amounted to $131 billion—or 18.4 percent of gross national product.

I might add at this point that the $131 billion is the unduplicated count of expenditures—that is the total amounts are adjusted to eliminate duplication resulting from use of cash insurance benefits to purchase medical care and educational services. The individual areas will add up to a couple of billion dollars more when you look at them separately, but this is the attempt to appraise an unduplicated expenditure of organized funds in this area. It doesn't include every single type of personal expenditure that might be involved, but rather broadly, organized public or private expenditures of funds for health, education, and welfare. This comes, as I said, to 18.4 percent of the GNP.

In fiscal year 1962, expenditures were $93 billion or 17.2 percent of GNP. The growth rate in expenditures between these 4 years exceeded that in GNP.

Total expenditures for these functions under public programs—Federal, State, or local—reached $88 billion: Federal expenditures accounted for $47 billion, and State and local expenditures for $41 billion. In recent years, total public expenditures for health, education, and welfare have also been increasing faster than the GNP and the share of GNP devoted to these areas has risen from 11.5 percent in fiscal year 1962 to 12.3 percent in fiscal year 1966.

As President Johnson pointed out in his Economic Report: " * * * Americans have insatiable appetities for more education and better health." This is reflected in the rapid rate of increase in public funds that are devoted to these programs.

For example, between fiscal year 1962 and fiscal year 1966, total public expenditures for these programs rose by 41 percent while GNP rose only 31 percent—with a 54 percent increase in educational expenditures and a 61-percent increase in spending on public housing leading the way among traditional programs. In addition, the new programs authorized under the Economic Opportunity Act of 1964 have grown rapidly.

The figures on public expenditures that I am discussing, if you wish to go into the details, are in table 1, following. The table shows the total public expenditures, expenditures from State and local funds and from Federal funds since 1934–35.

Expenditures for the Federal programs rose more rapidly than did State and local government spending—in total amount and in almost every major category. By the end of fiscal year 1966 the total Federal expenditures of $46.8 billion exceeded the State-local total by $6 billion as compared with 1961–62 when State-local expenditures exceeded Federal expenditures by almost $1 billion.

DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE PROGRAMS

The President's 1968 budget for the Department of Health, Education, and Welfare calls for expenditures of $11.7 billion—an increase of $1 billion over the previous year—in addition to social security trust fund payments in the neighborhood of $31 billion. Assuming the President's recommendations are carried out, the budget as you said, Senator Proxmire, will total $44 billion.

These expenditures will be made through programs, most of which are carried out through the active cooperation and active participation of State and local governments, nongovernmental institutions and individual citizens. About 90 percent of Department of Health, Education, and Welfare funds derived from general revenues are allocated to State and local governments, other non-Federal institutions and individuals. This is how "creative federalism" works and it has been through this venturesome partnership that we have made great economic and social gains.

We can expect in the future, as in the past, that increasing shares of the Nation's output will be devoted to the development of human resources. By strengthening the programs of the Department of Health, Education, and Welfare, we seek to strengthen the entire system for providing services at every level. Through better management and more careful evaluation of the effectiveness of programs, we can insure more effective use of all of our resources.

TRENDS IN POVERTY

Now I would like to turn to another aspect that I think the Members of Congress will be interested in, how our particular programs relate to the national objective of minimizing and reducing the extent of poverty in the United States.

Rapid economic growth combined with increasing expenditures for health, education and welfare and related areas have had a significant impact on poverty. Over the past several years, as GNP grew rapidly, unemployment rates declined and public expenditures for health, education, and welfare, and related activities increased, the incidence of poverty declined. In 1959 some 38.9 million individuals—or 22.1 percent of the total population lived in households falling below the poverty levels of income developed by the Social Security Administration; by 1965 the number had declined to 32.7 million individuals—or 17.1 percent of the population. The sharpest declines have been among families with a male nonaged head of household, and the declines have been greater for whites than nonwhites. Increasingly, the poverty roster is becoming the hard-core groups: Aged persons, families headed by a woman and the disabled. Thus, we cannot rely on economic growth alone to pull households out of poverty as heavily in the future as in the past. This is a major reason why we must continue to improve our social security and other income maintenance programs—particularly for those not in the labor force.

Some of the worst pockets of poverty are in those parts of the central cities where living costs are highest and where resources for aiding the poor are inadequate. As compared with surrounding suburbs, central cities of our metropolitan areas have disproportionate numbers of the aged poor and of children in poor families. For example, within the central cities, 17 percent of the total population is poor, by the standards I previously stated.

Twenty-seven percent of the aged are living in poverty and 66 percent of the individuals in nonwhite families headed by a woman are living in poverty. In metropolitan areas, there are 10 million poor persons in the central cities while 6 million poor live in the surrounding suburbs. It is more likely that the head of a family living in the city will be out of the labor force than the head of the family in the suburbs. If he is working the chances are greater that he will have a low-skilled, low-paid job.

The increasing demand for health, education, and welfare services for the groups who remain in poverty in the city is growing, particularly as our awareness of their special needs grows—but the resources for meeting these demands are not growing at a fast enough pace.

Income Maintenance

A reasonable level of living for all Americans is the ultimate objective of our income maintenance programs. Putting a floor under income through income support programs so that no one falls below a minimum of need, is an intermediate step in achieving this objective. Although the objective of social security is not solely the reduction of poverty it is a major instrument in reducing the extent of poverty in this country. Public assistance programs are directed to the poor and have provided a basic income for several millions of persons. Without these programs many more persons would be in poverty and the disparity in income much greater. It is estimated that—

Without social security payments a much larger fraction of the aged would be poor. We estimate that about 37 percent of the aged beneficiaries under social security have been brought out of poverty as a result of the social security benefits that were added to whatever other income they might have had.

Of the $3.5 billion of public assistance payments to noninstitutional recipients in 1965, virtually all went to the poor.

The income deficiency of the poor, that is the gap in the amount of income between what they actually have and the social security standard of poverty in 1965 was $11 billion; this is the total amount by which their incomes fell short of the poverty line. Without the social security and public assistance programs the deficiency would have approached $20 billion. The impact of the present programs is very substantial, but of course a substantial gap remains as well.

Despite the improvements that have been made in these programs in recent years many persons still remain poor. Legislation proposed this year, both for social security and public assistance will further improve these programs—but we will still be short of filling the basic income needs of the poor—even of the poor who could not be considered potential labor force members.

SOCIAL SECURITY PROPOSALS

The President has proposed a number of significant improvements in the social security program. They are designed primarily to raise benefits from their present inadequate levels, but there are other objectives as well; to permit greater work force participation of beneficiaries who are able to work; to provide health insurance benefits to disabled beneficiaries; to seek better coverage of farmworkers who are presently severely disadvantaged because of the transitory nature of their employment; to provide benefits for disabled widows; and to guarantee at least $100-per-month benefit for anyone who has worked substantially in covered employment, under the social security program, for 25 years. There are other significant but less general changes proposed. These revisions will increase old-age, survivors, and disability insurance (OASDI) outlays by about 20 percent—by $4.1 billion—in the first year after they take effect in July 1, 1967.

Many people not only have been but are disturbed when they learn that almost 2.5 million OASDI beneficiaries have benefits of $44 or less per month; that 2 million aged persons are receiving public assistance; and that one-half of the OAA recipients are OASDI beneficiaries whose incomes are below destitution level even though they earned social security eligibility. It is an uncomfortable fact that despite OASDI over 5 million of the aged have incomes below the poverty level at the present time.

Some persons are convinced that we should not spend additional amounts for social programs at the present time. The administration has taken the view that although some types of expenditure should be postponed; others should not. There is a vast difference between rescheduling the completion of public works such as superhighways and putting off action on the plight of elderly citizens. Similarly, action must be taken promptly for widows and children who are trying to subsist on lagging survivor benefits.

The administration seeks in its proposals:

(1) To make some adjustments which improve protection for currently active workers. For most of them the social security system is their major bulwark against income loss when they retire, are disabled, or die leaving dependents.

I want to emphasize, Mr. Chairman, and members of the Joint Economic Committee that the social security system is not solely a retirement system. It also provides disability insurance and survivors benefits—what you might call a form of monthly life insurance protection. Survivors' benefits for the widow and children are really a form of monthly payments of a life insurance character. There are three types of benefit provisions.

The proposed revisions increase coverage for some new workers and in a series of steps broaden the base upon which benefits are calculated. The base will increase by steps from the current $6,600 a year to $10,800 in 1974. The change will increase the value of survivor's insurance for the worker's family. It will do that, of course, reasonably promptly.

It also raises the size of the disability and retirement benefit which the average worker may utlimately receive. As a result he may look forward to a more satisfactory level of income replacement when he becomes disabled or retires.

(2) To raise benefits for the 23 million beneficiaries already on the rolls who have been experiencing loss of real purchasing power because of price increases and whose benefits even before such deterioration were lower than I think this country should accept. At the present time a man who had earnings at about the average for male workers today will get a retirement benefit that replaces only about 30 percent (the man and wife both of whom are 65 and over, about 45 percent) of his previous earnings. Each of the 23 million social security beneficiaries will gain as a result of the changes but gains will be relatively greatest for those currently receiving minimum benefits.

The proposed changes are designed to improve protection for both covered workers (roughly, 86 million if you take into account people who come in and out of the labor market and not just the ones who are just working at the given moment), and current beneficiaries (roughly, 23 million).

The new benefit formula provides that persons currently receiving minimum benefits will have their benefits increased by 59 percent. More than 1 million persons over 72 years of age who receive benefits although they do not meet the insured status requirements will receive sharply increased benefits. These changes, which seen modest in absolute terms (the minimum primary insurance amount will go up from $44 to $70; payments to the special group over 72 increases from $35 to $50 for an individual) should have a substantial impact on poverty among the aged.

New provisions extending coverage to an additional 500,000 farmworkers would increase protection for a group among whom the incidence of poverty is high.

The combined changes in social security suggested by the President would reduce by more than 1.5 million the number of persons in the United States living in poverty, and I think that is a rather striking and important aspect of these recommendations. It would reduce the number of aged poor as well as the number of disabled and survivors, who are living in poverty.

Proposals that would provide only an 8-percent-benefit increase, a number of which have been introduced in Congress, would reduce the numbers of persons in poverty by only one-half million.

The proposals, made by the President, also include liberalization of the retirement test. Beneficiaries who are in a position to earn will be permitted somewhat more earnings than at present and still receive their full benefits.

Because of the pressure of time, it is necessary to pass over some of the other detailed proposals. The addition of benefits for disabled widows and the extension of health insurance to disabled beneficiaries are critical for the disabled persons involved and represent another adance in social awareness. Provisions to insure areas access to some type of protection through the social security program for workers who work for the Government for less than 5 years is no less vital to the large groups affected.

Financing the Proposals

Now I would like to discuss some of the broad financing implications of these recommendations.

The 1967 legislative proposals continue well-defined financing policies of the past. There has been a careful weighing of costs and provision of revenues to cover them. The benefit and contribution bases have been raised to reflect more nearly than at present the original relationship of taxable to total wages and salaries.

Emphasis upon full discussion of eventual costs and explicit provision of revenues required is a tradition of the social security program. For this reason Congress has, from the beginning, considered carefully the current and long-range level of costs and has made appropriate provisions for both short-range and longer range income to the system. From time to time Congress has created advisory councils composed of distinguished citizens to review the financing of the system.

The Chief Actuary of the Social Security Administration, Mr. Robert J. Myers, estimates that the combined changes in OASDI involve increases in level costs of 1.5 percent of taxable payroll. Part of this increased cost can be financed without changing the contributions because long-range income is now estimated to exceed long-range costs of present benefits. (Table 5, p. 331, shows that the present system has a positive actuarial balance, or actuarial surplus of 0.74 percent of payroll. That is roughly, three-fourths of 1 percent of payroll.)

Adequate financing for the other added costs in the OASDI program will be provided partly by the gradual increase in the contribution base; partly by an increase in contribution rates. Table 5 shows that the OASDI contribution rate increases proposed is equivalent to only 0.25 percent of payroll while the recommended contribution base increase is the equivalent of 0.50 percent of payroll.

In other words, when I said originally that the total benefit increase that we are recommending is 1½ percent of payroll, roughly half of that, 0.75—the actual figure is 0.74—is made up of the favorable actuarial balance. Then a half of a percent of payroll is made up through the base increases, and a quarter percent is made up through the rate increases. That is why I said earlier the benefits proposed by the President are fully financed through these three sources.

The rates are altered (table 6) and the total contributions of individuals, particularly those with higher incomes are increased (table 7). Both aspects are fully presented in order to avoid any suggestion that the significant improvements sought are costless, or nearly so. They involve acceptance of higher long-term commitments.

Although the contribution rates recommended do not change in 1967–68, there will be an immediate fiscal impact.

Both income and outlays of the trust funds will be higher than they otherwise would be. In both calendar 1967 and calendar 1968 the excess of income over outgo will be less if the changes are made than if no benefit increases are made. This decrease, unless other offsetting actions are taken, will have a stimulating effect upon the economy. The Actuary estimates that, if the 1967 proposals are adopted, the OASDI trust funds will sustain a $1.7 billion excess of income over outgo in calendar 1967; or about $600 million in calendar 1968. If no changes are made, the excess would be $3.8 billion in calendar 1967 and $4.2 billion in calendar 1968.

Representative REUSS. May I interrupt you there to do a little arithmetic?

What is the difference between adopting the proposal and not adopting it?

Mr. COHEN. If the proposals are adopted, the buildup in the reserves in those 2 years would be $2.1 billion less in calendar year 1967 and $3.6 billion in calendar 1968.

We believe that the policy which has been pursued by Congress since 1950—a policy of virtual pay-as-you-go financing accompanied by frequent examinations of longer range actuarial needs—has proven it merit and should be continued.

The President's proposals would make important improvements in the social security program that would help to meet the needs of the aged and reduce the extent of poverty. There is no reason, in my opinion, in a country as prosperous as the United States why social security beneficiaries—the retired, widowed, orphaned, and disabled—should be denied a measure of dignity and self-sufficiency in our society. They have contributed a share in the growth of this Nation and I believe that the social security system is a mechanism by which they should and can share in our expanding prosperity.

HEALTH AND EDUCATION

Now, turning very briefly to some of the education and health aspects of our Department, which are, of course, among the Nation's overriding concerns. They are essential to human development and fulfillment. Unnecessary suffering and ilness, illiteracy and inferior education hold men in bondage.

While great strides have been made in recent years in both health and education, there are still many unfilled needs and our task is not yet complete. Thus, the President has proposed major improvements in education and health programs. These include—

Additional funds for the Elementary and Secondary Education Act so that we may reach an additional 1 million culturally deprived children.

An increase in the amount of aid provided or guaranteed to college students of $200 million allowing an increase of over 300,000 in the number of students aided or a total exceeding 2 million individuals.

Additional funds to increase the number of community mental health centers, the number of medical schools, and the number of students enrolled in the health and allied health professional fields.

Funds to develop improved methods of child health care and expanded efforts in early case finding and treatment of children in low-income areas. As a matter of fact, Mr. Chairman, and members of the committee, the President is sending his message on children and the youth to the Congress today which will, of course, discuss in substantially more detail recommendations in this area.

CONCLUSION

In conclusion, I believe that great opportunities are being realized through the Department's programs. The advances that can be made in the well-being of our citizens are closely related to the Nation's economic progress. Each benefits from the other. There is a distinct correlation between a healthy, educated citizenry and national productivity. Better qualified workers produce more. Healthier workers also produce more, and so on, in other aspects of the security of the people. Thus, the Department shares your concern for a healthy, stable, and growing economy and through its programs attempts to reinforce other efforts in this direction.

Chairman PROXMIRE. Thank you, Mr. Cohen. I take it that your supplementary statement is part of your presentation.

Mr. COHEN. Yes.

Chairman PROXMIRE. Without objection that will be printed in the record, and the following tables, which are very, very useful, will also be printed in the record in full.

(The material referred to follows:)

SUPPLEMENT TO STATEMENT OF UNDER SECRETARY COHEN

1967 SOCIAL SECURITY RECOMMENDATIONS: SUMMARY OF MAJOR PROPOSALS

The President has recommended improvements in the social security program that would result, in calendar year 1968, when all of the proposals will have gone into effect, in an overall 20-percent increase in benefit disbursements.

The increase, in terms of additional cash payments, would be the largest increase in benefit payments ever enacted; it would result in additional cash benefit payments of $4.5 billion in calendar year 1968.

The level of living of the 23 million people who are now getting social security benefits would be greatly improved, and 1.4 million aged people among them would be moved out of poverty. In addition, the protection of current workers and their families—about 86 million will work under social security in 1967—would be very significantly improved.

Following is a list of the major proposals that the President has recommended:

1. A benefit increase amounting to at least 15 percent for all beneficiaries now on the rolls, with a minimum benefit of $70.

This provision would result in additional payments of $3.9 billion in the first 12 months of operation.

2. A special minimum benefit of $100 for workers with at least 25 years of coverage under social security; the special minimum would be equal to $4 multiplied by the number of years of coverage up to 25.

About 100,000 people would benefit under this provision. About $7 million in additional benefits would be paid in the first 12 months of operation.

3. An increase from $1,500 to $1,680 in the amount of annual earnings a beneficiary under age 72 can have without having any benefits withheld, and an increase from $125 to $140 in the amount of monthly earnings a person can have and still get a benefit for the month. Under the proposal, as under present law, $1 in benefits would be withheld for each $2 of the first $1,200 of earnings above the annual exempt amount, and $1 in benefits would be withheld for each $1 in earnings thereafter.

About 750,000 people would get additional benefits under the provision. An estimated $185 million would be paid out in additional benefits in the first full year of operation.

4. Monthly cash benefits for the disabled widow of an insured worker where the widow becomes disabled before 7 years after the worker's death or before 7 years after termination of her entitlement to benefits as a mother.

About 70,000 widows would benefit immediately and about $75 million in additional benefits would be paid out in the first 12 months of operation.

5. Health insurance benefits for disabled beneficiaries—disabled workers, disabled adults getting benefits on the basis of disabilities that have continued since childhood, and disabled widows under age 65.

An estimated additional 1.5 million social security beneficiaries—1.2 million disabled workers, 200,000 people getting disabled child's benefits, 100,000 disabled widows under 65—would be eligible for health insurance benefits. Benefit payments under this proposal in the first year are expected to be $225 million under the hospital insurance program and $100 million under the medical insurance program. (Similar protection would be provided for qualified disabled railroad retirement annuitants.)

6. Social security credit, through transfers of credit, for Federal employment of workers whose Federal service is subject to the civil service or the foreign service retirement system if benefits are not payable to the workers or their families under such system at the time they retire, become disabled or die.

Adoption of this proposal would prevent losses of protection by employees who leave Federal service in the future.

7. An increase from $35 to $50 (from $52.50 to $75 for a couple) in the special payments that were provided under the 1965 amendments and the Tax Adjustment Act of 1966 for certain people age 72 and over who cannot meet the regular insured status requirements of the program.

The increase in these payments would amount to about $240 million in additional benefit payments during the first 12 months of operation. Of this amount, $215 million would be met from general revenues. (The old-age and survivors insurance trust fund pays for the cost of benefits only for those who have worked for more than half a year under the program.) About 1.2 million people would qualify for some payments or higher payments as a result of this proposal.

8. A change in the present coverage requirements for agricultural workers which would provide coverage for the farmworker if he was paid at least $50 (instead of the present requirement of $150) in a year for farmwork by an employer or if he worked at least 10 days (instead of the present requirement of 20 days) in a year for that employer.

This proposal would improve the social security coverage of 500,000 agricultural workers, including migratory workers, who in many instances do not meet the coverage requirements in present law.

9. Coverage of podiatrists' services under the supplementary medical insurance program where the services are of the type now covered if performed by a physician.

10. An increase in the contribution and benefit base to $10,800, to be reached in 3 steps—$7,800 in 1968, $9,000 in 1971, and $10,800 in 1974.

11. Increases in the contribution rates for the cash benefits part of the program. The change scheduled in the employer-employee rate for 1969 under present law (from 3.9 percent each to 4.4 percent each) would be raised by 0.1 percent, to 4.5 percent each. The change scheduled under present law for 1973 and thereafter (to 4.85 percent each) would be raised by 0.15 percent each, to 5.0 percent each.

For the self-employed, the increased scheduled under present law for 1969 (from the present 5.9 percent to 6.6 percent) would be raised by 0.2 percent and thus would come to 6.8 percent. This rate would remain in effect until 1973, at which time the increase to 7.0 percent scheduled under present law would go into effect.

At the present time, the social security program has a significantly favorable actuarial balance; that is, it is expected that over the long-range future the income to the program will considerably exceed the costs of the program. The benefit improvements recommended by the President will cost about 1½ percent of covered payroll. It is possible to meet about half of the cost of the recommended benefit improvements from the present favorable balance. The remainder of the cost of the proposed changes would be met through the increases in the contribution rates for the cash benefits part of the program and in the maximum amount of annual earnings subject to the tax and used in computing benefits.

The rate increase averaged over the long run would be equivalent to one-fourth of 1 percent of payroll; the earnings base increase is equivalent to one-half of 1 percent of payroll. These two financing recommendations would yield income equal to three-fourths of 1 percent of payroll, which, when combined with the actuarial balance of the present system, would fully meet the cost of the recommendations.

Hospital insurance protection for the disabled could be made available without any increase in the hospital insurance contribution rate because of the additional income that would result from the increased contribution base. Supplementary medical insurance protection would also be made available on the same basis as it is for the aged—that is, on a voluntary basis, with the beneficiary paying a monthly premium of $3 and the Federal Government paying a matching amount.

TABLE 1.—*Social welfare expenditures under public programs, selected fiscal years, 1934–35 through 1965–66* [1]

[In millions; revised estimates]

Program	1934–35	1939–40	1944–45	1949–50	1954–55	1959–60	1961–62	1962–63	1963–64	1964–65	1965–66 [2]
	Total expenditures										
Total	$6,417.0	$8,761.7	$8,859.0	$22,972.6	$32,243.9	$52,154.4	$62,203.9	$66,542.9	$71,081.7	$77,505.4	$87,578.2
Social insurance	383.9	1,217.7	1,418.5	4,873.0	9,854.2	19,297.4	24,199.9	25,592.0	26,966.8	28,078.2	31,905.8
Old-age, survivors, and disability insurance [3]	----	28.1	266.8	784.1	3,436.3	11,032.3	13,984.6	15,344.3	16,200.8	16,997.2	20,292.3
Railroad retirement	----	115.7	143.7	304.4	575.6	925.4	1,033.2	1,073.8	1,103.5	1,126.7	1,204.9
Public employee retirement [4]	210.0	254.5	382.8	743.4	1,388.5	2,569.9	3,189.7	3,569.3	4,056.7	4,520.6	5,150.8
Unemployment insurance and employment service [5]	----	553.0	216.7	2,191.9	2,080.8	2,829.6	3,863.8	3,373.0	3,270.2	2,976.3	2,608.0
Railroad unemployment insurance	----	18.9	4.3	119.6	158.6	215.2	163.3	122.8	92.6	76.7	54.4
Railroad temporary disability insurance	----	----	----	31.1	54.2	68.6	56.8	52.8	50.1	46.5	53.4
State temporary disability insurance, total [6]	----	----	5.1	72.3	217.5	347.9	407.1	444.2	467.9	486.9	502.0
Hospital and medical benefits [7]	----	----	----	2.2	20.0	40.3	45.5	48.4	50.4	50.7	56.0
Workmen's compensation, total [8]	173.9	247.5	399.1	626.2	942.6	1,308.5	1,505.4	1,611.8	1,725.0	1,847.3	2,050.0
Hospital and medical benefits [7]	65.0	90.0	122.0	193.0	315.0	420.0	475.0	510.0	545.0	585.0	625.0
Public aid	2,997.6	3,598.7	1,030.5	2,496.2	3,003.0	4,101.1	4,945.1	5,295.4	5,642.0	6,177.6	6,824.1
Public assistance [9]	623.9	1,124.3	1,028.8	2,490.2	2,941.1	4,041.7	4,675.0	5,028.7	5,381.3	5,873.8	6,455.9
Vendor medical payments [7]	----	----	----	51.3	211.9	492.5	812.4	1,000.7	1,147.6	1,367.1	1,620.0
Other [10]	2,373.7	2,474.4	1.7	6.0	61.9	59.4	270.1	266.7	260.7	303.8	368.2
Health and medical programs [11]	434.4	681.7	2,331.0	2,087.1	3,054.4	4,454.8	5,225.8	5,608.7	6,010.5	6,429.8	7,179.8
Hospital and medical care	259.8	440.0	1,985.7	1,230.1	1,980.7	2,817.0	3,115.1	3,248.8	3,504.7	3,607.1	3,989.6
Civilian programs	231.8	340.5	354.7	914.5	1,217.3	1,952.2	2,132.0	2,274.5	2,446.8	2,511.8	2,593.9
Defense Department and medicare	28.0	99.5	1,631.0	315.6	763.4	864.8	983.1	974.3	1,057.9	1,095.3	1,395.7
Maternal and child health services [12]	6.7	13.8	62.1	29.8	92.9	139.4	174.1	186.2	201.0	222.5	258.2
Medical research [13]	----	3.0	15.0	69.2	132.8	448.9	780.5	920.3	1,042.5	1,166.6	1,347.5
School health (educational agencies)	9.9	17.9	23.3	30.6	65.9	101.0	129.0	128.4	127.7	132.0	135.0
Other public health activities [14]	119.7	166.6	195.0	358.6	404.6	431.6	506.0	576.5	602.3	713.2	843.5
Medical-facilities construction	38.3	40.4	50.0	368.8	377.5	516.9	521.1	548.5	532.2	588.4	606.0
Defense Department	----	----	----	----	33.0	40.0	24.0	23.0	42.4	34.8	28.6
Other	38.3	40.4	50.0	368.8	344.5	476.9	497.1	525.5	489.8	553.6	577.4
Other welfare services	53.0	77.0	159.0	422.7	573.4	1,014.1	1,304.0	1,448.4	1,562.9	1,948.9	2,739.2
Vocational rehabilitation, total	2.2	4.1	10.2	30.0	41.4	100.4	135.3	156.6	194.3	222.5	328.2
Medical rehabilitation [7]	.2	.4	1.4	7.4	9.2	17.7	22.5	26.0	31.2	34.2	54.3
Institutional and other care [15]	24.8	27.9	45.9	96.1	103.3	176.0	306.5	386.9	366.4	398.5	419.5
School lunch [16]	----	----	47.4	191.7	293.6	526.2	615.8	636.6	638.7	797.1	752.0
Child welfare [17]	26.0	45.0	55.5	104.9	135.1	211.5	246.4	268.3	313.4	352.4	381.6
Special programs [18]	----	----	----	----	----	----	----	----	----	178.4	858.0
Veterans' programs [19]	449.8	535.1	892.1	6,380.8	4,369.5	5,106.4	5,389.8	5,584.6	5,749.2	5,965.1	6,333.5
Pensions and compensation [20]	390.2	447.8	755.9	2,092.8	2,712.5	3,425.7	3,774.8	3,947.4	4,033.1	4,186.1	4,465.1
Health and medical services	58.9	86.3	116.5	745.8	761.1	957.1	1,047.0	1,121.7	1,179.4	1,250.6	1,330.8
Hospital and medical care	56.0	72.1	98.3	585.9	722.6	884.5	968.0	1,022.0	1,069.9	1,132.8	1,205.4
Hospital construction	2.9	14.1	16.2	156.2	33.0	57.5	52.1	69.8	76.4	80.9	83.2
Medical and prosthetic research	----	.1	2.0	3.7	5.5	15.1	26.8	29.9	33.2	30.9	42.2
Education	----	----	9.7	2,689.1	609.9	404.7	153.3	97.5	66.1	41.4	35.4
Welfare and other [21]	.7	1.0	10.0	853.1	196.0	318.7	414.6	418.1	470.6	487.0	502.2

Education	2,098.3	2,647.3	3,017.5	6,698.3	11,299.2	18,003.9	20,949.9	22,766.9	24,878.4	28,591.5	32,248.4
Elementary and secondary, total	1,890.1	2,360.5	2,656.4	5,724.3	10,006.8	15,598.6	18,028.8	19,369.7	20,805.9	23,105.1	25,805.3
Construction [7]	157.3	289.0	83.7	1,018.7	2,362.4	2,868.7	3,071.6	3,227.7	3,203.7	3,510.0	3,796.0
Higher and other, total	208.2	286.8	361.1	974.0	1,292.4	2,405.4	2,921.2	3,397.2	4,072.5	5,486.4	6,443.1
Construction [7]	[22] 30.0	32.6	[22] 9.1	315.5	198.8	395.0	409.8	519.8	550.4	1,158.1	1,392.8
Public housing [23]	----------	4.2	10.4	14.5	89.3	176.7	216.4	246.9	271.9	314.3	347.5
	From Federal funds										
Total	3,107.2	3,466.8	4,083.2	9,998.1	14,230.9	24,724.3	30,630.4	32,967.1	35,591.4	38,786.9	46,804.5
Social insurance	98.9	354.9	759.8	2,028.1	6,404.7	14,298.0	18,295.6	19,395.6	20,638.3	21,778.8	25,608.3
Old-age, survivors, and disability insurance [3]	----------	28.1	266.8	784.1	4,436.3	11,032.3	13,984.6	15,344.3	16,200.8	16,997.2	20,292.3
Railroad retirement	----------	115.7	143.7	304.4	575.6	925.4	1,033.2	1,073.8	1,103.5	1,126.7	1,204.9
Public employee retirement [4]	90.0	107.5	184.8	433.4	808.5	1,519.9	1,903.7	2,145.3	2,486.7	2,780.6	3,225.8
Unemployment insurance and employment service [5]	----------	70.5	145.5	330.4	321.0	473.5	1,086.2	584.4	628.3	673.5	707.5
Railroad unemployment insurance	----------	18.9	4.3	119.6	158.6	215.2	163.3	122.8	92.6	76.7	54.4
Railroad temporary disability insurance	----------	----------	----------	31.1	54.2	68.6	56.8	52.8	50.1	46.5	43.4
Workmen's compensation total [6]	8.9	14.2	14.7	25.1	50.5	63.1	67.8	72.2	76.3	77.6	80.0
Hospitalization and medical benefits [7]	3.0	5.2	4.7	5.2	6.9	9.0	8.4	10.2	10.4	11.3	12.0
				3.2							
Public aid	2,373.7	2,245.9	420.1	1,103.2	1,504.2	2,116.9	2,741.0	2,999.1	3,207.1	3,488.1	3,854.9
Public assistance [9]	----------	281.1	418.4	1,097.2	1,442.3	2,057.5	2,470.9	2,732.4	2,946.4	3,184.3	3,486.7
Vendor medical payments [7]	----------	----------	----------	----------	23.3	199.6	394.8	510.0	593.0	703.4	743.0
Other [10]	2,373.7	1,964.8	1.7	6.0	61.9	59.4	270.1	266.7	260.7	303.8	368.2
Health and medical programs [11]	50.1	159.9	1,775.6	586.0	1,174.4	1,748.9	2,237.8	2,456.3	2,751.1	2,951.5	3,517.8
Hospital and medical care	39.6	124.4	1,660.6	362.0	829.8	967.9	1,096.1	1,093.8	1,188.7	1,231.1	1,539.6
Civilian programs	11.6	24.9	29.6	46.4	66.4	103.1	113.0	119.5	130.8	135.8	143.9
Defense Department and medicare	28.0	99.5	1,631.0	315.6	763.4	864.8	983.1	974.3	1,057.9	1,095.3	1,395.7
Maternal and child health services [12]	----------	7.8	55.2	20.1	23.7	33.3	50.1	50.8	59.1	69.6	82.2
Medical research [7]	----------	----------	----------	----------	.2	.6	.8	1.0	2.7	4.3	5.8
Medical research [13]	----------	3.0	15.0	69.2	132.8	425.9	743.5	875.3	992.5	1,111.6	1,286.5
Other public health activities [14]	7.2	24.3	44.8	67.9	70.6	87.9	112.0	176.9	223.6	239.8	293.5
Medical-facilities construction	3.3	.4	(24)	66.8	117.5	233.9	236.1	259.5	287.2	299.4	316.1
Defense Department	----------	----------	----------	----------	33.0	40.0	24.0	23.0	42.4	34.8	28.6
Other	3.3	.4	(24)	66.8	84.5	193.9	212.1	236.5	244.8	264.6	287.4
Other welfare services	1.8	4.5	64.2	166.7	243.4	407.9	509.3	548.2	619.8	876.8	1,519.5
Vocational rehabilitation, total	1.0	2.0	7.5	21.0	26.4	64.3	86.7	100.9	127.1	145.7	231.9
Medical rehabilitation [7]	.1	.2	.7	3.7	5.7	11.2	14.2	16.1	19.3	21.2	33.7
Medical research [7]	----------	----------	----------	----------	.3	6.6	11.0	12.8	20.3	22.4	29.9
Institutional and other care [15]	.8	.9	7.9	20.3	39.2	24.1	34.0	37.5	44.3	35.8	39.4
School lunch [16]	----------	----------	47.4	121.2	170.7	306.1	370.4	383.2	419.1	504.7	428.0
Child welfare [17]	----------	1.6	1.4	4.2	7.1	13.4	18.2	26.6	29.3	34.4	40.2
Special programs [18]	----------	----------	----------	----------	----------	----------	----------	----------	----------	156.2	780.0
Veterans' program [19]	449.8	535.1	892.1	5,918.8	4,307.9	4,994.3	5,294.6	5,564.6	5,730.3	5,944.7	6,312.5
Pensions and compensation [20]	390.2	447.8	755.9	2,092.8	2,712.5	3,425.7	3,774.8	3,947.4	4,033.1	4,186.1	4,465.1
Health and medical services	58.9	86.3	116.5	745.8	761.1	957.1	1,047.0	1,121.7	1,179.4	1,250.6	1,330.8
Hospital and medical care	56.0	72.1	98.3	585.9	722.6	884.5	968.0	1,022.0	1,069.9	1,132.8	1,205.4
Hospital construction	2.9	14.1	16.2	156.2	33.0	57.5	52.1	69.8	76.4	80.9	83.2
Medical and prosthetic research	----------	.1	2.0	3.7	5.5	15.1	26.8	29.9	33.2	36.9	42.2
Education	----------	----------	9.7	2,689.1	699.9	404.7	15.33	97.5	66.1	41.4	35.4
Welfare and other [21]	.7	1.0	10.0	391.1	134.4	206.8	319.4	398.1	451.7	466.6	481.2

See footnotes at end of table.

TABLE 1.—*Social welfare expenditures under public programs, selected fiscal years, 1934–35 through 1965–66* [1]—Continued

[In millions; revised estimates]

Program	1934–35	1939–40	1944–45	1949–50	1954–55	1959–60	1961–62	1962–63	1963–64	1964–65	1965–66 [2]
	From Federal funds										
Education [25]	$132.9	$162.3	$161.0	$180.8	$521.6	$1,014.8	$1,378.9	$1,811.9	$2,438.4	$3,512.6	$5,742.3
Elementary and secondary, total	69.2	74.2	48.2	73.1	341.8	507.2	557.8	614.7	665.9	880.6	2,253.3
Construction [1]	42.0	31.0	7.6	5.2	139.3	79.8	71.6	67.7	23.9	59.4	63.0
Higher education and other, total	63.7	88.1	112.8	107.7	179.8	507.7	821.2	1,197.2	1,772.5	2,632.0	3,489.0
Construction [7]	30.0	12.0	9.1	10.9	5.4	38.3	59.8	169.8	200.4	678.1	882.8
Public housing [23]	-----	4.2	10.4	14.5	74.7	143.5	173.2	191.4	206.4	234.4	249.3
	From State and local funds [24]										
Total	3,309.8	5,294.9	4,775.8	12,974.6	18,012.1	27,429.9	31,600.4	33,575.8	35,490.4	38,718.6	40,773.7
Social insurance	285.0	862.8	658.7	2,844.9	3,449.5	4,999.4	5,904.3	6,196.3	6,328.5	6,299.4	6,297.5
Public employee retirement [4]	120.0	147.0	198.0	310.0	580.0	1,050.0	1,286.0	1,424.0	1,570.0	1,740.0	1,925.0
Unemployment insurance and employment service [5]	-----	482.5	71.2	1,861.5	1,759.9	2,356.1	2,777.6	2,788.5	2,641.9	2,302.8	1,900.5
State temporary disability insurance, total [6]	-----	-----	5.1	72.3	217.5	347.9	407.1	444.2	467.9	486.9	502.0
Hospital and medical benefits [7]	-----	-----	-----	2.2	20.0	40.3	45.5	48.4	50.4	50.7	56.0
Workmen's compensation, total [8]	165.0	233.3	384.4	601.1	892.1	1,245.4	1,433.6	1,539.6	1,648.7	1,769.7	1,970.0
Hospital and medical benefits [7]	62.0	84.8	117.3	187.8	308.1	411.0	466.6	499.8	534.6	573.7	613.0
Public aid	623.9	1,352.8	610.4	1,393.0	1,498.8	1,984.2	2,204.1	2,296.3	2,434.9	2,689.5	2,969.2
Public assistance [9]	623.9	843.2	610.4	1,393.0	1,498.8	1,984.2	2,204.1	2,296.3	2,434.9	2,689.5	2,969.2
Vendor medical payments [7]	-----	-----	-----	51.3	188.6	292.9	417.7	490.7	554.6	663.8	877.0
Other [10]	-----	509.6	-----	-----	-----	-----	-----	-----	-----	-----	-----
Health and medical programs [11]	384.3	521.8	555.4	1,501.1	1,880.0	2,705.9	2,988.0	3,152.4	3,259.4	3,478.3	3,662.0
Hospital and medical care	220.2	315.6	325.1	868.1	1,150.9	1,849.1	2,019.0	2,155.0	2,316.0	2,376.0	2,450.0
Maternal and child health services [12]	6.7	6.0	6.8	9.7	69.2	106.1	124.0	135.4	142.0	152.9	176.0
Medical research	-----	-----	-----	-----	-----	23.0	37.0	45.0	50.0	55.0	61.0
School health (educational agencies)	9.9	17.9	23.3	30.6	65.9	101.0	129.0	128.4	127.7	132.0	135.0
Other public health activities [14]	112.5	142.3	150.2	290.7	334.0	343.7	394.0	390.6	378.7	473.4	550.0
Medical-facilities construction	35.0	40.0	50.0	302.0	260.0	283.0	285.0	289.0	245.0	289.0	290.0
Other welfare services	51.2	72.5	94.8	256.1	330.0	606.2	794.6	900.3	943.1	1,072.1	1,219.7
Vocational rehabilitation, total	1.2	2.1	2.7	9.0	15.0	36.1	48.6	55.7	67.2	76.8	96.3
Medical rehabilitation [7]	.1	.2	.7	3.7	3.5	6.5	8.3	9.9	11.9	13.0	20.6
Institutional and other care [15]	24.0	27.0	38.0	75.8	64.1	151.9	272.5	349.4	322.1	362.7	380.0
School lunch [16]	-----	-----	-----	70.6	122.9	220.1	245.4	253.5	269.6	292.4	324.0
Child welfare [17]	26.0	43.4	54.1	100.7	128.0	198.1	228.1	241.7	284.2	318.0	341.4
Special programs [18]	-----	-----	-----	-----	-----	-----	-----	-----	-----	22.2	78.0

Veterans' programs [19]	----------	----------	----------	462.0	61.6	111.9	95.2	20.0	18.9	20.4	21.0
Education	1,965.4	2,485.0	2,856.5	6,517.5	10,777.6	16,989.1	19,571.0	20,955.0	22,440.0	25,078.9	26,506.1
Elementary and secondary, total	1,820.9	2,286.3	2,608.2	5,651.2	9,665.0	15,091.4	17,471.0	18,755.0	20,140.0	22,224.5	23,552.0
Construction [7]	115.3	258.0	76.1	1,013.5	2,223.1	2,788.9	3,000.0	3,160.0	3,180.0	3,450.6	3,733.0
Higher education and other, total	144.5	198.7	248.3	866.3	1,112.6	1,897.7	2,100.0	2,200.0	2,300.0	2,854.4	2,954.1
Construction [7]	([27])	20.6	([27])	304.6	193.4	356.7	350.0	350.0	350.0	480.0	510.0
Public housing [23]	----------	----------	----------	----------	14.6	33.2	43.2	55.5	65.6	80.0	98.2

1 Expenditures from Federal, State, and local revenues (general and special) and trust funds and other expenditures under public law; includes capital outlay and administrative expenditures, unless otherwise noted. Includes some expenditures and payments outside the United States. Fiscal years ended June 30 for Federal Government, most States, and some localities; for other States and localities, fiscal years cover various 12-month periods ended in the specified year.

2 Preliminary estimates.

3 Excludes net payments in lieu of benefits (transfers) under the financial interchange with the railroad retirement system.

4 Excludes refunds of employee contributions to those leaving the service; Federal expenditures include payments to retired military personnel and survivors. Data for administrative expenses not available for Federal noncontributory programs.

5 Includes unemployment compensation under State programs and programs for Federal employees, for ex-servicemen, and for veterans under the readjustment acts of 1944 and 1952, payments under the temporary extended unemployment insurance programs and training allowances under the Manpower Development and Training Act and Area Redevelopment Act.

6 Cash and medical benefits, including payments under private plans where applicable in the 4 States with programs. Includes State costs of administering State plans and supervising private plans; data for administrative expenditures of private plans underwritten by private insurance carriers or self-insured are not available.

7 Included in total shown directly above; excludes administrative expenditures, not available separately but included for entire program in preceding line.

8 Cash and medical benefits paid under Federal workmen's compensation laws and under State laws by private insurance carriers, by State funds, and by self-insurers. Excludes administrative costs of State agencies before 1949–50 and all administrative costs of private insurance carriers and self-insurers. Beginning 1959–60, includes data for Alaska and Hawaii.

9 Includes cash and vendor medical payments under old-age assistance, aid to families with dependent children, aid to the blind, aid to the permanently and totally disabled; medical assistance programs; and, from State and local funds, general assistance. For 1939–40, Federal expenditures include $1,000,000 in administrative costs for which distribution by source of fund is not available.

10 Work program earnings, other emergency aid programs, and value of surplus food distributed to needy families.

11 Excludes expenditures (1) for domiciliary care in institutions other than mental or tuberculosis (included under institutional care); (2) for health and medical service provided in connection with State temporary disability insurance, workmen's compensation, public assistance, vocational rehabilitation, and veterans' programs (included in total expenditures for these programs); and (3) those made directly for international health activities and for certain subordinate medical programs such as those of the Bureau of Mines, the National Park Service, and the U.S. Civil Service Commission.

12 Services for crippled children and maternal and child health services.

13 Medical research of the U.S. Public Health Service, Food and Drug Administration, Atomic Energy Commission, National Aeronautics and Space Administration, and Department of Defense.

14 Excludes expenditures for water supply, sanitation services, and sewage disposal but includes regulatory and administrative costs of these services; also includes expenditures for medical equipment and supplies for civil defense.

15 Expenditures for homes for dependent or neglected children and for adults other than veterans and the value of surplus food for nonprofit institutions.

16 Federal expenditures represent cash apportionment and the value of commodities purchased and distributed under the National School Lunch Act, the value of surplus commodities distributed under other agricultural programs, and, beginning 1954–55, special school milk program. Nongovernmental funds are also available from private organizations and from payments by parents (in 1965–66, parents' payments totaled an estimated $835,000,000).

17 Includes foster-care payments and payments for professional and facilitating services; excludes expenditures of public institutions and public day-care centers, capital expenditures by courts and by youth authorities, payments from parents and relatives, and direct appropriations by State legislatures to voluntary agencies and institutions.

18 Programs authorized under the Economic Opportunity Act; excludes programs delegated to or reported with data for the Office of Education and the Welfare Administration.

19 Federal expenditures exclude bonus payments and expenditures from veterans' life insurance trust funds; State and local expenditures refer to State bonus and other payments and services (local data not available).

20 Includes burial awards.

21 Includes vocational rehabilitation, specially adapted homes and automobiles for disabled veterans, counseling, beneficiaries' travel, loan guarantees, and domiciliary care.

22 Federal expenditures only, data for State and local expenditures not available.

23 Federal and State subsidies (and administrative costs) for low-cost housing.

24 Less than $50,000.

25 Represents Office of Education administrative costs; training of Federal personnel; and "grants" as reported in the summary table prepared by the Federal Education Program Branch, Office of Education, except (1) those covered under other social welfare programs such as veterans' programs and (2) the value of surplus property. Beginning 1937–38, includes revenue from public lands for education and, beginning 1950–51, includes training grants and basic research for which data were not available in earlier years.

26 Except as otherwise noted (see footnotes 6 and 8).

27 Data not available.

Source: Data taken or estimated from Treasury reports, Federal budgets, and available reports of Federal, State, and local administrative agencies.

75–314—67—pt. 2—7

TABLE 2.—*Trends in poverty and low-income status, 1959–65—Number and percent of noninstitutional population who were poor or near poor*

Type of unit and income level	The poverty and low-income roster							The incidence of poverty and low-income status						
	1959	1960	1961	1962	1963	1964	1965	1959	1960	1961	1962	1963	1964	1965
	Persons poor or near poor [1] (millions)							Percent of persons poor or near poor [2]						
Total with low income	54.7	54.8	52.9	52.8	51.0	49.8	47.5	31.0	30.5	29.3	28.6	27.3	26.3	24.8
Poor	38.9	40.1	38.1	37.0	35.3	34.1	32.7	22.1	22.3	21.1	20.1	18.0	18.0	17.1
Near poor	15.8	14.7	14.8	15.8	15.7	15.7	14.8	9.0	8.2	8.2	8.5	8.4	8.3	7.7
Unrelated individuals	5.6	5.5	5.6	5.6	5.6	5.8	5.6	52.5	50.5	49.7	50.3	49.8	47.8	46.5
Poor	5.1	5.1	5.0	4.9	4.9	5.1	4.8	47.4	46.5	44.7	44.2	43.9	42.0	39.8
Near poor	.5	.4	.6	.7	.7	.7	.8	5.1	4.0	5.0	6.1	5.9	5.8	6.7
Under age 65	2.9	2.8	2.7	2.7	2.6	2.6	2.5	41.4	39.2	38.0	38.6	37.6	35.5	33.7
Poor	2.6	2.6	2.4	2.4	2.4	2.3	2.1	36.8	36.1	33.9	34.5	34.2	31.2	28.7
Near poor	.3	.2	.3	.3	.2	.3	.4	4.6	3.1	4.1	4.1	3.4	4.3	5.0
Aged 65 or over	2.7	2.6	2.8	2.9	2.9	3.2	3.1	74.2	73.0	71.0	69.4	69.6	67.4	66.9
Poor	2.5	2.4	2.5	2.5	2.5	2.8	2.7	68.1	67.1	64.4	60.0	59.7	59.3	57.5
Near poor	.2	.2	.3	.4	.4	.4	.4	6.1	5.9	6.6	9.4	9.9	8.1	9.
Persons in families	49.1	49.3	47.4	47.3	45.5	44.0	41.9	29.7	29.3	27.8	27.2	25.8	24.8	23.4
Poor	33.9	35.0	33.1	32.2	30.4	28.9	27.9	20.4	20.8	19.4	18.5	17.3	16.3	15.6
Near poor	15.2	14.3	14.3	15.1	15.1	15.1	14.0	9.2	8.5	8.4	8.7	8.5	8.5	7.8
With no children under age 18	9.3	9.3	8.8	8.4	8.6	8.0	8.0	22.3	21.9	20.4	19.5	19.6	17.9	17.3
Poor	6.5	6.5	6.0	5.4	5.5	4.9	4.8	15.5	15.3	13.8	12.6	12.5	11.1	10.4
Near poor	2.8	2.8	2.8	3.0	3.1	3.1	3.2	6.8	6.6	6.6	6.9	7.1	6.8	6.8
With children under age 18	39.8	40.1	38.7	38.8	36.8	36.2	33.9	32.1	31.7	30.3	29.8	27.9	27.3	25.5
Poor	27.4	28.6	27.2	26.7	24.9	24.0	23.1	22.1	22.6	21.3	20.5	18.9	18.1	17.3
Near poor	12.4	11.5	11.5	12.1	11.9	12.2	10.8	10.0	9.1	9.0	9.3	9.0	9.2	8.1
Adults	16.1	16.5	16.2	16.0	14.7	14.5	21.4	26.9	26.8	26.3	25.5	23.5	23.0	19.6
Poor	10.7	11.4	11.2	10.8	9.6	9.2	13.6	17.9	18.5	18.2	17.2	15.4	14.6	12.4
Near poor	5.4	5.1	5.0	5.2	5.1	5.3	7.8	9.0	8.3	8.1	8.3	8.1	8.4	7.2

Children under age 18	23.7	23.6	22.5	22.8	22.1	21.7	20.4	37.1	36.2	34.1	33.8	32.1	31.3	29.3
Poor	16.7	17.2	16.0	15.9	15.3	14.8	14.3	26.1	26.4	24.3	23.6	22.2	21.3	20.5
Near poor	7.0	6.4	6.5	6.9	6.8	6.9	6.1	11.0	9.8	9.8	10.2	9.9	9.9	8.8
	Households poor or near poor [1] (millions)							Percent of households poor or near poor [2]						
Total with low income [3]	17.7	17.3	17.1	17.0	16.7	16.4	15.8	31.7	30.7	29.7	29.3	28.5	27.4	26.1
Poor	13.4	13.4	13.0	12.6	12.3	11.9	11.5	24.0	23.7	22.6	21.8	21.0	19.8	19.0
Near poor	4.3	3.9	4.1	4.4	4.4	4.5	4.3	7.7	7.0	7.1	7.5	7.5	7.6	7.2
Families of 2 or more	12.0	11.8	11.5	11.5	11.1	10.6	10.2	26.7	26.0	24.9	24.4	23.5	22.2	21.0
Poor	8.3	8.3	8.0	7.8	7.4	6.8	6.6	18.4	18.3	17.3	16.5	15.5	14.2	13.7
Near poor	3.7	3.5	3.5	3.7	3.7	3.8	3.5	8.3	7.7	7.6	7.9	8.0	8.0	7.3
With no children under age 18	4.3	4.3	4.0	3.9	3.9	3.7	3.7	23.6	23.2	21.5	20.7	20.7	19.1	18.5
Poor	3.0	3.0	2.7	2.5	2.5	2.3	2.2	16.4	16.3	14.5	13.4	13.2	11.7	11.2
Near poor	1.3	1.3	1.3	1.4	1.4	1.4	1.5	7.3	6.9	7.0	7.3	7.5	7.4	7.3
With children under age 18	7.7	7.5	7.5	7.5	7.2	6.9	6.4	28.8	27.7	28.0	26.9	25.3	24.5	22.9
Poor	5.3	5.3	5.3	5.2	4.9	4.5	4.4	19.7	19.5	19.2	18.6	17.1	16.0	15.6
Near poor	2.4	2.2	2.2	2.3	2.3	2.4	2.0	9.1	8.2	8.8	8.3	8.2	8.5	7.3
1 to 2 children	3.7	3.4	3.4	3.3	3.1	3.0	2.8	21.1	20.3	20.3	18.9	18.0	17.7	16.5
Poor	2.5	2.3	2.4	2.3	2.1	1.8	1.9	14.3	13.6	14.2	13.2	12.0	10.8	10.9
Near poor	1.2	1.1	1.0	1.0	1.0	1.2	1.0	6.9	6.7	6.1	5.7	6.0	6.9	5.7
3 to 4 children	2.7	2.6	2.6	2.6	2.5	2.3	2.2	35.3	33.0	31.7	31.3	29.8	28.0	26.7
Poor	1.8	1.8	1.8	1.7	1.6	1.5	1.5	23.3	22.9	21.9	20.2	19.5	18.8	18.2
Near poor	.9	.8	.8	.9	.9	.8	.7	12.0	10.1	9.8	11.1	10.3	9.2	8.5
5 or more children	1.5	1.5	1.5	1.7	1.5	1.6	1.4	67.9	68.2	63.0	65.3	58.8	56.6	52.0
Poor	1.1	1.2	1.1	1.3	1.1	1.1	1.1	51.2	54.1	47.1	48.7	43.5	41.0	38.5
Near poor	.4	.3	.4	.4	.4	.4	.4	16.7	14.0	15.9	16.6	15.3	15.6	13.6

[1] Income, for the specified year, of family unit or unrelated individual below the Social Security Administration index at the poverty level by family size and sex of head or, alternatively, at the somewhat higher low-income level. (See the Social Security Bulletin, April 1966 issue, pp. 20-21). The SSA index has been adjusted for price changes during the period.

[2] The percent that poor or near poor persons (or families) are of total number of persons (or families) in each category in the noninstitutional population. All persons in institutions and children under age 14 who live with a family of nonrelatives are not represented in the low-income roster because income data are not collected for inmates of institutions or unrelated individuals under age 14. As of March 1966, there were about 346,000 such children and 2,133,000 persons of all ages in institutions.

[3] Includes unrelated individuals shown separately above.

Source: Derived from special tabulations from the Current Population Survey for March 1960-66 by the Bureau of the Census for the Social Security Administration.

Table 3.—*Incidence of poverty in 1964 of unrelated individuals and persons in families, by race and metropolitan-nonmetropolitan residence*

[Millions of persons]

Family status and race	Total, United States			Metropolitan area: In central cities			Metropolitan area: Outside central cities			Nonmetropolitan area: Nonfarm			Nonmetropolitan area: Farm		
	Total number of persons	Poor persons: Number	Poor persons: Percent of total	Total number of persons	Poor persons: Number	Poor persons: Percent of total	Total number of persons	Poor persons: Number	Poor persons: Percent of total	Total number of persons	Poor persons: Number	Poor persons: Percent of total	Total number of persons	Poor persons: Number	Poor persons: Percent of total
Total	189.9	34.3	18.0	58.6	10.1	17.2	62.6	6.3	10.0	55.4	13.5	24.4	13.3	4.4	32.9
Unrelated individuals	12.3	5.3	43.2	5.5	2.0	36.9	2.9	1.2	40.7	3.5	1.9	54.7	.4	.2	49.2
White	10.5	4.3	41.2	4.4	1.5	34.3	2.6	1.0	39.1	3.1	1.7	52.6	.3	.1	44.2
Nonwhite	1.7	1.0	55.3	1.1	.5	47.2	.2	.1	61.2	.4	.3	73.1	(1)	(1)	(2)
Persons in families	177.6	28.9	16.3	53.1	8.0	15.1	59.8	5.1	8.6	51.9	11.6	22.4	12.9	4.2	32.5
White	156.9	19.3	12.3	42.6	4.1	9.7	56.4	4.1	7.3	46.8	8.1	17.4	11.2	2.9	25.9
Male head	145.2	15.4	10.6	38.1	2.8	7.4	52.9	3.1	5.9	43.4	6.6	15.3	10.8	2.8	26.1
Female head	11.8	3.9	32.9	4.4	1.3	28.9	3.5	1.0	28.2	3.5	1.5	44.1	.4	.1	20.2
Nonwhite	20.7	9.7	46.7	10.5	3.9	37.0	3.4	1.0	29.7	5.0	3.5	68.9	1.7	1.3	75.1
Male head	16.1	6.4	40.0	7.9	2.2	27.5	2.9	.7	24.0	3.8	2.5	65.0	1.5	1.1	75.7
Female head	4.6	3.2	70.3	2.6	1.7	66.3	.5	.3	63.8	1.3	1.0	80.7	.3	.2	71.6

[1] Fewer than 50,000 households.
[2] Not shown for base less than 100,000.

Source: Department of Health, Education, and Welfare.

TABLE 4.—*Number of poor persons and incidence of poverty, 1959 and 1965*

Characteristics of head of household [1]	Persons in poor households [2] (millions)		Incidence of poverty (percent) [3]	
	1959	1965	1959	1965
Total	38.9	32.7	22.1	17.1
Aged (65 years and over) [4]	5.3	5.0	42.9	32.9
White	4.8	4.4	41.1	31.0
Male	2.7	2.1	33.6	21.6
Female	2.1	2.3	57.8	50.8
Nonwhite	.5	.6	70.6	60.1
Male	.3	.3	65.2	50.9
Female	.2	.3	79.9	73.9
All other [5]	33.7	27.8	20.6	15.7
Farm	6.4	3.0	43.1	27.0
White	4.3	1.8	34.3	19.3
Male	4.1	1.7	33.8	18.8
Female	.2	.1	49.2	31.5
Nonwhite	2.2	1.1	87.5	80.1
Male	2.0	1.0	88.4	81.1
Female	.2	.2	79.9	(6)
Nonfarm	27.3	24.8	18.3	15.0
White	19.2	16.4	14.5	11.3
Male	14.3	11.8	11.8	8.9
Female	5.0	4.6	40.9	34.2
Nonwhite	8.0	8.4	49.0	42.5
Male	5.2	5.1	41.9	34.5
Female	2.8	3.3	71.4	66.4

[1] Household defined here as either a family or an unrelated individual.
[2] Persons in households with family income or income of unrelated individual in 1965 below the Social Security Administration poverty index, taking into account family size, composition, and farm-nonfarm residence.
[3] Poor persons as percent of all persons in the category.
[4] Includes only 1- and 2-person households with head aged 65 years and over.
[5] Includes all households headed by persons under age 65 and families of 3 or more headed by an aged person.
[6] Percent not shown because of small number of persons.

Source: Derived by SSA from special Census Bureau tabulations of March 1960 and March 1966 Current Population Surveys.

TABLE 5.—*Financing OASDHI (percent of payroll)*

	OASDI	HI
Present program:		
Level equivalent of income	9.53	1.23
Level cost of benefits	8.79	1.23
Actuarial balance	+.74	0
Effects of proposed changes:		
Cost of proposal:		
Benefit increase	1.36	
Other improvements	.12	.11
Total	1.48	.11
Additional income to finance proposal:		
Contribution base	.50	.21
Contribution rates	.25	0
Total	.75	.21
Net effect of proposal	−.73	+.10
Proposed program:		
Level equivalent of income	9.78	1.23
Level-cost of benefits	9.77	1.13
Actuarial balance	+.01	+.10

Table 6

PRESENT & PROPOSED OASDI CONTRIBUTION RATES

YEAR	EMPLOYEE AND EMPLOYER, EACH		SELF-EMPLOYED	
	PRESENT LAW 1/	PROPOSED 2/	PRESENT LAW 1/	PROPOSED 2/
1967-68	3.9%	3.9%	5.9%	5.9%
1969-72	4.4	4.5	6.6	6.8
1973 and after	4.85	5.0	7.0	7.0

1/ $6600 EARNINGS BASE

2/ $7800 EARNINGS BASE EFFECTIVE 1968 THROUGH 1970; $9000 EARNINGS BASE EFFECTIVE 1971 THROUGH 1973; AND $10,800 EARNINGS BASE EFFECTIVE 1974 AND THEREAFTER

TABLE 7

EMPLOYEE CONTRIBUTIONS FOR OASDI
(MONTHLY AMOUNT)

MONTHLY EARNINGS	YEARS: 1968		1969-70		1971-72		1973		1974 AND THEREAFTER	
	PRESENT LAW	PROPOSED LAW	PRESENT LAW	PROPOSED LAW	PRESENT LAW	PROPOSED LAW	PRESENT LAW	PROPOSED LAW	PRESENT LAW	PROPOSED LAW
$100	$3.90	$3.90	$4.40	$4.50	$4.40	$4.50	$4.85	$5.00	$4.85	$5.00
200	7.80	7.80	8.80	9.00	8.80	9.00	9.70	10.00	9.70	10.00
300	11.70	11.70	13.20	13.50	13.20	13.50	14.55	15.00	14.55	15.00
400	15.60	15.60	17.60	18.00	17.60	18.00	19.40	20.00	19.40	20.00
550	21.45	21.45	24.20	24.75	24.20	24.75	26.68	27.50	26.68	27.50
650	NO EARNINGS ABOVE $6600 COUNTED FOR CONTRIBUTIONS OR BENEFITS	25.35	NO EARNINGS ABOVE $6600 COUNTED FOR CONTRIBUTIONS OR BENEFITS	29.25	NO EARNINGS ABOVE $6600 COUNTED FOR CONTRIBUTIONS OR BENEFITS	29.25	NO EARNINGS ABOVE $6600 COUNTED FOR CONTRIBUTIONS OR BENEFITS	32.50	NO EARNINGS ABOVE $6600 COUNTED FOR CONTRIBUTIONS OR BENEFITS	32.50
750		NO EARNINGS ABOVE $7800 COUNTED FOR CONTRIBUTIONS OR BENEFITS		NO EARNINGS ABOVE $7800 COUNTED FOR CONTRIBUTIONS OR BENEFITS		33.75		37.50		37.50
900						NO EARNINGS ABOVE $9000 COUNTED FOR CONTRIBUTIONS OR BENEFITS		NO EARNINGS ABOVE $9000 COUNTED FOR CONTRIBUTIONS OR BENEFITS		45.00

TABLE 8

MONTHLY SOCIAL SECURITY CASH BENEFITS
UNDER PRESENT LAW AND UNDER PROPOSAL

AVERAGE MONTHLY EARNINGS	RETIRED OR DISABLED WORKER 1/		RETIRED OR DISABLED WORKER AND WIFE 1/		WIDOW AGE 62 OR OVER		YOUNG WIDOW AND 1 CHILD	
	PRESENT	PROPOSED	PRESENT	PROPOSED	PRESENT	PROPOSED	PRESENT	PROPOSED
MINIMUM BENEFIT	$44.00	$70.00	$66.00	$105.00	SOLE SURVIVOR $44.00	$70.00	$66.00	$105.00
$100	63.20	72.70	94.80	109.10	52.20	70.00	94.80	109.10
150	78.20	90.00	117.30	135.00	64.60	74.30	117.40	135.00
200	89.90	103.40	135.90	155.10	74.20	85.40	135.00	155.20
250	101.70	117.00	152.60	175.50	84.00	96.60	152.60	175.60
300	112.40	129.30	168.60	194.00	92.80	106.70	168.60	194.00
350	124.20	142.90	186.30	214.40	102.50	117.90	186.40	214.40
400	135.90	156.30	203.90	234.50	112.20	129.00	204.00	234.60
450	146.00	167.90	219.00	251.90	120.50	138.60	219.00	252.00
500	157.00	180.60	235.50	270.60	129.60	149.00	235.60	271.00
550 2/	168.00	193.20	252.00	283.20	138.60	159.40	252.00	289.80
650	168.00	221.00	252.00	311.00	138.60	182.40	252.00	331.60
750	168.00	248.00	252.00	338.00	138.60	204.60	252.00	372.00
900	168.00	288.00	252.00	378.00	138.60	237.60	252.00	432.00

1/ ASSUMES THAT RETIRED WORKER AND WIFE ARE AGE 65 OR OVER WHEN BENEFITS START.
2/ MAXIMUM POSSIBLE UNDER PRESENT LAW.

JAN 1967

Chairman PROXMIRE. I am a little bit confused by your analysis of the fiscal impact of your proposals. I had assumed superficially, without having had the very helpful presentation you have given us, that the impact of the 20-percent increase in social security payments on the economy, beginning July 1, would be about at an annual rate of $5 billion—roughly $5 billion—a year in increased Government expenditures, increased expenditures by beneficiaries.

Mr. COHEN. About $4.5 billion.

Chairman PROXMIRE. About $4.5 billion?

Mr. COHEN. Yes; at a full 12 months' rate.

Chairman PROXMIRE. It is fairly close to the impact of the expected increase in Vietnam expenditures—something like that, or maybe a little bit smaller. But you seem to say here that you would modify that to some extent through calendar 1967. Am I wrong, or is that about right?

Mr. COHEN. You are correct.

Chairman PROXMIRE. There would be no increase in contributions; no increase in taxes?

Mr. COHEN. That is right.

Chairman PROXMIRE. Until January 1, 1968. Is that correct?

Mr. COHEN. That is right. The full figure for the fiscal year 1968 is actually $4.1 billion.

Chairman PROXMIRE. But it would be bigger than that, I should think, in the last half of 1967, inasmuch as there would be no increase in contributions in the last half of 1967. There will be an increase because of the larger base in the last half of the fiscal year or the first half of 1968.

Mr. COHEN. I was giving you the expenditures first, and you are correct, that in the last 6 months of calendar 1967, there is no proposed income increase—neither a rate increase or a maximum earnings increase. So for the last 6 months, roughly $2 billion of that $4.1 billion—the annual rate—would be a benefit expenditure without any increased income coming into the system.

Chairman PROXMIRE. This is spending in a way that is quite dynamic. Insofar as I understand it, my assumptions, at least, have been that this money is really spent. Relatively a small proportion is saved. For most income, I assume, the taxpayer when he gets a tax cut will save about 7 or 7½ percent of his tax benefit. I would assume that social security beneficiaries would save very little because of their age and because of their low income; is that correct?

Mr. COHEN. I think that is correct.

Chairman PROXMIRE. So that their saving might be only 1 or 2 percent.

Mr. COHEN. I think it would be very slight.

Chairman PROXMIRE. I would like to know how you anticipate this money is likely to be spent at this time. For example, my own assumption would be that very little of it would be spent on education, which is good, because we have terrific demand for education, facilities that strain the manpower available in educational facilities. Is that correct from an economic standpoint?

Mr. COHEN. Yes.

Chairman PROXMIRE. These are people who are over 65 and are not going to go back to school, in most cases. In some cases, I suppose, they would help the family to finance a child who is going to school.

Mr. COHEN. Yes.

Chairman PROXMIRE. But this would be rare.

Mr. COHEN. I don't have the exact number but as a result of the 1965 Amendments to the Social Security Act, a child age 18 to 22 attending school, whose father is retired, disabled, or deceased continues to get this social security benefit.

Chairman PROXMIRE. It would be relatively few.

Mr. COHEN. Yes; a relatively small number, but I do think that, although it is small, it has a very significant impact on the particular family.

Chairman PROXMIRE. Yes.

Mr. COHEN. We have many striking individual cases.

Chairman PROXMIRE. I am trying to look at this on the overall aspect of the impact of the economy, and particularly, in the first place, on prices.

Mr. COHEN. No; it probably would not have much effect.

Chairman PROXMIRE. Then there is another very strained area of our economy, and that has to do with medicine, doctors, nurses, and so forth. This particular increase would not greatly affect that, I should think, because most of these people are on medicare anyway; is that correct?

Mr. COHEN. Although I don't have any objective information—I rely mostly on my experience with members of my own family—I think the problem is that medicare only covers roughtly about 40 or 45 percent of the total medical costs of aged people, and they still have an unfinanced burden. However, a substantial number of them do carry voluntary private insurance.

Chairman PROXMIRE. Are you talking about the total program?

Mr. COHEN. Yes, sir.

Chairman PROXMIRE. Including the voluntary program?

Mr. COHEN. Yes, sir. Even with the two combined programs there are still significant exclusions. For instance, consider drugs. The cost of drugs is a very notable exclusion. A very small part of the nursing home costs are covered by the medicare program. And there are others.

Chairman PROXMIRE. This is likely to put significant pressure in this area then.

Mr. COHEN. Yes: and I think quite frankly that since medical costs are still going up——

Chairman PROXMIRE. The most rapid rising elements.

Mr. COHEN. They are the most rapidly rising element in the CPI. I think that a part of the benefiit increase would be spent on rising medical care costs.

Chairman PROXMIRE. Then I take it, in addition to this, you are going to have a salutary effect, I should think, in the construction and homebuilding aera? I mean these people won't be buying homes, but they may be moving into somewhat better homes which might have an effect in this area which is so heavily depressed, or am I wrong about that?

Mr. COHEN. I think housing conditions for the bulk of aged people are very, very tragic.

Chairman PROXMIRE. This would help them improve those conditions.

Mr. COHEN. It would; although I think there is another factor and that is the tendency of older people not to leave their immediate neighborhoods or contacts, no matter how bad the housing is, because they don't like to move away from familiar circumstances. I think there is a built-in reluctance to move. The two big problems of the aged, medical care costs and housing conditions, still need a great deal of further attention.

Chairman PROXMIRE. Then can you summarize in general what effect you think this is likely to have on prices, this increase in benefits coming at this time, looking at the economy as you would, as an excellent economist and as a member of the administration?

Mr. COHEN. I would say, taking the disadvantageous aspect first; namely, in a period of rising prices and particularly, rising medical care prices, part of the benefit increase, in a sense, may be used up because aged people will be only meeting the cost changes that are occurring.

But, on the other hand, I think the benefits will be expanded rapidly, and they will serve to provide the aged with a somewhat better standard of living.

Chairman PROXMIRE. Yes. What I am concerned about, and of course, we are all deeply concerned with that, but I am also concerned right now with what effect this is going to have on prices across the board. They will spend less of this on housing because of patterns and habits and because they are older people and would be less inclined to move. They would be spending probably little on autobomiles.

Mr. COHEN. That is right.

Chairman PROXMIRE. I imagine some in that area but not very much. Not much on recreation because these are people who need the money and have to spend it on necessities. Some on travel.

Mr. COHEN. A very major part would be spent for food.

Chairman PROXMIRE. A very major part would be food?

Mr. COHEN. A very major part, I think, would be spent for food. What the impact of that would be on prices in relation to agricultural products and demand I am not sufficiently aware of, but I do think that a benefit increase would be reflected in additional purchases in food, and unfortunately it may be reflected in somewhat higher rents for those who have rental housing. When social security beneficiaries get an increase it becomes known in the community and the costs which have been somewhat held down are reflected in higher prices for medical costs and housing.

Chairman PROXMIRE. We have been so much concerned with the impact of farm production policies on prices for food and so much less on the demand side that my instinct is that this would not have a great effect on increase in food prices.

Mr. COHEN. I would not think so.

Chairman PROXMIRE. We have almost an unlimited capacity for production of food. We have Government programs that try to help the farm income by retarding production. But I would think that from that standpoint, it would not be inflationary.

Mr. COHEN. I would not think that it would be substantial, even if there were some increase.

Chairman PROXMIRE. Secretary Wirtz said yesterday that we could practically eliminate unemployment if we only had the structural and administrative manpower and some additional know-how. From a national standpoint, how do we know to what extent our resources are being fully utilized?

What I am getting at, frankly, is that I am concerned with the enormous amount we spend on the space programs, which absorb the energies of people who I think ought to be active in the field of education, to a great extent. And, if we can save money in this program, and maybe in some other programs, or at least establish priorities, perhaps we could move ahead in this area, which is deflationary in my judgment, of getting more people educated, so that instead of being consumers strictly, recipients of benefits, they are people who can become productive and producers.

Mr. COHEN. I certainly share——

Chairman PROXMIRE. With the priorities we have.

Mr. COHEN. I share Secretary Wirtz' views. Secretary Gardner and I have met with him several times, to discuss what we think is one of the most difficult problems that we have to face; namely, the development of training programs for the hard-core groups in our society. They are the adults, many with fourth, fifth, sixth grade education, with very few skills, a great deal of repeated unemployment during the last 5 or 10 years, living in labor market areas where there are not always a full range of opportunities. How do you develop a program that will develop these individuals' potentialities and resources and encourage the attitudes, motivations, skills, ability, and I would even say dress, looks, composure, so that they can become persons in the labor market who can get jobs? I am not talking now of very highly skilled jobs, because I do not think that can be done as quickly or easily. But I am talking about the great host of barely semiskilled, even unskilled routine jobs that are going begging. Our training programs at the present time do not really help these untrained individuals become available for competitive work in our society.

Chairman PROXMIRE. My time is up, but until we come back, you might be thinking of this—if you can think while you are answering the other questions—but this is what I am going to go after on the next turn. I want to press this point. That is, how do we know that the resources we have, the people we have who are teachers, who are educators, who can work as instructors, that this vital and precious resource is being utilized properly? Why don't we have a priority system and so forth?

Mr. COHEN. Yes.

Chairman PROXMIRE. That is what I want to get. I don't want to impose on Congressman Curtis' time. I will come back to that question.

Representative CURTIS. Thank you, Mr. Chairman.

What I want to do first is to suggest three areas where I would like to see some studies. Maybe they are already in progress. If they are, then I would like to have a report for the record on that. If they are not in progress, what comments you might make as to why you think that they are not feasible. This all can be done for the record. If they are in progress, some comment for the record would be helpful as to what stage they are in.

The first is a study of the economic impact of the payroll tax—it, in effect, being a tax on jobs—and the problems we have in this area of jobs versus machines.

The first question would be, what study might be in progress? If you aren't studying this, why don't you think that it is important?

The second one comes out of the interrogation of Secretary Wirtz yesterday. The figures that I worry about, and the Secretary presented them again in his paper, show the increase in unemployment among the young Negroes, male and female, particularly in the years 1965 and 1966, which is since the date that the war on poverty has started. Yet it would seem to me, if there were any group that were a major part of this war on poverty, it would be this group.

In other words, a study on why this increase in unemployment should be occurring when all of these programs, that are supposed to be hitting at that, have come into being. And this is in contrast to the rest of the society where the unemployment ratio is going down.

So again the question is, has this been studied? If so, what progress has been made? If it hasn't, what your comments might be about conducting a study.

The third area—and this, too, I touched on in my interrogation of Secretary Wirtz—is trying to find out what is the employment resulting from the Vietnam war, in the military establishment, including civil service employees, and certainly in the private sector, including those which we could identify in munitions industries. What is this increased employment, and what is its impact on the manpower programs that we have? This would relate, too, to this second area that I mentioned.

Again the question is, are there studies in this area? If so, what progress is there? This would have further implication for our problems if we shift from war to peace.

We have a Subcommittee on Economy in Government of this committee, which I hope will get into this very important area, both when we have to shift from a peace economy to a war economy, and likewise, when you shift back again.

I might add here that I am very disturbed when the administration spokesmen keep talking about how good the economy is, because it is not a peacetime economy. Even though this war is a lesser percentage of GNP, still, I think we would have to identify our present situation as a wartime economy. So that is the third area.

(The reports and comments in reference to the three areas presented by Representative Curtis follow:)

Question: What study is in progress on the economic impact of the payroll tax?

Answer: The Social Security Administration has a basic interest in studies of the effects of social security contributions. In June 1966, the Social Security Administration and Brookings Institution held a joint conference to discuss social security financing. It was an exploratory session at which a group of distinguished scholars discussed the basic issues. Representatives from the Treasury, the Bureau of the Budget, and from the Council of Economic Advisers attended the session. Arrangements are underway for follow-up meetings. We have in progress a study of the incidence by income group of contributions and benefits which involves careful analyses of payroll tax incidence based on new data developed by the SSA. The SSA is also keeping in touch with studies and research on the impact of payroll taxes being carried on at the Brookings Institution and elsewhere.

Question: What is the reason for the increase in unemployment among young Negroes in 1965 and 1966?

Answer: A recent study published by the Department of Labor (*Negroes in the United States: Their Economic and Social Situation*, Bulletin 1551, June 1966) analyzes the problem as follows:

"Unemployment rates are especially high for all youths. When the disadvantages of inexperience and limited training are compounded by the results of discrimination and impoverishment, the barriers to employment become formidable.

"Nonwhite graduates do less well than white graduates in getting and keeping a job. They earn less than white youths who have left school before graduation. More of them begin in the lowest status jobs.

"Thus, the advantages of education to nonwhite youths are barely beginning to make themselves felt in the job market. . . . Clearly nonwhite youths are preparing for today's jobs faster than existing practices are changing to absorb them."

Question: What employment has resulted from the Vietnam war and what will be our problems if we shift from war to peace?

Answer: The Department of Health, Education, and Welfare has not made estimates of the extent of employment resulting from expanded national defense activities. We have conferred with the Department of Defense and understand that they have a report on the economic impact of defense programs in preparation. This Department has in the past worked with the Disarmament Agency on policies that would ease the transition from substantial defense activities to peace-time activities.

Representative CURTIS. I want to interrogate you specifically on an item that is right before Congress and does come within the purview of this committee; namely, the social security trust fund. Secretary Fowler testified before the Ways and Means Committee that if Congress didn't give the administration its increase in the debt ceiling, that the payments out of the social security fund to social security beneficiaries would be cut back.

I, in cross-examining him, said I couldn't understand this. The social security trust fund is a contingent fund, and it is for the very purpose of taking care of contingencies so there would be no hiatus in the payment of benefits.

Then the Secretary went on in his testimony to talk about how this fund was not really liquid, so that you could immediately convert it to cash. He said there would be delays.

Well, this comes to the question whether, as I had thought, we looked upon this fund as a contingent fund in a liquid state. I would like to be reassured about this: That the social security fund is liquid, and would be available to take care of this kind of contingency. Therefore, I hope that you are going to say that the Secretary of the Treasury was uninformed on this point. Would you comment?

Mr. COHEN. Yes. Let me say first that I would certainly hope, whatever the technical financing problems of the Treasury Department are, that the day would never come when the social security beneficiaries wouldn't receive their checks on time.

Representative CURTIS. That is right. We all hope that.

Mr. COHEN. Yes, of course.

Representative CURTIS. But the point is, what is the debt ceiling argument?

Mr. COHEN. Yes.

Representative CURTIS. Which is a serious argument on its own merits.

Mr. COHEN. Yes.

Representative CURTIS. What has that got to do with paying social security benefits?

Mr. COHEN. Right.

Representative CURTIS. Inasmuch as we have $20 billion in this contingent fund.

Mr. COHEN. Yes. I think the problem arises from the technical method of meeting the expenditures. There is roughly, and I will just use round figures now to illustrate it, about $18 billion invested in U.S. Government bonds out of the total $20 billion in the OASI fund.

Representative CURTIS. But are those marketable?

Mr. COHEN. Yes, some are marketable.

Representative CURTIS. That is right.

Mr. COHEN. Not all of them are marketable, but some are marketable.

Representative CURTIS. We are talking about liquidity, aren't we?

Mr. COHEN. Yes. But here is where that situation arises. There is about $2 billion in cash that is not invested at a given moment of time—this is the amount at the end of the month. That is, there is roughly about 1 month's benefit that is not invested at this given moment of time. I think the problem that arises is if you have to redeem one of the special obligations, then the Treasury in effect has to raise the money elsewhere to pay for it.

Representative CURTIS. No, could I stop you there?

Mr. COHEN. Yes.

Representative CURTIS. This is the point. It is true if the Treasury had to do that. But if these are actually marketable bonds—like a company would hold or that an individual might hold—you don't have to go to the Treasury. The trustees of the fund certainly could just go out and say "I have got a perfectly good Government bond," just like anyone else might have, and sell it on the market. That is liquidity.

Now maybe the Secretary of the Treasury is right. We may have to do something about getting this trust fund into a real contingent fund to do this, but from what I understood, Mr. Secretary, there were about $3 or $4 billion of Government securities that are of the marketable type in the fund.

Mr. COHEN. That is about correct.

Representative CURTIS. Well then, as I thought, the Secretary of the Treasury is misinformed, and that is what I wanted to be sure of. Any further response you would like to make for the record on this point, I would appreciate. I do think though that when we have our big go around in the next month or so on the whole social security program, we will be wanting to look into the assumptions of the fund, and also this point.

Mr. COHEN. Yes.

Representative CURTIS. This point of liquidity, so that we can reassure the people that this really is a trust fund, that it is set aside for social security benefits, that the rest of the Government financing, whatever it might be, is not going to have an impact on that fund, at least until the fund itself is reduced enough.

Mr. COHEN. Yes. I would say personally that between the cash balances and the marketable funds, there ought to be some method to take care of the benefit payments for at least 1 or 2 months, so that there wouldn't be an immediate crisis.

Representative CURTIS. I think it would be more than that really, wouldn't it, because your collections are coming in?

Mr. COHEN. Yes.

Representative CURTIS. And that will take care of a good bit of it, and this is only the fact that it is a contingent fund?

Mr. COHEN. Yes.

Representative CURTIS. We have done that in the past. The fund went down from $20 billion to around $17 billion as I remember, and now we have built it back up again. Certainly you were drawing down, in effect, on the fund to meet benefit payments in the past.

Mr. COHEN. Yes.

Representative CURTIS. Thank you very much. My time has expired.

Chairman PROXMIRE. Congressman Reuss?

Representative REUSS. Thank you, Mr. Chairman.

Mr. Cohen, we appreciate your help. One of the biggest items in the unsatisfactory cost-of-living increase in the last year was services, and one of the biggest elements in services was the cost of medical care, and one of the reasons for the increase in the cost of medical care is that there still aren't enough doctors in this country. I think all those assertions are valid, are they not?

Mr. COHEN. I do not think that is the whole story, though. I think that is part of the story. Just to give an illustration—one of the most significant factors in the medical cost situation is the increase in remuneration to nurses, which has been going on during this last year. Nurses in many communities were getting paid less than secretaries, and hospitals simply had to increase remuneration to nurses, in order to keep the hospitals going.

Representative REUSS. Yes.

Mr. COHEN. That is not the only thing. I am just giving another illustration of the factors involved in rising medical care costs.

Representative REUSS. I wasn't suggesting that the shortness of psysicians was the whole story. On nurses, they have received, I understand, considerable remuneration increases in the last year or two, and we do have a series of programs designed to increase the number of students in nursing schools and also allied health and professional fields.

Mr. COHEN. Not a sufficient number of students, but we are starting, anyway.

Representative REUSS. On our medical school program of the Federal Government, I have the impression that aids under that program are giving primarily for so-called new activities by the medical schools. Let me give you an actual case that has recently come to my attention.

I have had long discussions with the administration of Marquette University Medical School in my city, and I am told by them that their problem is a very general one, that while they can get matching 50 percent Federal funds for new and somewhat exotic though worth while programs, they get very little or nothing to bolster existing programs, and thus, says Marquette, since they want to go into these new programs, if the Federal money is there, this takes a 50-percent sharing by them out of their meager budget, and as a result, these tried and true, but very necessary courses in, say, pharmacology or internal medicine, are shortchanged, and they are unable to turn out anywhere near the number of pharmacologists and internists that our society needs.

Is that a valid appreciation of our present aid to medical schools program, and if it is, don't we need to alter the program and help medical schools on the tried and true conventional pharmacology, internal medicine elements, and not concentrate as much as we are apparently doing on the more exotic?

Mr. COHEN. I think there is a great deal of truth in what you say, Congressman Reuss. I think what has happened in the past has been caused by two factors.

First, through the National Institutes of Health, money is given on a project basis for research and training, and this tends to focus on special areas of great interest with which a particular scientist or a particular institution is concerned. I think this has resulted in some problems because it has motivated individual scientists, individual departments to work in a particular area. As a result, that particular facet of the institution expands so markedly that other supporting elements in the institution, which are necessary, relatively fall behind.

Then the second factor is the medical school program. The medical school program involved many years of debate, as you well know, about whether the Federal Government should get into this area. The final result was that the law put restrictions on the Federal Government and Federal moneys can be used only where additional students and expansion will result—again, a desirable objective.

But I think the time is ripe for a complete reexamination of whether there shouldn't be what I would call institutional support for medical schools, rather than this special type, so that the medical schools can be well rounded, that they have the supporting services that are necessary, and that they can expand in quite a number of areas that are essential to broad public interest.

Let me put it this way. I sense that the medical schools themselves are examining this matter right now, because they are taking a look at all these bits and pieces. When you realize that the Federal Government today, through all of these different programs, is paying for a very major part of both research and training, and to some extent construction of medical schools, it might be proper to completely reexamine the whole area and the Federal Government's role in financing medical education.

Representative REUSS. My hunch is apparently right then, that our so-called Federal aid to medical education program hits around the fringes in the new and exotic, all of which is fine. I have nothing against it. But it does not provide help to the medical schools, and training more students in internal medicine, pharmacology, pathology, and the more conventional elements of medical education.

Mr. COHEN. Well, let me put it this way. Through the National Institutes of Health, particularly through the fellowships, doctoral and postdoctoral fellowships, training of people in the medical and allied science fields and expansion of medical schools to take this on are encouraged. But the extent of the financial support at what you might call the regular student level—the person who is just going through 4 years of medical school and using costly services, facilities, and teaching resources—from the Federal Government is relatively little and goes through different types of programs.

It may well be that looking at the problem, as I say, on an institutional basis, and providing Federal grants on an institutional basis, may be useful.

The reason this hasn't happened up until now is that medical schools themselves were afraid that an institutional grant might involve Federal control of the medical schools. During the whole development and passage of this legislation, while Senator Ribicoff was Secretary, medical schools were assured that money would come to them without any Federal dictation or control over how they operated.

Representative REUSS. Hasn't this had the following ironic effect? In the process of assuring the medical schools that there wouldn't be any Federal control or supervision or skewing of what they are doing, haven't we achieved exactly that? We have skewed them in favor of the exotic in the use of Federal funds, and we have impoverished their central budget, which should be devoted to the job of producing more good, modern, all-around physicians and surgeons, the people who comprise 90 percent of the physicians of this country, who actually treat patients.

Mr. COHEN. First, I think institutional grants would give the institutions greater freedom and less Federal control. When you have categories and subcategories, as you say, the Federal Government is really prescribing the area where that money ought to go. I think institutional grants may be given without control.

Quite frankly, I think they are less attractive to Members of Congress. That is the difficulty. In going through the congressional process of both the legislative committees and the Appropriations Committees, my experience has been that the first question they ask is, "Mr. Secretary, what will this money be used for specifically?"

When you say "it will be used to provide a better medcal school" or "more medical schools" that usually isn't a specific enough reason. Thus the legislation tends to become categorical, subcategorical, more limited, more prescribed. I think the Members of Congress have to be convinced consideration of the problem may be in the national interest.

Now there is one other problem. If you use institutional grants for medical schools, you might well have to consider this approach for institutions generally. A wide variety of other types of fellowships, scholarships, and so on, are earmarked through many different kinds of grants in education. Now university presidents are asking Secretary Gardner and me why we do not have institutional university grants generally. I think the question merits attention.

Representative REUSS. We may need some education of the Congress.

Chairman PROXMIRE. May I point out we have a terrific attendance here of committee members—with no television—which I think speaks both for the attractiveness of your subject and your capacity to present it, and also, of the quality of the members of this committee.

Mr. COHEN. I see many members of the committee who are on other legislative committees that I am to appear before during this session of the Congress, so I sense that this may be a little preview of what will come later. I am glad to have this opportunity to see what will be forthcoming.

Senator JAVITS. It is always good to have humility, Mr. Secretary.

Mr. COHEN. Yes.

Senator JAVITS. I would like to emphasize and call attention to the figures you bring forth in your statement, because I think they are so important. We speak loosely of 25 percent of the population living in a poverty situation, and 35 million Americans. Now those figures are out of date. I note it is now 32.7 million Americans and 17.1 percent of the population, and you expect, if these social security improvements go in, it will reduce that figure by one and a half percent, is that correct? That is an absolute one and a half percent.

Mr. COHEN. I said one and a half million persons.

Senator JAVITS. One and a half million persons?

Mr. COHEN. Yes. I actually think it is going to turn out to be a little larger. I hope that by July 1, 1967—these figures presented in the testimony are for 1965—the number in poverty possibly will be less than 30 million.

Senator JAVITS. Realizing your worst fears, I would like to ask you this question. We, in the Committee on Labor and Public Welfare, were all interested in the hospital modernization bill, which is critically needed, and which the administration submitted last year, calling for $1 billion a year for 10 years. You are not even proposing that this year in the budget. We are all interested in facilities for higher education. You are proposing $408 million under the authorization and $72.9 million under the fiscal year 1966 appropriation.

Part A of my question: Does this represent a calculated policy of the administration to cut down on major construction in this period, as these are two major construction propositions?

Part B: Has the administration considered, assuming the answer to A is in the affirmative, whether this would give us a backlog crisis situation like we faced after World War II, and whether in view of the fact that the Vietnam war, as these things go, is not a big war, is this justified?

Mr. COHEN. I think two streams of thought came together in this fiscal year. As you know, Senator, when we proposed the hospital modernization program last year, the hospitals of the United States were very unenthusiastic about our recommendations, because the proposal did not provide what they thought was an adequate Federal subsidy for the modernization program. As a result of that, I believe we never did have hearings on the proposal in your committee.

Senator JAVITS. One day of hearings in April 1966.

Mr. COHEN. One day of hearings. I guess that one day indicated that there wasn't much prospect of arriving at a solution to the problem. I think it is true that the administration does not wish to accelerate construction programs this year. When we reviewed the problems of hospital modernization programs last fall, we were aware that there are, as well, a whole series of problems with respect to the development of the extended care facilities for the medicare program and nursing homes.

We called a group of people in and discussed the problem. They gave us food for thought in saying that: "You had better look out before you expand and modernize." They said: "There is a kind of a Parkinson's law at work in medical facilities. If you construct more and build more, doctors in the communities will fill them up."

They asked us specifically to consider, before we went on an extensive new construction program, as important and as serious as we think it is, as evidenced by our original recommendations, a whole series of other alternative proposals. They said that we should not come to the Congress only with a set of proposals for putting people in institutions, because that seems to be the easy way.

Some people when they are sick think they are better off in a hospital or a nursing home, whereas home nursing services, outpatient diagnostic and treatment centers, and a whole host of other types of institutions ought to be considered.

The Hill-Burton Act is expiring on June 30, 1969, and, I believe I testified before your committee and you cross-examined me extensively on it. The Hill-Burton Act has tended to build hospitals in the small towns and rural areas, where there was a great deficiency. It has been suggested that now more of the money ought to go to larger urban areas.

It is our thought that we would make a major reevaluation of the Hill-Burton program, along with other alternatives, and a modernization program. I would say, in summary, modernization is very essential, but it is one part of a total program that ought to be considered. The President's budget this year does include a total appropriation of $280 million for all aspects of the Hill-Burton program.

Senator JAVITS. Mr. Cohen, I might say that I don't agree that you have to starve the hospitals in order to discourage doctors from putting people in them. I think there are better ways than that kind of bloodletting to deal with the hospital overuse, but we will not try you on that. I have other things I want to ask you.

What is the attitude of the Department, which I see an implication in your statement of these direct income support programs which have been testified to so much before the committee which Senator Ribicoff heads?

Incidentally, I would like to apologize to Senator Ribicoff, because I mentioned yesterday a concept with respect to housing——

Mr. COHEN. I didn't quite get the import of your question, Senator Javits.

Senator JAVITS. The import is: Does the Department look with favor on guaranteed minimum income programs, like Moynihan and others testified to, of which you get an implication at the bottom of your statement?

Mr. COHEN. We think there should be a complete study of all income guaranteed proposals. I think some guaranteed income plans, whether of the nature of the family allowance system that Mr. Moynihan has been suggesting, a negative income tax, or other proposals of that general type, raise a fundamental question in our wage related free incentive economy of paying some people who are employable as much money as they can get or more, paying them through an income program more than if they are working, which in turn raises very serious problems as to whether the plans, in the present situation, would be workable. The President has indicated he intends to establish a commission of leading Americans to examine these proposals.

Let me say this. I don't think the problem of meeting, of solving, the problem of poverty, is any longer an economic or a fiscal problem. As I said in my statement here, to meet the income deficiency so that poverty would no longer exist in this country would cost about $11 billion. That is about 1.6 of the GNP. The problem is how to devise an income guarantee program which would be acceptable in our economic system.

When I first started to work on social security 35 years ago, you could not have suggested a comprehensive income guarantee program, because it would have cost so much in relation to the GNP that it couldn't have been considered practical.

Now I think the problem has changed from one of money or cost. I don't see any reason why, with $800 to $900 billion GNP, you couldn't find some way, in the next year or two, to spend $8 to $10 billion to alleviate poverty, but when the type of a system is inaugurated to pay individuals who have an employable or semiemployable man or woman in the family, as much or more than he could earn in the labor market, I think that some people will think you are setting up disincentives to work, which may be difficult to overcome.

Now one way to overcome the problem, and there has been a lot of thought given to it, is not to pay an individual as much as he could earn.

Senator JAVITS. Of course.

Mr. COHEN. But then you don't fully meet the poverty problem. You are faced with a dilemma. For example, would an individual with say five, six, or seven children, under an income guarantee program, get much more than he would earn?

Now under both Mr. Moynihan's proposals and other proposals, you could say we would probably pay them a little less, as Mr. Moynihan does with the family allowance, but then we would still need a welfare program to support special types of cases.

The net effect of that type of program would not completely eliminate welfare—you would still have it, and you would also have another type of program. What would be the relation of an income guarantee program to the social security program? I think there are a number of questions which really have not been adequately solved which require further study. The relation of an income guarantee to a job guarantee and training program would need to be explored.

Senator JAVITS. Mr. Cohen, my time is up, but I have two other questions which I will dictate into the record and ask you to submit the answers. One is this:

How much of an increase in social security benefits can be financed, in the judgment of the Department, out of the current surplus in the social security trust fund?

The other question is: Does the Department have in contemplation any new plan for medicare-medicaid to deal with the problems of the unemployed and the retired or disabled persons, and what is its attitude on including in medicare the cost of drugs for patients outside of hospitals?

(The questions asked by Senator Javits and the responses by the Department, subsequently submitted for the record, follow:)

Question: How much of an increase in Social Security benefits can be financed in the judgment of the of the Department out of the current surplus in the Social Security Trust Fund?

Answer: According to the latest long-range actuarial costs, the Old-Age, Survivors, and Disability Insurance Program has a positive actuarial balance (or "actuarial surplus") of 0.75 percent of taxable payroll. If this were utilized to increase benefits, an across-the-board increase of 8 percent could be made, and the system would be in actuarial balance. Under these circumstances, no change would be needed in the presently-scheduled financing provisions (i.e. maximum taxable earnings base and contribution rates).

Question: Does the Department have in contemplation any new plan for Medicare-Medicaid, to deal with the problems of the unemployed and the retired and disabled as well as for cash assistance recipients?

Answer: As the President has announced, we recommend that the same medicare protection now provided for the aged be provided for social security beneficiaries getting disability benefits. Under this proposal hospital and medical insurance protection would be available to 1½ million disabled persons under 65—workers, adults getting benefits based on childhood disabilities, and widows. In addition, we will recommend several relatively other changes that will increase the administrative effectiveness of the medicare program.

We also recommend that the States be authorized to enter into agreements under which they can pay the $3 monthly premium for supplementary medical insurance on behalf of the medically needy aged and disabled as well as for cash assistance recipients.

We are very much concerned about the problem older people have in meeting the cost of prescription drugs. We recognize that this matter deserves our prompt attention. The President has asked the Department to undertake a comprehensive study of the problems of including the cost of prescription drugs under medicare, and this study is underway.

Chairman PROXMIRE. Senator Talmadge?

Senator TALMADGE. Mr. Secretary, there was recommended in the report on public welfare minimum standards for public assistance payments below which no State may fall. Would you comment on this proposal?

Mr. COHEN. Yes; the Advisory Council report proposes two rather strikingly new principles in the public welfare program. It says that there should be a minimum standard of subsistence determined by Federal law.

But recognizing that many States, particularly the low-income States, and I should say they are largely the Southern States, cannot meet that minimum standard entirely out of their own income under the present matching formula, the Advisory Council proposed revising the Federal matching formula system to one where the Federal Government would assume the full responsibility for the difference in cost between the State share and the total cost of the State program.

Let me try to make it very simple. Let's say that the State share is one-half of 1 percent of the total personal income payments in that State. The Federal Government then would pay the whole additional cost above that to meet the standard.

In other words, my comment on that report is that it really involves a very interesting and striking change in Federal-State relationships and Federal-State financing. A Federal standard is proposed which heretofore has not been in the Federal law. The report proposed that in order to meet the standard, a different type of Federal matching relationship would be needed. It is certainly worth considering.

It, of course, would also take quite an additional amount of Federal money to carry out and I should add that as a third factor. It is of some significance, because you can't have a standard with a hundred percent Federal financing above the State's share without it costing the Federal Government more than at present.

Senator TALMADGE. Am I correct in assuming, therefore, that you oppose that recommendation?

Mr. COHEN. Well, I had not yet supported it or opposed it because we are studying it, but I recognize that there is a great deal of merit in it, because there are many people on the welfare rolls today who are receiving amounts below the poverty level, and I think that is unfortunate. We must find some way to correct this situation.

On the other hand, I think it is also true that many Southern States are making as much or more effort in relation to their fiscal ability to try to meet this situation, and that probably some modification of the Federal matching formula is necessary.

Now the President's recommendations this year, which will be before your Senate Finance Committee and the Ways and Means Committee, do attempt to go a step in that direction by requiring the States to pay 100 percent of their standard of need as defined by the State, and in no case, less than two-thirds of what the medicaid standard would be.

This does involve a new principle because it says "We are going to hold the States responsible for trying to come up to some kind of a minimum standard" but the minimum standard would be the standard they set. I would be glad to discuss that at some length. It is a significant step.

Senator TALMADGE. In your response to Senator Javits' question a moment ago about your comment in your statement, and I quote:

> Putting a floor through direct income support programs so that no one falls below a minimum need is an intermediate step in achieving this objective.

Am I correct in assuming that that is not to be construed that you are endorsing the so-called negative income tax proposal or guaranteed minimum wage for all citizens?

Mr. COHEN. I am neither endorsing or opposing those proposals, no, sir. I think they require very careful additional study.

Senator TALMADGE. In your response you point out some of the same problems that it would involve that I have. We have seen that no matter how much our prosperity increases, our job opportunities become greater, and our standard of living increases, our welfare benefits and our welfare costs also go up astronomically.

Now I hear from time to time reports from all over the country about people who are seeking employees to work for them, and they get a flat refusal, and sometimes I get letters telling me the reason they refuse them is because they are satisfied with living on their welfare benefits and don't want to work. Does the Department have any reports of a similar nature?

Mr. COHEN. Could I make several comments on that?

Senator TALMADGE. Now what program, if any, do we have—I think everyone is sympathetic with everyone in need, in ill health, that can't get a job and can't earn a living, but I have no sympathy with the individual who prefers not to work, who wants to live on welfare. What programs do we have that divest these people of welfare benefits when they have actually refused to work?

Mr. COHEN. Let me say, Senator, just taking one illustration, the Public-Welfare Amendments of 1962, which the then Secretary Ribicoff proposed to the Congress, included a program to encourage State welfare departments to set up training programs for employable people who are on welfare and to give them work experience. This was very minimal. This is not the kind of training we are talking about for very highly skilled people. This was to train people who had not had work experience over the years.

Yes, to date, only 11 States have taken advantage of that program, and in fact I have a list of 32 jurisdictions that have given us notice that they are not intending at the present time to implement it.

I think this is extremely unfortunate, and included in the President's recommendations this year, is a recommendation that, as a basis for getting welfare payments, the States would have to have a community work training program, so that employable people on welfare would be given an opportunity for work and training to help them get off the welfare rolls.

Senator TALMADGE. I supported that program and I am in sympathy with it, but I am talking about a citizen who is now drawing welfare benefits, and someone offers him a job, "Come go to work for me." He says, "No, I don't want to" and he continues to draw his welfare benefits. Do you have any programs that could cut them off and say, "You ought to quit loafing and start making a living for yourself?"

Mr. COHEN. Yes. I don't know all the facts about a particular type of case, but if he is an employable person and drawing benefits under the aid to families with dependent children, and refuses to accept a bona fide work opportunity, the State may exclude him from assistance.

Senator TALMADGE. One of the things that I also hear considerable criticism about, too, is the ADC program. Lots of women from time to time for various reasons find it a more interesting life to produce children and to receive welfare benefits than to work. I believe in some of our urban areas, they draw as high as several hundred dollars a month for aid to dependent children, don't they?

Mr. COHEN. For a family of three or four children, yes, that would be possible.

Senator TALMADGE. What programs does the Government have of trying to eliminate this subsidization of illegitimacy at the taxpayers' expense?

Mr. COHEN. We have this dilemma. After the child is born, we are faced with the problem of taking care of the child irrespective of what the family circumstances may have been or the previous situation, and I think it is important, whatever the situation may have been, that those children grow up to be responsible citizens. So we have that problem.

Over the course of the last year, we have announced to the States that they may use Federal funds for a family planning program. States may use the Federal funds to have a family planning program of information and services for people receiving cash assistance or medical assistance under medicaid.

Senator TALMADGE. Some of them are more interested in the money than they are the family planning aspect of it. I would hope, Mr. Secretary, that you would make a diligent effort to study these various programs. I think we ought to be careful so as not to destroy the incentive to work. I was happy to hear you make a similar comment.

Those in need, fine. Let's assist them all we can. But let's try to devise some program to keep it from becoming so attractive to make a life on welfare continue sometimes into the third generation. There ought to be some action whereby the States and the Federal Government could join hands and say to the welfare recipients, "Now look here, you have been offered a job. You have turned it down. We are not going to continue to support you as long as you can get a job."

There ought to be some program it seems to me whereby people that are producing illegitimate families and find it attractive to do so, sometimes three generations live under one roof, all of them drawing ADC payments, and supporting their paramours too. I have known lots of families of that type. There ought to be some program whereby that is stopped, because the taxpayers of this country, if I judge the sentiment and attitude correctly, are greatly concerned, not about supporting the needy, not by helping those who need help, but by constantly and enormously raising taxes to support ladies who are shiftless and who don't want to work and who are satisfied to live off the taxpayers.

My time has expired. Thank you.

Chairman PROXMIRE. Mr. Widnall?

Representative WIDNALL. Thank you, Mr. Chairman.

At this point I would like to ask unanimous consent to insert in the record two articles that are pertinent to what we are talking about today, from nationwide magazines.

The first is from the U.S. News & World Report, dated January 30, 1967, entitled "Is Social Security To Get Out of Hand?" The second is from Business Week, February 4, 1967, entitled "White House Escalates War on Air Pollution."

Chairman PROXMIRE. Without objection those will be put in the record at this point.

(The articles referred to follow:)

IS SOCIAL SECURITY TO GET OUT OF HAND?*

New plans for Social Security, promising still more benefits and adding billions to costs, are raising questions about the future of the system.

LBJ urges higher pensions, broader medicare, easier rules. Price: well over 4 billions a year. And many argue the Johnson plan isn't enough.

In prospect is a cost explosion. The big question is where to get the money to finance it all.

Social Security in this country gives every sign of getting out of hand as it already has done in some countries of Western Europe.

Each generation of older people is insisting on higher and higher benefits, covering a wider and wider range of needs, to be available on retirement or sooner.

Few seem willing to pay the full cost of these benefits. Congress finds irrestible this demand of millions of voters to get something for nothing.

The result is an engine for pouring dollars into pockets of people who have not paid their way in taxes or savings—and on a scale that feeds the forces of inflation. This situation is causing concern among many officials of Government and analysts of private industry.

Even now the "unfunded liability" of the Social Security system—the obligation to pay benefits for which reserves are not now in hand—is estimated at around 400 billion dollars.

What President wants. President Johnson now is recommending that pensions of those drawing benefits, or who will draw pensions in the future, be increased by an average of 20 per cent.

This increase, when voted, will add about 100 billions more to the "unfunded liability," bringing the total to around 500 billions, which is half a trillion dollars. That is a total 50 per cent larger than the entire national debt on which interest is being paid.

However, to make sure that there is money enough to meet current benefits, it is going to be necessary to raise taxes on payrolls.

*Reprinted from U.S. News & World Report, Jan. 30, 1967.

The combined employer-employe tax now totals 8.8 per cent on $6,600 of individual income.

It will have to go up to at least 9.3 percent on $7,800 of income just to keep from falling behind. Mr. Johnson has not yet broken this news to the Congress. Yet today's situation is being described as only the beginning.

The history of the Social Security system in the United States, extending over the last 30 years, has been one of steadily rising benefits, steadily rising taxes and steadily rising obligations for which money some day will need to be found.

Nobody in an official position is willing to guess where this process will end.

An "escalator clause" is being proposed in Congress to carry pensions higher almost automatically as the cost of living goes up, with no provision to add automatically to taxes.

Medicare, too, is only beginning. Experience in all nations abroad having comparable systems indicates that the public's demand for an expansion of medicial-service programs is insatiable, tending to outstrip the demand for old-age pensions.

Pensions are a fixed obligation that can be figured accurately.

Medicare benefits are a service-type benefit for which no reliable estimate can be made.

The Social Security system was created by law in 1935, and a special tax on payrolls was first levied in 1937. The first pensions were paid in 1940, permitting a reserve to be built.

How tax has increased. The starting tax was 2 per cent—1 per cent each on employer and employe—levied against the first $3,000 of income. The tax on Jan. 1, 1967, had moved up to 8.8 per cent on $6,600 of income, and it will continue rising. Payroll taxes even now are second only to income taxes as a form of levy.

Old-age benefits have gone up steadily over the years. Coverage has been broadened, and the scope of protection has been increased.

In the original act, dependents of retired persons were not covered. They were brought into the system before the first retirement benefits were paid in 1940. In 1950, farm workers, domestics and nonfarm, self-employed persons were covered.

Six years later, pensions were provided for persons totally and permanently disabled at the age of 50 or above. In 1956, too, the retirement age for women was lowered to 62 from 65, and, in 1961, men were made eligible to retire at 62. In 1960, disability at any age was made ground for a pension.

At the start, a person retiring on a Social Security pension could earn only a nominal amount without facing a reduction in his pension. That amount gradually has crept up to $1,500 a year.

President Johnson drew cheers from Congress with his recommendation that this amount now be raised further.

Many retired—and working. Many of the millions of Social Security pensioners are working on the side and are not really retired. Many others use Social Security pensions to supplement their private pensions.

This whole process of expanding coverage and broadening benefits is viewed as leading inevitably to coverage of most medical care as the years go on.

President Johnson is asking Congress in the present session to extend medicare benefits to those totally and permanently disabled who are under 65. It is just one jump to extend coverage to dependents of retired and disabled persons.

The cost of drugs for medicare patients outside hospitals is not now covered but seems sure to be included soon, and the same is true of a good many other services now excluded.

Once hospitals and the medical profession can get adjusted to carrying the load of medicare for persons 65 and over, the age limit—if experience is any guide—will be lowered.

Just what the cost of all this is going to be is anybody's guess. Old-age pensions, pensions for dependents, and disability pensions now are up around 22 billion dollars a year. Medicare accounts for an additional 2 billion.

Mr. Johnson is asking Congress to add to the retirement system benefit increases that will total more than 4 billions a year. Medicare, on its present limited basis, will expand to 3 billions in the next two or three years.

Treasury takes a look. The explosion in costs of the Social Security system is forcing the U.S. Treasury and Social Security officials to consider the problem of future financing.

When this system was first being studied, President Franklin D. Roosevelt wanted a system that was fully "funded"—one in which earnings of a trust fund would guarantee the pension benefits.

After studies by actuaries showed what the required size of such a fund would be, the President backed off from that idea. He found that it would not be long before the Social Security trust fund would own all of the national debt then existing and would be looking around for other places to put its money.

The thought was offered that maybe the Social Security trust fund would have to buy up the nation's railroads or some of its utilities.

So the plan was shaped to provide a partial reserve fund, and payroll taxes were collected for three years to build this fund before paying any pensions. The Social Security trust fund was supposed to grow with the years. Plans still call for an increase over the years.

Experience indicates, however, that Congress prefers to operate the system on a pay-as-you-go basis—with a trust fund little, if any, larger than needed to meet benefits of a year ahead.

Now even that concept is beginning to be challenged as taxes on payrolls approach—and soon will be passing—10 per cent of a continually rising level of individual income.

Senator Robert F. Kennedy (Dem.), of New York, with the backing of a number of "liberals" in Congress, is proposing that—instead of trying to pay all the benefits from revenues flowing out of payroll taxes—the Social Security system should be allowed to write checks against the general revenues of the U.S. Treasury as well.

The Kennedy plan calls for raising benefits generally by an average of 50 per cent. The highest family benefit would be increased from $368 a month now to $833.20, or about $10,000 a year. Each time the cost of living rose 1 per cent, the benefits would go up.

To meet these added expenses, there would be a 10 per cent total tax on earnings up to $15,000 a year. This tax would be expected to meet about 65 per cent of costs. The general fund of the Treasury then would be drawn on for the remaining 35 per cent, or about 14 billion dollars a year by 1975.

Effects of private plans. Expansion of Social Security, with its rising costs, is causing the Treasury to eye private pension plans and their benefits, as well as their reserve funds.

The Treasury figures that more than 2 billion dollars a year in revenue is lost to the Government through tax-free deductions of income that goes to establish and build private pension funds. Reserves of these private funds, invested in stocks and bonds for the most part, now total around 90 billion dollars.

Income from these stocks and bonds in reserves of private pensions likewise is tax-free and results in a further loss of federal revenue.

In commenting on a study of private pensions plans, William T. Gibb III, an official of the U.S. Treasury, said on Dec. 6, 1966: "We must ask ourselves whether we are getting a fair return for the public moneys spent on the private retirement system."

The Government has been exploring plans that would increase the cost of providing private pensions, with the alternative to higher cost a reduction in pensions that are promised to higher-paid employes. The effort would be to move toward equalizing pensions or considering Social Security and private pensions as a unit.

Said Mr. Gibb, after some strong public protests over suggested changes:

"It would seem to me that it would be hazardous to assume that nothing will come of a project that represents three years of work and the thinking of people high in Government."

The Government, too, is eying the reserve funds of private pension plans.

There is a feeling that the very size of these reserves—rising at the rate of billions each year—will require regulation by Government to guard against abuses and to protect against immense scandals in case unscrupulous groups should get control of individual funds. It will not be many years before 125 billion dollars in assets is involved.

A growing worry. What you find is that plans to protect people against the hazards of life—both public and private—are proliferating and expanding at a rate that suddenly is beginning to cause official concern.

Yet political pressures are so great, and the range of protections which can be added is so wide, that the whole system is tending to mushroom, with no real limit yet in sight.

IF YOU THINK WELFARE COSTS ARE HIGH IN THE UNITED STATES

As Social Security costs mount in the United States, official Washington is taking a close look at what other countries are doing in this field.

What's found is that, by comparison, the U.S. is only a beginner in the effort to provide cradle-to-grave security.

In major countries of Europe, for example, where welfare is an old story, these programs have been expanded over the years to provide far more types of aid than does the U.S.

In some countries, welfare costs dominate national budgets and claim a major share of all the taxes collected.

A question raised in Washington: Is the same thing going to happen in U.S.?

Here is a report on latest developments in the welfare system of some other principal nations:

France. It's the employer who bears the brunt of Social Security costs in France, paying a tax of more than 40 per cent on payrolls. The employe contributes about 6 per cent of earnings. These contributions pay for a welfare system regarded as setting standards for other countries of the Common Market.

A married worker who turns 60 can keep working full time and collect a pension equal to about 30 percent of his regular pay. If he waits till 65, the pension amounts to 60 per cent.

Health insurance pays up to 80 per cent of medical expenses, including dental care, for young and old, with no time limit. Then there are disability insurance, sick pay and family allowances that can add 50 per cent to the income of a typical worker with three children.

Germany. Spending on social welfare amounts to 18 per cent of Germany's gross national product, or nearly double the proportion spent in the U.S.

Generous pensions for retired workers are being raised by 9 per cent in 1967 for more than 8 million beneficiaries to keep pace with inflation. Sick-pay benefits now provide up to 85 per cent of regular earnings for a family man. That's in addition to medical care for all ages.

Growing in popularity among German workers is a periodic "health" trip to a spa, with social insurance picking up the bill, including $2 a day for pocket money.

Plans now are to slow down growth of Government spending on welfare, currently at 6 billion dollars a year, or one third of the federal budget.

Italy. The trend in Italy is away from payroll taxes to bigger Government contributions from other revenues.

Social insurance is being liberalized up and down the line. A worker can collect an old-age pension at any age after 35 years of coverage. Otherwise, men begin collecting at age 60, women at 55. Old-age pensions are being boosted substantially. So are payments to widows and disabled workers, as well as family allowances.

As the Government takes on more of the load, payroll taxes on employes have been reduced. Still, employers are taxed about 45 per cent of payrolls, among the highest rates in the world.

Sweden. "A classic example of an overambitious welfare state," is the way one economist describes Sweden.

Welfare spending on cradle-to-grave programs has doubled in five years. Further rises in pensions, to cover higher costs of living, are on the way. Maternity benefits have been doubled for many, including unwed mothers.

Payroll taxes for old-age and health insurance are soaring. Most welfare expenditures are financed out of other revenues, however. This means more tax boosts. In March, the sales tax goes up to 11 percent from 10 percent, and extra levies on taxis and motor cars will also be raised.

Complaints over tax increases are spreading in Sweden. Even so, as tax receipts grow, more costly welfare schemes are proposed.

Britain. Spending on social services, up nearly 65 per cent in the last five years, is taking a growing share of Britain's resources.

Costliest part of the system is sickness insurance, now running into trouble as demand for free care strains the supply of doctors and hospital space.

A flat pension of only about $11 a week is paid to retired workers, though a supplementary plan will gradually raise payments to those who retire in the future. Sick pay, maternity benefits and family allowances are also provided for British workers.

Canada. This country, once lagging far behind the U.S., now is in the midst of an explosion in social insurance.

A retirement plan getting under way this year will eventually provide a pension equal to 25 per cent of regular pay. That comes to top of a flat $75 a month which Canada pays all residents over 68—or $150 to an aged couple—retired or not. By 1970, people will be eligible to collect at 65.

Benefits will also be paid, for the first time, to widows and disabled workers. Then, 1968, will come a comprehensive medicare program for all.

Around the world. In one country after another, the trend is toward higher benefits and more social services. Holland is raising old-age and sick-pay benefits. In New Zealand, half the people now get some kind of social-welfare payment from the Government.

Payroll taxes, already heavy in many nations, are going up still further. Governments are making bigger and bigger contributions out of general revenues. Many think the same thing will happen in the U.S. in years ahead.

Secretary Cohen later submitted for the record the following letter by Robert J. Myers, Chief Actuary of the Social Security Administration, commenting on the U.S. News & World Report article reprinted above:

DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE,
SOCIAL SECURITY ADMINISTRATION,
Washington, D.C., January 27, 1967.

MR. DAVID LAWRENCE,
Editor, U.S. News & World Report,
Washington, D.C. 20037

DEAR MR. LAWRENCE: Your January 30 issue contains an article, "Is Social Security to Get Out of Hand?", which contains a number of factual points of an actuarial nature that I should like to discuss to point out certain errors that are present.

In the first box at the bottom of page 42, it is stated that the original program was to be financed on the basis that "a huge reserve was to be built up so that the system would be fully 'funded' ". This statement—although frequently appearing in one form or another—is completely incorrect. The system as it was under the 1935 Act did not provide for full actuarial reserves that would, at all times, be equal to the accrued liabilities of the system. As a matter of fact, the financing basis now is exactly the same as it was then insofar as general principles are concerned—namely, that full actuarial reserves are not developed; rather, over a long-range future period, the income is estimated to meet the outgo. In fact, you correctly state the matter in the last paragraph of the second column on page 44.

Further in regard to the first box at the bottom of page 42, it is stated that the early cost estimates as to how the program's experience would be in 1967 are far different from the actual experience. This is really like comparing apples and elephants, because both the benefits and the coverage of the system have been greatly changed in the three decades and because earnings levels have risen so significantly during this period. Quite necessarily, the OASDI actuarial cost estimates made at any time are for the program as it is then in existence and for the earnings level then prevailing. One would hardly reasonably expect the actuary to predict future legislative changes some 30 years off in the future. Similarly, we assume level earnings because of the difficulty in projecting earnings rates and, more importantly, because the benefits structure adopted at any one time is necessarily based on the earnings levels at that time.

In the third box at the bottom of page 42, you accurately compare the combined employer-employee contribution rate and the earnings base for 1967 under the original law with what it actually is now. However, it is interesting and significant to make this comparison on the basis of total wages. Under the earnings levels prevailing in 1935, a combined employer-employee tax rate of 6% on a $3,000 maximum base was equivalent, on the average to 5.5% of total wages (which might be said to be the ultimate tax burden anticipated)—since the $3,000 base covered 92% of total wages. The present 8.8% on a $6,600 earnings base is equivalent, on the average, to a rate of 7.0% of total wages (since the $6,600 earnings base covers about 80% of total earnings). Thus, the differential in the tax rate as between the present law and the original law is not nearly as large as it would at first seem. Moreover, it must also be kept in mind that insofar as the employer is concerned, the net tax rate for unemployment insurance is well below what might have been anticipated in the mid-1930's, so that this reduction is a partial offset to any increase in his OASDI tax rate. Another thing that should be kept in mind, of course, is that these tax rates pay toward considerably more protection than was originally contemplated.

In the second column of page 42, you refer to the unfunded liability as now being about $400 billion and that this will increase by about $100 billion more under the President's proposal. You define this unfunded liability as being "the obligation to pay benefits for which reserves are not now in hand", which is a rather loose definition. Actually, what is meant by this concept is the amount of money that would currently have to be on hand in interest-bearing obligations if the system were to be soundly and adequately financed over the long-range future *under the completely artificial assumption that from this day on no new entrant would come into the program.* The latter assumption is one that can be dealt with in actuarial calculations, but it is meaningless in a social insurance system that provides for compulsory, continuous coverage of virtually the entire labor force.

A figure for the unfunded liability of $321 billion had been published for the system as it stood before the 1965 Amendments. The result of these amendments, according to my estimates, was to increase this figure to about $350 billion (not to $400 billion, the source of which I question). Furthermore, your statement that the President's proposal would increase the unfunded liability from $400 billion to around $500 billion (or by 25%), is not correct, since one must take into account not only the increases in benefits, but also the future increases in contributions on the presently covered group.

In the last paragraph of the third column on page 42, you surmise that the combined employer-employee tax rate will have to increase to at least 9.3% on an earnings base of $7,800. It is not quite clear what is meant here—whether this is to be the situation in the next year or two, or whether it is to be the ultimate situation. It would appear that the former is the case, because even under present law the rate rises well above 9.3%. Considering the short-range situation only, as you now know, the financing will be adequate at the present 8.8% for 1967–68, if the earnings base rises to $7,800 in 1968 (and income will exceed outgo in each year).

In the various boxes on pages 42–44, cost data are given for the actual experience in 1967 under the proposal, as contrasted with what is stated to be the "original estimate". Actually, as you bring out, the "original estimate" is really that for the 1939 Amendments as made in 1943 and not the real "original estimate" that was made for the 1935 Act in 1935. The figures that you give are reasonably accurate, although in certain instances I would come out with slightly different results.

Sincerely yours,

ROBERT J. MYERS, F.S.A.,
Chief Actuary.

WHITE HOUSE ESCALATES WAR ON AIR POLLUTION*

How Johnson would would clean up the air—

These new regulations . . .

—Power to control emission levels for industries with heavy pollution, with tougher standards in heavily polluted areas
Stronger Federal enforcement procedures
—Registration of all fuel additives with Health, Education, & Welfare
Annual inspections of smog-control devices on autos

. . . would be combined with more research

50% more spending on research on sulfur-free fuels, disel fuel smoke and odors, new propulsion systems

Program proposed by the President would be headed by Federal agencies working with industry and local governments. Big question is who will pick up the tab?

"Control now for clean air" was the theme Washington pushed last December at a conference on air pollution. This week, President Johnson asked Congress to translate that slogan into a comprehensive Air Quality Act of 1967.

In a special message on protecting the nation's natural heritage, the President proposed a tough program against dirty air, with the federal government taking

*Reprinted from Business Week, February 4, 1967.

the lead. Without strengthened regulatory and research efforts, he said, the U.S. in 10 years will "have lost the battle for clean air."

New task. Technical grasp of the air pollution problem and its solutions admittedly is incomplete. But the Administration now is taking the tack that necessity is the mother of invention, and improvements can be incorporated as they develop. The moves come against a background of the Thanksgiving Day smog crisis in New York, where the President estimates 80 persons died.

John W. Gardner, Secretary of Health, Education & Welfare, says that the air pollution level is "advancing more rapidly than our efforts at control, and our best estimates indicated that the present pace of control efforts we would lose ground steadily.

Who pays? Who will pick up the tab for the program is uncertain. The cost to industry is bound to be heavy. Several bills have been introduced into Congress for quick tax write-offs on both air and water pollution abatement works. But these are not expected to pass this year. For one reason, the President in his message called for HEW to huddle with the Council of Economics Advisers to look at ways of encouraging industry and local governments to abate pollution. So more study will precede a policy decision on whether industry should bear all the cost, or get tax credits or subsidies.

Federal action is required, Johnson argues, because local governments failed to come through under the 1963 Clean Air Act. This act provided three federal dollars for each dollar in local money to develop interstate control programs. However, the President said, "despite this incentive, no effective regional programs have been developed."

Proposals. The President now asks for:

- Emission control levels for industries that are heavy polluters. Probable first targets are electric power generation, petrochemicals, paper and pulp, metallurgical processing, and fertilizer manufacture.
- Regional air quality commissions to enforce control in interstate areas the experts are now describing as airsheds. Penalties of $1,000 per day are proposed for failure to comply. Roughly, 80 airsheds now can be identified across the country.
- Inspection of auto exhaust control devices, with the new Transportation Dept. providing matching grants to states to set up inspection programs and the Secretary of HEW establishing criteria for the grants.
- Tightening of enforcement procedures. Now, it takes more than a year before an interstate commission's orders can be backed up by a federal court. The new bill would cut this to 60 days.
- Accelerated research in fuel additives, with all additives registered with HEW.

The Administration figures that the new program will cost $18-million more to carry out in fiscal year 1968 than the $64-million now authorized. Some $15-million of the new money would be earmarked for research.

Congress goes along. The Senate is moving swiftly and seems receptive. Senator Joseph S. Clark (D-Pa.), commented: "I am confident that any politician who picks up this issue and runs with it will never regret it."

Senator Edmund S. Muskie (D-Me.), chairman of the Public Works air and water pollution subcommittee, readied the Prsident's bill and immediately scheduled hearings, with HEW Secretary Gardner and Presidential science adviser Donald Hornig to testify next Wednesday. Senator Muskie then takes off on a series of cross-country air pollution hearings.

In the House, a more critical reception is expected in the Interstate & Foreign Commerce Committee.

First targets. For industry, the President's program could have fast impact. HEW feels some pollution levels can be set as soon as six months after legislation receives final Congressional approval. First likely targets are such industries as steelmaking and electric power production.

The President disavows a relationship with industry that is just "one merely of regulator and regulated." He said in his message that "out of personal interest, as out of public duty, industry has a stake in making the air fit to breathe. An enlightened government will not only encourage private work toward that goal, but join and assist where it can. And a HEW official said that consultation with industry will be one part of the standard-setting process.

Reactions. Specific industry standards plus the prospect of federal enforcement came as a surprise to most of the industries named in the President's message. At least two provisions are certain to raise questions. One gives

HEW the power to subpoena documents for use in abatement hearings. The other is the right to enter plants to make inspections and to see company records.

William J. Clapp, president of Florida Power Corp., thinks the federal government has a place in fixing standards in air pollution, but calls attention to many electric industry programs under way to control sulfur dioxide emission and air borne particles.

Standards also bother E. J. Hanley, chairman of Allegheny Ludlum Steel Corp. He says: "I hope the government works with industry on this. I'd hate to see happen what happened with the auto companies where safety points were listed by the government and then the companies asked to come talk about them." Hanley denies that the steel industry has been as negligent as critics say.

Joel Hunter, president of Crucible Steel Co. of America, has misgivings about "such broad and sweeping authority" resting in the hands of HEW.

Water standards. The President's message made only slight mention of water pollution. One Administration official pointed out that under the present laws, "it will take us all this year to set water quality standards and to shift from low gear to high gear." These standards are being set by the states and must be approved by the Secretary of Interior.

Significantly, standard-setting by the states is being abandoned in Johnson's approach to air pollution. "We learned from water pollution and other efforts that if you take a more involved process, you just lose time," said one HEW official.

CHICAGO DIGS ITSELF OUT

Last weekend's blizzard is second disaster in month for the Windy City. It cost some $150-million in lost goods and services, brought business to standstill.

Few in the Midwest had reason to regard last weekend's blizzard as a bonanza, but Tom Meyer of Cleveland was one of the few.

He is president of Meyer Products, Inc., whose principal product is snow plows. "One of our distributors sold out his entire stock of 50 plows over the weekend. Other dealers could have sold more, but their employees couldn't reach the shops to service the demand."

However, for anyone in northern Illinois, northern Indiana, and southern Michigan not in the snow removal business, it was a cold, bleak three days.

White stuff. Chicago, which bore the brunt of the bilzzard, was the recipient of an estimated 24-million tons of snow during a 29-hour period beginning early Thursday morning. The 23-in. fall cost the city an estimated $150-million in lost production of goods and services and came right on the heels of the disastrous McCormick Place fire.

Traffic arteries were completely clogged on Friday, and many employees were unable to get to work. Marshall Field & Co., Carson Pirie Scott & Co., and other big department stores, lacking the staff to man their counters, had to close. A major part of the financial district including the Federal Reserve Bank of Chicago, the Mercantile Exchange, and the Board of Trade also had to call it a day.

Workers failed to get to plants in outlying areas, too, and companies such as Zenith Radio Corp., Sunbeam Corp., and a Ford Motor Co. assembly plant were closed.

Not only employees failed to reach their destination. O'Hare International Airport—the nation's busiest—was closed for more than three days, and thousands of would-be travelers were stranded. Another 7,500 were stuck in Milwaukee while waiting for O'Hare to reopen.

With storekeepers and police immobile, shops and untended snowbound trucks on Chicago's West Side—where race riots erupted six months ago—were looted. When the melee ended, 200 people had been arrested, 4 injured, and a 10-year-old girl was dead.

At midweek, when a fresh snowfall started, many Chicago businesses closed early and several plants cancelled night shifts in fear of a new blizzard even before the weekend snow had disappeared.

Representative WIDNALL. Thank you.

Mr. Secretary, in the U.S. News & World Report article on social security, it calls to the reader's attention how the early concept of social security has changed. It gives the early projections of how social security financing would stand by 1967, and how far different from the way it was projected and has turned out.

In benefits, the original estimate for 1967 was $2 billion, and today's estimate for 1967, $26.3 billion.

In payroll tax, the original plan for 1967 was 6 percent on the first $3,000 of worker's pay, and the actual for 1967, 8.8 percent on the first $6,600 of worker's pay.

We are now considering projections for the future which will involve an increased payroll tax and also an increased base for social security. We also find that on top of that, what we have in the reserve fund has diminished considerably. The original estimate for 1967 was $54 billion, and today's estimate for 1967, $23 billion.

Doesn't this disparity alarm you and indicate to you that we are going to run into a completely unsecure reserve fund?

Mr. COHEN. Let me make two points before I answer that question. It is clear that Congress has made striking changes in the social security system over the years. I think this is sound. I think Congress has repeatedly reexamined the social security system in the light of remarkable economic and social changes that have occurred, attitudinal changes as well, about the role of the Federal Government in this area and its relation to private pension plans, and except for very minor points, I think all of those improvements have been highly successful and important.

I would also like to say, while there are two members of the Ways and Means Committee and a member of the Finance Committee and a former Secretary of Health, Education, and Welfare here, that if you go back and look at those 30 years of experience, you will find that every administration and every Secretary and every Ways and Means Committee and Finance Committee have given great weight and consideration to the longrun financing of this program.

There may have been differences on just how to deal with specific points, but I think I can say with absolute assurance that no matter who has been chairman of the Ways and Means Committee or the Finance Committee, or under what administration—Mr. Myers has been the chief actuary since the beginning—they have always asked and gotten information about the long-range financing implications of costs, how to finance the program, and they have put something in the law related to that long-run cost.

Now that doesn't mean that the answer was necessarily correct or will turn out to be correct in years to come. I would put it this way. I think they did the best that human intelligence could do under the circumstances in recognizing, as I said in my prepared statement, what the long-run costs are.

Now when you are living in a dynamic capitalist economy, such as we have, a free enterprise economy, in which the gross national product is going up $30 or $40 billion a year, obviously, the social security system ought to change in relation to the dynamic character of the economic system, or otherwise the distribution of income to the aged and the disabled and the widows and orphans would be out of balance with the rest of the economy.

Social security, its great virtue, is that it is a mechanism for distributing the productivity of the whole economy, not merely to the people who are productive, but to the people who are outside of the labor market.

Representative WIDNALL. Mr. Secretary, may I interrupt you at this point?

Mr. COHEN. Yes.

Representative WIDNALL. That isn't what I am getting at. What I am getting at is the adequacy and the soundness of the reserve fund.

Mr. COHEN. Yes, sir.

Representative WIDNALL. And I believe in your prior testimony, prior to my taking up the questioning, you indicated that there was just enough in cash available to take care of 1 month's payments. There is about $18 billion in other reserves.

Mr. COHEN. Yes.

Representative WIDNALL. Now, what are the reasons for the social security reserve funds, if you don't have available the moneys to instantly pay when required in time of crisis?

Mr. COHEN. In answer to that I would say I would feel a great deal better if the amount in the reserve were somewhat larger than it is now. The total reserve at the present time is equivalent to about 1 year's benefit. That is, we are spending in the nature of $20 billion to $25 billion at the present time; and the total reserves, including those in the health insurance trust fund, are about $23 billion.

I am being very general now. But it would be, in my opinion, much better if the reserve were somewhat larger. On the other hand, though, in relation to these arguments, I want to make the point that a governmental social security system does not need to have a so-called fully funded reserve. By a fully funded reserve, I mean a reserve that you would have to have if you were a private insurance company which would probably have about $350 billion for the social security program at the present time.

Now, as I said in my statement, I think we can have a reasonable pay-as-you-go financing, with a reasonable contingency reserve but, in any case, there must always be a prospective contribution rate in the law tht the Actury says will fully cover future costs. Then you have a sound system. But I think Congress should, at least every 3 to 5 years, reexamine the whole actuarial and economic base to see if they want to change the contribution and benefit levels.

But in answer specifically to your question, I would say a reserve of somewhat more than the present reserves roughly 1 year's benefit dispersals, would be desirable.

Representative WIDNALL. I believe you just said we could reasonably have a pay-as-you-go system. We do have a pay-as-you-go system right now, don't we?

Mr. COHEN. Well, it depends on exactly how you define "pay-as-you-go." We have a pay-as-you-go system now in which some small part, around 5 or 10 percent, of the cost of the program, is paid out of interest. This is, of course, substantially less than it was under the original law.

As I remember, under the original law of 1935, in the eventual long-run future, about a third of the benefits would have been paid out of interest.

Now, in answer to your previous question, that is a remarkable shift in policy in the program—to shift from a program in which one-third of the benefit disbursements were paid out of interest to 5 or 10 percent. And so we are on a somewhat more pay-as-you-go system, but I always think in a system like this, in an economy which is as dynamic as ours, in which the purpose of social security is to assure people of continued payment of benefits, that a somewhat larger current reserve would be more satisfactory.

Representative WIDNALL. One other thing. I am very deeply concerned by the fact that I believe right now we have built into the social security system a means of trying to keep people on the poverty level, and that is by the limitation on earnings.

It seems to me that that is one of the first things we should do. We should materially increase the amount of earnings a person could have and still retain their social security, and I know in our own office and many other congressional offices, we are told there are thousands and thousands of people who are physically capable of working who find difficulty in getting full-time jobs at their age, but are perfectly capable of taking part-time jobs that could materially add to their earnings, and also maintain them on a far better than poverty level.

Mr. COHEN. The President's recommendations would increase the present $1,500 limitation to $1,680, Mr. Widnall. That is a 12-percent increase.

Representative WIDNALL. But I think that is really chickenfeed when you are talking about the rise in the cost of living in our economy, the material increases that have taken place. I think something substantially more than that must be done.

Mr. COHEN. Well, I think the problem presented there is the distinction between part-time and full-time work. I think the question is at what point would you be paying people their full benefit while they are working full time.

In other words, at some point along here, we will have to make a decision of whether we want to pay social security benefits when people are working full time. Should it be an annuity program or should it be a retirement program?

Now I appreciate that there are differences of opinion where the exempt amount should be, $1,500 or $1,680 or some higher amount, but if you pay all individuals over 65 who are working, it would cost $2 billion more in benefit expenditures per year. And all of that money would be going to people who were working, while the people who were not working wouldn't get any increase in benefits. So I think you have to balance those factors.

I am just saying that major fiscal, economic and social policies are involved in making that decision.

Representative WIDNALL. Thank you, Mr. Cohen. My time is up.

Chairman PROXMIRE. Mrs. Griffiths?

Representative GRIFFITHS. Thank you, Mr. Chairman.

May I ask, Mr. Secretary, if a man is working in covered employment and passes away, what is the maximum family maximum that the widow and children can draw?

Mr. COHEN. Today, under the present law?

Representative GRIFFITHS. Yes.

Mr. COHEN. $368, Mrs. Griffiths.

Representative GRIFFITHS. How many children?

Mr. COHEN. A widow and two children, or a family consisting of three children would get $368.

Representative GRIFFITHS. If the mother were working in covered employment and passed away, what is the maximum that the father and children could draw?

Mr. COHEN. Generally the father could not draw any benefits, but the family could draw $368 if there were three children.

Representative GRIFFITHS. If there were three children?

Mr. COHEN. Yes.

Representative GRIFFITHS. If the mother takes a job, how much can she earn without giving up any of the social security?

Mr. COHEN. At the present time? If she has earnings up to $1,500 per year, she can continue to draw her full benefit.

Representative GRIFFITHS. If the father continues to work, how much social security does he get with three children?

Mr. COHEN. Mr. Myers can answer that.

Mr. MYERS. Mrs. Griffiths, if there is a father with three children, who can draw the $368, it does not matter whether he works or not, since the children draw that much by themselves. If there is a mother with two children——

Representative GRIFFITHS. She can draw it.

Mr. MYERS. She would have to give up some of it if she works. But if she has three children, the full $368 is paid regardless of her working.

Representative GRIFFITHS. But if she has two children and works, she has to give up or she can only make $1,500, can she?

Mr. MYERS. That is correct.

Representative GRIFFITHS. What is the average mean wage of women? Isn't it about $3,000?

Mr. MYERS. The average wage for what you might say is a full-time woman worker under the system, who works in all four quarters of the year, is now about $3,600 a year.

Representative GRIFFITHS. What is the average for men?

Mr. MYERS. It is about $6,000.

Representative GRIFFITHS. So what real objection do you have to that woman worker drawing $368? She is going to be paying into the system. What objection do you have? Why is she treated like a retired worker? This is simply income that is taking the place of the father's income, and obviously he made much more money. Why do you want to take that money away from her?

Mr. COHEN. I think your question really goes basically to the question of whether you should have any type of retirement test at all where there are young children. Now I think that is worthy of exploration. That is different from the kind of question that Mr. Widnall asked me, because I think you should make the presumption, where there are children, that the mother ought to be able to stay home with the children if she elects to do so.

Representative GRIFFITHS. Not only the presumption—pardon me, do you think the presumption should be that she should stay home with the children?

Mr. COHEN. Yes, I would say.

Representative GRIFFITHS. Of the women in this country, 56 percent aren't staying home with the children; 81 percent of the college educated aren't staying home with the children.

One of the real shocks that I have heard this year is that in Fall River, Mass., 90 percent of all married women work. It has the lowest juvenile delinquency rate in Massachusetts. Maybe we ought to reverse this. Maybe we ought to keep the fathers at home and pay them. What kind of nonsense is it that says that a woman has to live on $368, when she makes 1 cent over $1,500, she is taxed 100 percent on it?

Mr. COHEN. Above $1,500——

Representative GRIFFITHS. Yes, she is taxed 100 percent.

Mr. COHEN. No.

Representative GRIFFITHS. She has to give up $1 for every dollar.

Mr. COHEN. No; she only gives up 50 percent for the next $1,200. Your point, despite that, is still germane.

Representative GRIFFITHS. The real truth is that the system would be taking in money if the woman worked, wouldn't it?

Mr. COHEN. There would be an additional cost to the system of full benefits were made payable to women who work regularly, but a woman who worked would pay contributions.

Representative GRIFFITHS. Of course, she makes a contribution. So you really couldn't have any objection.

Mr. COHEN. No, I don't think——

Representative GRIFFITHS. You are operating on a myth, the whole thing. How many women are drawing under this?

Mr. COHEN. How many women are drawing benefits?

Representative GRIFFITHS. Yes, how many families where the father is deceased? How many families draw?

Mr. COHEN. I don't know that I have it right here, Mrs. Griffiths. Do you want to make an estimate, Mr. Myers?

Mr. MYERS. There are approximately 1 million survivor families, and of those about 700,000 of the mothers are drawing benefits. The other 300,000 are working in full-time employment and are not.

Representative GRIFFITHS. Now how much does it cost the social security system to pay to the mother as long as the children remain in school to 22, what is the cost of that between 18 and 22?

Mr. MYERS. In those cases, there are no benefits for the mother.

Representative GRIFFITHS. The benefits though is paid for the child, but the mother gets that money.

Mr. COHEN. You want to know what the cost for the child is?

Representative GRIFFITHS. What was the cost to the social security system of that?

Mr. MYERS. The cost of that change in the law, which was made in 1965, was 10 percent of the taxable payroll, represents about $300 million a year.

Representative GRIFFITHS. Now one of the problems that you have in the whole system is that once you keep these women home, once they are not permitted to earn beyond a certain amount without losing money, then they arrive in their 50's and you hear from them. We should reduce the age at which women draw social security. They haven't worked throughout the whole time. Why don't you withdraw this penalty against them? They are not getting too much anyhow, and they are not going to earn too much, and they are going to pay into the system, and keep those women working, and stop lowering the age at which people can draw social security.

Mr. COHEN. Certainly if the age were going to be lowered, it would be much more costly than paying young widowed mothers who work.

Representative GRIFFITHS. And they are not going to get enough money anyhow, but they are going to try to live on it and they are going to die from malnutrition diseases.

Mr. COHEN. Is it your point they should receive benefits irrespective of the amount of money——

Representative GRIFFITHS. The $368 that women should receive no matter what she makes. What you are trying to do is to replace the husband's income. What you have never noticed in the Social Security system is that women are now working. If you reduced the amount she could earn, but also looked at the fact that a family works and didn't tax the woman at all, I might go with it. But the only time you are observing that the woman works is when you are reducing the amount you pay her. You aren't saying, "Well, a whole family is paying in and you are never going to get any money out of it." You don't object to her paying the money, but you object to paying her.

This is one of the things that I think would be very helpful, and I would like to ask you this: One of the real problems that you have, even with ADC, is that you aren't training these women; you aren't helping women. We have a whole system set up here that is keeping them from getting jobs. We are penalizing them, just as you are penalizing this woman from getting a job, and as long as the only thing that is available to that woman to get money is to have children, she is probably going to have them.

Mr. COHEN. Might I say on the ADC, Mrs. Griffiths, I think you are quite right. We are recommending a change in the law this year. There has been under this program a policy in the law of not recognizing that when the mother goes out to work she now has to give up her benefits dollar for dollar under AFDC and that acts as a disincentive to work.

We think there should be in effect an exemption or an incentive so that when she goes out to work, she can keep some of that money and raise her standards, so that she not only has work experience, but that her attempt to meet the level of her family is——

Representative GRIFFITHS. How many States refuse to permit a person any money who is drawing welfare?

Mr. COHEN. Quite a number of States, where we permitted disregarding the first $20 of earned income of aged people who work plus one-half of the remainder up to $80. I have a list here of 28 States that have said that they will not implement this for the aged, and 9 in which they have no intention of implementing it. In other words in subtracting these from the 50 States there are only 15 States that even did it for the aged, for which of course there was the greatest political and social interest in doing it.

Even with regard to disregarding income for the disabled, where in a rehabilitation program you want to encourage the disabled to work so they can get back to work, I have a list here of 35 States that have not implemented it.

Then there is one in connection with children for exemption of income of children.

We have a provision that was put in the law a couple of years ago, where a child under age 18 could go out to work, let's say a job on

Saturday or delivering newspapers, and we exempt income up to $50 per child or $150 per family.

I have a list here of 24 States that have indicated that they do not implement this provision.

Representative GRIFFITHS. This is one of the problems. They can't replace that money. My time is up, but I want to ask one more question for you to answer in the record.

What does it cost, what is the administrative cost of welfare? Will you please answer that for the record?

Mr. COHEN. Yes.

(The question and answer, subsequently submitted, follow:)

Question: What is the administrative cost of welfare?

Answer: In fiscal 1966, total costs of administration, services and training for all six categories of welfare totalled $611.5 million, of which $359.2 million was the Federal share.

Administrative costs per casemonth in the fiscal year 1965 were:

Old-age assistance	$5.27
Aid to the blind	8.70
Aid to disabled	9.87
Families with dependent children	21.35

Chairman PROXMIRE. Mr. Rumsfeld?

Representative RUMSFELD. Mr. Cohen, I followed Mrs. Griffiths' line of questioning. I found it persuasive.

I might say that I have received a number of letters from individuals in my constituency who argue the same point, although possibly not as eloquently.

I would be curious to know, Mr. Chairman, whether or not it would be appropriate for Mr. Cohen to give some thought to the questions that Mrs. Griffiths has raised, and possibly report back to this committee at some future point. I appreciate the difficulty of responding to her immediately, and I do not think you did respond in full.

Mr. COHEN. No.

Representative RUMSFELD. And I sense you feel the same way.

Mr. COHEN. I will certainly look into it.

Representative RUMSFELD. I think it is an important and interesting matter.

Chairman PROXMIRE. Yes, indeed. Let me say that I think it would be perfectly proper for Mr. Cohen, in revising his remarks in the record, or in the transcript, to add whatever he would like to add, and I take it he can add something on that point.

Mr. COHEN. May I say to the Congressman, I will be appearing before Mrs. Griffiths in about 3 weeks, before the Ways and Means Committee, and I presume she has given me advance notice that I should be better prepared to answer that question at that time, which I will do.

Representative RUMSFELD. Regardless of where you end up in responding to her, I would be very interested in seeing the reasons and the arguments that you arrive at.

There was a question that was raised in one of our committee hearings earlier this week that has also come to my attention as a result of mail from my constituency. It involves the question of individuals coming into the United States, working for the minmum period to qualify for social security, returning to their native country, and drawing social security benefits.

This practice of course has an effect on our balance of payments. It has, I think, some impact on some of the statistics you have given us here, because you have not drawn any distinctions between payments that end up in this country, and therefore work against the problem which you have outlined so well, and those payments which do not end up in the country, and which therefore would have no effect whatsoever on the problems we are discussing. I would be interested in having factual information as to the total dollars and the number of individuals involved, by country.

Mr. COHEN. Yes.

Representative RUMSFELD. I have had instances where individuals who have themselves come to this country and have written me saying that I should do everything possible to prevent others, by specific names, because, these people wrote me, of the fact that that was their intention, and they did not feel it was fair to this country to have these people come in and then return and simply draw their payments. If you are prepared to give those statistics now, I would be happy to have them. If not, I would like them for the record.

Mr. COHEN. I can put them in the record. I might say, Congressman, that the law, in general, provides that a person must have resided in the United States 10 years, if the payment is to be made outside of the United States, or else there must be a reciprocal treaty or agreement between this country and the other country of which he is a citizen.

I have no doubt that there are some people that came to the United States to become entitled to benefits and returned to their native lands. I think the question is should a person who has worked x or y number of years in this country have the right to have eligibility for social security even if he leaves the country.

Obviously there has to be some minimum period, and Congress made it 10 years. I think it is reasonable. But it may well be that experience shows that there should be some other period of time.

Representative RUMSFELD. I think this is a possibility, that the changing picture on balance of payments might very well indicate to the Congress that some amendments to these provisions might be appropriate.

(The following material, relative to the questioning above, was later supplied by the Department for the record:)

Question: What part of SSA payments go abroad and what effect does this have on the balance of payments, particularly those people who may come into this country, work a minimum length of time, and return to their native country to draw benefits?

Answer: As of June 30, 1966, there were 175,541 beneficiaries living in foreign countries. The total benefits paid to persons living abroad in fiscal year 1966 was $156,598,000, seven-tenths of one percent of all payments in that year. The table below shows the number of beneficiaries in specific countries. A little over one-half (52 percent) of the workers on whose account the claim is being paid are U.S. citizens. A somewhat larger proportion (58 percent) of all *benefits* paid are based on the work of U.S. citizens, whose benefits are higher on the average than those of non-citizens.

Thus in fiscal year 1966 approximately $65,771,000 went to non-citizens abroad. These beneficiaries were either citizens of countries having treaties with the United States or whose social security systems have been found to provide U.S. citizens comparable treatment under the country's social security system, or persons or the dependents of persons who had worked at least ten years in this country or had been in the active military service of the U.S. According to Department of Commerce figures total government payments abroad involving a dollar outflow in 1966 amounted to $5.3 billion. Total SSA payments abroad to non-citizens ($66.7 million) thus represented only 1.2 percent of total U.S. government expenditures abroad that resulted in a dollar outflow.

TABLE 6.—*OASDHI—Benefits in current-payment status for individuals, by country or continent—Monthly amount payable to beneficiaries living abroad, by type of beneficiary, June 30, 1966*

Beneficiary's place of residence [1]	Total	Retired workers [2]	Disabled workers [3]	Wives and husbands [4] of—			Children [5] of—			Widowed mothers [6]	Widows and widowers [7]	Parents [2]
				All workers	Retired workers	Disabled workers	All workers	Retired and deceased workers	Disabled workers			
Total	$12, 107, 235	$7, 843, 848	$322, 149	$1, 012, 491	$983, 665	$28, 826	$963, 959	$910, 214	$53, 745	$265, 738	$1, 644, 082	$54, 968
Africa	68, 038	42, 826	524	7, 254	7, 203	51	8, 967	8, 865	102	1, 522	6, 670	275
Cape Verde Islands	42, 567	26, 754	112	5, 374	5, 323	51	4, 191	4, 089	102	729	5, 330	77
South Africa	9, 601	6, 901	0	948	948	0	868	868	0	139	745	0
Other	15, 870	9, 171	412	932	932	0	3, 908	3, 908	0	654	595	198
Asia	770, 829	513, 079	12, 671	74, 077	72, 499	1, 578	59, 755	56, 303	3, 452	20, 171	89, 444	1, 632
Cyprus	19, 854	13, 470	603	2, 029	1, 924	105	1, 219	1, 026	193	186	2, 291	56
Hong Kong	135, 068	70, 989	562	22, 696	22, 492	204	9, 310	8, 924	386	4, 153	27, 040	318
India	7, 771	4, 936	93	989	943	46	791	745	46	240	657	65
Israel	146, 623	107, 947	4, 589	12, 926	12, 591	335	5, 381	4, 693	688	1, 635	13, 979	166
Japan	313, 069	224, 583	2, 758	23, 653	23, 324	329	20, 361	19, 559	802	8, 362	32, 908	464
Jordan	18, 938	9, 645	1, 308	2, 137	1, 833	304	3, 607	2, 838	769	621	1, 451	169
Lebanon	43, 873	27, 868	916	2, 778	2, 711	67	7, 523	7, 152	371	1, 496	3, 242	50
Macao	18, 726	8, 715	598	2, 107	2, 089	18	632	596	36	229	1, 387	58
Ryukyu Islands	31, 038	20, 173	678	2, 736	2, 627	109	3, 769	3, 632	137	1, 367	2, 088	222
Syrian Arab Republic	7, 788	5, 704	0	449	449	0	704	704	0	156	711	64
Turkey	14, 000	9, 619	0	697	697	0	1, 711	1, 711	0	477	1, 496	0
Other	19, 066	9, 430	566	880	819	61	4, 747	4, 723	24	1, 249	2, 194	0
Canada	1, 625, 374	1, 029, 132	39, 266	122, 038	118, 775	3, 263	158, 661	150, 192	8, 469	38, 441	233, 035	4, 801
Central America and West Indies	219, 739	158, 439	6, 312	11, 273	11, 233	40	17, 602	17, 180	422	4, 192	20, 315	1, 606
Bahamas	13, 261	8, 528	176	918	891	27	1, 604	1, 604	0	323	1, 668	44
Barbados	26, 842	19, 749	877	1, 620	1, 620	0	692	630	62	133	3, 663	108
Bermuda	9, 057	6, 591	0	927	914	13	695	593	102	60	784	0
British Leeward and Windward Islands	28, 623	20, 951	465	2, 101	2, 101	0	1, 176	1, 176	0	175	3, 474	281
Costa Rica	11, 500	7, 463	628	707	707	0	1, 414	1, 414	0	404	792	192
Dominican Republic	11, 012	7, 089	842	300	300	0	1, 483	1, 436	47	284	950	64
Jamaica	68, 930	56, 649	1, 869	2, 675	2, 675	0	2, 149	2, 042	107	542	4, 685	361
Nicaragua	9, 462	5, 543	466	345	345	0	1, 741	1, 741	0	766	534	67
Trinidad and Tobago	11, 895	8, 321	277	382	382	0	1, 139	1, 139	0	130	1, 490	15
Other	29, 157	17, 555	812	1, 298	1, 298	0	5, 509	5, 405	104	1, 375	2, 275	333
Europe	7, 999, 079	5, 428, 577	204, 350	668, 843	652, 393	16, 450	391, 479	367, 074	24, 405	110, 426	1, 176, 035	19, 369
Austria	124, 084	94, 492	3, 301	6, 182	6, 024	158	5, 486	4, 989	497	2, 171	12, 260	192
Belgium	49, 566	32, 507	723	4, 020	4, 020	0	2, 885	2, 728	157	1, 162	8, 168	101
Bulgaria	13, 229	6, 455	0	1, 363	1, 363	0	320	320	0	139	4, 952	0

Denmark	80,438	62,553	1,834	5,011	4,905	106	2,205	2,027	178	521	8,314	0
Finland	57,585	44,200	1,509	2,947	2,820	127	1,003	871	132	275	7,548	103
France	178,002	131,409	4,897	9,782	9,316	466	12,035	10,792	1,243	3,996	15,408	475
Germany (U.S. Zone)	833,763	619,940	26,943	40,076	38,955	1,121	43,230	40,931	2,299	18,460	84,568	1,148
Greece	1,041,041	716,343	19,938	87,170	84,841	2,329	78,755	75,743	3,012	14,482	120,269	4,084
Ireland	309,247	237,835	13,189	13,327	12,617	710	14,431	13,207	1,224	4,279	24,148	2,038
Italy	2,551,699	1,633,781	68,405	278,666	272,433	6,233	91,804	84,066	7,738	25,264	447,873	5,906
Malta	38,723	25,528	2,400	2,258	2,041	217	3,134	2,649	485	1,073	4,274	56
Netherlands	58,761	38,876	839	4,633	4,585	48	5,196	5,100	96	1,588	7,520	109
Norway	331,440	241,918	8,371	27,820	27,121	699	10,626	10,070	556	3,231	39,033	441
Poland	128,881	56,071	2,661	13,691	13,396	295	1,315	1,163	152	123	53,696	1,324
Portugal	303,669	197,003	11,155	34,889	33,759	1,130	15,647	14,002	1,645	3,294	41,487	194
Rumania	9,042	3,140	0	1,297	1,297	0	179	179	0	0	4,382	44
Spain	390,777	280,058	10,254	32,305	31,728	577	16,719	15,498	1,221	3,670	47,032	739
Sweden	338,988	273,458	5,022	20,124	19,958	166	4,923	4,533	390	1,032	34,192	237
Switzerland	140,982	112,609	2,528	7,649	7,501	148	4,428	4,085	343	991	12,415	362
United Kingdom	675,455	447,252	13,575	36,809	35,678	1,131	65,153	62,770	2,383	22,007	89,386	1,273
Yugoslavia	331,859	164,498	7,060	38,315	37,526	789	10,710	10,168	542	2,426	108,366	484
Other	11,848	8,651	348	409	509	0	1,295	1,183	112	242	744	59
Mexico	584,592	266,839	28,209	39,603	36,503	3,100	160,507	152,638	7,869	43,546	35,363	10,525
Oceania	60,661	30,641	1,865	2,784	2,516	268	14,865	14,272	593	4,271	6,095	140
Australia	48,583	24,718	1,661	2,112	1,962	150	11,385	11,067	318	3,180	5,387	140
New Zealand	9,972	4,877	90	558	497	61	2,770	2,552	218	1,030	647	0
Other	2,106	1,046	114	114	57	57	710	653	57	61	61	0
Philippines	656,496	306,272	26,088	79,030	75,330	3,700	127,894	120,356	7,538	38,618	62,796	15,798
South America	103,203	60,698	2,770	7,035	6,659	376	16,426	15,592	834	3,995	11,457	822
Argentina	24,011	15,115	466	1,574	1,509	65	1,706	1,641	65	676	4,332	142
Brazil	23,787	13,075	1,185	1,739	1,580	159	4,197	3,844	353	1,108	2,319	164
Chile	9,973	5,741	226	670	670	0	1,800	1,800	0	460	1,076	0
Colombia	9,549	5,549	562	540	419	121	1,983	1,630	353	232	550	133
Peru	11,912	6,919	237	803	803	0	2,205	2,205	0	752	784	212
Venezuela	11,031	6,156	94	649	618	31	2,533	2,470	63	399	1,200	0
Other	12,940	8,143	0	1,060	1,060	0	2,002	2,002	0	368	1,196	171
U.S. possessions	19,224	7,345	94	554	554	0	7,803	7,742	61	556	2,872	0
Canal Zone	18,673	7,345	94	554	554	0	7,353	7,292	61	521	2,806	0
Other	551	0	0	0	0	0	450	450	0	35	66	0

[1] Based on monthly benefit check address. Data for places with 100 or more beneficiaries shown separately. All benefit payments were being withheld on June 30, 1966, from beneficiaries living in the following countries in which conditions were such that there was no reasonable assurance that the payee would actually receive the check and be able to negotiate it: Albania, China (including Outer Mongolia and Tibet), Cuba, Czechoslovakia, Soviet Zone of Germany, Hungary, North Korea, and the Union of Soviet Socialist Republics (including Estonia, Latvia, and Lithuania).

[2] Aged 62 and over.

[3] Under age 65.

[4] Includes wife beneficiaries under age 65 with entitled children in their care, and divorced wives.

[5] Includes disabled persons aged 18 and over whose disability began before age 18 and entitled full-time students aged 18–21.

[6] Includes surviving divorced mothers with entitled children in their care.

[7] Aged 60 and over for widows and surviving divorced wives, and aged 62 and over for widowers.

Source: U.S. Department of Health, Education, and Welfare, Social Security Administration, Office of Research and Statistics, Division of Statistics, February 1967.

TABLE 7.—*OASDHI—Benefits in current-payment status for individuals, by country or continent—Number payable to beneficiaries living abroad, by type of beneficiary, June 30, 1966*

Beneficiary's place of residence [1]	Total	Retired workers [2]	Disabled workers [3]	Wives and husbands [4] of—			Children [5] of—			Widowed mothers [6]	Widows and widowers [7]	Parents [8]
				All workers	Retired workers	Disabled workers	All workers	Retired and deceased workers	Disabled workers			
Total	175,541	92,433	3,126	25,825	25,051	774	24,477	22,699	1,778	5,066	23,827	787
Africa	1,037	481	5	183	182	1	232	230	2	30	103	3
Cape Verde Islands	665	294	1	137	136	1	133	131	2	16	83	1
South Africa	126	77	0	22	22	0	14	14	0	2	11	0
Other	246	110	4	24	24	0	85	85	0	12	9	2
Asia	11,649	6,294	127	2,020	1,976	44	1,483	1,378	105	333	1,369	23
Cyprus	327	172	6	65	62	3	46	40	6	3	34	1
Hong Kong	2,318	938	7	640	635	5	239	228	11	71	419	4
India	115	59	1	23	22	1	17	16	1	4	10	1
Israel	1,819	1,198	45	278	270	8	87	69	18	20	189	2
Japan	4,567	2,814	28	653	643	10	409	387	22	132	525	6
Jordan	421	126	13	77	68	9	164	138	26	14	24	3
Lebanon	722	321	8	83	81	2	229	218	11	31	49	1
Macao	236	116	6	61	60	1	25	23	2	4	23	1
Ryukyu Islands	537	273	7	84	80	4	111	105	6	24	35	3
Syrian Arab Republic	113	66	0	12	12	0	21	21	0	2	11	1
Turkey	187	101	0	18	18	0	39	39	0	9	20	0
Other	287	110	6	26	25	1	96	94	2	19	30	0
Canada	23,887	12,804	391	3,255	3,148	107	3,340	3,008	332	694	3,343	60
Central America and West Indies	3,013	1,930	65	265	263	2	374	365	9	73	283	23
Bahamas	197	103	2	26	25	1	33	33	0	6	26	1
Barbados	347	233	9	34	34	0	16	14	2	3	50	2
Bermuda	114	72	0	18	17	1	12	10	2	1	11	0
British Leeward and Windward Islands	413	257	5	52	52	0	41	41	0	3	52	3
Costa Rica	167	91	5	17	17	0	33	33	0	8	10	3
Dominican Republic	168	96	10	10	10	0	33	32	1	5	13	1
Jamaica	875	684	19	59	59	0	39	37	2	8	61	5
Nicaragua	152	76	4	10	10	0	40	40	0	13	8	1
Trinidad and Tobago	157	105	3	8	8	0	18	18	0	2	19	2
Other	423	213	8	31	31	0	109	107	2	24	33	5
Europe	107,106	62,402	1,944	16,155	15,779	376	7,858	7,259	599	1,666	16,841	240
Austria	1,524	1,080	31	134	131	3	84	74	10	28	165	2
Belgium	634	372	7	89	89	0	45	41	4	16	104	1
Bulgaria	184	75	0	31	31	0	6	6	0	2	70	0
Denmark	974	701	17	107	105	2	33	30	3	6	110	0

Finland	733	521	14	67	64	3	18	15	3	4	108	1
France	2,262	1,524	47	216	206	10	203	177	26	61	206	5
Germany (U.S. Zone)	10,408	7,172	251	884	851	33	749	687	62	275	1,064	13
Greece	14,744	8,273	198	2,285	2,231	54	1,816	1,741	75	230	1,888	54
Ireland	4,039	2,826	126	335	319	16	316	282	34	67	342	27
Italy	35,606	18,891	660	6,952	6,817	135	1,974	1,789	185	385	6,669	75
Malta	492	278	21	55	50	5	65	53	12	15	57	1
Netherlands	762	463	8	101	100	1	79	77	2	23	97	1
Norway	4,186	2,744	71	614	599	15	176	163	13	43	532	6
Poland	1,755	633	25	294	288	6	28	25	3	2	759	14
Portugal	4,402	2,329	103	919	877	24	413	373	40	54	600	2
Rumania	127	37	0	27	27	0	3	3	0	0	59	1
Spain	5,004	3,074	92	759	747	12	350	322	28	55	665	9
Sweden	4,120	3,083	48	433	429	4	92	83	9	17	444	3
Switzerland	1,685	1,248	23	160	157	3	72	65	7	15	163	4
United Kingdom	8,664	5,161	132	790	758	32	1,074	1,008	66	325	1,167	15
Yugoslavia	4,648	1,828	67	910	892	18	237	222	15	39	1,562	5
Other	153	99	3	11	11	0	25	23	2	4	10	1
Mexico	11,734	3,413	275	1,272	1,171	101	5,121	4,801	320	980	528	145
Oceania	884	354	17	65	57	8	291	269	22	76	79	2
Australia	688	283	15	46	41	5	216	203	13	57	69	2
New Zealand	158	58	1	15	13	2	58	50	8	17	9	0
Other	38	13	1	4	3	1	17	16	1	2	1	0
Philippines	14,465	3,934	276	2,435	2,309	126	5,323	4,959	364	1,135	1,081	281
South America	1,445	720	25	159	150	9	309	285	24	65	157	10
Argentina	316	180	4	35	34	1	25	24	1	10	60	2
Brazil	328	151	11	41	37	4	75	65	10	16	32	2
Chile	130	63	2	13	13	0	30	30	0	8	14	0
Colombia	157	71	5	16	13	3	51	40	11	4	8	2
Peru	148	73	2	16	16	0	34	34	0	11	10	2
Venezuela	175	82	1	15	14	1	53	51	2	8	16	0
Other	191	100	0	23	23	0	41	41	0	8	17	2
U.S. possessions	321	101	1	16	16	0	146	145	1	14	43	0
Canal Zone	303	101	1	16	16	0	131	130	1	12	42	0
Other	18	0	0	0	0	0	15	15	0	2	1	0

1 Based on monthly benefit check address. Data for places with 100 or more beneficiaries shown separately. All benefit payments were being withheld on June 30, 1966, from beneficiaries living in the following countries in which conditions were such that there was no reasonable assurance that the payee would actually receive the check and be able to negotiate it: Albania, China (including Outer Mongolia and Tibet), Cuba, Czechoslovakia, Soviet Zone of Germany, Hungary, North Korea, and the Union of Soviet Socialist Republics (including Estonia, Latvia, and Lithuania).

2 Aged 62 and over.

3 Under age 65.

4 Includes wife beneficiaries under age 65 with entitled children in their care, and divorced wives.

5 Includes disabled persons aged 18 and over whose disability began before age 18 and entitled full-time students aged 18-21.

6 Includes surviving divorced mothers with entitled children in their care.

7 Aged 60 and over for widows and surviving divorced wives, and aged 62 and over for widowers.

Representative RUMSFELD. In your statement you say: "The income deficiency of the poor in 1965 was $11 billion. This is the total amount by which their incomes fell short of the poverty line. Without these programs"—and I am not quite sure what "these programs" means—"the deficiency would have approached $20 billion."

This means, that "these programs" reduced the potential deficiency by $9 billion?

Mr. COHEN. Right.

Representative RUMSFELD. Could you explain what "these programs" are and what their cost was?

Mr. COHEN. The two general programs that I was dealing with was the so-called social security program, and the public assistance or public welfare program.

Representative RUMSFELD. What were their cost?

Mr. COHEN. Their total benefit expenditures at the present time would be in the nature of about $5 billion for public assistance and about $20 billion for the social security program. That is about $25 billion.

Representative RUMSFELD. So an expenditure of $25 billion reduced the deficiency from $20 billion potential to an estimated $11 billion.

Mr. COHEN. Public assistance payments in 1965 were $3.5 billion, 100 percent of which went to the poor. In 1965, social security cash benefits were $18 billion. In the social security program of course, the payments are not made only to the poor. Any person who has contributed and meets the eligibility requirements receives benefits and there are large numbers of middle-income groups who, if they have private pensions and other investment income or if they are still working some or less than full time are not in the poor category.

Representative RUMSFELD. I appreciate that. I would just like to concur with the comments of Mr. Widnall concerning your comment about greater work force participation of beneficiaries who are able to work.

I have had a bill in that would accomplish this for a period of years. It has never received favorable consideration. I am hopeful that we can do something in this area. I think it is very important.

I have a number of questions, but one is quite general, and I will pose it first. You have indicated that the social security income and output of the programs have a stimulating effect on the economy, in your opening remarks, a net stimulating effect.

Certainly the administration's proposal for a tax increase will have a depressing effect.

Let's say they are offset, which I think is not an inaccurate statement. The net result is that with respect to the effect of the economy, they are offset, and yet the other effect is that you will have higher taxes, non-social security, and in addition, you will have higher social security taxes, and there will therefore be a smaller total percent of earnings left to individual wage earners as a result of both of these factors, and therefore Government will be playing a larger role in the expenditure of an individual's total earnings than previously, and yet there is no net effect there on the economy.

Now you made a very fine statement in response to the question concerning a guaranteed income, and you said a number of things that I agree with you on very strongly.

It seems to me that this trend that you have described in your statement works directly against the response you have made I believe, to Senator Talmadge or Senator Javits, about the need for incentives in our system.

The fact is that, in the last analysis, incentive is most important in solving some of these problems, and you suggested that with respect to the hard-core unemployed it isn't just dollars that are going to solve the problem. Are you worried about this? Are you worried about the fact that the net effect of the administration's proposals will tend to work against the things you believe in with respect to incentive?

Mr. COHEN. Well, of course incentive is not easily measured by the usual kinds of tests. It involves psychological as well as economic factors.

As a taxpayer, like everyone else, I don't like to pay higher taxes per se. But with respect to the social security system, as the contributions go up, I think that if you assure the average worker that he is getting a greater degree of protection, the evidence seems to be on the whole that he is willing to pay for a reasonable amount of protection.

Representative RUMSFELD. You don't feel therefore it doesn't have an unfortunate effect on the incentive question because of this compensating factor you mentioned?

Mr. COHEN. I would have to admit that it would have some effect on some people. I could conceive of the problem in lower and intermediate income levels. Quite frankly I don't think it is a disincentive on higher income people.

I see no evidence whatsoever that people with higher incomes and with higher education and with greater opportunities have a disincentive because of higher social security taxes or in most cases higher income tax rates.

But I would have to admit the validity of your question. You have to look all the way down the line and see what the disincentives are to people of less education, less opportunity, and maybe there comes a certain marginal point balancing a lot of other things where there could be a disincentive. In other words, I don't want the social security tax to go so high that it is a disincentive. I don't think we are at the point at the present time.

Representative RUMSFELD. My time is up. I would like to ask one or two questions for the record.

First of all, your statement is interesting. I am a little concerned that it doesn't seem to consider the effect of inflation, increases in the cost of living, as far as impact on the problems you have outlined here to the extent I would be satisfied. I think you have overemphasized one side of the picture and underemphasized the other.

In your statement, in the section called "Expenditures for health, education, and welfare," I would like to have submitted for the record a breakdown as you have done in part for Federal public, State and local public, and private, with the trend say, since 1962, both in actual numbers and as a percentage. I would like to see what the trend of the private contribution in these areas are.

I mention this because I have seen instances in Illinois, where the private sector, the voluntary organizations are pulling out of areas as Government money comes in.

We just had a former member of this administration who is now running one of the great foundations of this country, announce that they were pulling out of many areas because of the Federal Government's involvement in those areas, and I think this is something that needs much more attention than we are giving it.

Mr. COHEN. Yes, sir.

Representative RUMSFELD. Because we are taking it out of one pocket and putting it in another, and we don't solve any problems that way.

Mr. COHEN. I would like to put something in the record in answer to your question, because I think, overall, there is no evidence that the private sector in health, education, or welfare has diminished. As a matter of fact, it has also gone up rather markedly, although the character of the expenditures may have changed.

Mr. RUMSFELD. I want to see it as a percentage.

Mr. COHEN. We will be glad to put it in the record.

Representative RUMSFELD. Thank you, sir.

(The material referred to follows:)

Question: What is the trend in private expenditures for health, education, and welfare?

Answer: Public and private expenditures for health, education, and welfare, fiscal years 1961–62 through 1965–66:

[Dollar amounts in billions]

	1961–62	1962–63	1963–64	1964–65	1965–66	Percent increase, 1962–66
Total public and private [1]	$93.0	$100.0	$108.0	$117.0	$131.0	41
Total public	62.2	66.5	71.1	77.5	87.6	41
Federal funds	30.6	33.0	35.6	38.8	46.8	53
State and local funds	31.6	33.6	35.5	38.7	40.8	29
Total private [1]	32.7	35.2	38.4	42.1	45.9	40

[1] Total adjusted to eliminate duplication resulting from use of cash insurance benefits to purchase medical care and educational services.

Chairman PROXMIRE. Congressman Brock?

Representative BROCK. Let me say first I have enjoyed very much your testimony.

Mr. COHEN. Thank you, Mr. Brock.

Representative BROCK. I appreciate it, Mr. Cohen. You have been clear and concise. I am just particularly interested in the questions asked by Mrs. Griffiths and also Congressman Rumsfeld and others, on this problem relating not only to women but to the aged.

With your limit on income, it seems to me that you do have a disincentive there. I am concerned lest we seem to be telling people when you get to be 62 or 65, why don't you just lay down and die. Don't be productive any more. I don't know—what is the average payment to a social security recipient now?

Mr. COHEN. About $84 a month.

Representative BROCK. That is $1,000 a year, approximately. You are talking of a $1,500 limit on the income. That is a $2,500 gross, if they work, for the average.

You have got half the people that are below the average. They are getting even less. I can't imagine why this administration or the Social Security Administration would want to limit the productivity of an individual. We all age in differing degrees and at different times, and it seems to me that those who want to remain productive in society ought to be encouraged in every way possible to do so. Is there some reason other than what you have said?

Mr. COHEN. Well, I don't know that I could amplify any more on what I have already said. I think it is a matter of degree.

In the recommendation to increase the earnings exemption to $1,680 we recognize the same principle as you. The question is at what point would you not be giving an incentive, because there would be people who would work anyhow and draw their full benefits. You would be taxing younger people to pay for people who would work anyway.

What we are trying to do is find some point on that scale where people are encouraged and given an incentive to work, but we do not necessarily want to pay an annuity to people who would otherwise work and not retire.

Representative BROCK. I am willing to do that, but I question whether we ought to keep that point below the poverty level. We keep talking about $3,000. I am not sure that $3,000 is anywhere near adequate to somebody in New York City, for example.

Mr. COHEN. Yes.

Representative BROCK. It may be in my district, but it certainly in some of the more metropolitan areas is not.

Mr. COHEN. This gets into a problem on the statistics. The actual poverty line for an aged individual 65 and over is $1,500, and for a man and wife, $1,890. The $3,000 figure is where there is a man, wife, and two children.

Representative BROCK. I don't know how many people you know who are trying to live on $1,500 today, with today's cost of living, but it is doggoned hard to eke out a bare existence, and I personally think if we would go somewhere closer to $3,000, it would be a lot better.

Another question, following Mr. Rumsfeld's thought. On these incentives, as I recall, there has always been this magic figure of 10 percent. I think Secretary Ribicoff, when he was Secretary, mentioned the maximum of 10 percent when you reach a point of diminishing returns on the productivity of this program.

You say we haven't reached it, and, of course, we haven't today, but we are programed to go beyond that, and I wonder if you have any concern, because you are proposing a 20-year increase this year. Subsequent Congresses probably will enact further benefits. How high do you think we can go? What is the point where we stop?

Mr. COHEN. I was with Secretary Ribicoff at the time he made that statement before the congressional committee, and after about a year or two of discussions in congressional committee, the 5 percent level was broken—eventually, not immediately—by including medicare. At the present time as you know, the eventual, not current, total employee tax rate would go as high as 5.65 percent, roughly 5⅔ percent.

Representative BROCK. How high will it go for the 20 percent this year?

Mr. COHEN. It will go to 5.8 eventually, not immediately.

Representative BROCK. You are getting close to 12 then overall.

Mr. COHEN. Yes, overall. Now I think you always have to look at that in terms of the distribution of income in the country. I think there is, quite frankly, a limit to the use of the payroll tax as a method of financing social security benefits. There is some point at which it would be a big disincentive.

Representative BROCK. Would you suggest going to general revenues at some point in the future then?

Mr. COHEN. Well, I think it is something that ought to be looked into, but before I would go to extensive general revenue financing, I think that Congress would have to take a very hard look at the role of payroll financing and general revenue financing, in relation to the benefits that are provided, the distribution of income, and what other types of programs it wished to finance in the income maintenance field.

Now if Congress were going to some guaranteed income minimum, some income deficiency program, in my opinion, that would have to be paid out of general revenues. And you would want to examine first the total type of program and its characteristics before you made a decision about using general revenues.

Representative BROCK. I certainly agree. I can ask you one other question.

If you were 21 years old today, would you consider social security a good investment?

Mr. COHEN. I certainly would, for two reasons, sir.

First many people do not realize that social security provides life insurance protection. A young man at 26 or 27 with two or three children gets the equivalent under social security of a $40,000 or $50,000 life insurance policy, which I don't think many young men who are starting in the work force could provide on their own at that time.

Representative BROCK. Did you ever, Mr. Cohen, inquire of any of the insurance companies as to what kind of annuities or insurance program they could furnish for the same amount of money?

Mr. COHEN. Well, you see there is a difficulty of just looking at an annuity. We are providing three types of group insurance in a combined package and that is the point I am trying to make.

Social security is not merely a retirement program. A young person gets $40,000 or $50,000 life insurance protection. The program also provides disability insurance coverage without a medical examination, which is very attractive to the middle-aged person when his family responsibilities are developing. He may have $40,000 to $50,000 disability insurance protection under social security. If he becomes disabled he may be a tremendous burden on his family and his relatives.

Now, of course, if a man lives to 65, and he hasn't died or become disabled that is fine; but you should include the valid cost of the protection he has had over the years.

Representative BROCK. I was interested to inquire of a local insurance company in my hometown. If they provided the protection against disability, the insurance, and the retirement program, all of the advantages that accrue through social security, what would be the premium charge to a 21-year-old, and it was significantly lower than the premium charge, if you want to call it that, for social security tax that that individual pays.

Of course, the obvious difference is that there is as you mentioned earlier, there is this fact that theirs is funded. It is invested.

Mr. COHEN. You are touching on an important point. What they charge you, I am quite sure, is the equivalent of what the employer and the employee contribute.

Representative BROCK. No; I asked for a dollar figure, and I compared it with what the gross figure was, and then what the individual paid.

Mr. COHEN. I would like to see it then, Mr. Brock. I don't think it is correct.

Representative BROCK. I am saying that it was lower than the joint figure. I am not saying it is lower than the individual, but I am saying that somebody has got to pay the joint figure. It is dollars that come out of somebody's pockets. This is hypothetical, and just an interesting philosophical inquiry.

Mr. COHEN. It is so easy to think of the Social Security System as just a retirement system and it is true if a man pays all his life and dies at age 64 and he is not married and he has no children, he has paid a whole lifetime without getting anything back. But that is part of the risk. I pay fire insurance and automobile insurance, and I am glad when I do not have to get anything back on that.

Representative BROCK. All I am trying to point out here, sir, is not any suggestion that we change what we are doing at all; but I am saying that when you start talking about funding this program out of general revenues, you are going to open a Pandora's box, because there is a very distinct choice then that we must, I think, in good faith, offer an individual, if he can acquire an equivalent program at the same cost.

If you are going to fund it out of general revenues, then we have got to give him an alternative, so that he has a right to make his own decision.

Mr. COHEN. Let me just put it this way—general revenue financing opens up a number of questions.

Representative BROCK. Yes, sir.

Mr. COHEN. Of which that is only one of the questions.

Representative BROCK. Thank you very much.

Chairman PROXMIRE. Thank you, Mr. Brock.

I might say that I want to pursue the line which Mr. Brock was pursuing.

It seems to me what is overlooked here is that the man who takes out an insurance policy with a private insurance company doesn't have Congress behind the private insurance company, and 35 years ago what was the maximum payment when the program started?

Mr. COHEN. Under the original act, as I recall, it was $85.

Chairman PROXMIRE. What was the minimum?

Mr. COHEN. Ten dollars.

Chairman PROXMIRE. Minimum monthly payment?

Mr. COHEN. Ten dollars.

Chairman PROXMIRE. Ten dollars a month?

Mr. COHEN. A month.

Chairman PROXMIRE. Of course, he would be stuck with that.

But Congress comes along and doubles it, triples it, and now it is going to be seven times as big as that, so I think it is quite a difference.

Mr. COHEN. You made a most important point, Senator Proxmire, and that is when you take out a private insurance policy under contract, you usually get a fixed number of dollars in return.

Chairman PROXMIRE. That is right.

Mr. COHEN. But under social security, although I don't want to predict what future Congresses will do, you really have what I call a dynamic benefit.

Chairman PROXMIRE. You sure do. I want to come to that, which I think is one of the most fascinating aspects of this. But, first, I just want to add my word to what has been implied, and I would go much further than some of the other members.

I would knock out the limitation on income for social security beneficiaries entirely. It seems to me it goes back to the old theory that we have a scarcity of jobs, and an abundance of labor, that we can't possibly solve our unemployment problem, and I think we are getting into a position now where we are confident we can.

In that kind of a society we want people to work if they want to work. We have two unfortunate immediate impacts.

One is it would increase the cost of the fund, and I think that even though they get revenues from people working, it wouldn't overcome that.

The other part, of course, is that unemployment statistics would go up, but I think those are both minor and superficial, compared to the advantage of getting people to produce as long as they want to.

Now I would like to go back to the question I asked when I finished previously, and you had replied in part. But my question was how do we know to what extent our resource-building resources, in other words, the people who are the instructors, teachers and so forth, are being fully utilized, and what kind of priority system is possible and feasible that we can set up to determine this? These are priorities within the Federal Government.

Mr. COHEN. Within the Federal Government?

Chairman PROXMIRE. Within the Federal Government; recognizing we can order States and private people around.

Mr. COHEN. Yes.

Well, I would say in the Federal Government we are only beginning to do it.

Chairman PROXMIRE. Don't you think we ought to?

Mr. COHEN. Yes, I do.

Chairman PROXMIRE. Isn't this the very heart of growth and development?

Mr. COHEN. Right. Now we have instituted, as you know, in the last couple of years under Assistant Secretary Gorham, a new system of program planning and budgeting, which is an attempt to make a cost effectiveness analysis of our programs. I think this bears partially on the question, because I happen to believe that the training programs have a higher degree of effectiveness than almost any other programs.

Chairman PROXMIRE. Secretary Wirtz said yesterday that in terms of welfare costs, a training program would pay for itself in 2 years. In terms of Federal tax revenues, it would pay for itself in 4 years.

It is just insane under those circumstances for us not to recognize this. Speaking strictly from a conservative fiscal standpoint of minimizing the cost to the taxpayers, let alone the humane elements which are far more important.

Mr. COHEN. I think I would say it is probably more difficult than Secretary Wirtz indicated.

Chairman PROXMIRE. He wasn't saying it would be easy at all. He recognized the very serious problems of getting the instructors in the right place.

Mr. COHEN. Right.

Chairman PROXMIRE. And getting the know-how and so forth. But he said that this from an economic standpoint is the answer.

Mr. COHEN. There is no question about this from a strictly economic point of view. Let me just give you an illustration. If we had the Milwaukee Vocational School in every major metropolitan area of the country, I think that there would be many more of these young people at work.

Chairman PROXMIRE. I agree with you. That is maybe not the No. 1—or maybe it is the No. 1. But the prime asset in Milwaukee is the fact that we have trained manpower. I read this and I don't know if it is true, that we spent something like 17 times as much in Milwaukee on vocational education as they do in Philadelphia. Whether those figures are true or not I don't know.

Mr. COHEN. Of course, the Milwaukee Vocational School is not a 1-year wonder. It has been developing in Milwaukee for 50 years and it has gained community acceptance. The quality of teacher instruction and the relationship with the labor unions and the employers has been excellent.

The unions and the employers are accepting this training. They are taking these graduates. They are helping the school. There are many communities in this country that are so far away from what is being done in Milwaukee. I think that there is a lot of other training that could be done. For example, Mr. Scheuer's whole thrust in getting us to train people for a whole host of what I call relatively unskilled jobs, is relatively untapped in this country.

Chairman PROXMIRE. How about the possibilities of developing a priority system? Can this be done? I left off at the end of my questioning before when I had finished my 10 minutes, with a reference to the space program, for example.

Well, that may not be very relevant, but I know the Federal Government is getting more, and more, and more, educational programs and getting to have a greater and greater influence on education, and I think we have to be very careful about leaving the States and localities with as much discretion as possible. But at the same time it would seem that even an announcement of an indication of where the priorities would be, that that would be most helpful.

Mr. COHEN. Yes, I think you are right. I don't know whether this would help, but I would say Mr. Scheuer's amendments to the Economic Opportunity Act, if proved successful, as I think they have been, should indicate that more money ought to be invested in the OEO program for training people in these very marginal areas.

I think also the instructors can come from the same area as the trainees. We are not talking about Ph. D. training now. We are not talking about electronics. We are not taking about plastics. I am talking about training people who can perform unskilled work in State hospitals; the people who will take care of the linens and the food distribution in hospitals, about unskilled staff who can work in nursing homes, about all sorts of aids in the educational process; for example, in the Headstart program.

I don't think we have to elevate this so high that it would take 5 years to accomplish. I think that you can train people for a whole host of jobs that are going begging at the present time, and I think, as Secretary Wirtz said, it would be a good investment. Some of them would come off the welfare rolls, maybe not all of them, but many of them could.

Chairman PROXMIRE. Now I want to ask you about something else. This is from what I think is a very delightful column by Paul Samuelson, you may have read it, on social security in the current issue of Newsweek. I would like to read three short paragraphs because I think that they pose a most interesting problem that has been raised here but do it, I think, in a very dramatic way:

> The beauty about social insurance is that it is actuarially unsound. Everyone who reaches retirement age is given benefit privileges that far exceed anything he has paid in and exceed his payments by more than 10 times as much or five times counting employer-employee payments. How is this possible?
>
> It stems from the fact that the national product is growing at compound interest and can be expected to do for as far ahead as the eye can not see. Always there are more youths than old folks in a growing population. More important, with real incomes growing at some 3 percent per year, the taxable base upon which benefits rest in any period are much greater than the taxes paid historically by the generation now retired. And social security unlike actuarial funded insurances is untouched by inflation.
>
> After Germany's terrible 1923 inflation, private insurance was wiped out but social insurance started all over as if nothing had happened. Social security is squarely based on what has been called the eighth wonder of the world. compound interest. A growing nation is the greatest Ponzi game ever contrived, and that is a fact. not a paradox.

Now the question is are you presiding over "the greatest Ponzi game ever contrived," and isn't this ponzi game possibly based not only on Samuelson's most optimistic assumptions about a continuously growing economy, and this is the kind of talk we got in 1929 you know, and we do live, as you say, in a capitalistic system.

What happens under these circumstances with only 1 year's reserve funds, if we suffer a cyclical, a serious cyclical setback and suffer a serious recession?

Mr. COHEN. Well, first, let me say I would rather feel that I was presiding over the eighth wonder of the world than over a ponzi game, and I do think that there are some really miraculous principles involved in social security.

Chairman PROXMIRE. You see all this is based on the assumption that you are always going to grow.

Mr. COHEN. Yes.

Chairman PROXMIRE. You are always going to move ahead.

Mr. COHEN. There is a built-in conservative influence in the actuary's estimate because he assumes a level wage in his actuarial estimates. He does not assume a constantly increasing wage based on an increasing gross national product. So that is part of the reason why periodically in the reevaluation of the actuarial estimates, you can improve benefits. If wages do go up, you get more income into the system, which can be used in benefit payments. Mr. Myers, for I think all of these 30 or 35 years, has always used a level wage.

Chairman PROXMIRE. The increased base will go up.

Mr. COHEN. Yes, and I think as that base goes up and as earnings go up and you get more income into the system you can somewhat improve the system. But I do feel that the social security system basically is a method by which at any given moment, society, through Congress, can decide how to distribute part of the gross national product.

I don't want to be overoptimistic, but as you said earlier, I think you can get a better deal out of the dynamic adjustment of social security than you do from a fixed contract from a private insurance company.

Chairman PROXMIRE. You indicated earlier you were very concerned, may be I don't use the right adjectives but you were somewhat concerned about the size of the reserve fund. You would feel better at least if it were bigger rather than as small as it now is.

Mr. COHEN. I think 2 or possibly 3 years of benefit payments would be more protective to the system.

Chairman PROXMIRE. That would be a lot bigger than it is now. It is only 1 year.

Mr. COHEN. It is only 1 year at the present time.

Chairman PROXMIRE. What is it, $23 billion? It should be $46 billion?

Mr. COHEN. About $45 or $50 billion would be 2 years.

Chairman PROXMIRE. I suggest what we should do as soon as possible, maybe we should instead of waiting until January 1, strictly from this standpoint, disregarding the economic problems, and I want to come back to that right away, but maybe what we should do is impose a social security tax increase July 1.

Mr. COHEN. Well, it is very difficult to do.

Chairman PROXMIRE. Particularly we might do that if we decide not to go ahead with the surtax.

Mr. COHEN. The problem of changing the social security tax in the middle of the year becomes very, very complicated for employers.

Chairman PROXMIRE. They need that much time?

Mr. COHEN. It isn't a matter of time.

Chairman PROXMIRE. They start at the first of the year.

Mr. COHEN. They start at the first of the year and by April or May, they have already collected the full tax on the wage base of $6,600 from high-income employees. If you levy the new tax, would the employer start all over? There are some complications. But it is not easy to levy a new tax in the middle of the year.

Chairman PROXMIRE. Rather than bite into this little surplus, it would seem to me it would be better for us to maybe impose a slightly higher tax than has been proposed until we build up the reserve to this 2- or 3-year level.

Mr. COHEN. Of course, it doesn't——

Chairman PROXMIRE. We can make other economic adjustments.

Mr. COHEN. Yes.

Chairman PROXMIRE. As far as economics, by not increasing the surtax, or by tax reductions.

Mr. COHEN. The amounts are all significant, but, of course, the difference for the last half of the year is in the nature of $2 billion.

Chairman PROXMIRE. If you are going to build up a $50 billion reserve, instead of a $23 billion reserve, and do it in a reasonable time, you would have to have a fairly substantial tax increase.

Mr. COHEN. Yes, you would. I don't know how rapidly it would be possible to do that.

Chairman PROXMIRE. And certainly under this system it would be a wise thing to do. You want to do it now, not in a period when the economy is moving downward.

Mr. COHEN. No, and of course, you wouldn't want to build it up so fast. You probably wouldn't want to build it up more than a couple billion dollar a year.

Chairman PROXMIRE. No. That would be 25 years.

Mr. COHEN. It would take some time to do it.

Chairman PROXMIRE. Fifteen years.

Mr. COHEN. Yes.

Chairman PROXMIRE. Let me just ask a couple of questions before I yield to Congressman Scheuer. These will be brief.

Why not tie the social security benefits to the cost of living?

Mr. COHEN. That is a very intriguing suggestion that has many pros and cons. I think on the pro side, individuals would feel a sense of assurance or security to know that if the price level went up, they would get the increased benefits. Congress, as you know, has adopted cost-of-living adjustment for military and civil service retirement benefits, and I think Federal workmen's compensation. The argument on the other side I think is twofold.

One question that arises is that if Congress did make the change, would there be a tendency to preclude periodic reexamination of the benefit level?

Chairman PROXMIRE. I would doubt it. Knowing how popular this is and how receptive and responsive we are to what our constituents are interested in, the way these things go, they are almost unanimous.

Mr. COHEN. There is another point that Member of Congress have made to me. They say: "We prefer not to put the increase in benefits in the hands of the bureaucrats. Congress is here every 2 years."

Chairman PROXMIRE. We like to do it every 2 years.

Mr. COHEN. Members of Congress say: "We like to do it every 2 years or so and we prefer to do it rather than have some automatic adjustment."

Another factor is the problem of an incentive for inflation. An inflation proof benefit makes a person, you might say, perfectly willing to accept inflation. If 23 million beneficiaries believe: "Inflation doesn't make any real difference to me because my social security benefit will be increased," will they become less opposed to inflationary pressures? Congress has provided automatic adjustment provisions in several small systems, as I mentioned. But what would be the effect if you did it as a general matter of policy, affecting 20 or 25 million?

Chairman PROXMIRE. The last question I have is the percentage that are pulled into—I don't know if you can give this, make a rough estimate—pulled into the poverty class for each 5-percent increase in the cost of living? You have told us how to get people out of the poverty class by an $11 billion investment. Do you have any notion at all, or is there anyway we can compute how inflation pulls people into the poverty class by diminishing the value of their income?

Mr. COHEN. You have to make a static assumption there that the cost of living goes up but their earnings do not go up.

Chairman PROXMIRE. That is correct. I am talking particularly about people who are on fixed income.

Mr. COHEN. We will try to make an estimate of that for you.

(The information referred to, subsequently filed for the record follows:)

Question: What is the percentage that are pulled into the poverty class for each five percent increase in the cost of living?

Answer: The SSA poverty index has been adjusted year by year to reflect changes in the cost of living. More precisely, the estimated food costs at the poverty level have been increased in proportion to rises in the per capita cost of the U.S. Department of Agriculture economy food plan.

From available data, it is clear that as the state of the economy has improved, those groups who could take advantage of increased earnings opportunities have declined as a proportion of the total poor. For them the effect of price rises has been more than offset by increased employment and higher earnings levels. It is the groups on fixed incomes—primarily the retired aged, and families headed by women who cannot work—who have been most seriously disadvantaged by price increases, although social security benefit increases resulting from the 1965 amendments helped some of them.

The SSA is looking into the possibility of developing some rough estimates of the proportion of aged retired persons in fixed incomes who would fall below a poverty line 5 percent higher than that used for 1965. We do not have these estimates at this time. It should be noted that, since food prices may not rise as fast as the total consumer price index, the poverty line may not—presumably will not—rise as much as the "cost of living" in any given period.

Chairman PROXMIRE. Congressman Scheuer?

Representative SCHEUER. I am very grateful to the chairman for his kindness and consideration in letting me ask you some questions, Mr. Cohen.

Chairman PROXMIRE. Let me tell you, Congressman Scheuer, judging by the questions you ask, we are mighty happy to hear them. I think we ought to make you an honorary member.

Representative SCHEUER. I accept. I had a small taste of being honorary chairman for a few seconds. The chairman is very generous indeed, and I am grateful.

Mr. Secretary, I enjoyed your always stimulating and brilliant testimony very much. I recall in your testimony you referred to the fact that administration proposals for additional funds for the elementary and secondary educational program will help us reach an additional million culturally deprived children.

Can you tell us what the total constituency is of culturally deprived children in the elementary and secondary years?

Mr. COHEN. Do you mean sort of conceptually or numerically?

Representative SCHEUER. How many culturally deprived kids do we have in this country?

Mr. COHEN. Oh, how many do we have?

Representative SCHEUER. Very roughly.

Mr. COHEN. I would start with the 14 million children who live in families below the poverty level. I would say some of them are not culturally deprived, and some of those with incomes over that are. My target figure would be in the nature of 10 to 15 million children.

Representative SCHEUER. That seems reasonable. How many of them are we reaching now, impacting in some way?

Mr. COHEN. Last year under the Elementary and Secondary Act there were 7 million children who benefited in some way under title I.

So, roughly, you might say we are reaching somewhere between a half to 70 percent of the total.

Representative SCHEUER. That is certainly a very respectable total if the impact were a real one and a meaningful one and not a trivial one.

On the question of Headstart, we had about 187,000 kids involved in the fiscal 1967 Headstart program. They now have applications, actual registration forms, for 400,000 kids, and we have a constituency there of about 2.5 billion kids. How many kids in the preschool area, where from the evidence that we have adduced we seem to have hit real paydirt in helping those kids begin to make a go of their school situation, how many kids will be impacted by your Headstart proposal this year?

Mr. COHEN. I think, and you correct me if I am wrong, that your committee put $350 million into the Headstart program last year, and I think the President's recommendations this year involve substantially the same amount, but giving a greater degree of priority to the children in the year-round program, rather than the summer programs.

Representative SCHEUER. That is right; 187,000 in fiscal 1967 were year around.

Mr. COHEN. Yes. So, that while there is no appreciable increase of money, the experience has demonstrated so well that the large number—500,000 who were in the summer program—could benefit from a year-around program.

Representative SCHEUER. Yes; there was a large number.

Mr. COHEN. The administration would like to start the year-round program. The President has included in the OEO budget $135 million for the followthrough to start in the first three grades. Actually, there isn't going to be any net expansion in the Headstart program, but the real expansion comes in the continuity of Headstart—starting with the first grade and then going on. I think the idea is rather than putting more money into Headstart at the present time, we should see how much we really can justify as a bona fide expenditure by following through and retaining the advantages that occurred between the ages of three and five up through the ages six to nine.

I think the philosophy behind this recommendation is that if we can demonstrate that the idea of Headstart is correct, although we can't yet, but I think it probably was the belief of your committee in the House and the administration that that is correct, then we ought to follow through in successive years with a great deal more money in the whole Headstart program and title I of the Elementary and Secondary Education Act.

Representative SCHEUER. This really gets to my question. I think you are a thousand percent correct in not only the validity of the Headstart approach, but also of the absolute indispensibility of following through with Headstart kids when they get to the public school system. I am sure you are familiar with the Max Wolfe study.

Mr. COHEN. Yes.

Representative SCHEUER. Where the public school system isn't doing the job, the Headstart kids who are doing very well, not only don't do very well in school but they actually go to the bottom of the class.

Mr. COHEN. Yes.

Representative SCHEUER. It is a very disillusioning experience.

Mr. COHEN. I think we need some more studies like the Wolfe study.

Representative SCHEUER. Yes.

Mr. COHEN. We need them either to confirm or replicate or diversify our experience. If what the Wolfe study shows is correct and if Congress believes that it is so, I would hope that then in the next 5 years Congress will put much more money into title I for this purpose.

Representative SCHEUER. My question would be this: Don't we know enough to know that we could invest far more resources in this continuum of Headstart and followthrough? Isn't there enough evidence that this does make a qualitative difference in the way the kids catch on in school, and if we consider that the billion dollars that we spent on title I was, in itself, only perhaps a 2- or 3-percent increase in the elementary and secondary school budget, the $135 million that we are talking about for followthrough for the first couple of grades is really trivial in scope. Why aren't we doing a better and a bigger job?

Mr. COHEN. I think there is another factor though, Congressman Scheuer, that enters in. The Coleman study on the equal opportunity, and other studies I have seen, indicate to me that there is one other factor, and that is the home environment. The President's message, which he sent to Congress today, stresses the child and parent centers. I think that it is also important in Headstart, or followthrough programs to add a component for reaching the parents so that whatever this element, let's call it motivation for the sake of another word, that is put into both the child is also put into the parent. Educational attainment, work incentives, improvement, followthrough in the family, the child, and the community should all interlock.

Representative SCHEUER. I couldn't agree more. I think one of the things the Headstart program proved to the school system was the absolute necessity of parent attitude, involving the parents. The President's program that is coming up today is really an elaboration of the experience we learned in Headstart.

Mr. COHEN. It is.

Representative SCHEUER. My question is: taking the President's program that is coming up today, and Headstart, and followthrough as a continuum, why aren't we now devoting vastly greater resources to this program? And I will take the suggestion of Senator Proxmire as indicative of the kind of point I would like to make, where he quoted Secretary Wirtz yesterday as saying that when we invest resources in the most difficult single minority of our population, the long-term, hard-core structurally unemployed, we get it back in 2 years in welfare savings, and we get it back again, double our money, so to speak, in the first 4 years when these people are on a taxpaying status.

Now, if you can apply this kind of a cost-benefit payout of such spectacular success with the most difficult single group in our population, why can't we apply the same kind of cost-benefit analysis to the expenditures of the early years before the trouble really gets to be deeply rooted, when I think we all agree that a dollar saved now will save $10 or $20 later on in juvenile delinquency costs and in the costs of very expensive programs like Job Corps, when these kids get together high school dropouts and functional illiterates in 8th grade. Don't we know enough about the cost-benefit implications of these expenditures early in the child's life to feel that on an actuarial basis, from the point of fiscal and economic policy, as Senator Proxmire pointed out, we ought to be putting vastly more resources into this continuum now?

Mr. COHEN. Although mathematical proof of it is not always down on paper to say that we know enough, I happen to believe that it is true, and as I read the material that comes across my desk, it convinces me that what I believed previously is true.

But I do think that we have to develop more concrete evidence through what I call longitudinal studies that follow the family for 15 or 20 years, to show how these increased investments in the educational system really pay off. I think they will pay off, and I agree with you the $100 million more spent between ages three and seven has a very good payoff.

Representative SCHEUER. You wouldn't advocate that we wait until the Headstart kids from last summer graduate from graduate school to decide whether the Headstart program last summer paid off.

Mr. COHEN. No. I would prefer to operate on my biases and prejudices than wait for that statistical information to come in.

Representative SCHEUER. Good. I hope this will be translated into programmatic requests from the Congress. Just one last question, because I know the hour is getting late.

We have had two reports from the National Advisory Council on title I, two reports that I consider the most sensitive and compassionate and brilliant pieces of "governmentalese," if I may say that, that I have ever seen. They were really of the highest quality of excellence. We know how title I is functioning. We know the deficiencies, we know the pluses and the successes too. We have heard a great deal of discussion in recent months of doing away with the grant-in-aid program, doing away with the tax-sharing—the Heller program—we have heard of. Based on the successes and the failures of the title I program, which did operate through the States, what is your reaction as to whether we should continue the grant-in-aid programs with the Federal guidelines and the criteria and so forth, and some Federal presence, or do you think we can afford to wipe the slate clean and proceed with the States and the cities in these vast educational programs which we hope will be upcoming pretty soon, on a general tax sharing formula?

Mr. COHEN. Well, I have to again admit to a prejudice in answering that question. I personally favor very strongly what I call categorical programs as you might say, contrasted to something like the Heller-Pechman plan, and I favor categorical programs, because I think what they do is they establish a national priority determined by Congress as to what it thinks is important.

I am perfectly willing to admit that Congress can in its wisdom make a mistake, and be either too narrow or too limited, but I think on the whole, deciding you want to eliminate air pollution and rifling in on that objective by merging all your available resources to attack it for a period of time is certainly a reasonable decision on the part of Congress. Or trying to deal with disadvantaged children, or Headstart, or whatever else you want to deal with in the same way, because it expresses the national interest and it rationalizes resources, and it directs public attention to the problem.

It helps people train, knowing that a program exists, to get jobs, to have an opportunity to be employed, and thus be of service.

However, on the other side now, quite frequently we have established categorical programs, and then after we have attained a large part of our objective, we tend sometimes to keep the program from responding to changing emphasis or priorities. I don't think that because we have established a program at a particular time it ought to remain the same program forever. You might be able to modify or merge it.

Now taking your point, I think that maybe 10 years from now or 8 years from now, title I, Headstart, followthrough, maybe some other education titles, might be enveloped in a broader educational category.

Representative SCHEUER. We certainly hope they will be embraced by the public education system itself, don't we?

Mr. COHEN. Now that is part of the problem. You see, you have touched on it. The fact of the matter is we have had such notable weaknesses in many local educational boards and agencies throughout the country that Congress really said "Gee, we can't afford to allow some people to decide not to do these things for our children. We are going to make the categorical grant very attractive." And they did, title I is a 100 percent Federal grant if the community has a maintenance of effort provision for dealing with disadvantaged children. Well, I guess there are 17,000 school districts now participating in title I, and that is what Congress wanted. I would be the last to say that Congress exercised an unwise judgment in making that decision. But if after 5 or 8 or 10 years and you have attained 70 percent of your objective, you might then add some other elements and make a broader category. I think that it is perfectly reasonable for Congress to do this.

I think you can undertake the Heller-Pechman plan in addition to some of these things, but I strongly would not like to see categorical programs that are meeting the national interest, and those aimed at national interests not yet attained, eliminated. I might say this for Senator Proxmire—the lesson I learned at the University of Wisconsin under my professors who were most concerned about retaining a Federal-State-local system was that the categorical grants allowed you to attain a national objective with a decentralized method of administration. In our creative Federal system, you can meet national needs with Congress acting as the board of directors. I think experience, despite all the trials and errors and difficulties, has shown in these last 30 years that a lot has been accomplished.

Representative SCHEUER. I thank you.

Chairman PROXMIRE. Thank you again, Mr. Scheuer, for your fine questions.

I want to thank Mr. Myers and Mrs. Merriam as well as Secretary Cohen, and I can tell you, Mr. Secretary, that Wisconsin and Milwaukee are mighty proud of you and I think they are very proud of your performance this morning, which has been excellent, responsive, and thoughtful and very welcome.

The committee will reconvene tomorrow morning at 10 o'clock to hear the noncontroversial Chairman of the Federal Reserve Board, Mr. Martin. Thank you.

(Whereupon, at 1 p.m., the committee adjourned until Thursday, February 9, 1967 at 10 a.m.)

THE 1967 ECONOMIC REPORT OF THE PRESIDENT

THURSDAY, FEBRUARY 9, 1967

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

The joint committee met at 10:05 a.m., pursuant to recess, in room S-228, the Capitol, Hon. William Proxmire (chairman of the joint committee) presiding.

Present: Senators Proxmire, Talmadge, Symington, Miller, and Javits; and Representatives Bolling, Reuss, Griffiths, Moorhead, Curtis, Widnall, Rumsfeld, and Brock.

Also present: John R. Stark, executive director, James W. Knowles, director of research, and Donald A. Webster, minority economist.

Chairman PROXMIRE. The committee will come to order.

Our witness this morning is the very able Chairman of the Federal Reserve Board, who is an old friend of the committee and a man who has been sitting on the hottest economic policy seat in Government for the last year or so.

You are welcome here this morning, Chairman Martin. Go right ahead.

STATEMENT OF HON. WILLIAM McCHESNEY MARTIN, JR., CHAIRMAN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM; ACCOMPANIED BY DANIEL H. BRILL, SENIOR ADVISER TO THE BOARD AND DIRECTOR, DIVISION OF RESEARCH AND STATISTICS; AND ROBERT SOLOMON, ADVISER TO THE BOARD AND DIRECTOR, DIVISION OF INTERNATIONAL FINANCE

Mr. MARTIN. Senator, may I start by congratulating you in assuming the chairmanship of the Joint Economic Committee, and assure you that the Federal Reserve System wants to do everything in its power to help the committee in pursuing its work.

Chairman PROXMIRE. Thank you very much.

Mr. MARTIN. Monetary policy is unique among the economic tools available to Government in the promptness and flexibility with which it can be adapted to changing economic circumstances. This capacity for prompt, flexible adaptation has been essential over the past year and a half—and it has been amply demonstrated. Within this short period, monetary policy had first to play a major role in moderating an excessively rapid expansion that was generating strong upward price pressures. And when—within the year—the pace of expansion was brought into better balance with the growth in resources, financial restraint was relaxed and policy turned promptly toward encouraging increased flows of money and credit.

The timing of changes in policy, as well as the degree to which policies of restraint or ease may be carried, are necessarily matters of judgment. There is still much to be learned about economic stabilization policies, both fiscal and monetary, in a high employment environment.

Nevertheless, the difficulties encountered should not be allowed to obscure the rapid and favorable response of the economy to changes in the direction of monetary policy. For example, since indications of abating inflationary pressures last fall made it possible for monetary policy to be redirected toward ease, interest rates have come down swiftly, with some rates already below their levels of a year ago; bank credit has expanded at a vigorous rate; inflows of savings to thrift institutions have picked up very substantially; the housing outlook has brightened considerably; and resumption of more orderly and balanced economic growth is in prospect. The experience of the past year and a half should serve as a warning against underestimating the resilience or responsiveness of the U.S. economy.

Nor should we overlook the substantial gains recorded by the economy last year, despite our valid concerns for those sectors of the economy that did not share fully in the advance. The year 1966 was one of considerable economic achievement. Our gross national product rose by 5½ percent in real terms, well above the long-term growth trend. More than 3 million workers were added to the Nation's payrolls, and the capacity of our factories grew by almost 7 percent. Moreover, for the first time in over a decade, the United States was able to achieve substantially full utilization of its growing resources. Unemployment fell below 4 percent, the lowest level since 1953. And unutilized industrial capacity declined to the lowest level since 1955. This was an impressive performance, one in which we all can take some satisfaction.

But the record was not unblemished. Indeed, in pushing forward under forced draft, some serious strains and distortions emerged in the structure of production, finance, and our balance of payments—flaws, which if not corrected, could seriously hamper our ability to sustain rapid economic progress. Let me touch on the most important of these, for there are lessons to be learned by policymakers in all branches of Government from the failures as well as the successes of economic policy.

First, as we approached full utilization of resources, demand pressures manifested themselves in a strong and pervasive rise in costs and prices. In an economy where many wage contracts are geared to cost-of-living changes, yesterday's price increases become tomorrow's cost pressures. It may prove difficult to avoid, in 1967, some reflection in costs and prices of the failure to restrain adequately the inflationary pressures of 1966.

Second, the excessively rapid pace at which domestic demands grew meant that they could not be satisfied from domestic sources alone. Our imports of materials and finished goods—particularly capital goods—surged. And although U.S. exports continued to rise somewhat faster than their long-term uptrend, our favorable net balance on international trade was seriously reduced—by almost one-fourth.

Third, rapidly rising demands by Government for defense needs and by business for capital investment programs preempted a large share of our physical and financial resources. Homebuilding was elbowed to the rear of the line; residential construction activity was reduced far below the levels needed to meet our long-term housing needs.

No country can long sustain economic progress if wages and prices keep leapfrogging each other, if it continues to lose ground in international commerce, or if it permits serious imbalance in the composition of output. The task of stabilization policy last year was to strike at the root cause of these distortions and imbalances—an overrapid pace of expansion of aggregate demand.

The need for moderating expansion became evident even before 1966 began, as acceleration in defense outlays was added to the stimulus to private spending provided by earlier monetary expansion and the tax reductions of 1964 and early 1965. In the final months of 1965, economic activity spurted—but so did prices. The rate of increase in the GNP deflator—which measures the extent to which the dollar growth in GNP is a result of rising prices rather than rising output—doubled in the fourth quarter of 1965.

Moreover, increasing evidence was becoming available to suggest that demand pressures would intensify further. Restraint was needed and needed promptly. As the current report of the President's economic advisers puts it, "All in all, the economy exceeded reasonable speed limits in the period from mid-1965 through the first quarter of 1966."

In response to intensification of inflationary pressures, Federal Reserve policy moved toward greater restraint. This was signaled by the announcement in December of an increase in the discount rate from 4 to 4½ percent. To prevent an abrupt constriction in the flow of credit, the maximum rate banks could pay for time deposits was raised, and reserves were provided generously through open market operations over the subsequent year-end period, weeks usually marked by turbulence and crosscurrents in financial markets.

Net reserve availability was reduced gradually in early 1966, and increasingly, banks were forced to turn to the discount window to obtain additional reserves. Their borrowings from the Federal Reserve rose from an average of about $400 million in January to about $700 million by June.

At certain critical times, however, such as around the March-April tax period and again around the midyear tax period, nonborrowed reserves were supplied to banks in substantial volume to help moderate the temporary but intense money market pressures being generated by enlarged corporate needs for funds to meet accelerated taxpayments. With business loan demand strong, failure to provide additional reserves to banks at these times would have prompted more rapid liquidation of bank holdings of securities; the consequent rise in interest rates would have accelerated the outflow of funds from thrift institutions to financial markets. It would also have prompted even more widespread and aggressive efforts by banks to attract consumer savings into time deposits. Such efforts would have intensified the developing shortage of mortgage money at a time when financial supervisory agencies lacked the flexible authority—granted by Con-

75-314—67—pt. 2——11

gress later in the year—to limit excessive competition for savings funds.

Nevertheless, in the absence of greater fiscal restraint, the basic economic situation continued to oblige the Federal Reserve to maintain an overall posture of monetary restraint. Prices were continuing to rise rapidly; in the second quarter of the year, the GNP price deflator increased at over a 4-percent annual rate. Successive surveys of business plans for capital spending indicated that the exceptionally strong advance in business captal outlays was likely to continue. Pressures on financial markets mounted as businesses sought credit at banks and in capital markets to finance current needs and prospective capital spending programs, and enlargement of the Federal Government's financing requirements added to these pressures.

To limit expansion of bank credit and moderate bank competition for savings, the Federal Reserve raised reserve requirements against time deposits in June and again in August, and reduced the maximum rates banks could pay on certain maturities of time deposits. Commercial banks found it increasingly difficult to compete effectively for large blocks of corporate liquid funds, as market rates on competitive instruments rose to—and subsequently above—the ceiling rates on large denomination certificates of deposit.

Some banks with branches abroad were able to compensate, in part, for reduced availability of domestic sources of loanable funds by borrowing through their branches in the Eurodollar market. This absorbed dollars that might otherwise have flowed to foreign monetary authorities, and as a result, the U.S. balance of payments on an official settlements basis moved into substantial, though temporary, surplus in summer.

But not many banks had direct access to foreign sources of funds. The Federal Reserve's general policy of restraint on domestic credit expansion, as well as its specific attempts to diffuse the impact of restraint, were evidenced in a declining share of total credit flows passing through commercial banks. By the third quarter of 1966, commercial banks were able to supply only 7 percent of the funds raised by consumers, corporations, and governments, down from about 25 percent of the total in the first half of the year, and over 40 percent of the total in all of 1965.

Viewing credit flows in broader perspective, all financial intermediaries—banks as well as thirft institutions—were falling behind in the competition for savings flows; investors preferred the higher yields available through direct investment in market securities. Consumers as a group, for example, allocated over one-fourth of their net financial savings flows last year to direct purchases of securities, compared with the less than 3 percent invested directed, on average, from 1961 to 1965. Corporations, too, diverted funds to market instruments, and drew down their holdings of negotiable certificates of deposit and other cash assets as external financing became more costly and less easily obtainable.

The diversion of savings flows away from financial intermediaries severely limited the availability of funds to those borrowers most dependent on institutional sources of financing. Particularly affected were builders and home buyers, since ordinarily the great bulk of the financing of construction and purchase of homes in the United States is supplied through financial institutions.

Institutions specializing in mortgage finance, by and large, did not possess the financial resources or flexibility to cope with large and sudden shifts in savings flows and still maintain a flow of commitments and funds into the housing industry. The bulk of the liabilities of savings and loan associations and mutual savings banks are payable on short notice, while the bulk of their assets are of fixed yield, and turn over slowly. These institutions have been relatively slow in developing a structure of liabilities which would permit them to offer higher returns in order to immobilize, for fixed periods, the most highly interest-sensitive funds. Moreover, only a limited volume of loanable funds could be obtained from liquidating assets or borrowing from the Federal home loan banks to supplement diminished savings inflows.

Rigidities in our financial system, therefore, helped focus on home-builders and home buyers much of the initial impact of the financial restraint needed to curb inflationary credit flows. But as the year progressed, flows of credit to other borrowing sectors became more limited. State and local government borrowing began to be curtailed as large commercial banks, previously very active buyers of municipal securities, reduced their purchases to husband available funds. Consumer credit lenders, finding funds more expensive to acquire, began screening out some marginal borrowers. Credit extended to foreign borrowers by American lending institutions was sharply curtailed, even below the limits established in the voluntary foreign credit restraint program. Even domestic business firms, which previously had been most successful in increasing their external financing, were experiencing constraints on their borrowing ability, particularly at banks.

In addition to the earlier Board actions aimed at limiting the diversion of funds from the mortgage market, the presidents of Federal Reserve banks addressed a letter on September 1 to member banks urging moderation in business loan expansion in the interest of achieving a more balanced economic and credit expansion. The letter assured System members that banks losing deposits and adjusting their positions through curtailment of loan commitments would be able to obtain accommodation through the discount facilities of the Federal Reserve for longer periods than would be required if adjustments to deposit losses were to be accomplished through disposition of securities. The longer lived availability of Federal Reserve discount credit would thus permit member banks to adjust to deposit losses without adding to the pressures on construction finance or on markets for State and local government securities.

A similar kind of contingency planning had earlier been introduced with respect to nonbank thrift institutions and commercial banks not members of the Federal Reserve System. Some of these institutions have only limited access to public sources of emergency credit. Arrangements were activated, therefore, to permit Federal Reserve banks to provide credit assistance to any such institution that might suffer sudden withdrawals that could not be met by resort to its usual sources of funds. This facility was not expected to be needed, and has never in fact been used; it represented simply an assurance that protection existed against the remote possibility of exceptional drains of funds that could not be accommodated through normal adjustment procedures.

When, in late September, Congress enacted legislation granting the Federal Reserve and other financial regulatory agencies temporary additional authority for establishing maximum rates payable on deposits and shares, the Federal Reserve acted promptly to reduce the ceiling rates commercial banks could pay on consumer-type time deposits. This was part of a coordinated effort by the regulatory agencies to limit further escalation of interest rate competition among depositary institutions for consumer saving.

A reduction in the overall degree of monetary restraint was not possible, however, as long as the pace of aggregate economic activity continued to outstrip the growth in resources, and prices remained under strong upward pressure. Federal spending contributed to the rising pressures on the economy, as expenditures increased much more rapidly than revenues. The Federal Government's budget, on the national income accounts basis, moved from a surplus position in the spring to a deficit after midyear. Through August, industrial production and wholesale prices continued to rise rapidly, spurred not only by the sharp acceleration in defense spending but also by continued large increases in business outlays for capital equipment and a rebound in consumer spending, particularly for durable goods.

In September, several fiscal actions were proposed by the President, and subsequently enacted by the Congress, that helped share the task of containing inflationary pressures in the economy. The suspension of the investment tax credit and accelerated depreciation provisions was directed at one of the major expansionary forces in the economy, business capital outlays. Moreover, the President's announcement of intended reductions in lower priority Federal expenditures indicated another area where action to moderate inflationary pressures would be taken.

The monetary and fiscal actions undertaken to convert an overexuberant economy to one expanding at a slower but healthier rate were successful. By fall, business plans for capital spending were being tailored to a more sustainable rate, any new orders for durable goods began to level off. The rise in prices began to slow, too, principally in reflection of larger supplies of agricultural products, but also because demand pressures for some materials were subsiding.

Responding to these signs and portents of abatement in inflationary pressures, monetary policy promptly moved to relax the degree of credit restraint. By November, the provision of reserves to the banking system through open market operations began to increase, and in December, the Board announced that the special discount arrangements outlined in the September 1 letter were no longer needed. Bank credit, which had contracted over the summer and early fall, began a vigorous expansion in December that has continued through the early weeks of 1967. The expansion in bank credit in December was at a 9-percent annual rate, and preliminary estimates put the January expansion at around 15 percent.

Market interest rates have declined substantially from their late summer peaks. For example, yields on new prime corporate bonds have fallen by about a full percentage point and delines in Federal, State, and local bond yields range from a half to a full percentage point. At the moment, bond yields are at their lowest levels in over a year.

Even more dramatic have been the declines in some of the more sensitive short-term or money market rates, such as those on Treasury bills. In some instances, these rates have fallen by as much as 1½ percentage points. For example, the 6-month Treasury bill rate has fallen from a peak of just over 6 percent to just over 4½ percent recently. Some rates which characteristically adjust more sluggishly to changes in general credit conditions, such as mortgage yields and bank lending rates, have shown less downward movement thus far, but in varying degree they have also turned lower.

There are encouraging signs that the economy is responding well to these changes in financial conditions, undertaking orderly corrective adjustments to last year's excesses. Overoptimistic estimates of market demands in 1966—typical of emerging inflationary expectations—had induced business to produce far beyond current sales requirements. As a result, inventory accumulation was large throughout the year, and stocks began to pile up in exceptionally large volume in the final months of 1966. Efforts are currently being made to bring production into line with sales in many industries, providing a sounder basis for expansion later in the year.

Moreover, as the pace of industrial activity has slowed, imports have begun to subside. With export growth maintained, there are signs that the U.S. international trade balance is on the mend again. This is indeed a welcome development at a time when our balance on international capital flows shows signs of slipping.

Further, flows of savings to thrift institutions have resumed with vigor. The net inflow of funds to savings and loan associations showed substantial improvement in November and December, and high inflows appear to have continued in January. Similar inflow gains are being reported at mutual savings banks and in time deposits at commercial banks. It would appear that the shortage of funds for the housing industry is well on its way to being alleviated.

The task of economic policy in the period ahead is to support continued full utilization of resources, while assisting the economy in restoring the price stability and international trade trends that graced the expansion from 1961 through mid-1965. It will not be an easy task, possibly not one we can accomplish within so short a span as a year. But with monetary policy responding flexibly to changing pressures on the economy, and with the President's tax proposals a bulwark against a repetition of surges in demands that marred the economy's performance in 1966, we can look forward with greater confidence to a better balanced expansion in 1967.

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

First, I want to congratulate you on a clear and candid statement and a helpful and enlightening statement.

Since you put a great deal of emphasis at the end, particularly, on the tax increase proposed by the President, the 6-percent surtax which you say would be a bulwark against excessive demand, I wonder if you would feel that it would be equally helpful if, instead of the increase in taxes, there was a commensurate reduction in spending with the net same effect on the budget, or is there something about a tax increase psychologically and for other reasons, technical reasons, that might be more helpful?

Mr. MARTIN. I would think that if it is possible to reduce expenditures, it would be equally satisfactory. I do think there is the psychological point of paying for the war in Vietnam, which at some time ought to be considered. It seems to me that we have to pay for those expenditures in one way or another.

Chairman PROXMIRE. Of course, we can pay for those expenditures by making sacrifices in other programs.

Mr. MARTIN. In other programs, and if that can be done, that would be equally satisfactory. You either have to reduce expenditures or increase taxes to deal with the problems that, seem to me, confront us.

Chairman PROXMIRE. Now we are moving into a different kind of an economic situation in 1967 than we had in 1966 in economy. The indicators, which were very expansive in early 1966, seem to have leveled off a great deal. This is true of automobiles. It is true in many other areas of industry. Inventories are high in relation to sales and so forth.

Under these circumstances, I wondered what emphasis you would put on the fact that the monetary policy is a mixed tool. It is more subtle and sophisticated than many of us realize. I know you understand that fully.

What I have in mind especially, is the impact of tight money in pushing up some aspects of cost last year. The report of the Council of Economic Advisers says the following:

> Mortgage interest rates, which had remained quite stable in preceding years, rose by 12.4 percent in 1966 alone. As shown in table 4, these higher financial costs accounted for were one-third of the total advance in the prices of services during 1966.

Now in view of the fact that services was the biggest element along with food increases, in prices in 1966, in view of the fact that it is clear that monetary policy cannot restrain demand in food, we don't eat less because interest rates are higher, doesn't it seem that even in 1966 that the impact of tight money in keeping prices down, which I agree the net overall was positive, may not have been as clearly deflationary as has been argued by some?

Mr. MARTIN. Well, it was not as satisfactory as we would have liked it to be, of course, but I think it is important for us to concentrate on the future rather than the past.

Chairman PROXMIRE. Yes. Go ahead.

Mr. MARTIN. But I would just like to put this in the perspective as I see it, which is that it seems to be that we would have been wiser if we had been following a more restrictive monetary policy from mid-1965 on. Also, if we had reduced expenditures and increased taxes, we would have had a better and smoother flow of funds through the economy than we have had.

Chairman PROXMIRE. But the fact is, when your Board does tighten credit, it does have the effect of pushing up the cost of borrowing money, pushes up the cost of mortgage interest and other borrowing costs which are an element in cost. At the same time it does restrain demand and lessen pressure elewhere. The reason I have asked this is because it has a great deal of pertinence for the future.

It is my understanding that in the present economy we have pressures on demand, and in the coming year more likely cost pressure on prices from the cost side of the economy, especially in view of the large number of wage settlements involving 3.1 million workers, involving such militant labor groups as the auto workers and the truckers and so forth. This could push up costs considerably, if added to that we have a situation in which tight money pushes up costs too, and if the demand element in the economy is not as pressing on prices as before.

I am wondering if it isn't especially desirable now to continue as much ease, even if the Congress does not pass the President's tax proposal.

Mr. MARTIN. I want to point out that the Federal Reserve started to pursue an easier monetary policy before the tax proposal was made, and we have been moving in this direction quite apart from these other considerations for the very reasons that you are talking about.

We think the legacy that we are dealing with is an overhang of inventory which was caused by the inflationary pressures that got ahead of us in the early stages of last year, particularly in the first and second quarters. This is the legacy that we are dealing with, and if it were not for that, I think that we would be in a much stronger position than we are today. We are going to have to deal with this during this current year.

I think we are making some very commendable adjustments, but with banks having reached a very high loan/deposit ratio, it is not easy, until they restore their liquidity, to get them to resume lending. Naturally, they want to avoid overextending themselves. But we have been pursuing an easier monetary policy, definitely, since the latter part of November, and we have been moving in that direction in the early weeks of this year.

Chairman PROXMIRE. I certainly welcome that and I agree. What concerns me, however, is that some analysts say that the policies you have followed so far are easy for those of us who are in politics and run for office to approve, but it is going to be harder to pursue these policies now because of the international payments situation. You point out in your next to the last page that the capital inflows that took place last year may be subject to reversal, if we drop interest rates now.

Now if we recognize that that pressure to keep interest rates up, and perhaps to be a little more hesitant in reducing short-term interest rates especially, then it might be incumbent upon the Congress to follow an expensionary fiscal policy. If for international payment reasons our monetary policy has to be tighter than we would like it to be for domestic reasons.

Mr. MARTIN. Well, I don't think there is quite the sharp division between the balance of payments and the domestic economy that frequently is made. I think we have to be concerned with having a high level of economic activity and high levels of employment at home.

What we have to really concern ourselves with is that we don't want either high interest rates or high taxes. This is not something that we are seeking at the present time. What we are seeking is a balance here. It is clear in my judgment that we have been trying to do too much too fast, and we have had spending plans converging on labor shortgages and on practically no efficient unutilized resources, in such a way that you can't possibly supply additional funds to the market without having an increase in spending that will be totally out of balance with the savings of businesses and individuals, which the economy would need and require.

Chairman PROXMIRE. What concerns me is your capacity to really restore the construction industry, especially the homebuilding industry, for several reasons. One reason is because it is so much harder to get long-term rates down. It takes longer to do it.

No. 2, I am told by some people in the homebuilding industry that the money is there. It is coming in.

Mr. MARTIN. Right.

Chairman PROXMIRE. However, the demand doesn't seem to be there, and if we are going to get the demand there, it is hard to get it there if we are going to increase taxes, if we are going to follow a restrictive policy fiscally. So it is not easy as you have said so often, I think very persuasively. You can't push a string. You might lower these interest rates some but unless we have demands for homes it is going to be hard to revive that industry.

Mr. MARTIN. It is going to be hard to revive it but I think it will come. The rigidities in the housing market are what we have to deal with here. It is not as flexible as other areas of the market. The thrift institutions, the financial intermediaries that channel funds into housing are not as flexible in the use of these funds as they might be, and I think it is very important that we cooperate in every way with the builders and the building industry to improve the secondary mortgage market, and to get a more flexible balance of funds in the industry.

Chairman PROXMIRE. Isn't it true as it has been reported that the situation in other countries, in Europe particularly, is such that the lower interest rates there would seem to be more feasible than they have been in the past, and that for that reason, with the good work of Secretary Fowler, in working with foreign finance ministers, that this might be more promising if we could persuade some of these countries to moderate their interest rates and get away from the kind of high interest competition we have had.

Mr. MARTIN. I think Secretary Fowler's visit to Chequers and the group that have been participating in this have unquestionably performed a useful service in tackling this problem, but we must never forget that interest rates can't be ordained. You can't just pull levers.

Chairman PROXMIRE. That is why I say isn't it true that the domestic situation in these countries is such with less pressure on resources.

Mr. MARTIN. That is right.

Chairman PROXMIRE. So that interest rates may be able to moderate there.

Mr. MARTIN. I think that it depends on environment. The danger is that you can get the idea that you can just have a meeting and lower interest rates. This, I don't think is possible. If the conditions in the countries are such that they can, and I think they are at the moment, Senator Proxmire, then this can be a very helpful exercise.

I think the interrelationship of all of these countries is such that when they restrain or when they expand, it has an effect on other countries, and that all of us have got to take into consideration the united effects of these moves. Therefore, I think any closer cooperation between finance ministers and central bankers in the Western World that we can get is going to be beneficial.

Chairman PROXMIRE. Thank you very much. Congressman Curtis?

Representative CURTIS. Thank you, Mr. Chairman.

It is a pleasure to see you, Mr. Martin, under these circumstances. I recall our hearings back in December 1965. Perhaps things were a little different.

I want to call your attention to the section in the President's Economic Report, chapter 1, dealing with money and credit. I would be curious to know whether you feel that this is a fairly accurate account of monetary policies and the issues that seem to confront us?

Mr. MARTIN. I do indeed. I have read that very carefully and I think it is a very satisfactory account.

Representative CURTIS. I do, too, because it is, in my judgment, entirely different from the approach in the speeches made by the administration back in December 1965, even continuing through calendar 1966, and I am most pleased to see this kind of an account there. It is balanced. I think it explains a great deal of the problem, and I would say in effect it praises the monetary policy that was followed given the economic circumstances.

Mr. MARTIN. I have no quarrel with the statement that you refer to.

Representative CURTIS. Half jokingly, I asked Chairman Patman whether you had written that section. You didn't write it, did you?

Mr. MARTIN. I had nothing to do with writing it.

Representative CURTIS. However, I find that the administration witnesses who have appeared before this committee apparently haven't read this section or they don't agree with it.

You are not an administration witness. You are representing an independent board, is that correct?

Mr. MARTIN. Yes, the Federal Reserve System.

Representative CURTIS. That is right, I hope it remains that way.

Mr. MARTIN. Which is independent within the Government, but not independent of the Government.

Representative CURTIS. That is right. The administration witnesses, speaking of those who, and rightly so, should reflect the policy of the executive branch of the Government, have characterized last year as one of fiscal restraint. Do you feel that there was adequate fiscal restraint, and if so, why indeed was the monetary policy so tight?

Mr. MARTIN. Well, I have to be perfectly blunt on the matter. I don't think there was adequate fiscal restraint. This is a matter of judgment, but I don't think that there was.

Representative CURTIS. I have seen in the newspapers and elsewhere remarks that the administration is asking for a tax increase this year, this 6-percent surtax, in order to get the Federal Reserve to follow an easier monetary policy. Is this interpretation true in your judgment, and does the Federal Reserve need this kind of inducement to follow an easier monetary policy?

Mr. MARTIN. No. There is no deal, no agreement of any sort with respect to an easier monetary policy, but the tax increase here is designed to be a defense against what might occur again in late 1967, and I think it is a very prudent and intelligent move that the President and the administration have made in introducing it. If it turns out that it isn't needed, why then I think that we will in the course of events find that out. But I think actually we are still dealing with problems of inflation. We do have this overhang of inventory, which in my judgment has been brought about by letting inflation get ahead of us in the late 1965 and 1966 period.

Representative CURTIS. I am not asking you this to get you involved in this issue, but from a monetary standpoint wouldn't expenditure restraint of an equal amount to what is expected from the tax increase do the same thing?

Mr. MARTIN. This would do exactly the same thing.

Representative CURTIS. That is the course I would much prefer to see us take, and, I think, the course of more prudent judgment. This leads me into another area, namely, debt management.

Wouldn't more of the Federal debt in the longer maturity area, 5 years and beyond, assist somewhat in developing easier monetary policies—both in tempering interest rates and in treating the problem of increasing the money supply in accordance with anticipated economic activity?

Mr. MARTIN. I think this committee is familiar with my views on this. I think we would be wise to remove the 4¼-percent interest ceiling on the longer term maturities. If this had been done, I don't believe we would have had a bill rate at 6.04 this summer. I think we would have had lower interest rates across the board and better structure and a better setup for the entire debt if that had been possible.

Representative CURTIS. And also, I would argue, for the consumer and the businessman who is in the market for investment capital.

Mr. MARTIN. That is correct. I want to reiterate every chance I get that the Federal Reserve is not in favor of high interest rates any more than we are in favor of high taxes. We would like to see interest rates as low as it is possible to have them, because in my considered judgment, you will have the largest amount of capital formation that way. But interest rates cannot be dampened or controlled if you are going to try to do too many thins at the same time, and are going to have spending converging on what amounts to skilled labor shortages, and no efficient unutilized plant and equipment capacity.

Representative CURTIS. I am very disturbed, Mr. Martin, by the aggregate figures on the marketable debt, which is about $218 billion. Almost 50 percent of it is in maturities of 1 year and less—$105 billion as of late December.

And then that which is 5 years and less is a total of 77 percent of the marketable debt. I think this is a grave imbalance. Would you comment?

Mr. MARTIN. Well, I personally think we would have a better debt structure if we had more of it at longer term than we have. But I think the Treasury has been making heroic efforts to do that and I think one of the things that has made it difficult for them is this four-and-a-quarter-percent interest ceiling.

Representative CURTIS. Almost impossible, because the Secretary of the Treasury said the last time they marketed any securities beyond 5 years' duration was May 1965, so there has been no opportunity except through the debt participation certificate device——

Mr. MARTIN. Under current conditions it is impossible.

Representative CURTIS. Now that leads me to another area of great concern—the international balance of payments. In Morgan Guaranty Trust Monthly Survey of last month they were pointing out that one reason that our balance of international payments looks a bit better was because a great deal of foreign capital, which was really in the short-term area, and really would have been in 1-year or less securities, actually moved into some securities that were just beyond the 1-year maturity date. The warning was that because of the way we compute the international balance of payments we should be aware of the fact that this probably is really short-term money that could go out just as fast as it came in. I wonder if you could comment on that.

Mr. MARTIN. Yes. I think that that is something that we have to be concerned about. I think that one of the interesting things is that over the last three and a half years we have financed our deficit almost entirely by our outflow of gold. We have not been borrowing as some of our foreign friends like to say we have; we have not been using our deficit position to borrow. We have been treating it just the same as any other country will treat its balance of payments, and we have been financing it by an outflow of gold.

Now this, of course, concerns us, and we would hope—we are well aware of the fact that part of the reason we have been able to do this has been that higher interest rates here have caused a reflow of funds from abroad. Last summer at one point over $2 billion came back. This could easily go in the opposite direction.

Representative CURTIS. Particularly if we were to achieve our policy of trying to get interest rates lower for the domestic economy.

Mr. MARTIN. We would hope, as Senator Proxmire said earlier, that this would be done, not on a unilateral basis, but that the interest rates—differentials—around the world would be lower. I think the same comment I made about our own domestic interest rates is true abroad. I think as low interest rates as we can have is the desirable thing to have, provided those interest rates are not being used to promote inflation.

Representative CURTIS. My time is up. Thank you.

Chairman PROXMIRE. Congresman Reuss?

Representative REUSS. Thank you, Mr. Chairman.

Chairman Martin, I want to thank you for getting up to us yesterday the advance page proofs of the Fed's annual report, and that of its Open Market Committee. I have had a chance to look at them, and they make fascinating reading.

Let me first ask a series of questions having to do with the policy actions of the Federal Open Market Committee.

Last October the Congress passed a tax increase law suspending the investment tax credit and also changing the depreciation allowance. Thereafter, on November 1, 1966, the Open Market Committee had a meeting and determined to maintain its policy of monetary restraint. That is a correct reading of the record?

Mr. MARTIN. Yes, that is about correct. It made no change at that time.

Representative REUSS. Then on November 22, 1966, the Open Market Committee in its record took five pages to describe the current economic state of the Union, without any mention whatever of the tax increase which Congress had enacted in October, and then went on for other reasons, apparently, to moderate credit restraint. Is that a fair statement of the record?

Mr. MARTIN. We did moderate credit restraint on November 22. I want to point out we probably would have done it on November 1 except for the fact it was an even keel period for the Treasury. In other words, the Treasury was facing a financing there, and we do not as a rule make changes if we can help it, when they are going to finance, you see. We want to be as helpful to them as we can. We do not try to make overt changes during such a period.

But I think the record of November 1 will show that we were tending in this direction at that time. We carried through on November 22 with the official change.

Representative REUSS. I don't mean at this time to go into all of the reasons, which are well set forth in the policy record of why on November 22 you did ease credit. The fact that I happen to have agreed with that action is also irrelevant here. My question was whether, in the five-page record of policy action published in your annual report, there is any mention of the tax increase by the Congress, and your answer is "no, there isn't."

Mr. MARTIN. I don't know whether there is or not, but I think you have got a point; it would have been wise to mention it, if we didn't mention it. But I am sure that that was an oversight as far as that is concerned.

Representative REUSS. Then the next meeting of the Open Market Committee was on December 13.

Mr. MARTIN. Might I just interrupt, Mr. Reuss?

Representative REUSS. Yes.

Mr. MARTIN. And say that Mr. Brill tells me we did mention it on November 1.

Representative REUSS. Yes, it is mentioned briefly on November 1, but you did not take action to ease credit on November 1.

Mr. MARTIN. The reason was primarily—I am not speaking for all my associates, but the reason primarily in my own mind was the Treasury financing on November 1, you see, the "even keel" considerations.

Representative REUSS. Yes. Then, on December 13, you issued a directive, continuing your easing of credit—and here the policy record takes seven pages—and I find not a word about the tax increase. If I have overlooked anything, I would be delighted to have it called to my attention.

My point, which I have probaby telegraphed by now, is simply this: Is it really a very likely assumption that, if Congress votes another increase in taxes next July 1, this will play any more part in the Fed's deliberations than the formal record shows was played in the Fed's deliberations after the last tax increase? And if the record is a true index of what was in the Fed's mind, there were a great many things in the Fed's mind in taking these salutary and wholesome actions other than the tax increase. Is there any reason to suppose it would be any different next July if we voted a tax increase?

Mr. MARTIN. I wouldn't for a moment want to forecast what conditions will be next July, but we will certainly consider every aspect of conditions, just as we did in November. The tax increase would be one of the factors to be taken into account.

Now on this tax increase, we have to realize that when we come to the budget that you are talking about—let's not argue about whether it is the administrative budget or the cash budget or the national income accounts budget for the moment; let's just take the administrative budget—you have a deficit of $8 billion, roughly. If the tax increase is not enacted, that goes up by $4.6 billion. If they don't sell the participation certificates, it goes up another $5 billion. If they don't get the postal rate increase it goes up another $700 million. These are all things we have to take into consideration.

(Chairman Martin submitted the following for inclusion in the record:)

The record of policy actions of the Federal Open Market Committee includes five separate references to suspension of the investment tax credit, either specifically or by referring to the "fiscal program announced by the President" or "fiscal policy measures * * * recently enacted by the Congress." The references may be found in the policy record entries for the meetings of September 13, October 4, and November 1.

Representative REUSS. Your point is well taken. May I now turn to the record of the policy action of the Federal Reserve, with particular reference to the meeting of July 15, 1966, where I was most interested to learn the Federal Reserve Board turned down recommendations of various of the Reserve banks, to increase the discount rate from 4½ percent to 5, and in some cases to 5½ percent.

Again, though it is not relevant to my question, I approve of the vote of the Federal Reserve Board in turning down that discount rate increase. But what concerns me is the whole business of the announcement effect of discount rate changes.

As one reads the record of the Board meeting on July 15, 1966, one can't but be struck by the self-torture that the Board undergoes by the supposed necessity of setting discount rates. It worries—and I would too if I were on the Board—at the announcement effect of a discount rate increase.

There is some evidence in the record that the Board did not undertake an increase in the discount rate last July because of the so-called announcement effect. Reading the record over the years as I have, I find other occasions when it seemed to me that the announcement effect of a discount rate increase produced a result that the Fed would not have particularly wanted.

Now to my question. Isn't it time for a thoughtful reexamination of our discount policy? I can see certain defects in the way we do it now. As I have said, the announcement effect frequently produces a result counterproductive to what the Fed in its judgment would have wanted. At other times, the overhang of an announcement effect keeps the Fed from doing what it otherwise would have done. Compounding this is the Fed's habit, which I am not undertaking to criticize, of moving the discount rate in rather a wide swing, half a percentage point, which is a big change, because quite understandably it doesn't want to make a lot of little shivering changes in the discount rate. It uses it much as a Treasury does when it contemplates devaluation of the currency. "We might as well do this right, boys, so we don't have to do it again in a few weeks."

In the light of this, isn't there much to be said for the suggestions made by Warren Smith and other economists that the Fed would be better off if it said "From now on, we are trying the discount rate to the Treasury bill rate, perhaps adjusting it weekly, monthly, or quarterly"?

And when the Fed wishes to announce something, it will use the English language and announce it. It probably won't want to do this very often, but when it has something to say, it will say it in English, not in the language of flowers that your discount rate change gives you.

I am sure this concerns you and your associates. And let me say now, because the time you are doing to have to answer it in this morning is necessarily very brief, that I would appreciate it if in addition to what you are able to respond this morning, you would file at this point in the record as complete and thoughtful a statement as the Board of Governors cares to make, with such additional views and dissents as the Governors may feel. Now, would you respond, sir?

Mr. MARTIN. My response to this would be that we are making a very careful study of the discount mechanism within the System at the present time. This is under Bob Holland, who is our specialist in this and who is the Secretary of the Open Market Committee now. He has been meeting with the discount officers of the 12 Reserve banks and others, and we have been reviewing this entire matter. As you stated, it will take a long time to go into the various aspects of it, but we hope to have that study completed before too long and give you the whole study.

Representative REUSS. Meanwhile, pending the completion of the study, I would appreciate it if you could give me, and if the members of your Board could give me, the benefit of their thinking at this time, recognizing that it would be on a preliminary basis.

Mr. MARTIN. We will do the best we can with it, but it is a very complicated and difficult research problem.

Representative REUSS. I am glad you recognize, as I do, that it doesn't look as if it is perfect the way it is done now. Maybe we ought to consider improvements.

Mr. MARTIN. Let me say, perhaps this is a needless comment, but never has the Federal Board in recent years claimed to be anywhere close to perfection in its activities.

Representative REUSS. Thank you.

(The following letter, responding to the request of Representative Reuss, was subsequently submitted for the record:)

BOARD OF GOVERNORS,
FEDERAL RESERVE SYSTEM,
Washington, D.C., March 6, 1967.

Hon. HENRY S. REUSS,
House of Representatives,
Washington, D.C.

DEAR MR. REUSS: This letter is in response to your question, at the time of my testimony before the Joint Economic Committee on February 9, concerning the review of our discount mechanism.

The Federal Reserve System has been engaged, for a little over a year, in an intensive and far-ranging examination of its discount operations and policy. This study represents the first such investigation since the early 1950's, at which time Regulation A, governing the discount operations of the Reserve Banks, was revised to its present form.

The period following the Treasury-Federal Reserve Accord of 1951 saw the development of the Government securities market to an extent which permitted the bulk of monetary policy actions to be carried out in that market. At the same time, most banks held ample supplies of these highly liquid Government securities. These holdings were an aftermath of war financing and enabled banks to make most adjustments in their reserve positions by sales of these readily marketable assets.

In this environment, the discount window served only a marginal role as a supplier of reserves. It was designed to give banks assistance over the peaks of temporary, emergency, or seasonal needs for funds that exceeded the dimensions that the banks themselves were capable of reasonably meeting out of their own resources. To foster this kind of bank use of the discount window, chief reliance was placed upon the tradition against bank borrowing, buttressed as when necesary by disciplinary contacts by discount officers. Given this kind of discount policy, open market operations could be undertaken with a new degree of vigor and precision, secure in the knowledge that only marginal reserve additions would be introduced through the discount window—in effect, just enough to lubricate the many joints in the banking machinery.

The financial environment has changed markedly in the past decade, and increasing evidence suggests that the discount mechanism may be in need of modernization. Banks no longer hold large amounts of Government securities. In recent years non-Federal debt has increased far more rapidly than Federal debt, and bank portfolios have reflected this development. The supplies of liquid assets available for reserve adjustment have been further curtailed by the rise in the total of public deposits which typically must be collateralized by the hypothecation of these assets.

In the absence of ample supplies of liquid assets, many banks find themselves adjusting their reserve positions more and more through the issuance of short-term liquid liabilities. This can be seen in the rapid growth of the Federal funds market, the intense competition for certificates of deposit, and the heavy reliance of some banks on the Eurodollar market. Meanwhile, the preponderant System dependence upon open market operations for the execution of monetary policy, while still working generally well, has at times involved market strains of a type that might have been ameliorated by a different kind of discount window assistance.

It was in the light of these developments, criticisms, and questions coming from both within the System and without, and the general belief that the tools of monetary policy should be periodically examined to evaluate their effectiveness in developing financial conditions, that the current study of the discount mechanism was undertaken. Participants in the study include the broadest cross-section of interests, opinions, background, and geographic assignments. The operation is headed by a Steering Committee composed of members of the Board and Presidents of Federal Reserve Banks. Under this Steering Committee was established a high-level staff Secretariat charged with the responsibility for conducting research and developing proposals for consideration by the Steering Committee and, in turn, by other principal System policy-making bodies.

Approximately two dozen separate research projects are presently in various stages of completion. These projects cover a wide variety of issues, some exploring the past history of the discount mechanism, others examining the discount window and other aspects of the financial system as they operate and interact today, and still others evaluating various changes and improvements which have been proposed in the light of the economic environment today and that expected to exist in the foreseeable future. One segment of these studies is examining the discount mechanisms employed by central banks in the other major industrial countries and evaluating the guidance they can offer for our own window. In this connection, the officials of these central banks have been contacted both by letter and in some cases by personal visits from our staff.

The views of a number of outstanding academic economists have also been obtained in connection with this study. One academic seminar on proposed changes in the discount mechanism has already been held, and another is contemplated shortly. In addition, a few academic economists have been commissioned to prepare papers on particular aspects of the subject.

At the end of a year of concentrated effort on this ambitious undertaking, significant progress has been made. However, the time is only now approaching when the results of this research are being interpreted and evaluated in terms of policy alternatives. Hence it is premature to do more than touch on possible findings of a policy nature.

Nevertheless, to try to be as responsive as possible to your inquiry, I can report that several possible implications of the findings have already begun to emerge, some of a general nature and others pertaining to more specific areas. Perhaps the most significant possibility is that the discount mechanism could be converted to a more active role. It could be more useful both to the Federal Reserve and to the member banks. This is likely to entail at least some increase in the proportion of reserves supplied through the discount window.

A great deal of time and effort is being invested in the study and consideration of the control mechanism for the new window. If the more active role now contemplated for the discount mechanism is finally instituted, the present degree of reliance upon the tradition against bank borrowing will no longer be feasible. Therefore, a wide variety of alternative means for influencing bank borrowing actions is being examined. Included are some more positive variants of the primarily administrative control exercised today, preponderant reliance on the discounts rate as advocated by some academics, various proposals for quantitative controls, and possible combinations of these methods too numerous to list.

Careful attention is being paid to the tied discount rate proposal that you mentioned in the hearings. In this connection the experience of the Bank of Canada between 1956 and 1962 is being evaluated, and the ideas of those academic economists advocating a tied rate are being studied. As you mentioned, a tied rate system can serve to minimize the kind of announcement effects that often attach to discretionary discount rate changes, even when the latter simply represents an action to maintain the rate in reasonable alignment with market rates. But there are also some serious difficulties that would confront any tied discount rate arrangement in this country. Some particular problems in this respect were outlined in some detail in the answers given by the Federal Reserve to the Commission on Money and Credit.[1]

With a banking system as diverse and fragmented as that of the United States, it is essentially impossible to identify any one rate which represents the cost of managing reserve positions in the absence of discounting. Yet to be an effective and equitable penalty, the discount rate would have to be tied to such a rate. In addition, the discount window will very probably continue to serve purposes (e.g. emergency credit assistance) for which a penalty rate is inappropriate or at best irrelevant. It should also be noted that a tied discount rate, unlike a fixed rate, exercises no moderating influence on money market fluctuations. Furthermore, it is by no means certain that the announcement effects of a discretionary change in an otherwise fixed discount rate are not oftentimes a constructive policy influence, or that such an influence could be effectively duplicated by varying the margin of the discount rate over the market rate to which it was tied. Each of these points at issue will have to be carefully weighed—along with the drawbacks of the present method of discount rate determination and announcement—in the light of the latest research before any definitive judgments as to future discount rate policy can be formulated. One early conclusion, suggested by review of both Federal Reserve experience and the discount mechanisms employed by various other central banking systems, is the wisdom of maintaining a degree of flexibility in the design and operation of the discount window to make it adaptable to changing circumstances.

While few of the specifics of the new discount mechanism have yet become clear, it has been almost a foregone conclusion that the window will continue to supply emergency credit assistance. This is recognized as a basic responsibility of the Federal Reserve in its role as lender of last resort. Work in this area has been chiefly aimed at developing a better understanding and articulation of the System's responsibilities and objectives, and at discovering the most efficient and equitable means of providing emergency assistance, as regards both the institution requiring such assistance and the financial system in general.

In closing, I might mention that the document attached as an appendix to this letter contains several answers to questions that reflected the thinking going into and growing out of the 1955 revision of the Board's Regulation A concerning use of the discount window. Many of the surrounding circumstances have since changed considerably, as described in the earlier part of this letter; therefore, the specifics of these answers may be to some extent outdated. Nonetheless, the general philosophy underlying these answers is still subscribed to, and they may be read in this light.

We will continue to push forward diligently with this discount study, and we shall be glad to forward the results to you when it is completed.

Sincerely yours,

WM. MCC. MARTIN, Jr.

---

[1] *The Federal Reserve and the Treasury: Answers to Questions From the Commission on Money and Credit,* Prentice-Hall, Inc., 1963, pp. 140–147.

Chairman PROXMIRE. Senator Javits?

Senator JAVITS. Mr. Martin, may I join with the committee in welcoming you here. We had a little contretemps, Mr. Martin, with your associate in Government, Secretary Fowler. Secretary Fowler would have us believe that your action in raising the discount rate in 1965 was a calculated and deliberate action by the Federal Reserve Board following general policy of the administration, rather than as it was very clearly an independent act by the Federal Reserve Board because it found an economic situation in which the administration had not acted, and therefore it had to act. Now which is correct?

Mr. MARTIN. Well, I wouldn't want to enter into a controversy with the Secretary of the Treasury, with whom I have worked very successfully and whom I like very much. I would simply point out that in this matter of coordination, there has been no problem of information or of communication. There have at times been differences of judgment, and there was a difference of judgment at that particular time.

Now the Federal Reserve has a responsibility, as I see it, under the present law, for defending the dollar. Our independence is nothing that we flaunt, but we do have a responsibility to discharge our duty as we see it. As I testified earlier here, I think it would have been wiser if we had moved earlier rather than December of 1965.

There were differences of opinion, differences of judgment, honest differences between individuals on poilcy. I, therefore, think this was just a difference of judgment.

Senator JAVITS. Mr. Martin, the reason I asked you this is because I think we have the right to know what the Federal Reserve would do, if we don't raise taxes, because obviously in 1966 you waited for an increase in taxes, and it wasn't forthcoming, so you acted. Now suppose we don't raise taxes. What are you going to do then?

Mr. MARTIN. Well, it will depend entirely on the course of the economy.

Senator JAVITS. But you will act independently again.

Mr. MARTIN. We will indeed. When I say "act independently," we are making every effort at all times to coordinate our activities with the administration, and at any time we act independently, it is not because of any desire to flaunt our authority. It is purely out of the belief that this is our duty under the law.

As I testified in December of 1965, there was a problem of financing at the time. Even within my own Board, there were some differences. I just want to emphasize my conviction that markets don't wait for kings or presidents or prime ministers or secretaries of the Treasury or Chairman of the Federal Reserve Board. They have to be dealt with at the time.

Senator JAVITS. Now you are, as I understand it, because it is a necessary element of my question, in favor of the 6-percent tax surcharge.

Mr. MARTIN. That is correct.

Senator JAVITS. Are you in favor of waiting the 90 days that Gardner Ackley said we could wait, in order to look over the economic situation?

Mr. MARTIN. I would be in favor of enacting it right now.

75-314—67—pt. 2——12

Senator JAVITS. Right now. Is it fair, I want to ask you? Suppose we don't enact it right now. What does the Federal Reserve Board have in mind to do about it?

Mr. MARTIN. As I said earlier, this is a problem of expenditure control, of paying for the war. I am not criticizing the Defense Department or anyone else for the difficulty in getting accurate figures, but the expenses have burgeoned on us, and we haven't been able to reduce them. I hope that the overhang of inventory from the inflation that got ahead of us in 1965 and 1966 can be adjusted early this year in such a way that we will have a resumption of both housing activity and other activity in the last half of 1967. It may be that if that works out, a tax increase would be desirable as a means of preventing a recurrence of what happened last year when almost the entire brunt of this was borne by monetary policy.

There were some fiscal actions. I am well aware of the fact that the Treasury did speed up tax collections. Unfortunately, the speeding up of tax collections put additional pressure on the money market, and made it a very difficult period to handle. I have no question of their desire to cooperate with us, and we will continue to cooperate with them in every way that we can.

Senator JAVITS. Now the argument for the 90-day, wait-and-see proposition is that we may be facing an economic recession, and on the classic theory that at that point you certainly don't increase taxes. A lot of people feel we should wait 90 days. Now do you or the Board, whichever you can speak for, see any indications of a recession facing us which might be ascertainable within that period?

Mr. MARTIN. I am worried about the overhang of inventory in relation to sales, which was built up in a good many lines. I am not ready to forecast what the last half of 1967 is going to be, but I believe that the adjustments are being made in this overhang now, and I am optimistic about the economy.

Senator JAVITS. So you don't really think that we are justified on that account, because of fear of a recession, in waiting the 90 days, or any period.

Mr. MARTIN. There would be differences of opinion within the Federal Reserve Board and in the staff of the Federal Reserve Board on that. I do not.

Senator JAVITS. You do not. Now, finally, I would like to tell you this, if it does your heart any good, that this strange path trod by the Secretary of the Treasury goes like this. In 1966, the Council of Economic Advisers said:

> The Administration regretted that the discount rate increase last December interrupted that pattern, to wit, clearly fiscal and monetary policy must be closely cordinated, and effective coordination has prevailed in the past five years.

Nonetheless, the Secretary of the Treasury, testifying here the other day, said:

> I think that the Administration's economic policy as a whole in 1966, including our prudent use of selective fiscal tools as supplementary to general and severe monetary restraint, brought the economy through a trying time of transition and uncertainties with minimum damage, and so on.

Now that is quite a shift from the report of 1966, and I just thought that you ought to know the basis that made me say what I did. I have just one more question, if I have time. Are you concerned about the rate of capital spending in the second half of 1967?

Mr. MARTIN. I think the rate of capital spending in the second half of 1967 as presently projected is much more reasonable than it was in 1966. But I think it could build up very quickly.

Senator JAVITS. Would you favor, under those circumstances, anticipating as an alternative to a tax increase, the restoration of the seven percent investment tax credit?

Mr. MARTIN. I happen to be one of those who would like to see the 7 percent investment tax credit a permanent part of our machinery.

Chairman PROXMIRE. Would you say that again?

Mr. MARTIN. I said I happen to be one of those who would like to see the 7-percent tax credit a permanent operating part of our economy. I think a good many of my own staff and a good many others will disagree with me on this. But I think it is very desirable.

Senator JAVITS. Without regard to this tax increase.

Mr. MARTIN. That is correct.

Senator JAVITS. Whether we pass it or not. Thank you.

Chairman PROXMIRE. Senator Symington?

Senator SYMINGTON. Thank you, Mr. Chairman.

Chairman Martin, it is good to see you here, a friend and constituent. Some said on the Senate floor that it would affect the credibility of this administration if you were reappointed to your present position. I want you to know that if you are not reappointed to this position, in my opinion, it would be the greatest single thing the administration could do to reduce the confidence of business about its sincerity in preserving the integrity of the economy.

Mr. MARTIN. I appreciate that, Senator.

Senator SYMINGTON. Years ago I read a book by Gunnar Myrdal on the Negro problem. He said that first, the white people make the Negro clean their shoes, then criticize him for being a bootblack. You have become a comparable whipping boy. First, they pass the problem of inflation over to you, and don't do a thing about it from a fiscal standpoint. You do your best to handle it monetarily, which is all you can do; and then they criticize the actions you take.

I would ask a question I asked Secretary Wirtz, about the high cost of the Vietnamese war, which according to the Senate Appropriations Committee staff, is now some $2.5 billion a month.

I asked one member of the administration how long he thought we could go along with this type and character of expense in Vietnam. His answer as, "Forever, based on the percentage it was of the gross national product. Secretary Wirtz said to us:

> Let me say again I don't believe anybody is ever justified in military expenditures on the basis that you do not need to worry about it as long as it stays within a certain percentage of the gross national product.

Would you agree with that statement?

Mr. MARTIN. I agree.

Senator SYMINGTON. In a talk I made on the cost of the Vietnamese war recently, I said:

> A government as with an individual or a business, can only improve its living standards through additional borrowings so long as it is trusted by its lenders.

Would you agree that is true?

Mr. MARTIN. I do.

Senator SYMINGTON. A member of the committee just mentioned the omission of a word or thought in one of your discussions in your

Board. I have just read a book by perhaps the leading apostle of the "new economics." The word "gold" is not mentioned. Do you think the amount of gold we have to pay our current liabilities redeemable in gold, which has now fallen to about 10 percent of what we owe, is important? Is it important for us to have the gold stock necessary to pay our debts?

Mr. MARTIN. I do indeed. I think it is.

Senator SYMINGTON. What worries me, if all these people would say that gold wasn't important—but we say it is very important, and that we plan to correct the loss, and will establish policies that will result in no further loss of gold. But each year we lose more gold.

Now when we get into this justification of the high cost of Government expenditures, especially the war, on the grounds of its percentage of the gross national product, I have here a quotation from an article written for the Harvard Business Review by Dr. Robert W. Stevens, formerly senior economist of Standard Oil of New Jersey, now professor of international business at Indiana University. I would appreciate your comment.

He said:

> Whatever may have happened to the world dollar shortage, it is a fact of life that economic, political, and military attitudes, once well established, certainly do tend to persist. Today when our economy still remains unrivaled in the world, if the popular premise that economic strength always confers financial strength is sound, then people might still think it is "natural" for the United States to be running an international payments surplus, provided various frictions and temporary obstacles to its achievement could be removed. But the simple argument from basic economic strength to continuous financial strength is not valid, and there is no natural payments balance.
>
> A country's balance of payments at any time depends on many things, only one of which is the productive power of that country's economy.

Would you agree with those observations?

Mr. MARTIN. I would indeed.

Senator SYMINGTON. Now you mentioned the importance, from the standpoint of the Federal Reserve Board's activities of preserving the integrity of the dollar. Some people who are getting burned because of high interest rates, are lobbying pretty hard. They might think of what would happen if the dollar went to pieces, to a very large percentage of the American people—those folks with life insurance, with pension plans, a great new concept of union activity, not to mention social security and all retirement plans; that is, if there was major depreciation in the value of the dollar comparable to what has happened in most other world currencies in recent years.

Wouldn't such depreciation be a very serious, almost catastrophic development from the standpoint of the average wage earner?

Mr. MARTIN. I don't think there is any question of it. I think dependable money, which retains its purchasing power, is the bulwark of a strong country, and any country that loses that has lost its underpinning.

Senator SYMINGTON. Purchasing power is the base you might say.

Mr. MARTIN. That is right.

Senator SYMINGTON. One final question. Everybody today is a "Keynesian." Some stress structural employment, some public works expenditures; some lowering taxes. But the basic theory of Keynes, was it not, was in times of prosperity to increase taxes and reduce

Government expenditures; and in times of nonprosperity vice versa? We are not pursuing that policy, are we?

Mr. MARTIN. We have failed to compensate. We have been relying too much, in my judgment, on deficit finance without ever having a surplus. I think that you have got to have a balance. We should use deficit finance under certain circumstances, but if deficit financing becomes permanent then I think it is just a matter of time before you do undermine your currency.

Senator SYMINGTON. These disciples of Keynes perhaps haven't read everything he wrote on the subject of the importance of the integrity of the dollar. Many years ago, he said:

> Lenin was certainly right. There is no subtler nor surer means of overturning the existing basis of society than to debauch the currency. The process engages all the hidden forces of economic law on the side of destruction and does it in a manner which not one man in a million is able to diagnose.

Would you agree?

Mr. MARTIN. I would indeed, and I would like to interject here what I said in a recent talk I made in London. I had the privilege of knowing Lord Keynes, and I had several long discussions with him. Before the end of the war he was convinced that the main problem of the postwar world was going to be unemployment.

Later, when I sat at the Bretton Woods meeting in Savannah with him, I had a 2-hour conversation with him, in which he explained to me that his views had completely changed, and he was convinced that the problem of the postwar world was going to be dealing with inflation. He recognized that inflationary surges world bring inevitable adjustments from time to time, putting two and three people out of work when otherwise only one person would have been unemployed.

He told me that he wanted to do some work on this. I think he was going to do a book or do some similar work on it. Perhaps I am overstaying my time here, but I would say that one of the great sorrows of my life is when he had a heart attack at Savannah, and then another heart attack in April and passed on. I think he has been misquoted a great deal with respect to his attitude toward inflation annd deflation.

Senator SYMINGTON. Thank you, Mr. Chairman. My time is up. I also had the privilege of knowing Lord Keynes. In conclusion, I sure hope you stay on this job. You know more about money problems than any of my colleagues, or for that matter anybody else in this Government. You have been a great public servant. If the President is wise enough to send your name to the Senate, I am sure you will be confirmed for another rough time.

Chairman PROXMIRE. Congressman Widnall?

Representative WIDNALL. Thank you, Mr. Chairman.

Mr. Martin, let me first congratulate you on your healthy recovery from being tarred and feathered in December of 1965. It is good to see you before us, and you are an excellent witness, as always.

You have partly answered this question that I am about to ask you now, but I would like a more full answer. What was the impact on the financial market and interest rates last year of the administration sales of participation certificates and the larger acceleration of tax payments?

Mr. MARTIN. It added additional pressures to the market, at a time when the market was already under strain, and therefore it was a contributing factor to the rise in interest rates.

Representative WIDNALL. Has the coordination of economic policy between the Federal Reserve and the administration improved in your view since the increase in the discount rate in December of 1965?

Mr. MARTIN. I think our coordination has been good right along. I think, as I said earlier, information and communications has been 100 percent, and I think since the December action perhaps all of us have worked even harder to see that we were fully evaluating the views of the Board and the Treasury and the Council. I think we have worked very hard and very successfully on it.

Representative WIDNALL. Does this mean you have met more frequently than in the past?

Mr. MARTIN. I would say not much more frequently. We have these meetings that have been mentioned in testimony before you, consisting of the Secretary of the Treasury and the Chairman of the Council of Economic Advisers, the Director of the Budget and myself representing the Board. They have met on an average of about once every 5 weeks during 1966, and that was true of 1965.

Representative WIDNALL. Would you favor the removal or the reduction of the gold backing now required for the Federal Reserve notes?

Mr. MARTIN. I would not want to come up at the moment for it, but I think ultimately we may have to remove it. During the hearings on the legislation that repealed the gold cover requirement as to deposits but retained it for Federal Reserve notes, I testified that I did think it had some disciplinary effect on our activities. As time has gone on, I have come to wonder whether that displinary effect was as useful and as practical as I thought is was. My general position on this right along has been that gold is here to use, not to hoard. I would hope that within the next couple of years we will have an improvement in our balance of payments. If we succeed, gold will flow back.

Representative WIDNALL. So you are having a constant review of the situation now, and evaluating the value of keeping it as it is?

Mr. MARTIN. That is right.

Representative WIDNALL. How do you regard the proposals which have been advanced under which the United States would continue to sell gold at $35 an ounce, but would alter its buying policy either by not buying gold at all or by refusing to buy at $35 an ounce, or at any other predetermined price?

Mr. MARTIN. We have considered this at great length, and my own view is that this would be a mistake, that this would be tantamount to devaluation. I think it would not serve the purpose that individuals that are proposing it think it will.

Representative WIDNALL. In the long range it still would have a very adverse effect, you think?

Mr. MARTIN. I do.

Representative WIDNALL. Now is it true that late last year the Treasury borrowed from the Federal Reserve for the first time since 1958, and also there was only one borrowing, or has the Treasury resorted to the Fed on other occasions since that time?

Mr. MARTIN. That is the only time. But I see no reason at all why they shouldn't come in to us when they are down as low as they were in their balance. That is the reason we have this authority.

Representative WIDNALL. When did that take place?

Mr. MARTIN. That was on December 9.

Representative WIDNALL. In the overall picture, how do you size up the balance-of-payments outlook for 1967?

Mr. MARTIN. It is a little early to put your finger on it. I am not overly optimistic about it. I do think that there has been an improvement in our trade surplus, with the reduction of inflationary presures, and in the long run the only way we are really going to get a satisfactory balance of payments is to improve our trade surplus. Therefore, I attach a great deal of importance to this improvement.

On the capital flow—where, as Mr. Curtis pointed out earlier, we had an inflow that was partly due to the interest differential last summer—unless there is a more general adjustment in interest rates than is presently foreseeable, we may lose some of those capital inflows, and this may put additional pressure on that aspect of the balance of payments.

I would say that we have no right to be either pesimistic or optimistic about the balance of payments on February 9, today, of 1967. But it is a continuing problem, and it is one that is going to require constant and assiduous work.

Representative WIDNALL. And certainly one of the most important areas to watch, because we were helped so much within the last few months by the inflow of funds from overseas, because of our high interest rates, and it could go the other way very easily, if they don't reduce in line with our own reduction at the present time.

Mr. MARTIN. That is right.

Representative WIDNALL. It seems to me that we are now exhibiting in some areas a more rapid reduction than we expected, I believe, on some short-term borrowings, by as much as 1½ percent. Why has this happened so rapidly, rather than a gradual reduction?

Mr. MARTIN. I think it is too bad that we have had swings as sharp as this in either direction. But I worry a little bit about moving so quickly. I don't really think there is anything to be unduly alarmed about here. I think our principal problem, as I keep reiterating, is the overhang of inventory that a lot of firms have at the present time. I think this is due to the inflationary buildup that occurred in the second and third quarters of last year.

Representative WIDNALL. From the witnesses who have appeared so far before the committee, I gather that there is more of a realization on the part of the administration than they have been willing to admit in the past that monetary and fiscal policy have a place going along together, rather than operating in separate directions. Many of us have felt for a period of years that there wasn't the proper cordination between monetary and fiscal policy in order to achieve the results that we wanted.

I am very hopeful from what I have gathered from some of the witnesses before us that there will be that coordination and we can achieve the result which we could achieve much more easily with that coordination of effort.

Thank you, Mr. Chairman.

Mr. MARTIN. I am in complete accord with that, and I can assure you that the Federal Reserve is going to do everything in its power to see that its monetary policy is coordinated with the fiscal policy of the Government. We have no desire to be obstreperous. Our desire is entirely constructive, and we are sorry that some misinterpretation has been put on our action in 1965, to the effect that this was our intention.

Representative WIDNALL. Thank you.

Chairman PROXMIRE. Congressman Bolling?

Representative BOLLING. Thank you, Mr. Chairman.

Mr. Martin, I would like to join with my colleague from Missouri in his comments with regard to your long and useful public service. I have had the privilege of being on this committee for a good deal of that time, and while I haven't always agreed with you, I have admired your capacity, your integrity, and I think above all, your stamina.

I hope, too, that you will continue in this position, because I think that a great deal of the confidence that some of us here and others in the country have in the stability of the economy is based on your ability to be independent and to stand up against extremely difficult burdens that sometimes administrations and almost always Congress has put upon you.

Mr. MARTIN. Thank you, Mr. Bolling.

Representative BOLLING. Now you have indicated that your concern about the economy at the moment was these inventories that accumulated as you indicated in the second and third quarters. You are at the same time optimistic that they will be worked off in such a way that we will have—I don't know exactly how to say this and I don't want to put words in your mouth—a return to what, expansion in the third and fourth quarters of this year?

Mr. MARTIN. That is correct.

Representative BOLLING. Assuming that your estimate of the situation turns out to be correct, that we do work off the inventories, that we do have a return to expansion, and a third thing, that the Congress will talk a good deal about saving money but that it will not save any out of the budget—in effect, the budget or more will be appropriated—what then might be the effect on the economy of the failure by the Congress to enact the tax increase proposed by the President? Would there be an enormous pressure on the monetary authority perhaps similar or even greater than the one that existed during the months of pressure last year?

Mr. MARTIN. That is my judgment, and let me put this to you if I may, Mr. Bolling, in a simple way that appears to me. Not everybody agrees with me quite on this, but I think that when you have full employment and you have no unutilized plant and equipment capacity, and the savings of businesses and individuals are unequal to meet the demand for credit, that the pressure is put on the central bank to create money, and if we create money under those circumstances, that spending is bound to result in higher prices.

This is the root cause of inflation. I see no problem at all in the central bank supplying additional money to the economy, until we get to the area of full or virtually full employment, with no efficient unutilized plant and equipment capacity. If at that time you print money—which is the simple way of putting it—it can do nothing but cause a rise in prices.

Representative BOLLING. I might say I am entirely in agreement with that. My observation after a number of years on the committee is that the failure in coordination, if there be a failure in coordination, between monetary and fiscal policy, grows almost entirely out of the unwillingness of the Congress to accept the other half of Keynesism—that is, in times of prosperity and pressures on the economy, one must use a compensating fiscal policy. This is why for a number of years I have favored giving to the President, within very specific limitations, in effect the power to raise and lower taxes promptly, because only thus do I see the kind of flexibility in the fiscal end that could really effectively and quickly coordinate with the monetary end. I hope that I will live long enough and that we both will stay here long enough so that we will see that kind of a situation, where instead of the Fed being a whipping boy for all those who are unwilling to take what is allegedly a politically unpopular position, it will be a partner, an independent partner in a coordinated policy operation.

Thank you, Mr. Chairman.

Chairman PROXMIRE. Senator Miller?

Senator MILLER. Thank you, Mr. Chairman.

Chairman Martin, I wish for the record, to be associated with my colleague, Senator Symington, in his comments regarding you as a person who should be retained.

You stated that the policy on participation certificates last year tended to aggravate the high interest situation, is that correct?

Mr. MARTIN. That is correct, yes.

Senator MILLER. Then it would follow that the proposed sale of several billions of dollars more of participation certificates as set forth in the President's budget would also tend to aggravate the high interest rate problem.

Mr. MARTIN. Well, the conditions in the money market are different now, Senator.

Senator MILLER. I recognize that, but it was an aggravating situation last year, so would it not follow that it would be an aggravating situation this year?

Mr. MARTIN. It will be. Unquestionably, it is an additional item that has to be financed, you see. The Government does have to pay its way.

Senator MILLER. That is right. And would you also say that the Government financing of the budget deficit as set forth in the President's budget would also have an aggravating influence on the high interest rate problem?

Mr. MARTIN. Oh, yes; any additional borrowing adds to interest rate pressures.

Senator MILLER. Now I believe you said in response to a question by Senator Proxmire that we have a decision to make of either reducing expenditures on the one hand or increasing taxes on the other. But isn't there a middle ground, which is being used right now, and that is to not do either of those, or not follow either of those alternatives sufficiently so that we take purchasing power away from the people by inflation.

Mr. MARTIN. That is correct.

Senator MILLER. I take it that you are not in favor of taking purchasing power away from the people by way of inflation.

Mr. MARTIN. I am dead against it.

Senator MILLER. That being so, Mr. Chairman, how are we going to avoid doing that if we have the tax increase that is proposed and still end up with a budget deficit of $8, $9, $10 billion this year?

Mr. MARTIN. Well, we have ultimately to balance our budget. This is the problem. Of course, there are different budgets. I am not going to get into the three budgets. I happen to agree with the economists that it is the national income accounts budget that is the one we ought to be concerned about. We do need a lot of education on this budget.

Senator MILLER. Secretary of the Treasury Fowler testified here the other day that the administrative budget is the one we need to worry about insofar as financing a deficit is concerned.

In other words, it is the $8 or $9 billion administrative budget deficit which is going to have to be financed, and since there is a relationship between that and inflation, I would think that insofar as the financing of the deficit is concerned, you would be very concerned about the administrative budget.

Mr. MARTIN. And I am. This is why I applaud the President's action in seeking a tax increase. If you take an administrative budget deficit of $8 billion and you do not get this tax increase, the deficit goes up by $4.6 billion right away, and if you didn't sell all the participation certificates it is another $5 billion, and if you don't get this postal rate increase through it is another $700 million, so that we are talking about some pretty large figures.

I think at some point, deficits have to be brought under control. I thing the Secretary is quite correct when he talks about this tax being designed to pay for the war in Vietnam, and to keep the budget in reasonable relationship.

The Government has to pay its way. When it runs a deficit it has to either raise taxes to cover it, or it has to borrow, and if it borrows it is putting pressure on the money market to be sure.

Senator MILLER. And in turn, over a period of time at least, that brings about a foundation for inflation.

Mr. MARTIN. Exactly.

Senator MILLER. Then would it be fair to say that in evaluating the budget, which calls for a small tax increase on the one hand, but it also on the other hand calls for a budget deficit of rather a substantial figure, that this represents sort of a straddle position that purchasing power will be taken away in part by increased taxes and in part by inflation?

Mr. MARTIN. I would hope not. I would hope that the improvement in the economy would produce the revenues. We did have an increase in revenues last year. We were moving in the right direction there, with the acceleration in the economy. It was only when we got a GNP deflator of 4 percent that we were losing the advantage of rising income.

Senator MILLER. May I say I share your hope, Mr. Chairman, but is that hope a very rosy and optimistic hope?

Mr. MARTIN. Only time will tell.

Senator MILLER. Now in your statement you call attention to some economic facts, and state: "This was an impressive performance, one in which we all can take some satisfaction."

I wonder if you could give us an evaluation of how much this performance is attributable to the war in Vietnam, and the increase in defense expenditures running up to $2 or $2½ billion a month?

Mr. MARTIN. I find the Vietnam economic problem a very confusing one. I couldn't agree more that it is not the relationship of the war to the gross national product that counts, but what concerns me is the disruption in the flow of production that comes from having to grab certain items of a strategic nature for the Defense Department under certain circumstances.

Now I don't know how you evaluate this type of thing. This gets into the broad problem of guns and butter, and it is a very difficult thing to be sure you are right on. I have been worried about the Vietnam war and rising expenditures, but not so much about that aspect of it as I have ben about what happens when somebody has a production line here and somebody comes and grabs from this production line some item that is vital to the war in Vietnam. War is a very, very "discombobulating" activity in the economy. Despite the people who say to you "Well, if we had peace in Vietnam wouldn't this cause a collapse in the economy?" I would far rather deal with the problems of peace in Vietnam than I would to have to continue to deal with the disproportionate, unbalancing factors in production that come from even a small—relatively small in terms of gross national product—war such as we have.

Senator MILLER. I am sure your view on that point is shared by all of us up here. But I thought perhaps you were hinting at the relationship between the greater defense outlays due to the war in Vietnam, and the economic facts you set forth early in your statement, when later you referred to the "acceleration in defense outlays which added to the stimulus in the private spending."

Mr. MARTIN. I think it did, you see, because it built up faster certainly than I anticipated it would, and faster than a good many of my colleagues at the Board thought this would happen. That is no criticism of the Defense Department. That is just a fact of life that it did build up very fast. But it made it very difficult to assess policy.

Senator MILLER. But without the $2½ billion a month of defense spending, certainly which has occurred in the last 12 months——

Mr. MARTIN. We would have had a very different situation than we have now.

Senator MILLER. You also made a statement that "As the pace of industrial activity has slowed, imports have begun to subside." That is the first full paragraph.

Mr. MARTIN. Right.

Senator MILLER. I don't quite follow that. I wonder if you would explain why.

Mr. MARTIN. Well, there was pressure to build up these stocks on the assumption that you would be able to sell them at higher prices. People were unable to get deliveries in this country, so they were going abroad and importing their goods. When they found that the stocks were larger than they could effectively handle, in some instances, they stopped the imports and went back to the domestic supplier.

Now this has certainly occurred here in the last couple of months. How long it will continue, I don't know.

Senator MILLER. If prices continue to go up, due to inflation, this would tend to counterbalance that.

Mr. MARTIN. That is right.

Senator MILLER. Thank you, Mr. Chairman. My time is up.

Chairman PROXMIRE. Mrs. Griffiths?

Representative GRIFFITHS. Thank you very much.

It is nice to see you again. I will say that the first time that I ever saw you, you came before Banking and Currency, and it was one of the most interesting sessions I ever observed, with Mr. Patman as chairman. I was so enthusiastic, I went back and read the hearings and debates on the Federal Reserve Act.

I would like to ask you, can you see, foresee a time or the circumstances under which both an interest rate rise and a tax increase would be necessary or an interest rate decrease and a tax decrease?

Mr. MARTIN. An interest increase?

Representative GRIFFITHS. And a tax increase.

Mr. MARTIN. And a tax increase. I would think——

Representative GRIFFITHS. Or to have both of them go the other way. Under what circumstances would it be desirable?

Mr. MARTIN. Well, it would be under supply-and-demand conditions where there was a shortage of savings on the one side, and no way of balancing it in the marketplace. Interest certainly is a reward to the saver as well as a cost to the borrower. I think there could be a period, a short-lived period, where that might happen but I don't think it would continue any length of time.

Representative GRIFFITHS. How would you coordinate? What would be the mechanics of such coordination? Supposing that such a time arose? For instance, an interest-rate increase bears heavily upon some elements of the economy and is not really noticeable in others, whereas a tax increase or decrease would affect other groups. The fact that they paid high interest didn't really slow down investment in capital goods, but the suspension of the investment credit tax slowed it down. So how would you go about coordinating? With whom would you talk, and how would it be done?

Mr. MARTIN. Well, we would have to have a coordinated staff conference or conferences on this, and I think we would have to make a general evaluation at the staff level of what would be the effective way to deal with this. This would be a difficult situation that you are suggesting here.

Representative GRIFFITHS. And yet, don't you really think that it is much worse for us to have a fiscal policy going one way and monetary policy going the other way?

Mr. MARTIN. Well, I don't think that is necessarily so. I think that the two ought to complement each other. That is the ultimate way to solve it. But you could have a situation of overfull employment and overutilization of resources, and under those circumstances you could probably have a tax increase and rising interest rates.

Representative GRIFFITHS. One of the arguments that was made for the tax decrease originally was that it would promote many people depositing money, foreigners depositing money in American banks, and thereby help the balance of payments. You have pointed out that American based banks brought money back from their foreign branches to solve the problem. Did it really work out the way it was anticipated it would work out? Did we really have a larger inflow of investments in this country, or saving deposits in this country, once the interest rate was increased?

Mr. MARTIN. We had a very large inflow last summer from the Eurodollar market. It was well over $1 billion in the third quarter of 1966.

Representative GRIFFITHS. Was it money of foreigners in foreign institutions, or was it money of Americans from American institutions abroad?

Mr. MARTIN. I think it was both American and foreign money.

Representative GRIFFITHS. If it were the money of Americans, there would be other tools by which you could achieve the same result. You could repatriate that money, is that not true?

Mr. MARTIN. That is right. Mr. Solomon points out to me Americans were also borrowing extensively abroad last summer.

Representative GRIFFITHS. But part of their own money was coming back.

Mr. MARTIN. Part of their own money was coming back. They were also borrowing abroad extensively. For a lot of capital expenditures by American corporations, borrowing was undertaken in the foreign capital markets.

Representative GRIFFITHS. But there are other tools available by which we can repatriate American money, if we sharpen them up, than to increase the interest rate over here.

Mr. MARTIN. You are talking about direct——

Representative GRIFFITHS. Well, you could do it taxwise, could you not?

Mr. MARTIN. Well, we have the interest equalization tax.

Representative GRIFFITHS. There are other means to bring it back.

Mr. MARTIN. That is true.

Representative GRIFFITHS. Now I would like to ask you, are you developing tools or are studies being made by which you can tell us accurately or with any degree of accuracy the difference between a 1-percent interest raise, a rate of interest decrease, and a 1-percent tax increase or decrease?

Mr. MARTIN. We are making studies of this at all times, Mrs. Griffiths, but that is a very, very difficult measurement to make. The flow of funds is hardly amenable to any precise calculations with respect to what a given change in interest rates under certain circumstances will do.

I am very proud of the fact that at the Federal Reserve Board I think we have a staff as good at making models of the economy as anybody. I admit that I am still unpersuaded that these models are of any value except as general guides. They do not give you the precise answer.

Representative GRIFFITHS. We have up here a lot of laws that don't apply to the real world either. I would like to say that if the Government had a happy combination of monetary and fiscal policy, first, we have to set up some sort of institution by which the monetary authorities and those who are going to make the fiscal decisions have some communication, and to set it up originally, you have to have some facts on which to base it. So we need all of this in my opinion—we need a beginning towards all of it, don't we?

Mr. MARTIN. We do indeed, and in solving this problem I think that we are in a pioneering field in one sense.

Representative GRIFFITHS. Yes; I think so, too.

Mr. MARTIN. And I think we are going to have to continue to work at it aggressively.

Representative GRIFFITHS. Of course, just the tax decrease on the theory that you get more money was a miracle.

Mr. MARTIN. That is right.

Representative GRIFFITHS. Nobody believed that. And now nobody wants to increase the taxes, on the theory that you might decrease inflation. We have had more letters on the tax increase than anything else the President has suggested.

Mr. MARTIN. Well, I am in complete agreement with the need for further study in this area.

Representative GRIFFITHS. The letters are for decreasing and not increasing. They like that theory.

Thank you, Mr. Chairman.

Chairman PROXMIRE. I want to say before I call on Mr. Rumsfeld that I am going to have to go and vote. I will be right back.

Representative CURTIS. Would the gentleman yield?

Representative RUMSFELD. I would be glad to.

Representative CURTIS. I think the budget shows he is asking this for fiscal 1968 and it does not have an impact on fiscal 1967.

Representative RUMSFELD. It has a psychological impact.

Mr. MARTIN. Doesn't it start July 1?

Representative CURTIS. You said right now—that would be the rest of fiscal 1967. Fiscal 1968 begins July 1.

Mr. MARTIN. I see what you mean; yes.

Representative RUMSFELD. I think also there is the psychological aspect, which is what I was interested in.

Mr. MARTIN. Yes. Well, you have got a good point there.

Representative RUMSFELD. With respect to your position on this surtax, you just referred to the war in Vietnam in your response to me. Do you base your position with respect to the tax increase on an assumption that the war is going to proceed roughly at this level or that it will be reduced somewhat or increased somewhat? It must be based on something.

Mr. MARTIN. It is based on the budget as now presented, and I am not interpreting that budget. I am just taking it as it is presented.

Representative RUMSFELD. The reason I asked the question is because in the past, the budget estimates for the war in Vietnam have been rather dramatically understated.

Mr. MARTIN. That is correct.

Representative RUMSFELD. And there were those as long ago as a year ago who indicated that they were underestimated. The very day they arrived at the Congress. Again this week and last month, there were individuals who expressed the opinion that it is, again, being understated. I know you have no crystal ball, just as I don't have a crystal ball.

Mr. MARTIN. Right.

Representative RUMSFELD. But I think that it is a valid point. I have a question about a theory or a proposal that has been advanced that the price of gold be increased each year by some small percentage which is less than the prevailing level of interest rates. The theory is that this conceivably could increase liquidity and lessen the present incentive of private parties to hold gold, and further, that it might result in a release of gold from private hoards into official stocks. Obviously, this would take some international agreements. I would like to know what your reaction to this theory would be.

Mr. MARTIN. I am dead against a change in the price of gold. It seems to me that if it is going to be used as a standard, that it should not be changed in price any more than feet or inches are changed as a measure of distance. I have been through this for many, many years. I used to study under Irving Fisher at Yale, and he was a great proponent of the commodity dollar. If you are going to make this sort of change, why you have to do it every 5 to 10 years or so.

Representative RUMSFELD. I looked through a number of these policy actions statements, and the ones that I noticed were unanimous. Were they all unanimous during the past year?

Mr. MARTIN. I don't think so, Mr. Rumsfeld. For instance, in one case at the end of the year, as I remember it, the vote was 8 to 4. Are you talking about the Open Market Committee?

Representative RUMSFELD. Yes.

Mr. MARTIN. Another vote was 10 to 2.

Representative RUMSFELD. The ones I happened to see were unanimous and I was just curious to know what the pattern had been in the past year.

Mr. MARTIN. On November 22 there were two dissents, and on December 13 there were four dissents, as I remember it. Yes, four dissents, 8 to 4.

Representative RUMSFELD. In your comments in responding to Senator Javits' question, you seemed to me to indicate greater near-term concern about the dangers of overheating the economy than the dangers of a downturn in economic activity or a recession. First of all, is this an accurate interpretation of your view, and, second, if it is, is it at all based on the conviction or assumption that the administration does not plan to make any substantial reductions in Federal domestic spending during the next fiscal year?

Mr. MARTIN. Well, I feel that the adjustment process is proceeding satisfactorily at the moment, but I have repeatedly today stressed the overhang of inventories as a major problem.

Now we started to ease money because of a modest slowing up in the economy, in November last year, and we are continuing on that. We will review policy from day to day and week to week, and we will determine as we go along whether this is justified.

I have supported the tax proposal because I think that there is still a very strong likelihood that we will get a turnaround before long here, and unless the Vietnam expenditures are reduced or other Government expenditures are reduced, we can have another upsurge of inflationary pressures.

Representative RUMSFELD. From your prepared statement and some of your earlier comments, I had the impression that you favored the President's request for a tax increase. Then in response to a later question, you indicated that you, in fact, favored the tax increase now. There is a difference.

Mr. MARTIN. Is there a difference in the President's proposal?

Representative RUMSFELD. A difference between the proposal and an increase? I think so. I think with respect to timing and flexibility there is a substantial difference. My earlier impression was that you favored making the proposal as the President has done, but not necessarily to have the tax, the surtax, passed now. But you do favor the prompt action by the Congress?

I think we all recognize that ultimately the liquidity of the world will probably require some supplements to gold. Gold came about as an evolution from barter. That is my simple way of looking at it. In this evolutionary process we are going to have to continue some relationship to gold as a measure. If we were to change the price of gold it would lose its usefulness as a monetary standard. In any event, a change in the price of gold would be completely unacceptable.

Representative RUMSFELD. Returning to this question of coordination between the Federal Reserve Board and the administration, I asked Mr. Ackley the following question. I said:

Would you say that from hindsight the Federal Reserve decision to increase the discount rate in December of 1965 was as bad as was expressed at the time by the Administration?

He responded by saying:

I think one has to distinguish carefully the nature of the Administration's complaint about the December 5 lowering of the discount rates. It was our feeling then, and I think it remains our feeling that it would have been better if the Reserve Board had waited until the end of December or early January at that time. We could have made coordinated fiscal and monetary policy decisions on the basis of then somewhat better at least information on budget expenditures, and an opportunity for us to consider together what kind of tax proposals the President wished to make in his January message. There is no quarrel with the fact that the developments in late 1965 and the prospects for 1966, particularly after we received at the end of November and really early December the forecast of plant and equipment expenditures made clear additional strain on the economy would require both monetary and fiscal.

I said:

You do not disagree with the announcement as to the timing of the Administration and the opportunity to take steps.

He said:

That is correct.

Does this indicate a lack of coordination or, as you suggested, a fundamental difference in the judgment that was made?

Mr. MARTIN. I think there was a difference in judgment at that particular time, a very honest disagreement. I stated earlier, and I so testified in December of 1965, and I will reiterate it, that in my mind it was a market problem. I don't believe the market could have waited another 6 weeks.

Representative RUMSFELD. Is this roughly the view that was expressed to you by the administration at that time, that Mr. Ackley set forth here in his response to me?

Mr. MARTIN. Well, yes. I wouldn't challenge what Mr. Ackley said.

Representative RUMSFELD. No; he was talking from hindsight.

Mr. MARTIN. Yes.

Representative RUMSFELD. It wouldn't be challenging him.

Mr. MARTIN. There is no question about it: I was working on this to the best of my ability—and I have a Board to work with also you know—I was working on this from late September on. I think it is fair to say that I did not have any support from the Secretary of the Treasury or the Chairman of the Council of Economic Advisers or the Director of the Budget or the President, and I regret that very much. It was not a happy position to be in. If we had had agreement, we probably would have done it 3 months earlier.

Representative RUMSFELD. My time is up. I simply would like to join the other members who have commented on the fine job you are doing, Mr. Chairman.

Chairman PROXMIRE. Mr. Brock?

Representative BROCK. Mr. Martin, it is nice to see you again, sir.

Mr. MARTIN. Thank you.

Representative BROCK. I am part of a large crowd of your fans on the hill that are sometimes not quite as vocal as the other side.

I would like to talk just in general terms with you about the economy itself. I know we have seen statements by the administration that they feel that the budget and the tax program indicate a restrained approach, a very fine balance between the possibility of inflation and the possibility of recession.

I think the concern that I feel, Mr. Chairman, is the possibility that exists for both occurring at the same time. I don't think this is economically impossible. I think you can have inflation and recession, particularly under a wartime situation such as we have in Vietnam. I am concerned that this economy may be something like a sponge in that you have certain defense related industries going up to full production or perhaps somewhat in excess of that, and certain nondefense related industries such as the credit sensitive industries—housing and so forth—remaining in a very depressed state.

Is this a danger for us? Do you see it as a potential for 1967, or do you agree primarily with the administration that we can hope for the best of all worlds and a pretty good balance this year?

Mr. MARTIN. I am inclined to agree with the administration analysis here, and hope that the last half of 1967 will see us straightening out these things. But you raise a very real point, and it is one that worries me.

We know that we can get some demand-pull and cost-push inflation very quickly. This goes back again to my earlier comment with respect to the war in Vietnam. I find wartime pressures, regardless of how small the war may be in relation to gross national product, very unfortunate in terms of their impact on various segments of the economy, and the imbalances that arise as a result.

Representative BROCK. Isn't it a fairly logical development that war should be a smaller percentage as our GNP has grown so tremendously, and also as we have shifted more from a manufacturing-base economy to a greater emphasis upon services, which would not be directly related to war expenditures in any sense of the word.

Mr. MARTIN. That is correct.

Representative BROCK. We can't really equate apples and oranges. This isn't the same economy that we had in 1951, 1952, and 1953.

Mr. MARTIN. That is right.

Representative BROCK. Is it your opinion, as it is mine, that we have virtually come to the point where the inflation problem we face is more of a cost-push type than demand-pull? You mentioned your concern with inventory accumulation and I have the same concern. Certainly if you have excess inventories, you don't have a demand-pull inflation, but yet we did see an increase in prices. There still is not as great a leveling off as I would like to see in price increases, and isn't there a distinct possibility that with the contracts up for negotiation this year of a strong impetus towards a cost-push type of inflation?

Mr. MARTIN. I don't think there is any question about it. That is the thing to watch.

Representative BROCK. Do you honestly believe that taking purchasing power away from the American consumer in the form of a tax increase will affect a cost-push inflation?

Mr. MARTIN. Not at that particular point, but I believe that it is a matter of prudence in overall budget policy that we have to look toward minimizing the size of the deficit, and not think of the budget entirely all the time as the means of expanding or contracting the economy.

Representative BROCK. I couldn't agree more to that. I question, what I am getting at is the type of tool, be it monetary or fiscal, monetary has a broader scope, and it includes several different types of monetay tools and fiscal policy includes several different types. The question I am trying to point out is whether or not a tax increase represents the right tool, given a cost-push inflation, as opposed to a demand-pull inflation? I question whether we are using the proper tool for this particular problem.

Mr. MARTIN. I would go along with you that I question whether it is necessarily the right tool, but I think it is essential that we apply something to this.

Representative BROCK. I agree. Could you suggest for us some alternative tools? I don't mean to put you on the spot, Mr. Martin. Mr. Curtis suggested cutting the expenditures, and of course, I think you would share a concern in this area as I do.

Mr. MARTIN. Indeed.

(Additional material subsequently submitted by Mr. Martin, appears following his testimony (p. 434).)

Representative BROCK. Let me change the subject to something that is of great concern to me in light of yesterday's debate in the House. What is the impact on our monetary system of short-term refinanced debt as opposed to long term? The point I am trying to get at is this.

With our 4¼-percent ceiling on long-term interest rates, we have effectively precluded Treasury from borrowing on the long-term market. You simply can't sell bonds at 4¼ percent today, and everybody knows it. Nobody will buy them. As a result, a great percentage of our national debt is now in less-than-1-year, and a good percent is in less-than-5-year obligations, which means an enormous turnover must be accomplished each year in refunding the debt.

Now what is this effect upon the monetary markets of the country, interest rates, the availability of money and so forth?

Mr. MARTIN. It keeps them more upset than I would like to see them, because the short term flows are moving around like eddies in the stream all the time, and it makes it more difficult for our operations to keep the flow steady.

Representative BROCK. Doesn't it pretty well tie the hands of the Federal Reserve System to just such action as you took in December a year ago, an action which created some political repercussions, but which also, because we did not use a combination of policies, complementary policies, both fiscal and monetary, create in my opinion certain dislocations in the economy, particularly in the credit sensitive industries of homebuilding, durable goods.

Mr. MARTIN. No question about it, because the flow is at certain times impeded by rigidities in the market. Now the thing that has been so pressing from our standpoint with respect to housing has been that the rigidities in the market place an undue burden on housing.

If you have to restrain, something has to be restrained. I regret that so much of it fell on housing, because I think our long-term requirements for housing mean that we ought to have more housing.

Representative BROCK. I agree with you. I do think there are some pretty good signs of a resurgence now in the availability of money to savings and loans.

Mr. MARTIN. Oh, I do indeed.

Representative BROCK. And also in the homebuilding industry.

Mr. MARTIN. And we hope this part due to our present policies.

Representative BROCK. I do, too. I hope your present policies don't create another problem.

Mr. MARTIN. Right.

Representative BROCK. Specifically in the international balance of payments field, is it not true in funding debt on a short-time basis that we are actually paying a higher interest rate than we would if we could finance it on a long-term basis?

Mr. MARTIN. Well, it depends on the size——

Representative BROCK. I am talking about right now.

Mr. MARTIN. Right now, yes.

Representative BROCK. We are paying more money because we are forced into the short-term market.

Mr. MARTIN. I am absolutely convinced, as I said earlier, that the 6.04 rate on the 6-month bill that occurred during the summer would never have occurred, if it were not for the 4¼ percent interest ceiling, and the whole debt could have been financed at a lower rate.

Representative BROCK. We have discussed this before my committee on previous occasions, Mr. Martin, but I just want to be sure that your position hasn't changed. You would be interested in the Congress considering this particular problem, would you not?

Mr. MARTIN. I would indeed.

Representative BROCK. With a view toward——

Mr. MARTIN. I would be enthusiastic for it.

Representative BROCK. Thank you. One last comment. There have been some of our political figures in Washington and elsewhere who suggested that the Federal Reserve is making an unconscionable profit on the interest that is paid to it on the bonds that you own. Would you tell me, first, how many bonds are held by the Fed, U.S. Government obligations, today? Do you know offhand?

Mr. MARTIN. $44 billion.

Representative BROCK. What is the annual interest yield on those bonds to the Fed?

Mr. MARTIN. Last year our earnings were about $1.9 billion.

Representative BROCK. What were your expenditures on the Federal Reserve System?

Mr. MARTIN. Very, very small.

Representative BROCK. Just approximately? Was it $200 million, $150 million?

Mr. MARTIN. Yes. I would say about $200 million.

Chairman PROXMIRE. Perhaps you might supply it for the record.

Mr. MARTIN. I will put it in the record.

(The information referred to follows:)

EARNINGS AND EXPENSES OF THE FEDERAL RESERVE BANKS IN 1966 AND 1965

Preliminary figures received from the Federal Reserve Banks indicate that during 1966 their gross earnings amounted to $1,908 million. Distribution of gross earnings was as follows: expenses, $207 million; payments to the U.S. Treasury, $1,649 million; statutory dividends to member banks, $33 million; and additions to surplus accounts, $19 million.

Under the policy adopted by the Board of Governors at the end of 1964, all net earnings after the statutory dividend to member banks and additions to surplus to bring it to the level of paid-in capital were paid to the U.S. Treasury as interest on Federal Reserve notes.

Compared with 1965, gross earnings were up $349 million, or 22 percent. The principal increases in earnings were as follows: on U.S. Government securities, $329 million; on discounts and advances, $9 million; and on foreign currencies, $8 million.

Expenses in 1966 were up $3 million, about 1.5 percent, and dividends, $1 million.

[In thousands of dollars]

Item	1966	1965
Current earnings	1,908,500	1,559,484
Current expenses	207,401	204,290
Current net earnings	1,701,099	1,355,194
Net addition to current net earnings [1]	996	1,022
Net earnings before payments to U.S. Treasury	1,702,095	1,356,215
Dividends paid	33,696	32,352
Payments to U.S. Treasury (interest on Federal Reserve notes)	1,649,455	1,296,810
Transferred to surplus	18,944	27,054

[1] Includes net losses on sales of U.S. Government securities of $2,476,000 in 1966 and of $9,000 in 1965.

Representative BROCK. Let's say somewhere in the neighborhood of $200 million. What do you do with the balance of the interest?

Mr. MARTIN. Almost all of it is paid to the Treasury.

Representative BROCK. You refund it to the Treasury?

Mr. MARTIN. Pay it to the Treasury.

Representative BROCK. So in effect you are repaying about 90 percent of it, or a little less, back to the Treasury.

Mr. MARTIN. That is right.

Representative BROCK. And there is no validity whatsoever to the charge that the Fed is making a profit off of the Federal debt, is there?

Mr. MARTIN. Oh, no.

Representative BROCK. Thank you very much.

Mr. MARTIN. No, no, and our operations are never designed for profit.

Chairman PROXMIRE. Mr. Chairman, I want to say that I am shocked and surprised that you say that if you had your option, you would favor, would vote for, or would support an increase in taxes right now. You would impose the surtax today. That is what I understood you to say to Senator Javits.

Mr. MARTIN. Well, I am afraid I didn't put it very well. I wasn't suggesting to put the surtax on today, and I am glad you corrected it.

Chairman PROXMIRE. I understand, but may I then revise it? Would you say under present economic circumstances, budgetary circumstances and so forth, that you would feel that this is a time when we should impose the surtax?

Mr. MARTIN. Yes, I would think that is proper.

Chairman PROXMIRE. Now let's take a look at the indicators. I have asked the staff before asking that question to get me the information on what the 30 indicators were showing: 19 of them have a trend one way or another, the others are rather indefinite; 15 are down, only four are up.

Consumer prices have been stable since October, 114.5, 114.6, 114.7, which I think is a remarkable showing. And, of course, the lag in wholesale prices which have been stable for almost an entire year suggests stable consumer prices in the coming year. In February of 1966 they were 105.4; now they are 105.9. And recently they have been dropping.

Then we go over to business sales and inventories. We find that since June sales have been going pretty much on a level. In June they were $86,957 million. Now they are $86,999 million, almost exactly the same, fluctuating a little bit but in a growing economy this is an indication it seems to me of a trending off.

Then we move over to new construction and, of course, we know that has been in trouble. In September there was $73.4 billion; in December it was down to $70.4 billion. These are seasonally adjusted annual rates. It is down below what it was in 1965. That is overall construction, not just housing.

Then the steel production has been dropping since September. In September it was $2.6 billion; in December, $2.3 billion. It is approximately the same in the latest week in January for which we have figures. Then you look at the total industrial production—the overall industrial production. That was 158.0 in August, 158.7 in December. In fact, it dropped from November to December.

The weekly hours of work, from 41.5 in September to 41.0 in December. Employment has been pretty much stable for a year. It hasn't dropped. Expenditures for new plant and equipment have been rising at a far slower rate as you know. Since the third quarter of last year they have been going up steadily at the rate of about 5 or 6 percent instead of the 16 or 17 percent that it had been going up for 3 years.

Corporate profits have been going down—$48.7 billion in the first quarter of the year, down to $48.2 billion now. That has been pretty steady. Farm income is down.

So when you look at the whole picture, it would seem to me that now to impose a tax increase under these circumstances, when the economic indicators are down, would tend to slow down the growth of an economy which has available resources, and would be a mistake, because it might increase unemployment and aggravate an unpromising situation.

Mr. MARTIN. I am afraid you have misunderstood me. I probably haven't spoken very clearly on this, Senator, but what I was trying to say was I would favor the passage of this for imposition on July 1, which is what I conceive the proposal to be.

Chairman PROXMIRE. You see what I am concerned with now, so you take that position I think that there is a lot of wisdom in it. I would judge that Congress may not pass the tax increase if conditions in June are about what they are now. On the other hand, if conditions are more expansionary, if prices have gone up, if industrial production has resumed its rise, there is a much stronger argument for a tax increase. But I take it from your earlier response that you feel that if conditions are unchanged we should still have a tax increase. Is that right?

Mr. MARTIN. I think that the prudent course is to perceive that we ought to be doing something to close this gap by either reducing expenditures or by increasing taxes. Assuming the imposition of this tax as of July 1, whether it is passed now or 3 months from now is of no particular concern.

Chairman PROXMIRE. Now it is this gap concept that concerns me, because if we have a stable economic situation or a declining economic situation, and not the growth that we had hoped for, we will have a larger deficit, not a smaller deficit. Under these circumstances, should we increase taxes?

Mr. MARTIN. I think this ought to be very carefully considered: yes.

Chairman PROXMIRE. Shouldn't the principal judgment be on the impact on the economy, recognizing that after all if we have a serious recession we will have a big deficit, a $20-billion deficit.

Mr. MARTIN. This is one of the economic questions of our time. I insist that the problem of the next 10 years is going to be how we deal with the economics of full employment.

Chairman PROXMIRE. You put it very well in your statement when you said we should have the fullest possible utilization of our resources consistent with stable prices. Now if prices are fairly stable, our resources aren't being utilized, then isn't it clear that we should follow an expansionary fiscal policy Isn't that a time when maybe a deficit might not be a bad idea?

Mr. MARTIN. Well, yes; but there has to be some relationship to the past deficits. This is this matter of perpetual deficit.

Chairman PROXMIRE. I don't like perpetual deficits at all. I voted against the tax cut in 1964.

Mr. MARTIN. You and I are in complete agreement on perpetual deficits. We have talked on this before.

Chairman PROXMIRE. This isn't like the period of 1964 when unemployment was already declining. We should have, under those circumstances, a stable tax not have had a tax cut. By now the economy is going the other way and you propose a tax increase, not stable tax rates?

Mr. MARTIN. We may have to do that, but I still——

Chairman PROXMIRE. You say we may have to do that.

Mr. MARTIN. I still think the prudent thing is to look toward the imposition of the President's proposal on July 1. That is what I have been trying to emphasize.

Chairman PROXMIRE. But shouldn't that depend entirely on what the economic situation is in June when it comes before us. and I mean entirely, not on the budgetary situation but on the economic situation?

Mr. MARTIN. I am not convinced that you can ignore the budgetary situation.

Chairman PROXMIRE. All right, let me ask you about something else. There seems to be a direct conflict between the needs of the housing industry and our balance-of-payments situation. If you have to follow a policy to keep capital from flowing out, of keeping short-term rates from going down much lower, or even increasing them, this obviously is going to mean that money will not flow from short term into long term, so that under these circumstances you are going to have to seriously limit the monetary policy. Which do you do? We have a depressed housing industry, we have a balance-of-payments problem. Would you favor under these circumstances perhaps even tighter capital controls of some kind, or how do you resolve this dilemma?

Mr. MARTIN. I will cross that bridge when I come to it. We have been dealing with this for a long time. I don't have the answer.

Chairman PROXMIRE. You will cross the bridge or will you jump off the bridge?

Mr. MARTIN. I may have to do both.

Chairman PROXMIRE. You don't see any way prospectively that we can resolve this problem. You think we have used selective Federal controls wisely. The President suggested a doubling of the equalization tax.

Mr. MARTIN. We have the equalization tax, that is right.

Chairman PROXMIRE. We may have to use even more stringent policies in order to overcome a most unfortunate situation. You recognize, I am sure, the devastating impact on the housing industry of high interest rates last year, and I mean devastating. It was a depression wasn't it of housing, of homebuilding?

Mr. MARTIN. Well, it was a decline, a serious decline. I don't know how you measure how devastating it was, because some of this decline did make it possible to correct some problems, such as overbuilding in some areas. There has been a population problem in housing also. There have been some other factors. As I testified a year ago when I was up here, I think the population trend is going to favor housing from here on out. I think it was against it a year ago. These are some of the considerations.

Chairman PROXMIRE. Let me ask you apropos of using monetary policy from an inflation standpoint, do you have any studies to show just what prices are interest sensitive? I have already raised the point in earlier questioning that the increase in the mortgage rate was a big element in the increase in the cost of services. We know, at least I assume—maybe I am wrong and you can correct me—that food prices are not very sensitive to an increase in interest rates. The most rapidly rising element other than mortgage interest last year was the cost of medical services. I would assume that those are not particularly responsive to interest rates. Do you have an analysis that shows what happens when you follow a stringent monetary policy, restrain demand, what prices do respond and what do not?

Mr. MARTIN. I don't think we have any analysis that we would want to pass on. Mr. Brill is the head of our research division. He works in this field right along. I question very much whether we have anything really of value on this.

Chairman PROXMIRE. Do you feel that it is possible to make a useful study here that would tell us under what circumstances that a stringent monetary policy would be wise and under which it would not? Clearly when the problem is food, medical services and so forth, and a cost-push situation, the argument is much weaker for a stringent monetary policy, but it would seem to me that an analysis could be very, very helpful.

Mr. MARTIN. Mr. Brill says we submitted a paper on this to the Commission on Money and Credit. We might dig that up, and also see if we can't do some more work on it.

Chairman PROXMIRE. Wouldn't it be helpful for the Board to have their eye on this kind of thing?

Mr. MARTIN. Oh, absolutely, and we do have our eye on it. There is no question about that. The question is what you measure this by. We have our eye on it.

Chairman PROXMIRE. You are very sensitive to the fact that there is a lesser argument for stringent monetary policies in a cost-push situation.

Mr. MARTIN. Oh, no question about it.

Chairman PROXMIRE. One more question. You say in response to Mr. Brock that prudence and budget policy to minimize the impact of a deficit by using tax restraint. Now I would like to call your attention to what happened in 1952, 1953, and 1954.

Mr. MARTIN. I am very familiar with that period.

Chairman PROXMIRE. I know you are, far more familiar than I am, because you were right on top of it and in the middle of the hot seat. We had in 1952 to 1953 a rise in the cost of living of only 2 percent, although we took off price controls in April of 1953. We had unemployment drop from 3.1 percent down below 3 percent to 2.9.

Now in view of this, why should we feel that a 3.8 or a 3.9 percent unemployment which we have now puts us in such a tense situation that we have to consider invoking fiscal policy that would restrain us when we obviously have a slack at this time?

Mr. MARTIN. We obviously, in my judgment, have a different set of circumstances. We were coming out of World War II at that time.

Chairman PROXMIRE. No; that was the Korean war, 1952 and 1953.

Mr. MARTIN. It was the overhang, you see, that we were dealing with. I don't know what the right rates are here. I have puzzled with this a long time but I think there are basic differences. I think that in the skilled labor area, we have more labor shortages recently than we had at any time during that period, despite the difference in the unemployment rates. This is purely judgment.

Chairman PROXMIRE. Thank you very much. Congressman Curtis?

Representative CURTIS. Mr. Chairman, I do want to pursue this tax discussion a little more, because this is something that we face in the Ways and Means Committee. One thing I have been disturbed about is the macroeconomist approach to tax policy as part of fiscal policy, ignoring the details that go to make up taxes. Someone accused me a few years ago of being a microeconomist. I didn't even know what it meant but I guess that is what I am, because I think that our Federal tax rates are still too high, even after the 1964 cuts and the 1954 cuts.

By too high I mean that the rates are such that business judgment is often made on the basis of the tax consequences rather than on overall economic or business considerations. It does impede economic activity. It is true, however, when we extract taxes from the private sector it has some economic impact, but I am from the school that believes we should try to have as minimal an impact as possible.

Even if it is true that we are beyond diminishing returns in tax policy, I think it would create some very serious damage if we were to actually increase taxes. I put this on the record because this is one reason why I move toward expenditure cuts as a solution to what is an overall fiscal policy problem. We are going to have to finance this budget. If we don't do one or the other, increase taxes or cut spending, as you point out, we will have further deficits which then impinge on the money market.

The macroeconomists had their way in this removal of the 7-percent investment credit. If anyone paid any attention to the details of it I am sure he would realize that this credit is just about the worst kind of thing that they could use to turn off and then turn on again.

I must say, too, for the record, that I feel, unlike your testimony, the investment credit is unsound both economically as well as taxwise. I might say another thing, too. On expenditure policy I am convinced that improving our expenditure policy will go both ways. One: It will cut down the deficit. But also weeding out unnecessary spending is going to improve the programs. We flood the carburetor and damage what we are seeking to attain in many of these expenditure programs. I am simply taking this occasion to put these thoughts on the record, because I think this will come into the discussion when the Ways and Means Committee goes into this area of trying to figure out what, if anything, ought to be done about financing the budget.

Now if I could get over to questions. I will preface this by some remarks. The stock market I think is increasingly becoming a good economic indicator. I have always felt the flow of gold was one of the greatest economic indicators, if we follow it. Last year, as I understand it, no new gold, additional gold from all the mined gold, ended up in the hands of governments. To me this is a very disturbing indication of hoarding on the part of individuals and institutions, and suggests to me that there should be considerable concern. Would you comment on that?

Mr. MARTIN. Well, I regret the hoarding of gold that is taking place. And as you say, there was practically nothing left over last year for monetary purposes. This is one of the reasons why I think we ought to press our studies on international liquidity. I think that the International Monetary Fund is an ideal place to work on this. The administration is working quite hard in this area. It seems to me that this is a——

Representative CURTIS. Well, liquidity might help that part of the problem, but I was referring to this as an economic indicator. Why is it that institutions, private institutions and people around the world are in effect "battening down the hatches"? I think we had better look to see what they foresee, and this is what I say creates this disturbance. When I start looking at some of the indicators, I think I begin to share this concern.

It seems to me our international picture is in a very delicate balance, and certainly improving the liquidity or our methods of handling international imbalances would be helpful. But I think most people that I have heard would agree that this isn't going to get at our basic problem of a deficit in international payments and some other world problems. Would you care to comment?

Mr. MARTIN. There is no comment I could make other than that that is the problem.

Representative CURTIS. Now one of the other thinks that will be before Ways and Means almost as soon as we get back after raising money—I might say here that the Democrats do that as well as the Republicans around this time of year. Yesterday they tried to claim that when Lincoln ran the second time he didn't run as a Republican but as a Union candidate.

The interest equalization tax is up again before the Ways and Means Committee, and it has been proposed that the President be given the power to double the tax. To me this is a very unwise approach. Of course, I opposed it in the beginning. By the way, I was very pleased to see an article by Jack Behrman, who was the former Assistant Secretary of Commerce under President Kennedy's administration. He is now teaching at the University of North Carolina. He points out in this article that our foreign investment comes back within 2 years, so the impact of this on our international balance of payments actually is not as great as is often said. Certainly in the long run the restraints are deleterious, because as you mentioned, our greatest asset in our international balance of payments is our plus on trade and investment income. We have been getting a fine return on our investments abroad.

What is the policy, if there has been any expression on the part of the Federal Reserve, on continuing what was supposed to be a temporary restraint on private investment abroad?

Mr. MARTIN. Well, it is our hope that the voluntary foreign credit restraint program, which is our arm of this, you see, will not become permanent, but we decided after considerable discussion this year to continue it for another year and see how things develop.

Representative CURTIS. Did you continue it simply because of the equities involved, or did you do that as a basis of policy because you thought the entire weapon of restraining investment abroad was sound economics for these times?

Mr. MARTIN. We thought that under the current circumstances, the way it has been working, that it would be wise to give this a further try, and we have been following it very carefully. You know we have one of our Board members who works on this full time.

Representative CURTIS. I know. Let me see if I am coming through to you clearly. When we put the interest equalization tax into the law, it was quite a job to try to hit other areas in the same way, and now your program is part of a third area of control. But I think that it relates more to the inequity of hitting only one form of investment. When we first applied the tax, bank loans increased as a way of getting round it. Now the question is on direct investment. I am trying to find out whether the Fed's position is based on the fact that a principle has been adopted, to my regret, by Congress and the President and you are simply implementing that to create a more equitable situation, or do you think that the law itself is sound, and that we ought to be restraining foreign investments because of our problem with the international balance of payments. Do you understand what I am trying to say?

Mr. MARTIN. I think I got what you are saying but it is not easy to separate it. For the long term there isn't any question we favor foreign investment. It is an asset to us over the long term.

For the immediate problem we have decided to go along with these special measures, with the hope that the interest equalization tax, the voluntary foreign credit restraint program—both the Commerce part of it and ours—will not become permanent but will be temporary.

Representative CURTIS. Let me ask it this way. I see my time is up. The President has recommended that the interest equalization tax be extended. Does the Fed go along with that proposal?

Mr. MARTIN. Yes, I think the Fed does.

Representative CURTIS. I am very sorry to hear it.

Chairman PROXMIRE. Mr. Rumsfeld?

Representative RUMSFELD. Just to get this clear in my mind, your position is that your coments in your statement with respect to the President's tax proposal, and your support of that is based on basically your concern about the deficit, and that your overall attitude is that either of the two would be equally effective, whether it be a tax increase or reduction in Federal spending.

Mr. MARTIN. That is correct.

Representative RUMSFELD. Now with that in mind, did you take into consideration the President's proposal concerning changes in the Social Security Act, and if you did take it into consideration, did you make the assumption that his budget makes that they will in fact be passed at roughly the 20 percent level. And finally, does it make any difference to you, since it doesn't bear directly on the question of deficit?

Mr. MARTIN. Well, I wasn't involved in any way in that.

Representative RUMSFELD. I appreciate it, but you are making a judgment on the tax proposal and this is in the same general area. Are you assuming it will pass at the President's requested level?

Mr. MARTIN. Yes, I am.

Representative RUMSFELD. That is part of the assumption.

Mr. MARTIN. Right.

Representative RUMSFELD. Would it matter if it wasn't passed at that level in your position with respect to the tax? Say instead of passing it at the average 20 percent level it were passed at 8 percent with no increase in taxes, social security taxes. Since it doesn't affect the deficit, I would assume it wouldn't matter.

Mr. MARTIN. No, I don't think it would matter in that respect.

Representative RUMSFELD. I don't think it would matter particularly.

Mr. MARTIN. Yes.

Representative RUMSFELD. But with respect to your position on the tax.

Mr. MARTIN. That is right.

Representative RUMSFELD. I have been aware for many years of my absence of knowledge, but as a new member of this committee I have been impressed with the broad areas where we as the society lack knowledge and information, and the ability to effectively relate different trends and activities. Are you satisfied, I would guess you would agree with that statement from your earlier comment——

Mr. MARTIN. Right.

Representative RUMSFELD. Are you satisfield that the country is applying sufficient brainpower in these areas to try to see if we can't develop the ability to relate things more precisely? Do you have the feeling that generally in the country there is a good deal of attention being paid to making progress, or that we are not spending sufficient effort and brainpower on it?

Mr. MARTIN. I think we are making quite a bit of progress right now. I think in the academic fraternity, and in both government and business, that there is more attention being paid to this than there has been for a long time.

Representative RUMSFELD. I am glad to have that encouraging comment. Thank you, sir.

That is all, Mr. Chairman.

Chairman PROXMIRE. Mr. Brock?

Representative BROCK. Mr. Martin, to go back to the questions of both Senator Proxmire and Representative Curtis, Senator Proxmire suggested that one of our previous witnesses indicated maybe it would be well for Congress to consider reinstituting the depletion allowance.

Chairman PROXMIRE. Investment credit.

Representative BROCK. The investment tax credit at the rate of 1 percent a month, starting say in July, so that we do not have the full 7 percent hanging over our heads until December 31, 1967. Is this an approach which would be interesting to you?

Mr. MARTIN. I am really not competent in this area. It is a tax problem. I think it may have some merit. It appeals to me as an approach.

Chairman PROXMIRE. If the Congressman will yield at that point I would like just to say your response reminds me of the question "How is your wife?" and the answer "Compared to what?" You are certainly competent in that area or in almost any area with regard to economics.

Mr. MARTIN. On the tax you mean?

Chairman PROXMIRE. Yes, indeed. I disagree with you but you are certainly competent.

Mr. MARTIN. I try to keep out of precise details in the tax field in my present job. I do have some knowledge of it, but I really do not think that I ought to get involved in what is essentially the Treasury's business.

Representative BROCK. Let me phrase it from a different point of view. You do have a specific interest in our international balance-of-payments position.

Mr. MARTIN. I do.

Representative BROCK. Has it ever developed in discussions on the investment tax credit that we might consider the possibility of allowing extra inducement in this form to export industries, to ease our balance-of-payments position?

Mr. MARTIN. Oh, yes, and that has been considered actively in the Treasury.

Representative BROCK. Has any recommendation been made to the Congress?

Mr. MARTIN. No. I think they decided not to do it, but this has been considered.

Representative BROCK. On the international problem as you mentioned, this is of great concern. Someone brought up the subject of gold hoarding. If it is a fact that the production of gold today is going into nongovernmental hands, in other words, it is going into sources which do not use it as a reserve behind currency of any description, doesn't this tend to place even greater pressure on the dollar as the primary medium of international exchange?

Mr. MARTIN. It does indeed.

Representative BROCK. As Mr. Curtis was trying to bring out the fact that perhaps this could be an economic indicator. I think more than that, to me it is an international liquidity indicator. It would tend to give me concern over the dollar as the basis and foundation of international exchange in the coming 12 to 24 months. I think that is unrelated to the question of interest rates in this country, for example, but this is another pressure that can follow the dollar.

Mr. MARTIN. No question about it.

Representative BROCK. What development is encouraging to you on the international field insofar as international liquidity is concerned? Do you honestly think that we are making some progress in achieving a greater liquidity, and isn't this a problem, and doesn't this also relate to President de Gaulle's position of wanting to go to a full gold standard? Wouldn't that create the darnedest chaotic situation we ever saw specifically in light of this gold hoarding?

Mr MARTIN. I think you have raised the issue very clearly here. I think there is more attention being paid to this than in a long time. In the Group of Ten, in the OECD, I think that they have been gradually realizing clearly what the implications of the return to the old-fashioned gold standard would be, that there are no countries today that would permit an inflow or an outflow of gold to determine their domestic money supply. If you increased the price of gold and got out of the dilemma at the moment by doing that, for a little while it might operate, but then you would need fiduciary money on top of it.

Now the reason I am encouraged about this is that I think the International Monetary Fund is one of the real achievements of Bretton Woods, and I think that the participants, in their activities, are aware of this problem. The work on the liquidity problem has not yet reached the stage where there is general agreement, but there is general recognition of what the problem is. I think that is a precursor to getting——

Representative BROCK. But the essence of it is that you have some optimism about the possibility for greater cooperation.

Mr. MARTIN. I have indeed.

Representative BROCK. Thank you very much.

Chairman PROXMIRE. Thank you, Mr. Brock. And thank you very much, Mr. Martin. You have been an extremely responsive witness. We have heard you many times. You have always been good but I don't think you have ever been as concise and direct as you have today. It is refreshing to have a witness who is both responsive and concise and gives members of the panel a chance to ask all the questions they wish.

Our witness this afternoon is the Under Secretary of Commerce, Mr. Trowbridge.

The committee will recess until 2 o'clock.

(Whereupon, at 1:10 p.m., the committee recessed until 2 p.m. of the same day.)

(The following material was subsequently submitted in response to Representative Brock's questioning; see p. 422, preceding.)

Question. Is monetary policy less appropriate or less effective under conditions of "cost push" or "demand shift" inflationary pressures than under conditions of "demand pull" inflation? Is it possible to differentiate in practice as to when one or the other of these situations is dominant?

SUMMARY

Business fluctuations in the United States since World War II, while differing from one another in many ways, have had features in common with respect to the interactions of demands, output, costs, prices, and profits. The description of these relationships provided below indicates that the problems of inflationary pressures arise during the expansion phase of the business fluctuations characteristic of industrial economies, when demands are expanding. In the early stages of a business expansion, production and employment are likely to increase without generating widespread upward pressures on prices and costs. Continued expansion in demands eventually generates upward pressures on prices and costs as output in some industries reaches high levels in relation to capacity and unemployment is reduced. If the pace of expansion is moderate and competitive conditions are maintained, increases in prices and costs are likely to be confined to a relatively few markets. On the other hand, if demands expand rapidly and expectations are ebullient, increases in prices and costs are likely to become widespread.

With respect to the second of the two questions raised, once the process of inflation is under way, it is usually not possible to determine whether the dominant influence on prices stems from "cost push" or "demand shift." Since prices of goods and services represent costs to someone, increases in costs are one of the ways by which inflationary pressures are transmitted through the economy. At the same time, increases in some costs are promptly reflected in income payments and thus exert an influence on demands. Through this interaction of demands, prices, and costs, the inflationary process is initiated, and once in operation, the demand and cost elements interact in such a manner that they cannot be disentangled as separate and distinct forces.

In the chain-reaction process of demands, prices, and costs, the most direct influence that monetary policy can exert is on demands for goods and services. Through its influence on credit availability and on liquidity, monetary policy endeavors to maintain a climate of demands and expectations during business upswings that is conducive to a high rate of utilization of available resources without widespread upward pressures on prices and costs. Should upward pressures nevertheless develop, monetary policy can help to restrain them. Appropriate monetary policy can limit the funds that may be made available through bank credit to finance the expansion in demands stimulated by the income effects of price and cost increases, by expectations, and by other forces.

When business activity is high, prices generally are advancing, and the community expects continuing advances in prices, a monetary policy that restrains the use of bank credit is an appropriate and necessary tool. Whatever the causes or the means of propagating inflation, expansion of bank credit would influence both spending and expectations and so would provide additional impetus to the price-cost spiral. Under these conditions, individual and group efforts to hedge against inflation or to protect against it by tying contractual arrangements to price indexes would tend to aggravate inflationary forces.

In appraising the effectiveness of monetary policy, a number of factors must be considered. The formation of policy, first of all, depends on current assessments of developing business and financial conditions and, despite improvements in economic intelligence over the years, it is not possible always to judge accurately the strength of the forces developing. Other activities of the Federal Government, furthermore, have an impact on levels of production, employment, and income, and thus they influence needs for greater or lesser degrees of monetary ease or restraint. These policies, consequently, may complicate or simplify the task and they may inhibit or enhance the performance of monetary policy. Government policies that affect the functioning of markets and those that directly affect prices—such as import duties and quotas and antitrust policies—also bear on the effectiveness and results of monetary policy. The degree of market power exercised by private groups also may affect the sensitivity of markets to current and prospective demands. If monopoly power were widespread, it could have an influence on the effectiveness of both monetary and fiscal policies in pursuing their goals.

NATURE OF COST-PUSH AND DEMAND-SHIFT EXPLANATIONS

Controversy over causes of postwar inflation has focused mainly on developments since 1954. On the causes and nature of the episodes of inflation in the earlier postwar years, there appears to be widespread agreement. World War II left a legacy of accumulated demands for goods of all kinds, and methods employed in financing the war resulted in highly liquid financial positions. When wartime price controls were removed, effective demands at current prices were considerably in excess of supplies in virtually every market.

When the Korean War began in mid-1950, memories of war-induced shortages and price increases provoked protective buying by consumers and businesses, here and abroad. In both periods of inflation, costs as well as prices rose and there were large shifts in the composition of demands, but the influence of strong demands in originating and sustaining price advances was by far the predominant one.

In the 1954–57 inflation, demands were not strong in all markets simultaneously, and the advance in prices was moderate in comparison with the war-related experiences. In view of these circumstances, several interpretations of the period since 1954 have emphasized the independent nature of costs. Another interpretation has stressed rapid changes in the composition of demands. What is common to these interpretations is that they have attributed primary importance to rigidities or to autonomous elements in markets for goods and services and have given little or no weight to the role of aggregate demands. From these theses, further interpretation is drawn that use of general instruments of restraint on aggregate demands in order to check such price increases would be ineffective or would incur unacceptable social costs in terms of unemployment of human and material resources.

The "cost-push" approach to the explanation of price inflation seems fundamentally to assume that costs are more or less independently determined by market power and, therefore, little can be done about them. Prices are set by administrative decisions to cover all costs, including a satisfactory margin of profit, without regard to current or prospective demand conditions. Production is scheduled to conform to sales at these prices.

In such circumstances, it is said, Government policies—monetary and/or fiscal—must operate to provide demand sufficient to assure maximum output and full employment at the wages that are the result of labor-management agreements and at the prices businessmen—and, sometimes, public agencies—deem necessary. Otherwise, output and employment will be held or reduced below attainable levels, but there will be no appreciable restraint on advances in price levels and labor or other costs.

In practice, however, the extent to which the price of a product can be raised is limited by actual or potential competition from other products or from imports; these checks are strengthened by Government policies that operate to restrain demands and prevent ebullient expectations from developing. Competitive constraints on prices strengthen resistance to increases in costs and at times may exert downward pressures as businessmen attempt to maintain or increase profit margins. The influence on costs may take such forms as programs to raise productivity, various efforts to economize on the use of materials, control of administrative and other types of salaried employment, or resistance to increases in wage rates and fringe benefits.

The "demand-shift" explanation of the type of inflation experienced in the 1954–57 business expansion rests on a combination of factors. Inflation, it is said, originates in the general excess demands which temporarily emerge as the economy passes from recession to full employment, and from the excess demands in specific sectors that often remain after the aggregate excess has been eliminated. Inflation is perpetuated and spread throughout the economy, the argument proceeds, by the influence of costs in wage and price determination and by the relative insensitivity of prices and costs to decreases in demands.

In this view, particularly as it relates to the 1954–57 business expansion, demands increase and full employment is reached without generating upward price and cost pressures. Then, a rapid shift in the composition of demands is reflected in excess demands in some sectors and insufficient demands in others.

Because prices are more sensitive to increases than to contractions in demands, a general rise results as prices advance in those sectors where demands are increasing rapidly and decline by smaller amounts or not at all in those sectors where demands are decreasing. General monetary and fiscal policies appropriate to combat an inflation arising out of excess aggregate demand are not suitable, it is contended, to combat an inflation arising out of excess demands in particular sectors of the economy.

The composition of demands relative to the composition of available resources has an important bearing on developments in business expansions. The problems of inflationary pressures, however, are likely to arise well before demands and output reach the limits of capacity, partly because the use of marginal production facilities raises costs. Problems of inflation certainly arise before output reaches capacity in all major sectors because resources are not highly mobile. In 1955 and 1956, for example, output was well below capacity in the basic textile industries but very close to capacity in the basic metals industries. As E. A. Goldenweiser wrote in 1941:

"It should be mentioned * * * that there is no clear-cut line at which an increasing number of bottleneck advances in prices passes over into a general inflation. The development of a number of bottlenecks in many leading commodities may be the introductory phase of a general inflation. It can occur long before the entire country is operating at full capacity, because neither plant capacity nor labor supply is completely mobile. The existence of unused capacity in some industries may not prevent great shortages of capacity in others, and the presence of large numbers of unskilled workers without jobs may not prevent grave shortages in many skilled lines. So long as these instances of shortages are scattered and relatively few the situation is not properly described as inflation and can be handled by nonmonetary remedies. But it may become general long before full capacity is achieved. It should be kept in mind that it is the available supply of goods and not the theoretically possible supply that must meet a growing demand in order to prevent inflation."[1]

The demand-shift approach treats the milder, peacetime inflations of the sort experienced in 1954–57 as something different in kind from the type often associated with wars, whereas the difference appears rather to be one of degree. The immobility of resources is more obvious in the former cases, but it is not confined to them. In the more severe inflations, immobility of resources also limits shifts to areas of strongest demands, but its existence and influence are concealed by the general excess of demands.

In an economy with high and rising standards of living and many other features fostering change, demands are not likely to expand in such a way that their composition is always in balance with the location and types of existing plant and other resources. In business expansions, imbalances are likely to exist, and they are not likely to be precisely the same from one expansion to the next. Such imbalances operate to attract the newly available resources (and savings) into the sectors of strongest demand pressures.

PATTERNS OF PRICE AND COST CHANGES IN BUSINESS FLUCTUATIONS

Prices are determined by the interaction of a number of factors functioning continuously in many different types of markets, and there is an unending process of market adaptation to changes in the various factors. While business fluctuations differ from one another in important respects, they all have features in common with regard to the interactions of demands, output, costs, prices, and profits. Reviewing the process of change during postwar business expansions and contractions in this country, certain relationships and patterns of behavior are discernible.

Periods of expansion

Early in expansions of business activity, prices usually are rising in markets for "sensitive" industrial materials—that is, the materials whose prices are most responsive to short-run changes in demand. For rubber, hides, and some other sensitive materials, world production cannot be increased much (if at all) in the short run in response to rising demands. As a result, increases in demands are rather promptly reflected in price advances and may alter the international flows of commodities.

---

[1] E. A. Goldenweiser, "Inflation," Federal Reserve *Bulletin*, April 1941, p. 292.

Production or supply can be increased in the short run for other sensitive materials, such as scrap metals, wastepaper, copper, lead, zinc, and lumber. Because increases in output are accompanied by rising costs per unit of output or because of other conditions of supply, expansion in demands is reflected in price rises which provoke increases in supply. Price trends for a group of these sensitive materials often suggest the direction and strength of demands before other types of data for the same time period become available.

Many foods and foodstuffs—including livestock, poultry, and some crops—also conform to the type of market behavior described for sensitive industrial materials. For these, however, the response of domestic demands to cyclical and secular income changes is slight (the income elasticity of demand is low). Substantial changes in output may occur, however, mainly because of variations in weather, swings in the hog and cattle cycles, or rising productivity. Consequently, price fluctuations for these commodities usually reflect changes in supplies to a greater extent than they reflect shifts in demands.

Agricultural commodities subject to Federal support programs are largely protected from the price-depressing influence of large increases in production. At the same time, the existence of stocks previously accumulated in the process of supporting prices has limited in recent years the response of prices to a crop failure or other events that reduce production and supply.

For most industrial materials other than those described as sensitive, supply is expansible in the short run until some relatively high rate of capacity utilization is reached. This is true for steel mill products, paper products, many chemicals, cement, brick, and other materials. In the early stages of expansion, variable costs per unit of output are not likely to rise as increases in output are accompanied by gains in productivity and wage rates do not rise much. Fixed costs per unit and average costs per unit decline, and profit margins as well as total profits rise. Expansion in demands for these materials is accompanied for a time by rising output and supply without widespread advances in list prices. Absorption of freight and other concessions from list prices which had developed during the previous recession tend to be reduced during the early stages of expansion. These changes in actual prices are not reflected in the established price indexes, which are based mainly on manufacturers' published price lists.

The behavior of wholesale or manufacturers' prices of most finished industrial products in the early stages of expansion is much like that described for the second group of industrial materials—for similar reasons. Therefore, increases in their prices early in expansions are likely to be restricted in scope.

Continued expansion of demands eventually generates upward pressures of costs on prices of industrial materials in the second or nonsensitive group and on prices of finished products. The upturn in costs is primarily a consequence of higher levels of output in relation to available manpower and material resources.

Contrary to the suggestion sometimes made that pressures of demand against resources available to produce specific products cannot possibly contribute to increases in their prices and costs until operations are at 100 percent of capacity, costs of production often begin to rise before output approaches such high levels. The plant and equipment existing in an industry at any time is of varying age and efficiency. As demands expand, less efficient facilities must be used if output is to be increased to fill the rising volume of orders. Partly because these marginal facilities have to be activated, over-all productivity advance slows and may actually cease or be reversed. This contributes, along with increasing wage rates, premium payments for overtime, and advances in prices of some materials consumed in the industry, to rising costs per unit of output.

Price- and cost-raising pressures of demands in specific industries, furthermore, may become widespread enough to constitute a general problem before output reaches high rates in relation to capacity in all major industries. Usually, some industries are growing while others are not, and some regions are gaining while others are losing business. A number of important bottlenecks may develop even while unused capacity exists elsewhere. These developments also contribute to a higher level of frictional unemployment of labor than might exist otherwise. A judgment that output in the whole economy is at a high rate relative to plant capacity does not require that there be no margins of unused capacity, any more than "full employment" means that there are no persons looking for jobs.

Given variations in the timing and intensity of demand and cost pressures among industries, Governmental policies to further expand aggregate demands

75-314—67—pt. 2——14

in order to raise demands and output in those industries where capacity is not being intensively utilized would intensify demand pressures on those industries where output is already close enough to capacity to result in rising costs and higher prices. Consequently, while a higher level of aggregate demand might increase total output somewhat, it would also accentuate upward pressures of demand on prices.

An additional and important aspect of these developments and relationships is that an expansion of capital outlays is likely to be stimulated well in advance of full utilization of plant capacity. Business enterprises always have some capital replacement needs, and additional capital expenditures in most cases reduce costs or increase sales potentials. Incentives to undertake new commitments for expansion as well as for replacement are intensified if business managers expect higher levels of demand for their products from both secular growth and cyclical expansion. Since it ordinarily takes many months before new facilities can be acquired and efficiently integrated into the production process, business managers must plan expenditures to increase capacity well before output reaches the limits of their ability to produce.

Among the elements of cost, attention in recent years has been focused on changes in labor costs, partly because wage rates have risen persistently and labor costs are an important part of total variable costs. In major industries, where changes in wage rates tend to be industry-wide, such changes occur at a particular moment in time and they usually are widely publicized. On the other hand, changes in productivity, which operate in the direction of offsetting the effect of wage rate increases on labor costs per unit of output, occur over a period of time. Also, the advances are likely to vary considerably from plant to plant and from one producer to another.

For many industries, average measures of productivity show more cyclical variability than wage rates, rising in the early stages of expansion, leveling off as output approaches capacity, and declining in the early stages of recession. This pattern of change is probably accentuated by the short duration of the business fluctuations of postwar experience. Many new facilities are put in place late in expansion—or in the early months of recession—and there is some time lag between installation and their efficient operation. When there is such a lag, the resulting productivity gains may appear late in recession and early in expansion.

Partly for this reason, unit labor costs tend to decline in the early stages of expansion when productivity gains generally exceed increases in wages. As expansion develops, unit costs turn up because productivity advance slows and the rise in wages continues and possibly accelerates. In recession also, unit labor costs typically rise in certain industries as output per manhour declines.

Meanwhile, capital consumption and other relatively fixed costs—by definition—do not vary with the level of output. On a per unit of output basis, therefore, they show an inverse correlation with output, decreasing when output is rising and increasing when output is falling.

Cyclical variations in costs per unit of output, which result in considerable part from swings in production, are not accompanied by similar variations in prices. Consequently, profit margins fluctuate more widely than labor and other costs per unit of output, generally moving in the opposite direction. In the early stages of expansion, profit margins rise sharply; in later stages, they level off or decline; in recession, they decline decidedly.

The preceding review of price and cost influences indicates that in early stages of economic expansion, production and employment are likely to advance without generating widespread price and cost pressures. While wage rates and prices of certain materials increase, margins of profits over costs widen and are likely to approach their cyclical peaks. After expansion has progressed for a time, however, upward price and cost pressures build up, primarily because output in some industries has reached high levels in relation to capacity and unemployment has been reduced. As described earlier, less efficient plant facilities must be used and productivity advance slows or is reversed. At the same time, reduced unemployment and enlarged profit margins intensify pressures for increases in employee compensation.

With demands strong and output in some industries already at high levels in relation to capacity, the subsequent behavior of prices and costs is strongly influenced by the rate at which over-all activity has been expanding and by expectations. If the pace of expansion has been moderate, competitive conditions are maintained within most industries, between industries serving common markets, and between domestic goods and goods produced abroad. In these circumstances, increases in prices and costs are likely to be confined to a relatively few markets and are unlikely to be very large.

On the other hand, if demands have been expanding rapidly and assessments of prospects are highly optimistic, increases in wage rates and fringe benefits are likely to be large and price advances extensive. Increases in wages will be propagated throughout industry and may directly cause further expansion in demands for goods and services. Price advances may indirectly contribute to expanding demands by generating expectations of additional advances.

Increases in the price indexes will further contribute to cost increases through escalator provisions of labor, rent, and other contracts. Some State and local taxes and fees may be raised to cover the rising costs of current services and higher costs of school, highway and other construction. These taxes are also reflected in the consumer price index used for escalation purposes. And thus an interacting inflationary process of demands, prices, and costs can get in full operation.

Implicit in this description of price behavior for industrial commodities is the fact that relatvely few markets conform to an ideal competitive model. In the competitive model, prices are determined by the interaction of buyers' bids and sellers' asking prices in the market; the individual seller has no significant influence on total supply and therefore has no discretion except with regard to his acceptance or rejection of the going price or how much he will supply at that price. This type of market behavior is approached most closely in markets for livestock, some other agricultural commodities, and the industrial materials earlier described as sensitive.

Markets for industrial commodities, on the contrary, are generally characterized by "imperfect" or "monopolistic" competition. Prices in these markets often are described as "administered." In such industries, a producer must make decisions regarding the pricing of the product—including all the price-related decisions asociated with quality, design, and selling techniques. These pricing decisions are based on judgments of what sales would be at different levels of prices, on calculations of what costs per unit would be at various levels of production, and on the behavior of competing producers and products. Thus pricing decisions take into account, in addition to demand, the range of forces affecting production and costs, just as sales, production, and costs are influenced by pricing decisions. Producers must attempt to find a price that is in harmony with all the relevant short- and long-term demand and cost considerations, but without knowing precisely what will most effectively accomplish this aim.

The fact that prices are set by the decisions of producers implies a degree of market power—stemming from the nature of the product and the nature of the production prosess—but it does not connote full monopoly power. On the contrary, market forces—including competition within the industry and from other domestic or foreign products or alternative sources of satisfaction—are constantly working to alter past price decisions.

Rates for utilities, freight, public transportation, insurance, and postage are also administered prices, as are reates for many other business and consumer services. Both the cost and demand conditions encountered in the service industries vary widely. Some services are produced under conditions affording opportunities for basic technological improvement and productivity advance while for others such opportunities are limited. Some are primarily labor while others have a higher commodity content. Prices of some services are very responsive to local labor market and related economic conditions while others are subject more to nationwide forces. Some are regulated by public commissions and still others are stipulated fees for public services. In particular instances, service prices follow trends in wage rates fairly closely.

The result of most of these influences is that inflationary pressures in the economy are transmitted to services via increases in costs. For the regulated prices, advances may lag considerably behind the initiating causes and may occur in many instances even after business expansion has given way to recession.

Periods of recession

During contractions in demands and activity, changes in prices and costs and in relationship between them are determined mainly by the duration of the contraction and by developments in the preceding expansion. In a prolonged and severe depression, accompanied by distress sales and substantial decreases in prices of existing assets, strong downward pressures develop on prices of currently produced goods and on wage rates and other elements of production costs. Since a contraction of this severity has not occurred since World War II, attention may be confined to the milder recessions experienced since then.

In recession, prices of sensitive industrial materials generally decline. Contraction in domestic demands and decreases in prices may reduce domestic supply by altering international commodity flows and/or by making marginal operations unprofitable. For the nonsensitive materials, analysis is complicated by the tendency of producers to change prices by varying concessions and discounts from unchanged list prices. While it is known that net or actual prices fluctuate more widely than list prices, little information is available to show the degree of change in actual prices.

List prices tend to be maintained in the early stages of contraction and if the recession proves to be brief, recovery in activity begins before many list-price cuts have been made. When it becomes clear that demands are reviving, the list price for a product on occasion is lowered to conform to actual transactions prices—because the operation of new facilities or some other development causes demand-cost relationships to be fundamentally different from those on which producers had been basing their decisions.

In describing the behavior of nonsensitive materials during business expansion, it was emphasized that producers' price decisions are based largely on calculations of costs at various possible levels of output as well as on judgments about demand. When demands contract and production is reduced, many elements of costs do not decline. Wage rates, for example, are maintained—or may actually increase in some lines owing to the terms of long-run labor agreements. The tendency of wage rates to be maintained was characteristic also of the mild recessions of prewar years.

Even in an administered price market, individual producers, faced with declining demands, have an incentive to reduce prices in order to increase sales, if they think competing producers will not also reduce prices. This goes far to explain the preference of producers for unpublicized price cuts—for price cuts brought about through concessions rather than through reductions in list prices. In certain situations, however, there may be incentives to publicize price reductions by cutting list prices: a cyclical contraction in demand for a particular material may be accompanied by competition from a new and lower cost source of supply or a new substitute material, or it may be accompanied by a change in the methods of production that appreciably reduces costs.

The recession behavior of manufacturers' prices of most finished industrial products is similar to that of the nonsensitive materials. To the extent that prices of materials decline, however, downward pressures on prices of finished goods are intensified. Prices of services tend to resist forces of decline in recession. In many cases, they rise further because of the increases authorized by regulatory agencies on the basis of earlier increases in costs, but the rate of rise in average prices of services slows down.

To summarize, prices of many sensitive materials typically decline in recession. These commodities have little weight in broad price indexes, however, and their influence currently is much less than in the indexes available for prewar years. Declines in prices of some other commodities are likely to be concealed in concessions from stable list prices. Still other prices, however, may resist any downward adjustment to declines in aggregate demand in moderate recessions.

If the previous expansion was accompanied by inflationary developments and appreciable increases in levels of prices, the increases are not likely to be fully erased during mild business recessions, giving rise to what has been called the "ratchet effect." If, however, price increases in the previous expansion were small, they may be subsequently offset as the competitive pressures that develop during recession, domestic and foreign, strengthen incentives to cut costs and to reflect these reductions in the form of lower prices. This emphasizes the importance of containing growth in credit and in demands for goods and services during periods of economic expansion and of preventing a climate of expectations conducive to large and widespread advances in prices and costs.

DEVELOPMENTS SINCE 1954

The interpretations of the functioning of the market system which have led to skepticism about the efficacy of general measures of public policy have been supported almost exclusively by analyses of the 1954-57 business expansion. A comparison of developments in the period with the process described above will tend to show that the originating causes of inflation in the 1954-57 expansion—as in other periods of expansion characterized by inflation—were strong demands and overly optimistic appraisals of prospects. Once begun, the inflation was sustained by persistence of strong demands, by demand-price-cost-demand interaction, and by generation of widespread expectations of continuing inflation.

The business expansion that began in the spring of 1958 had not, through the spring of 1960, led to large and widespread increases in prices, as producers endeavored to hold down and reduce costs. Comparison of this period with both the process described previously and with the 1954-57 experience shows that the growth in final demands, while substantial, was reasonably well balanced and moderate in relation to available resources.

The 1954–57 expansion

Recovery from recession began in the second quarter of 1954. Expansion of consumer buying and residential construction activity was followed shortly by a shift from liquidation to accumulation of inventory. This was a period of rapid industrial expansion abroad, and foreign demands were contributing strength to domestic markets.

Prices of sensitive industrial materials began to rise in the spring of 1954, as shown in the attached chart, and were back to the prerecession level by the spring of 1955. By that time, prices of some other materials and producers' equipment also had been raised. Changes in wholesale prices of industrial commodities from June 1954 to June 1955, and over succeeding 12-month periods, are shown in the accompanying table.

Wholesale prices—Percent increase

	June 1954 to June 1955	June 1955 to June 1956 [1]	June 1956 to June 1957	June 1954 to June 1957
Industrial commodities	1.8	4.9	3.2	10.2
Materials	2.4	5.4	2.9	11.0
Sensitive	[2] 5.4	5.4	−2.6	8.1
Other	1.3	5.4	4.9	11.9
Finished goods	.9	4.2	3.7	9.0
Consumer	.3	2.6	2.5	5.5
Durable	.5	3.5	3.0	7.2
Nondurable	.2	2.1	2.1	4.5
Producers' equipment	2.1	7.9	6.1	16.9

[1] Well over half of the increases in this period occurred during the 2d half of 1955. The rate of increase in prices in that period was faster than after the end of 1955 when the rapid shift in the composition of demands is said to have become a major influence.

[2] The rise in this group began in March 1954, and from that time to June 1955 amounted to 7 percent

Source: Based on Bureau of Labor Statistics data.

Industrial production reached a new high in the spring of 1955 and continued to expand, while the labor market tightened. Sales and output of autos far exceeded previous records, under the influence of price concessions, radical changes in design, and a shift in credit terms to considerably longer maturities and lower downpayments. The volume of residential building was exceptionally large, and production of other consumer durable goods and business plant and equipment all advanced. Even though steel production reached capacity levels and output of other primary metals was at peak rates, metals were in short supply, and capacity was under mounting strain in many other important industries. Business profits after taxes increased considerably. This intensified incentives to expand capital investment and also provided some of the needed funds, with the result that business investment plans rose sharply further.

These were the conditions and expectations in mid-1955, when some important labor contracts were negotiated. Demands for large increases in wage rates and fringe benefits were strong, and resistance to them was weak. In the auto, steel, and certain other major industries, large increases were agreed upon, and these liberal contract terms were negotiated for the most part without work stoppages.

Given the demand conditions and prospects of the time, prices could be and were raised to cover not only the increases in wage rates but also advances in other costs such as those resulting from the sharp increase in hiring of nonproduction or salaried workers. Costs of materials and supplies were also advancing. Partly because of the lagged effects of the World War II and Korean War inflations on the book values of the stock of real capital, depreciation charges were higher in relation to sales than in earlier postwar periods of rising economic activity. A widespread rise in prices of industrial commodities erupted in mid-1955 and a price-cost spiral was set in motion.

By the spring of 1956, the rise in business capital expenditures—which had been stimulated partly by the surge of consumer buying in 1954–55—reached boom proportions. Total spending by government was also rising. Economic activity abroad continued to increase and foreign demands for United States products gained further in strength. Meanwhile, some categories of demand were increasing less rapidly than earlier and still others, such as demands for autos and new houses, declined.

Curtailments in output in some of these lines in 1956 released resources and thus permitted expansion elsewhere. Unemployment remained low. For the most part, pressure of demands against capacity in basic industries was maintained. The capital goods industries depend on many of the same materials and types of labor as are required in the auto industry. Similarly, industrial and commercial construction use essentially the same labor and some of the same materials consumed in residential construction.

In the industries producing basic metals, for example, the operating rate was about 93 per cent of capacity in mid-1955, when the advance in prices became widespread among industrial commodities. By the end of 1955, the rate was up to 97 per cent. New capacity was being installed in these industries during 1956, and at least some of it became fully available for production during that year. While rated capacity increased 4 per cent from the end of 1955 to the end of 1956, output rose 3 per cent, so that the year-end operating rate was 96 per cent. Some other industries producing basic materials also maintained very high operating rates.

Expectations of continuing prosperity remained strong in 1956, despite decreases in sales of autos and housing. The decrease in automobile sales came to be regarded as a normal falling-off from the extraordinarily high levels of 1955, and expectations in the industry and elsewhere were for a renewed rise after introduction of new models toward the year-end. The capital goods boom that began in 1955 continued through 1956 and into 1957.

Price and wage developments in 1956, then, were dominated by strong demands, by shifts in the composition of demands for finished durable goods, and by ebullient expectations. Prices of a few sensitive materials declined: prices of lumber declined after February 1956 in response mainly to the decrease in residential construction; and in the spring of that year, copper prices began to decline—from very high levels associated with strikes—as supplies caught up with demand. Prices of most industrial commodities, however, continued to increase.

In lagged response to the inflationary developments begun in 1955, moreover, the consumer price index began to rise in early 1956. This rise resulted in wage increases based on escalation clauses in existing contracts and intensified demands for other large wage increases. In the summer, long-term contracts negotiated in the steel, aluminum, and some other industries, provided for liberal annual increases in wages and fringe benefits and automatic cost-of-living adjustments.

In early 1957, prices of industrial commodities rose further—reflecting partly a working through of earlier increases in prices of materials and other costs and partly the fact that the expectations of inflation continued to be widespread. Concurrently, rising prices were limiting sales, and inventories were increasing. After nearly three years of expansion, the seeds of recession—invariably sown in a boom—were beginning to germinate.

By the autumn of 1957, wholesale prices of industrial commodities had risen about 10 per cent from the early 1954 level, the total wholesale index 7 per cent, and the consumer price index 6 per cent. Given the strength of demands and the optimistic nature of expectations, increases of these magnitudes over a three- to four-year period are perhaps not extraordinarily large. Nevertheless, the rise in prices would have been larger had monetary policies not been restrictive. Developments through the period emphasize the need for vigorous efforts to contain the growth in demands for credit and for goods and services during periods of economic expansion and to prevent the generation of a climate of expectations conducive to widespread advances in prices and costs.

The 1957–58 recession

In the early autumn of 1957, more than three years after the upturn in business, expansion gave way to recession. A capital equipment boom by its very nature cannot be indefinitely prolonged. Exceptionally high rates of capacity expansion, rapid rise in equipment prices, and reduction in business liquidity eventually weaken incentives to make additional outlays. A decline in business capital spending will usually entail a period of inventory liquidation for capital goods industries, with reduced employment in these industries. Secondary effects of these developments are reductions in business inventory holdings, employment, incomes, and demands generally. The recession that began in the autumn of 1957 was of this type—although other elements were present, including cutbacks in defense ordering and contraction in foreign demands for U.S. exports.

Recession was not accompanied by widespread liquidation of credit and distress sales, however, and the basis was soon formed for recovery and renewed expansion, in part because of the increased availability and reduced cost of credit. Policy actions had operated to restrain the use of bank credit for speculative purposes during the expansion, and then operated in recession to encourage expansion in bank credit and increase the liquidity of the economy.

During the recession, prices of sensitive industrial materials declined, as the chart shows, with the average returning to the early 1954 low. While it is likely that various forms of concessions from list prices developed for other industrial commodities, list prices generally were maintained and, in fact, were raised further for some commodities. The failure of list prices to decline may be attributed in part to continuance of expectations of rising prices, to additional increases in costs arising out of commitments made during the preceding boom, and to the brevity of the recession.

Expansion since early 1958

When recovery in business activity began in the spring of 1958, average levels of prices were appreciably higher than in early 1954—when the previous recovery began. Expectations of continuing upward creep in prices remained widespread. The reality of expectations of inflation became obvious not so much in the behavior of commodity markets but in a further advance in common stock prices to new highs and a continued increase in land values. Moreover, interest rates turned up promptly and long-term rates which had declined only moderately in the recession, quickly approached or reattained prerecession highs.

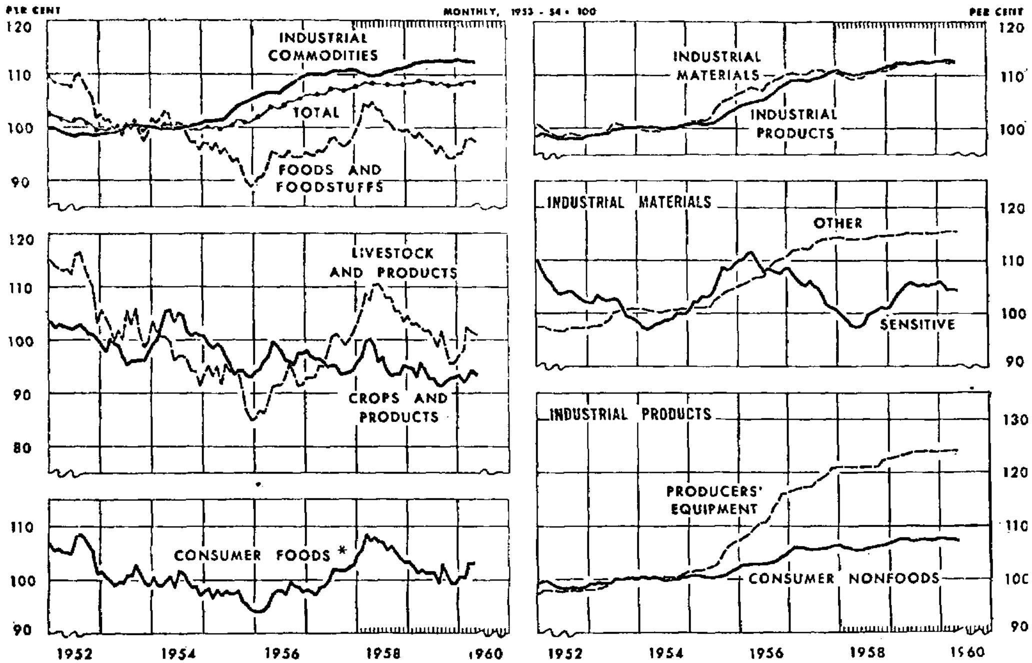
The pattern of demands, production, productivity, prices, and profits through the first year of expansion was similar in many important respects to the comparable period of recovery from the 1954 low. Consumer buying expanded rapidly, housing starts closely paralleled the rise of 1954–55, and liquidation of inventories slowed down and then gave way to accumulation toward the end of 1958. Constant dollar gross national product reached a new high in the fourth quarter of 1958 and industrial production exceeded the 1957 prerecession peak by March 1959. Prices of sensitive industrial materials responded to expanding demands, rising about as much in the fist year of economic expansion as in the comparable period of 1954–55.

However, growth in final demands was less rapid than in the comparable period of 1954–56. Consumer buying of autos rose less sharply—for a variety of reasons, including higher prices and no important further easing in credit terms on contrast to the marked liberalizing of terms in 1955. Moreover, merchandise imports rose substantially while exports changed little. In recent years, there has been a considerable improvement in the ability of other industrial nations to satisfy their own requirements and also, partly because of price advances in this country, to compete with American manufacturers of many materials and finished products in domestic markets as well as in markets abroad.

Consequently, while consumption of materials in manufacturing reached a new high in the spring of 1959 and inventories were being accumulated at a rapid rate (stimulated in part by the expectation of interruptions of supply by strikes), the margins of capacity over output for most major materials were somewhat greater than in mid-1955, and greater than during any other period of high-level activity since World War II. The margins were not large, but their importance was magnified by the fact that they existed simultaneously in several industries whose markets overlap. Government policy actions and policy pronouncements, furthermore, lessened the expectation of rising prices. Altogether, there was more uncertainty in the outlook, and prospects were for more intensive competition.

WHOLESALE PRICES

SPECIAL GROUPINGS OF B.L.S. INDEXES



BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

* INCLUDES FOODS OF BOTH LIVESTOCK AND CROP ORIGIN

From the spring of 1959 to the spring of 1960, therefore, developments were quite different from those in the comparable period after the spring of 1955. One of the most obvious differences was the development of strong resistance to cost increases as manufacturers were less confident of their ability to pass them on in the form of higher prices. Specifically, strong resistance to demands for increases in wages and fringe benefits in the steel and other industries, as reflected in prolonged work stoppages, resulted in generally smaller increases. Gains in productivity, meanwhile, were as large as or larger than in the earlier period. Salaried employment, which had declined more in the 1957–58 recession than in previous recessions, increased less rapidly than in the 1954–57 expansion. Advances in prices were limited, and wholesale prices of the various groups of industrial commodities were nearly stable.

AFTERNOON SESSION

Chairman PROXMIRE. The committee will come to order.

I might explain, Mr. Secretary, that we had a very late hearing this morning. It lasted until after 1 o'clock. The result is that the committee members are slow in coming back. We certainly welcome you to this committee and congratulate you as the Acting Secretary of Commerce—do I have the right title?

Mr. TROWBRIDGE. That is right, Mr. Chairman.

Chairman PROXMIRE. In any case, you have the authority of the office and all. You have a fine statement here. You may go right ahead, and we will be happy to hear you.

Mr. TROWBRIDGE. Thank you very much, Mr. Chairman. With your permission I will submit this statement for the record in its entirety, and in order to save time I would like to just go over some of the high points of the statement.

Chairman PROXMIRE. Very good. You might indicate the page you are on, to the extent that you skip, and so forth, so I can follow you.

Mr. TROWBRIDGE. Yes; I certainly will.

STATEMENT OF HON. ALEXANDER B. TROWBRIDGE, ACTING SECRETARY OF COMMERCE; ACCOMPANIED BY WILLIAM H. SHAW, ASSISTANT SECRETARY FOR ECONOMIC AFFAIRS; EDWARD K. SMITH, DEPUTY ASSISTANT SECRETARY FOR ECONOMIC POLICY; LOUIS J. PARADISO, ASSOCIATE DIRECTOR, OFFICE OF BUSINESS ECONOMICS; AND ROBERT L. McNEILL, DEPUTY ASSISTANT SECRETARY FOR TRADE POLICY, DEPARTMENT OF COMMERCE

Mr. Chairman, I am grateful to be given this opportunity to testify on the Economic Report of the President.

The great value of the Economic Reports and the hearings held upon them as they are transmitted to the Congress has been demonstrated over time. The work of the Council of Economic Advisers and the Joint Economic Committee has become more valuable with each passing year since the enactment of the Employment Act of 1946.

Business, labor, government, and the public at large have come more and more to recognize that we are not at the mercy of inexorable economic forces which propel us from boom to bust and back again. We have obtained an increasing control of economic forces, not by way of direct controls which we have avoided and must continue to avoid, but by use of general fiscal and monetary instruments, and more importantly by understanding how our economy works, where it is, and where it is likely to go, in the light of the policy decisions we wish to make. We have learned to look ahead.

The increasing flexibility of our responses to changing events has been demonstrated. In the face of uncertainty, flexibility is necessary. The quicker we are able to adjust the less we need fear uncertainty. Today we are operating with an economy which has moved forward since 1961 to close the gap between actual and potential output. The gap was closed last year. Now we have to operate in an economic setting which will preserve balance while the economy grows at a more moderate pace. But balance in total demand and supply does not mean balance for every element within these grand aggregates. We have to watch each element and the balances in each sector carefully. But we should be thankful we are concerned with specific imbalances and not with problems of total imbalance, with all that the latter implies for spiraling inflation or deflation.

If we have to live in a world of uncertainty, it is better to have uncertainty at full employment than to have the harsh certainty of boom or bust.

We should welcome a situation in which business cycle prognosticators are kept in a continuous ferment. In the long run we hope to put them out of business anyway.

The Current Status of the Economy and Recent Shifts

In my judgment, the President's Economic Report presents a cogent analysis of recent economic developments and a clear appraisal of the economic prospects and problems which we are likely to face in the year ahead.

Over the past year the economy has forged ahead at an exceptionally high rate. Real output recorded another sizable gain—5.5 percent. A major accomplishment was the reduction of unemployment to a rate of less than 4 percent, the first time since 1953 that such a low rate has been achieved. Civilian employment in 1966 increased by an average of 1.9 million with all major groups in the labor force benefiting in varying degrees. The purchasing power of our people, as measured by real disposable income per capita, advanced by 3.6 percent.

But our overall accomplishments were by no means uniform, either by industry or by groups of persons. The homebuilding industry, for example, suffered a severe setback and many groups in our society are still in an impoverished or otherwise underprivileged status. And we cannot forget the sacrifices being made by thousands of our men in the Armed Forces fighting the war in Vietnam.

Furthermore, the rapid expansion has resulted in some serious imbalances which must be corrected in the coming months in order to achieve a sustainable and healthier economic growth. In some sections of the economy, the combination of a relatively tight supply situation and rising costs brought on serious inflationary tendencies, thus interrupting the relative price stability that we had enjoyed in the preceding 6 years. Fortunately, in the latter part of 1966, some easing of the industry imbalances and price distortions was already evident.

Indeed, the fiscal measures taken in 1966 and the monetary restraints of the Federal Reserve Board became increasingly effective in the later months of the year. The economy cooled down to a more sustainable rate of growth. As the attached table and chart 1 show, the growth in real GNP in the first quarter of 1966 was at an annual rate of 6 percent, and by the fourth quarter the pace of advance had slowed to a little over 4 percent. But despite the reduced pace, the unemployment rate was maintained at less than 4 percent.

The slowing of the economic tempo came in the private sector as the rate of business fixed investment slowed, consumers' durable demand slackened, and housing activity continued to decline. At the same time inventory accumulation proceeded at a high and nonsustainable rate, particularly in the fourth quarter of last year. This easing of the economic pace has had salutary effects by moderating rates of capacity operations and by lessening price pressures.

According to McGraw-Hill estimates, the rate of manufacturing capacity utilization in December 1965 was 89.5 percent. During 1966 manufacturing capacity was increased by 8 percent. Manufacturing output over the year rose more than 6.5 percent. As a result the rate of capacity utilization in December 1966 was down to 88 percent. This lessened the pressure on industry to increase capacity and is one of the factors accounting for the current and pospective slowdown in the immoderate pace of fixed investment outlays.

Furthermore, the slowing economic tempo contributed in part to some moderation of the pace of price movements. Wholesale prices for 1966 as a whole were 3.2 percent higher than in 1965. As the year progressed these price movements came to a virtual halt and, in the last 3 months of the year, actually declined 1 percent. Consumer prices were 2.9 percent higher in 1966 than in 1965; but food prices receded during the last few months of the year.

As 1966 drew to a close, there were still some problem areas. Housing activity continued at depressed levels. Inventory accumulation was at a disturbingly high rate. Cost pressures on prices were being felt in many sectors. Certain skilled and professional workers were stilll in short supply relative to demand.

Clearly, further progress can be made in 1967 in correcting existing imbalances. While we must recognize the problems and make further progress in correcting them, we must not let our concern with them obscure recognition of the major accomplishments of 1966 The important point is that both employment and personal income have continued to make steady and impressive gains. In December of last year, civilian employment was 75.2 million (seasonally adjusted) up 1.8 million from December 1965. The employment gain has more than kept pace with the increase in the civilian labor force.

The major sources of demand which pushed the economy upward in 1966 were nonresidential fixed investment which rose more than $9.5 billion, and Federal Government purchases which rose more than $10 billion.

As to the other sources of demand, the charts clearly show the mixed picture which prevailed in 1966. Consumer purchases of durable goods rose much less than in 1965, expenditures for residential structures dropped 23 percent from the first to the fourth quarter, and net exports fell sharply. On the other hand consumer purchases of nondurables and services rose 8.3 percent, and State and local government purchases increased by nearly $7 billion.

This, then, is the general picture of the economy as it developed in 1966, and as it looks today. The expansion is moderating, and it is our task to see that this present less vigorous, but more sustainable pace, is maintained. At the same time we must see that those sectors which did not fare well last year participate more fully in the general progress of the economy, while those sectors of excessive demand which gave us problems last year continue to grow, but at a slower and healthier pace.

Prospects and Problems Confronting Us in 1967

A prerequisite for intelligent planning by the Government as well as by business is a reasonably accurate forecast of economic activity. However, as we know, economic forecasting is still an art involving the use of a combination of sophisticated techniques and the experience and judgment of the forecaster.

The Economic Report forecasts for 1967 an overall growth rate of 4 percent in real GNP, a price rise of slightly more than 2.5 percent, and a rate of unemployment averaging about the same as in 1966 — a little below 4 percent. On the basis of the information we now have, these appear to be reasonable expectations.

A year ago, the Economic Report forecast for 1966 an advance in real output of 5 percent, but it turned out to be 5.5 percent. The degree of escalation in Vietnam and its impact on the private economy was not evident in January of last year, and the forecasting of war expenditures is inherently difficult. Partly as a result of the much larger rise in GNP which occurred in 1966, actual Government revenues were far above those estimated; at the same time, Government expenditures greatly exceeded the forecasts made a year ago.

There are some specific aspects of the report which are very important as we look ahead, and I would like to review them in greater detail.

Purchases of goods and services by the Federal Government have risen sharply over the past year, mostly due to the acceleration of spending for the Vietnam operation. Chart 2 shows the recent spurt in defense purchases compared with prior years when such purchases were rising. For calendar year 1966 as a whole, defense purchases amounted to $60 billion—a rise of $10 billion from 1965. The budget implies a further rise of about the same size in calendar year 1967. In the fourth quarter of 1966, the annual rate of defense purchases was $65.5 billion, $5.5 billion higher than the average for the year 1966.

We know that unfilled orders of companies producing defense products have risen sharply over the past year. These orders are currently equivalent to nearly 11 months of the rate of shipments, compared with a little over 10 months ago. Thus, it may be expected that defense purchases will continue fairly strong in the first half of this year with a slowing in the second half of the year. I believe that this pattern of defense spending is realistic, unless, of course, a significant change should occur in the Vietnam situation.

We should be aware, however, of the implications of any marked deceleration in the pace of defense purchases later this year. While it is true that defense production would continue at an exceptionally high rate, a tapering off in the rate of advance in defense purchases could mean little or no further increases in job requirements of the defense-oriented industries. Providing an offset, in case such a development should occur, would be the moderately expanding Federal nondefense programs and expenditures, as now contemplated in the President's budget, such as higher social insurance benefits and enlarged grants-in-aid to State and local governments.

In addition, the President has instructed agency heads, under the leadership of the Chairman of the Council of Economic Advisers, to review priorities for programs and fiscal and monetary measures which will assure a flexible response to the opportunities peace will present, and assure continued growth and prosperity in our economy.

Chart 3 shows the recent upsurge in investment outlays. In the past 3 years alone these outlays have totaled $210 billion. The exceptionally high rate of investment in 1966 was not sustainable and, as I noted earlier, a considerably slower pace of advance in investment is now proceeding.

As chart 4 indicates, the rate of manufacturing capacity utilization had begun to drop in the fourth quarter. But perhaps the major factor affecting investment decisions has been the suspension last year of the investment tax credit and the accelerated depreciation allowances. In view of recent business intentions, the council has estimated an increase of less than 4 percent in capital outlays in 1967. This is a rather small increase and implies a leveling off in such outlays. But if the effect of the tax credit suspension is substantial, the leveling could be relatively brief, since this proved incentive for investment is scheduled to be restored next January 1. If a weakness not presently foreseen should develop here, it would be possible, of course, to consider an earlier removal of the suspension.

One aspect of the 1966 developments which is of particular concern is the admittedly excessive overhang of inventory. As chart 5 clearly shows, inventories have fluctuated widely over the postwar period, but last year inventory additions were exceptionally large. While most industries geared their inventory needs to their current operations, the booming capital goods, industry and the defense products companies increased their inventories on the basis of their sharply rising backlogs of unfilled orders. In the fourth quarter of 1966, the annual rate of business inventory accumulation was $14.5 billion, one of the largest quarterly increases of the postwar period. Some adjustment is in order, indeed, may have already started. Sharp repercussions on employment and income seem unlikely, however, since the smaller inventory requirements of the slower advancing capital goods and defense industries could be offset by increases in demand in other sectors such as consumer nondurables and services and housing. Nevertheless, the course of inventory investment must be watched closely.

I need not review the well-known troubles of the housing industry. But the picture is already beginning to brighten. With some easing in interest rates and a less restrictive monetary policy in recent months, the flow of funds into savings and loans associations is improving. The FNMA and the Federal home loan banks are providing further stimulus. In addition, the less vigorous demand for funds to finance capital goods should increase funds available to housing. Certainly, there is no lack of demand for housing, particularly in view of the more rapid growth in new household formations which is expected this year. On balance, it seems more than reasonable to expect accelerating improvement in housing activity, particularly after midyear.

The demand for consumer durables, particularly automobiles, is being influenced by both economic and noneconomic factors. Last year's 9.0 million new car sales, the second best year, followed the record high sales of 9.3 million in 1965. While it is difficult to prove conclusively, it would appear that the auto sales of the past 2 years were somewhat high in relation to expectations based on consumer incomes, car prices, and other factors. An adjustment more in line with the economic factors is now taking place, and auto companies are gearing their production schedules accordingly.

Consumer expenditures for nondurable goods and services comprised over 78 percent of the disposable personal income in 1966. In the past, these expenditures have been closely geared to personal income after tax, as is shown in chart 6. Since there is little reason to believe that this close relationship will change in the coming year, they are expected to advance along with the anticipated gain in personal income.

The council has forecast that overall prices will rise more moderately than the 3-percent increase of last year. It is true that recently the inflationary forces have abated, as is shown in chart 7. But many basic labor contracts are to be negotiated this year. Labor is reluctant to negotiate on the basis of the long-term average productivity gain, especially in view of the sharply rising consumer prices experienced in the past year and a half. If wage settlements significantly exceed the long-term average productivity gain, profit margins of many industries will be squeezed, thus putting pressure on such industries to raise prices. Corporate profits have flattened out in the past 6 months and with some further tapering in the advance in sales—particularly in those industries which account for a large proportion of profits such as autos and capital goods—profits may be squeezed later.

There is also the question of the productivity gain which may be realized this year. The 1966 productivity increase in the private economy was 2.8 percent, slightly below the long-term trend of a little over 3 percent per year. The 1967 gain may be somewhat higher than the 2.8-percent gain of 1966 in view of the large capital outlays of the past 2 years, which will bring in a substantial amount of more efficient productive facilities this year.

Thus, the 1967 price picture is not at all clear. Nevertheless, the expectation of a more moderate rise than in 1966 seems warranted, particularly if, as it now appears, food prices advance more slowly than last year. Prices of consumer services are sure to continue strongly upward. But the extent of the overall price movement will depend to some extent on the degree to which the unions restrain their demands for wage increases and the extent to which businessmen try to hold the line on prices.

In summary the economic picture is mixed, more so this year than it has been for some time. But the economy may be expected to proceed in a more balanced and orderly fashion than it did last year. Inflationary pressures, we expect, will continue to abate. Easier money and lower interest rates, already being felt, should help to revitalize housing. Consumer demand should be strong as incomes advance, and if social insurance payments are raised by the Congress, Government expenditures will increase, with State and local governments making a large contribution to the rise.

There remain a number of uncertainties notably in the areas of plant and equipment spending, inventory adjustments, and automobile purchases.

The President has wisely proposed that a 6-percent surcharge on personal and corporate incomes be made effective July 1. This will come at the proper time to steer the economy toward a more balanced and sustainable growth.

Given our present expectations, and assuming the policy changes to take place, this adds up to a rising pace of economic activity throughout the year ahead.

I am, on balance, cautiously optimistic in economic outlook. And I am optimistic also in the sense that I believe we have the tools to influence our economy in the direction of stability when instability threatens. This is the import of our mixed outlook and the package of responses to it, which have been admirably set forth in the President's Economic Report.

Let me now turn to some matters of importance to the Nation's economy, which are of particular interest to the Department of Commerce.

Foreign Trade

U.S. foreign trade reached new record highs in 1966.

U.S. exports—excluding military grant aid—rose to $29.4 billion. This was $3 billion or 10 percent higher than the 1965 total—a rate of growth well above the 7-percent average achieved during 1961–65.

Imports, however, increased by nearly 20 percent to $25.6 billion. The 1966 rise was double the average import growth rate in the preceding 5 years.

Thus, although exports showed great strength, the gross export surplus declined from its 1965 level by $1.5 billion to $3.8 billion.

A further expansion of U.S. trade is in prospect for 1967, with exports advancing almost as strongly as last year and imports rising at a considerable reduced rate. Unlike 1966 when our foreign purchases expanded at double the pace shown by our foreign sales, the growth rate for imports is expected to fall.

Exports of manufactured products are expected to continue at a brisk pace. Unfilled export orders for U.S. machinery point to a further rapid increase in shipments well into the first half. Continued technological progress will enable the United States to maintain its generally strong competitive position in several important fields. We may double the 1966 rate of increase in transport equipment exports.

There should be good gains in agricultural exports for the second year in a row. Last year's sharp rise, mainly in wheat and feed grains, will not, however, recur in 1967.

Imports are expected to increase much less strongly that last year in line with the more moderate pace of our economy. Imports of consumer goods should move up more slowly. Business purchases of foreign equipment are likely to be similarly affected by the much more moderate increase in spending on new plant and equipment. And as high inventories are drawn down, purchases of foreign industrial supplies could slacken appreciably. Moreover, a repetition of the unusual 1966 growth in food imports is not anticipated.

Commerce Programs for Trade Expansion

An important stimulus to further expansion of U.S. exports in 1967 will be stepped-up Government efforts in the export expansion field. Commerce will continue to improve its market research and other services to the U.S. foreign trade community and endeavor to bring new firms to new and existing world markets.

We will get more firms to use our oversea centers and match more new firms with established exporters in providing oversea distribution channels under our "piggyback" program. More foreign retailers will be encouraged to stage America Weeks programs.

Cooperation Between Business and Government on Trade Expansion

Cooperation with the business community is an essential ingredient of our program in the Department. It is reflected in continuing consultations with all parts of the business world—merchants, manufacturers, and bankers—small as well as large, and throughout the country.

The work of the National Export Expansion Council (NEEC) affords a good illustration. Composed of business executives in the field of international trade, the council serves in an advisory role in the promotion and expansion of U.S. exports. It also provides leadership and guidance to the 42 regional export expansion councils. Its work has assumed increasing importance in view of the pressures on our international balance of payments. It has contributed to new ideas and Government policies that help American business to become more competitive internationally.

Its recommendations on export financing led to improvements in the U.S. export credit and insurance facilities such as (a) a 15- to 25-percent reduction in certain Eximbank and FCIA fees and charges and liberalization of maturities of transactions eligible for Eximbank guarantees and FCIA insurance; (b) an expanded program of credit guarantees, including guarantees of long-term commercial bank loans to foreign buyers; (c) greater discretionary authority to provide guarantee coverage of export credits; and (d) a new Eximbank discount facility for export paper, with incentives for commercial banks to provide financing for U.S. exporters.

Travel Promotion

Tourism is big business and tourism is growing. But our travel deficit increases. It rose about $130 million in 1966, to over $1.8 billion. Our gain in oversea visitors has averaged 18 percent since 1961, but we need to gain about 25 percent yearly to hold even in the oversea account. We need to reduce the travel deficit in order to help our balance of payments.

We hope to increase our efforts to attract tourists this year, especially business travel, as trade and travel go together and we have requested more funds to bolster the operation of the U.S. Travel Service. Countries such as Mexico and Greece invest more than $5 to attract each foreign visitor. We spend 50 cents.

The President has stated in the Economic Report that "the most satisfactory way to arrest the increasing gap between American travel abroad and foreign travel here is not to limit the former but to stimulate and encourage the latter." The President intends to appoint a special task force drawn from industry and Government to advise on how best we can stimulate foreign travel to the United States. We will welcome this advice and the Department will promptly act on it.

Voluntary Program

Secretary Fowler has already discussed balance-of-payments developments and the programs designed to deal with the problem of the U.S. deficit. I will not duplicate that discussion, but will comment briefly on the Department's role in carrying out the President's balance-of-payments program.

Secretary Connor made a most significant contribution in formulating policies in this area, and we owe him a great debt of gratitude for enlisting the cooperation of the business community in an effective joint effort. The wide extent of voluntary participation in that effort has been a fine tribute to his leadership.

Business leaders realize that they have an especially vital interest in maintaining the strength of the U.S. dollar and in forestalling resort to radical measures. They are willing to lend their help in a balance-of-payments effort that avoids controls on international trade and continues to foster the healthy development of the world economy. Their investments abroad have continued to increase.

We must rely on the industrial and commercial sector of the economy for the foreign earnings to cover the bulk of our costs of foreign operations, both public and private. While we have always emphasized that the Department of Commerce program applies to this entire sector, we have asked only a selected list of some 750 companies to report regularly on their balance-of-payments transactions.

In the first 2 years of the voluntary program, these companies were able to expand their annual average balance-of-payments contributions by about $1.3 billion, largely through increased exports and repatriation of foreign earnings. In addition, they have made noteworthy efforts to contribute on capital account or limit the adverse effects of their own foreign investment programs. Their initial contributions in 1965 included repatriation of more than $400 million in short-term assets held abroad. Subsequently, they made unparalleled arrangements to borrow abroad in order to finance the rapid expansion of capital expenditures by their foreign affiliates and thus limit U.S. capital outflows.

In the 2 years 1965 and 1966, long-term foreign borrowing by the U.S. companies and their foreign affiliates has averaged about $1 billion more than in the preprogram year 1964. This borrowing, undertaken at high cost, made it possible for the companies to hold their direct investment transactions in developed countries below the levels we had suggested as targets for the 1966 program.

75-314—67—pt. 2——15

We have asked the companies to look carefully at investment proposals and to eliminate marginal projects, but we have not suggested the cancellation of projects vital to the competitive strength of U.S. business abroad. This year we have tightened our direct investment target somewhat, although in most cases the suggested level of outflows plus reinvested earnings in developed countries remains at or near the level occurring last year. The implication is that the growth in capital expenditures by foreign affiliates in developed countries should be financed abroad. This is not, in my mind, an unreasonable expectation. American businesses are adaptable. However, for individual companies it may require some sacrifices, especially if it should prove more difficult to raise needed funds in the European capital markets.

In view of the outlook for continued high levels of military expenditures abroad and a possible halt or even reversal of some of last year's capital inflows, there is a need for offsetting increases in contributions in other areas to proceed at an even more rapid rate in 1967. We hope that the reporting companies will be able to increase their overall net contributions on major selected transactions by $2 billion this year compared to an annual average increase of $1.3 billion in 1965 and 1966. The increase in contributions must come largely from expanding exports and increases in U.S. income from foreign investments. At the same time, these improvements on current account would be safeguarded from offsetting increases in capital outflows through the application of the direct investment target.

We are ever mindful of the fact that the voluntary program is by no means a permanent solution. It has helped to improve the balance of payments and had some favorable side effects, such as the accelerated development of the European capital market. But it was not designed as an element of a basic adjustment process. In current circumstances, however, faced with the special costs of the Vietnam situation, we found it reasonable to ask for an extension of the voluntary program. The American businessman has responded and will continue to respond to the interests of the Nation.

Kennedy Round

The substantial reductions in trade restrictions sought by the United States in the Kennedy round should contribute importantly to expanded international trade. These negotiations which formally opened in 1963 must be concluded in the very near future as the President's authority to negotiate reductions in U.S. duties expires with the Trade Expansion Act on June 30, 1967.

Issues that are both thorny and difficult of settlement remain to be resolved in the Kennedy round.

In the industrial area we need a consensus between ourselves and our negotiating partners as to what can be accomplished in the important sectors of chemicals, steel, pulp and paper, aluminum, and textiles, as well as in the important machinery sector.

The field of agriculture has its uncertainties, too. The EEC is being asked for liberalized access for its imports of agricultural products. One hopeful area for agricultural progress is in the area of grains where discussions aimed at a multilateral agreement are progressing.

In addition, there are problems of achieving general reciprocity, since there is unevenness in the offers of the United States as compared with those of some of our major trading partners.

The answers basically lie with the EEC. The Ministers are to meet again early in February. It is our firm hope that they will agree to clear mandates for their representatives so that conclusions may be negotiated in the weeks to come. Time is short. If we see renewed flexibility and adaptability on all sides our hopes for the future of liberalized trade in the free world will be confirmed. The opportunity must not be lost.

Trade Preferences for Developing Countries

Regardless of the outcome of the Kennedy Round, the developing countries are very likely to press even more vigorously than before for international answers to their trade problems. The developing countries are urging the developed countries to adopt a one-way, generalized system of trade preferences by all industrialized countries applicable to importation of processed and manufactured goods from all developing countries.

The United States has expressed serious misgivings about such a system and has questioned whether the advantages would really outweigh the disadvantages. Nevertheless, the United States is willing to explore all alternatives respecting this issue and together with senior trade policy officials of the United Kingdom, France, and the Federal Republic of Germany is engaged in a study of trade problems between developed and developing countries.

The aim of this study, which is being sponsored by the Organization for Economic Cooperation and Development, is to formulate constructive and concerted policies for encouraging increased export earnings by the developing countries. Thus far, the group has concentrated its attention on the preference issue and has been examining ways of dealing with the practical problems which would inevitably arise if new preferences were to be extended to the developing countries. The results of these discussions will have an important bearing on the outcome of the United Nations Conference on Trade and Development to be held next year.

East-West Trade

A third trade problem urgently requiring our attention is East-West trade.

Two-way trade between the free world and Eastern Europe, including the U.S.S.R., has increased substantially during recent years to about $12.5 billion in 1965. Over half—$7.7 billion—of this trade has been with Western Europe and the United Kingdom. However, I am encouraged by our 1966 trade which I believe will exceed $350 million—one of the highest levels attained in almost two decades. Under favorable circumstances, I can foresee substantial increases in our trade with Eastern Europe in goods and technology for peaceful uses.

Major increases in our trade will not be possible, however, until we remove the political and commercial obstacles involved in our continued denial of most-favored-nation tariff treatment of imports from most Eastern European countries. For its part, Eastern Europe must improve substantially its export products and its ability to market them in the United States.

The administration sought authority to extent most-favored-nation treatment as part of broad bilateral commercial agreements to be negotiated with these countries under the proposed East-West Trade Relations Act which Secretary Rusk submitted to the Congress last May. President Johnson has clearly indicated that he will seek similar authority from the present Congress. I fully support the need for such authority and believe the resulting commercial agreements would in many ways facilitate improved commercial relations with these countries and lead to worthwhile increases in peaceful trade.

Mr. Chairman, this completes my statement. Let me thank the committee again for the opportunity to appear before you.

Thank you.

(The tables and charts referred to follow:)

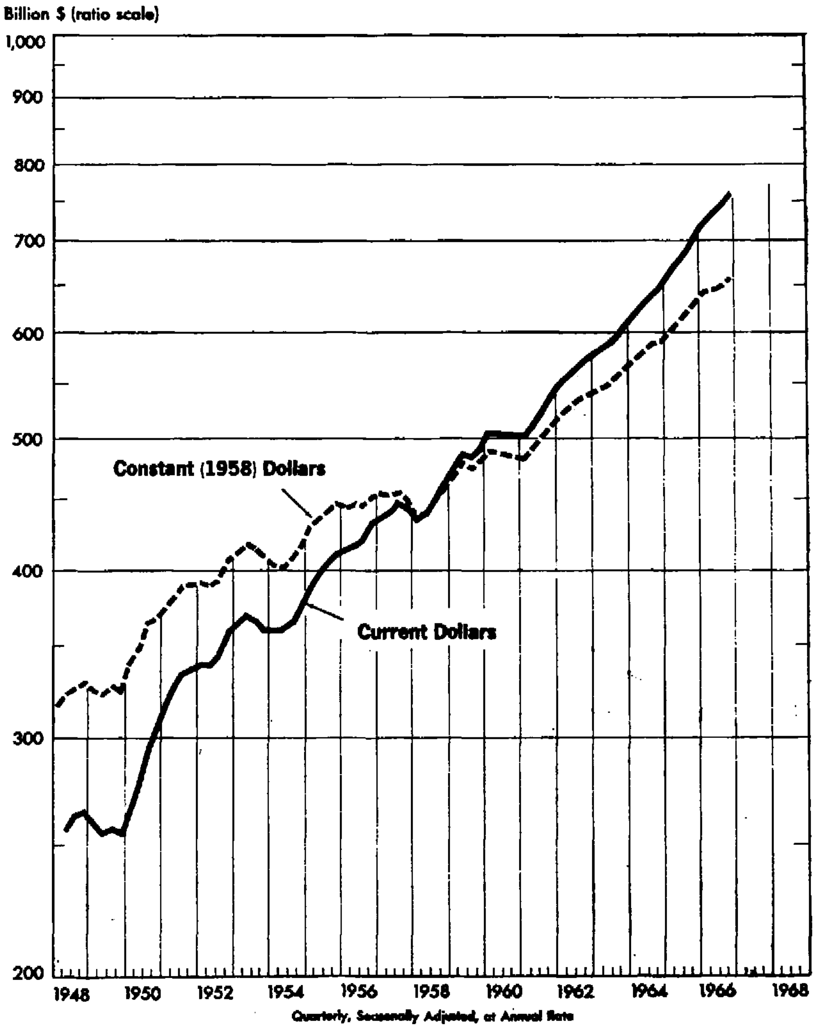
TABLE 1.—*A 3-year performance of selected major economic measures*

	Quarterly changes [1] in—					
	Real GNP	Real disposable income	Civilian employment	Wholesale price	Consumer price	Rate of unemployment
	Percent	*Percent*	*Millions*	*Percent*	*Percent*	*Percent*
1964:						
1st quarter	5.6	8.0	2.2	−0.4	1.2	5.5
2d quarter	6.0	10.6	1.7	−2.0	.8	5.3
3d quarter	4.8	5.2	1.0	1.6	1.6	5.1
4th quarter	1.6	3.2	2.0	.8	1.6	5.0
1965:						
1st quarter	8.8	4.8	1.8	2.0	.8	4.8
2d quarter	4.8	4.8	2.4	4.0	2.8	4.7
3d quarter	6.8	12.4	.8	2.8	1.6	4.5
4th quarter	8.4	6.4	4.6	2.8	2.0	4.2
1966:						
1st quarter	6.0	4.0	0	5.6	2.8	3.8
2d quarter	2.0	−.4	2.2	2.0	4.4	3.9
3d quarter	4.0	4.0	.7	4.0	3.6	3.9
4th quarter	4.4	4.4	4.2	−2.8	3.2	3.8

[1] Quarterly changes at annual rates; based on seasonally adjusted data.

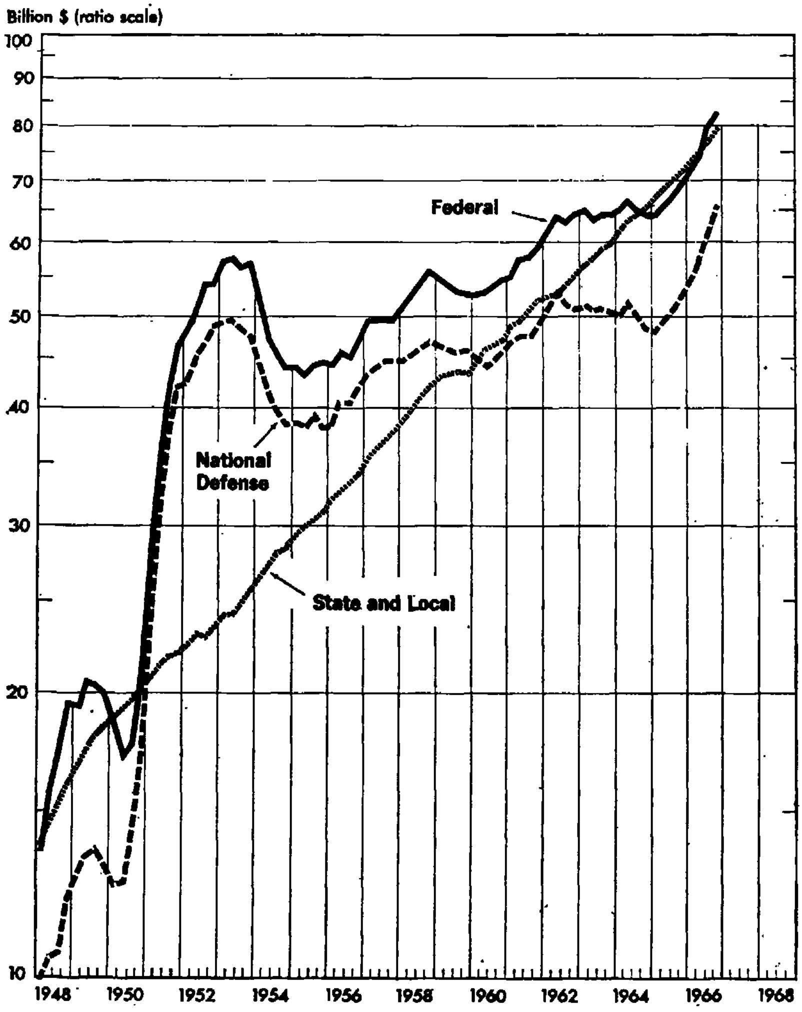
Source: U.S. Department of Commerce and U.S. Department of Labor.

CHART 1.—GROSS NATIONAL PRODUCT



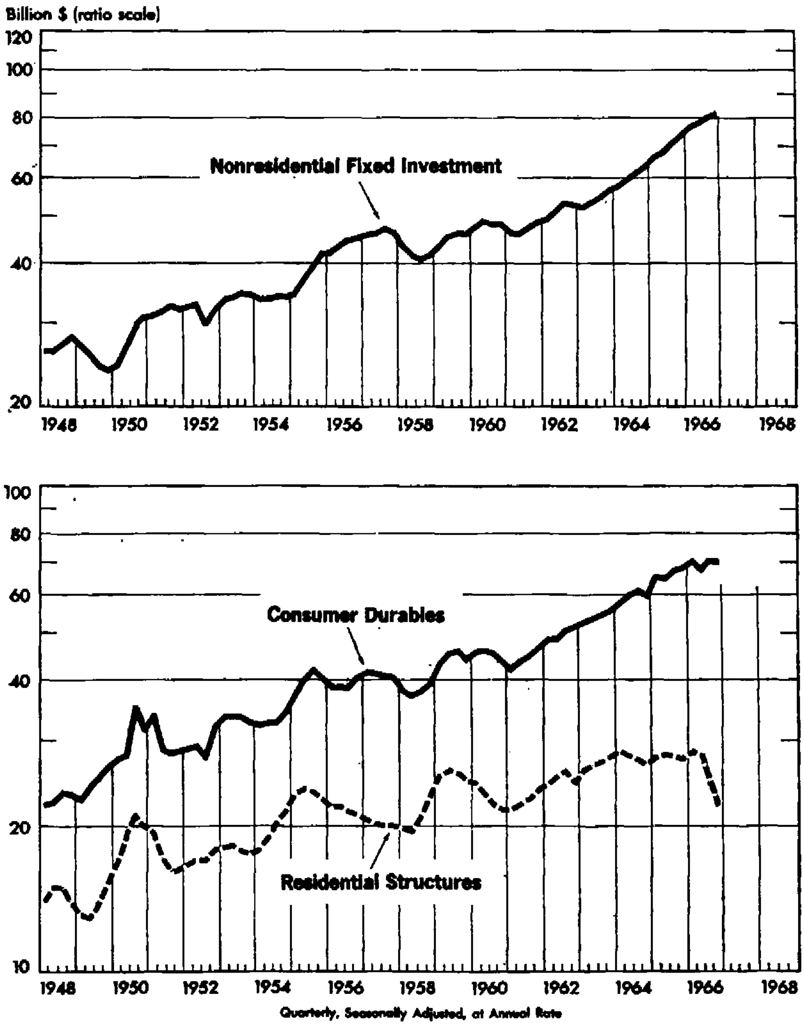
U.S. Department of Commerce, Office of Business Economics

CHART 2.—GOVERNMENT PURCHASES OF GOODS AND SERVICES



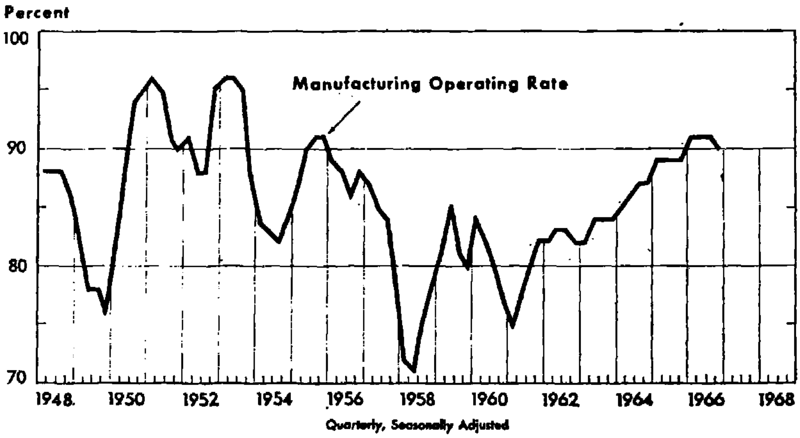
U.S. Department of Commerce, Office of Business Economics

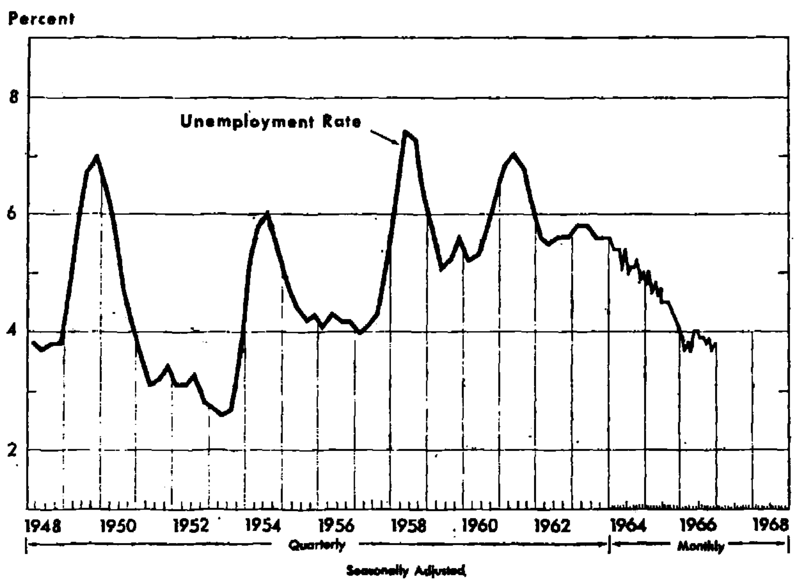
CHART 3.—**DYNAMIC SOURCES OF PRIVATE DEMAND**



U.S. Department of Commerce, Office of Business Economics

CHART 4 **MEASURES OF UTILIZATION**

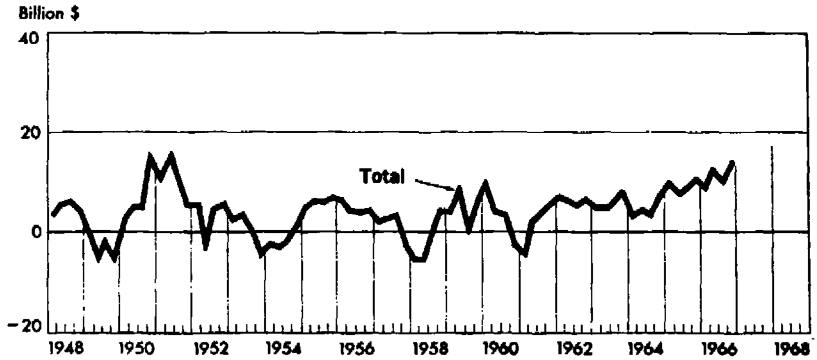




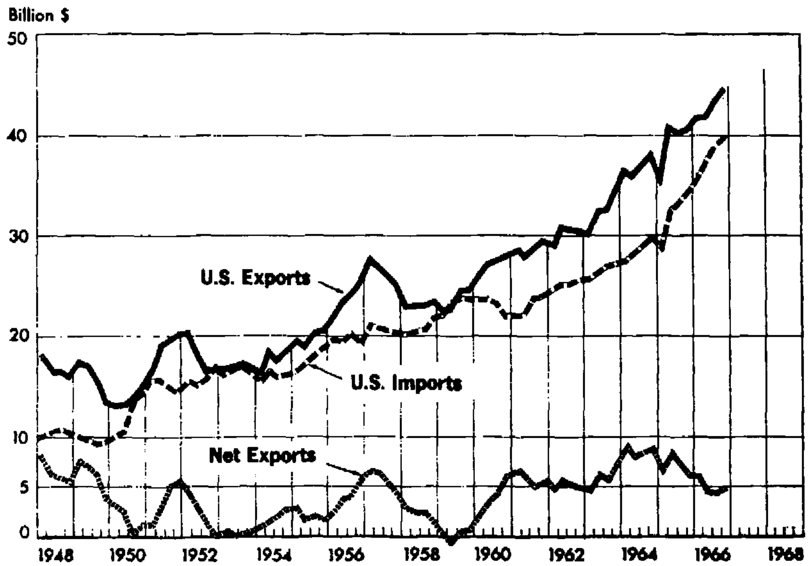
Data: Department of Labor, Federal Reserve

U.S. Department of Commerce, Office of Business Economics

CHART 5.—**CHANGE IN BUSINESS INVENTORIES**



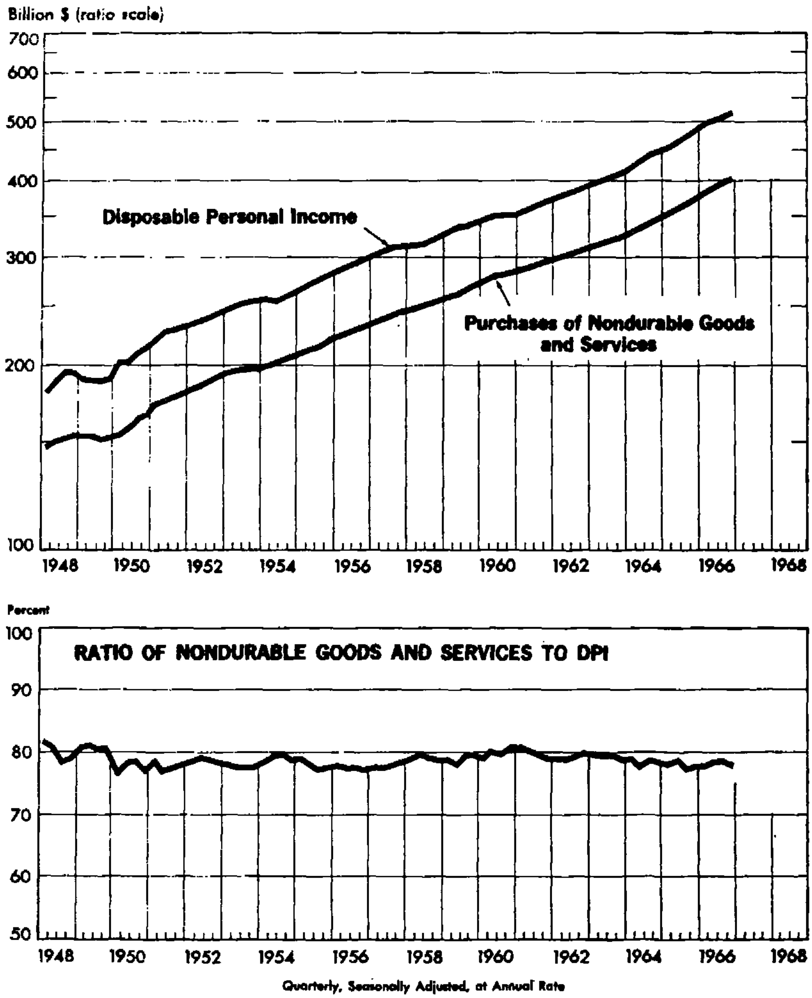
NET EXPORTS OF GOODS AND SERVICES



Quarterly, Seasonally Adjusted, at Annual Rate

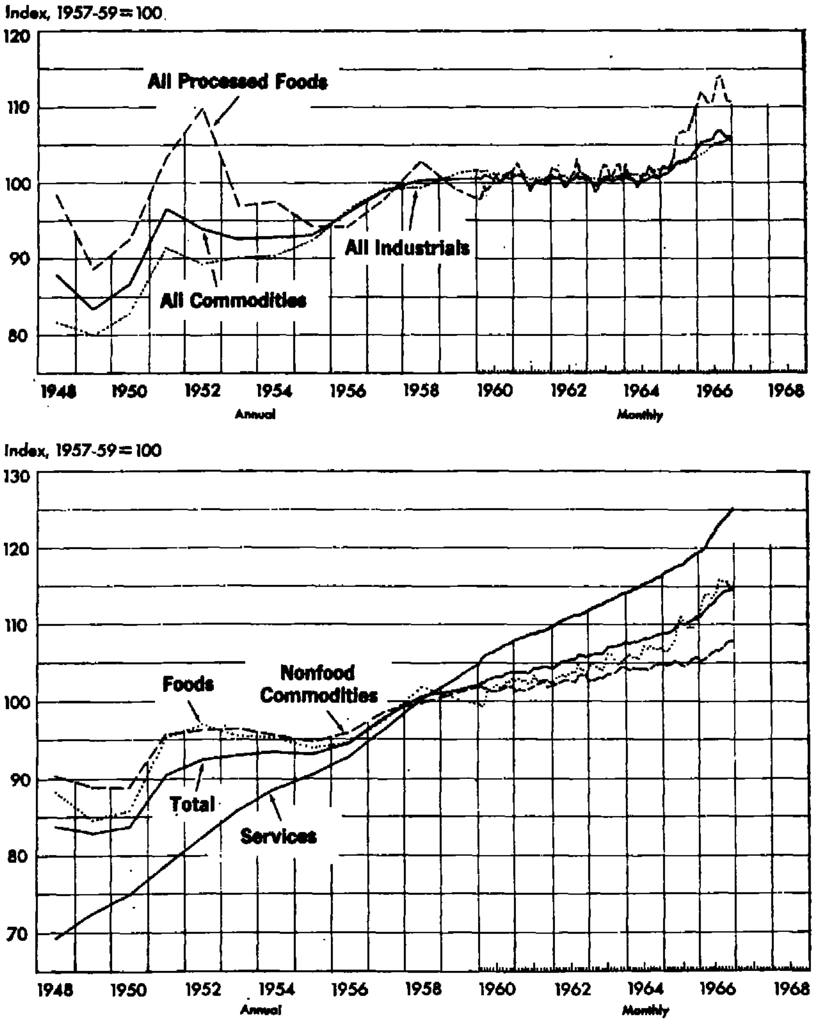
U.S. Department of Commerce, Office of Business Economics

CHART 6.—CONSUMER SPENDING ON NONDURABLES AND SERVICES MOVES WITH INCOME



U.S. Department of Commerce, Office of Business Economics

CHART 7.—**PRICES IN WHOLESALE AND RETAIL MARKETS**



Data: BLS

U.S. Department of Commerce, Office of Business Economics

Chairman PROXMIRE. Thank you very much, Secretary Trowbridge, for a very comprehensive and encouraging statement.

You have referred, in your statement, to the Council's Report, and to their estimate of the overall growth rate of 4 percent in real gross national product.

It has seemed to me that this 4 percent is pessimistic, when you recognize that the Department of Labor "Projections 1970" suggested that a 4.2 or 4.3 percent growth rate would be necessary between 1965 and 1970 to sustain even the present level of employment, and that if we have only 4 percent growth rate that we might suffer increased unemployment.

Now this is particularly true not only of the employment situation but of the plant capacity ratio.

You say that we operated in December of last year at 89.5 percent, and we are now down to 88 percent.

In view of the immense increase in the productivity of our plant facilities, it seems here again we are underutilizing our resources by setting too low a mark. What is your comment?

Mr. TROWBRIDGE. Mr. Chairman, I think the 4 percent projection, which is the growth in real GNP, is a fair one for this coming year. It seems to me that last year, in looking at what was the growth of 5.5 percent, I believe, in real GNP—closer to 8.5 including price rises—we were really operating at a rate of growth which I would prefer not to see on a constant basis, because it was basically pretty overheated.

I think we had in 1966 a substantial increase in the total GNP growth up to a level of $740 billion which I believe was the final figure. Projections for this year, with some moderation in the economy makes sense to look at the 4-percent figure as a real one.

We, yesterday, came out with the unemployment figures for January. They remain at about the 3.7 level. This may continue; it may inch up. But the projections, as the Council looks at it, in an economy where the first half of the year probably will be one of a certainly lesser growth rate, perhaps being spurred on in the second half of the year by increased consumer demand. I think the projection is at this point a realistic one: that we can maintain 4 percnt real growth and keep unemployment in the 4 percent or below area.

Senator PROXMIRE. I realize that this is realistic in the sense that it is easier to achieve than a more rapid growth rate, but since the Labor Department's projections, which were widely hailed as being competent, and this is an expert Department of Government estimates we need a 4.2 or 4.3 percent or better, if we are going to maintain the present level of unemployment, and since we have had lower unemployment, in 1952–53 unemployment hovered between 3.1 and 2.9 percent, with much lesser increase in the price level, 2 percent in 1952 I guess, about 0.7 of 1 percent in 1953, and it actually went down the following year.

I just think that we are being too pessimistic about what our economy can do, in view of that record, and the fact that we have expanded so rapidly, and what should result as you imply in your statement as a greater productivity because of the additions of new plant and equipment.

So I would hope that we would reconsider this, particularly since business, which the Department of Commerce to some extent represents, has been so progressive and so vigorous in making the kind of progress that it has made.

Mr. TROWBRIDGE. It certainly has. The business investment, the whole productivity of last year was going along at a tremendous rate. I know I dealt in more specific terms with a number of the problems that were created by some of our fast paced movements.

Chairman PROXMIRE. It creates problems, but it also opens up opportunities.

Mr. TROWBRIDGE. It does, of course.

Chairman PROXMIRE. The full utilization of our resources with stable prices is our objective.

Mr. TROWBRIDGE. That is right.

Chairman PROXMIRE. So the kind of investment in plant and equipment and new automated equipment and so forth is certainly in our interest, which calls my attention to the second point I wanted to raise. You talk about the incentive for investment, and say that will be restored January 1.

You don't seem to adjust your estimates in the latter half of the year for the fact that you have this big gap. September, October, November, December, with an anticipation that if they wait until January 1 for their investment in plant and equipment, they can get both accelerated depreciation and the restoration of the 7-percent investment credit.

This is likely to create a vacuum in the judgment of the experts in the machine tool industry. Why should anybody buy $100 million worth of equipment which some of these big firms do, in October of 1966, if they can wait 3 months and get a $7 million increase in their net profit by waiting that long. There doesn't seem to be any adjustment and any expectation that this is going to have much impact on the economy in the latter half of the year, and it seems to me it is.

You do say in the course of your statement that if the situation changes, you might request an earlier restoration of the investment credit. But you seem to make the assumption throughout that it is going to be restored on January 1, and there is no problem involved. Am I unfair?

Mr. TROWBRIDGE. Well, of course the current suspension, as approved by the Congress, if allowed to run its full course would carry the suspension through until January 1.

I have talked with a number of people in the machine tool industry, and they certainly reported to me as you have, that they are particularly concerned by holdup of potential orders that might come before the reinstitution of the 7-percent credit. But I have the feeling that there are lots of other factors that go into a business capital investment.

Chairman PROXMIRE. I am sure there are. Let me just interrupt to say that I understand there has already been some reduction attributable to the investment credit according to the McGraw-Hill study.

Mr. TROWBRIDGE. Yes.

Chairman PROXMIRE. But you would anticipate that that would be a lot less now than it is going to be later on?

Mr. TROWBRIDGE. Well, we have done some surveys on this, cooperating with the Securities and Exchange Commission, and our estimates of the impact so far that are reported by the business community as a result of the 7 percent investment credit suspension, is that the total amount of deferred new capital investment is somewhere a little above $2 billion, perhaps $2.3 billion.

Chairman PROXMIRE. And you anticipate that that would be considerably greater if it is allowed to work its course, just because of the obvious commonsense of the businessman who says "Why should I kiss off 7 percent net profit when I can wait a little while?" And the wait is a lot shorter.

Now I can see why any prudent businessman would say, "We have made our investment plans. It is either good or it is not. This marginal difference isn't very great."

Mr. TROWBRIDGE. That is right.

Chairman PROXMIRE. The marginal difference would be enormous in terms of interest in the last 3 or 4 months of this period.

Mr. TROWBRIDGE. Correct. Well, that could well happen. I think the happy thing is that we have a flexibility built in here. If we see a real need to reinstitute, I think the administration would come up and ask to do so.

Chairman PROXMIRE. The trouble with that flexibility, it takes an act of Congress. Sometimes those acts seem easy and sometimes they are, and sometimes they are not.

Mr. TROWBRIDGE. That is right.

Chairman PROXMIRE. You can get a pretty stubborn Congress. You might get a political situation where we have imposed a surtax on individuals of 6 percent, to take something off a business, that makes it harder.

How about considering the possibility of restoring this on a 1 percent a month basis? If you do this, you see, you don't have the gap. You eliminate it.

You still have a retarding effect. You move into the January 1 situation on a gradual basis. Why wouldn't that be acceptable from the standpoint of keeping the slowdown in effect but easing it off so that you don't have the punch at the end?

Mr. TROWBRIDGE. It is a little hard to look down the pike that far in advance, and have a completely crystal clear crystal ball. But it seems to me that the administration should and would be willing to look at the alternatives necessary, under conditions where perhaps an easing into that situation would be very helpful.

Chairman PROXMIRE. You see, the thrust of my question is this. You anticipate, as I understand it, an increase in investment in plant and equipment, whether it would be 5 or 6 percent as compared to the 15 to 17 percent we have had in the last 3 years.

This is a big slowdown, and it is a slowdown not only from the standpoint of stimulating the economy, but it is a slowdown also in our potentiality of being able to produce more and being able to keep prices down. So I am very concerned with this aspect of the administration policy, because it would seem to me that this is a good notion of having an investment credit, we should certainly have it in effect at a time when business seems to be slowing down and there is every indication that it is slowing down considerably now.

Mr. TROWBRIDGE. Well, it seems to me, Mr. Chairman, it is important to remember that we are slowing down from an extremely high plateau.

Chairman PROXMIRE. Oh, yes, that is true. I think that is a good qualification.

Mr. TROWBRIDGE. I think when we get into this relativity area, we have to remember——

Chairman PROXMIRE. We still have 3 million people out of work. We are still operating below the optimum capacity for business; we are operating at 88 percent. What is the optimum capacity, about 91?

Mr. TROWBRIDGE. Economists generally say in the range of 90 to 91. This is the point where you are really bumping the ceiling.

Chairman PROXMIRE. We are below that.

Mr. TROWBRIDGE. We still are, however, with an unemployment rate of 3.7 percent as of January. There is bound to be some fluctuation in that as we move along. But I think that when I use the words "cautiously optimistic" here, I mean it.

This recognition of the high level of activity and the health of our economy is something we have to remind ourselves of pretty strongly. We are going to have some leveling off, and indeed I think we can stand some moderation, because it was pretty highly geared in the last portion of last year. Inventory accumulation was particularly strong. But it seems to me we are heading into a year where continued economic activity at a high rate is going to be seen.

Chairman PROXMIRE. My time is up. I will be back with some more questions.

Mrs. Griffiths?

Representative GRIFFITHS. I would like to ask you about the investment credit myself. Did you actually have two-tenths or three-tenths of a million orders that were not placed? Are the toolmakers still in business, still turning out tools?

Mr. TROWBRIDGE. The toolmakers are very much in business, Mrs. Griffiths. If I am not mistaken, recent press reports have indicated a slight reduction in the size of back orders, of unfilled orders. I think it was down from—don't hold me to this exactly—I recall 11 months, and down to 10. And this survey, which has been held, is not indicative fully, doesn't tell us exactly, where the decisions were deferred. I would like to ask Assistant Secretary Shaw, if I might, to comment on this point. He has a little closer knowledge of it.

Representative GRIFFITHS. I would like to hear him.

Mr. SHAW. Mrs. Griffiths, may I make two comments. First, in connection with this survey of business spending on plants, this figure of between $2 and $2.5 billion is an estimate made by the companies that do the capital spending. It represents the amount by which these companies stated they will reduce capital spending in 1967, as a result of the suspension of the tax credit.

My second point has to do with this problem of orders, and, if I might, I would like to read a few figures on new orders in the machinery and equipment industries. In December 1965 these new orders were approximately $4.5 billion. Beginning with October 1966, and using figures on a seasonally adjusted basis, $4.8 billion in October 1966, $4.6 billion in November 1966, $4.6 billion in December 1966.

In these figures there is as yet very little evidence that new orders have dropped off sharply——

Mr. TROWBRIDGE. In the machinery and equipment industries.

Representative GRIFFITHS. I would say that the work within those plants has dropped off even less. I was asked just the other day to get 15 skilled workmen immediately for a Detroit plant. Now, I haven't been asked that before. So that I am sure that the toolmakers are still in business.

During the time that we discussed this on Ways and Means, I asked repeatedly what would be the effect of taking our goods in place and putting it back on orders, what the effect would be. That some of the largest concerns you would find on the first day of January 1968 would be able to buy fully equipped tools, and finally some manufacturer came in and said yes, he thought they would be.

You would have to place this in writing, to be able to walk in and buy it. But it would be made exactly to your plan.

In my opinion the suspension of investment credit really didn't do very much. The way it should have been suspended was to simply have repeal of the act, and when it was reinstituted it should have been based on orders, not on equipment in place.

Mr. TROWBRIDGE. I certainly can say my experience of the tightness of the skilled labor market in the machine tool industry—perhaps with your people, it is not as direct—that in the Department we have worked as closely as we could in trying to identify those areas where tightness in either raw materials or skilled labor was evident, and working with the industry and with the Department of Labor in manpower development work, it was very, very clear that the machine tool industry is one of the tightest; there is no question.

Representative GRIFFITHS. The staff would like to know now that the economy nears its potential, it seems essential to concentrate increasing attention on structural improvements. How are the area development programs of the Department of Commerce meeting this challenge?

Mr. TROWBRIDGE. The Economic Development Administration programs, which as you know have taken on the role once held by ARA, the Area Redevelopment Administration, are I think in good hands. They are working and are making good progress. There has been no question that in the period of adjustment, transition between the two administrations, that we have had to take care of and process a backlog of various projects that were under consideration.

A number of them did not get approved. A number of them couldn't be approved, because you can't fill all of the requests with the money available, and these resources were limited.

We have had about 565 areas, roughly 10 percent of the country's population, suffering from severe unemployment, and these areas will qualify for assistance in fiscal year 1968. The projection is that over 150,000 new jobs would have to be created simply to raise these areas to a minimal level of prosperity, and an additional 150,000 new jobs would be needed to match economic conditions in the rest of the country.

I think this gives an idea of the magnitude of the attempt. We have now established these regional economic development commissions. The chairmen of these commissions have been appointed, and they are in business. We look forward to a year in which we not only learn a lot but do a lot in the whole economic development area.

Representative GRIFFITHS. When you have identified these areas, what effort did you make to move the people out of the area or place some jobs in, or does this go to Secretary Wirtz only?

Mr. TROWBRIDGE. The movement of people?

Representative GRIFFITHS. Out of the area to where they———

Mr. TROWBRIDGE. I think the purpose really of the whole idea is to provide jobs in an area rather than move people out.

Representative GRIFFITHS. We have another program where we bring them out. That is over in the Labor Department.

Mr. TROWBRIDGE. I think it is.

Representative GRIFFITHS. If you identify the areas where there is high unemployment, maybe we can get the Secretary of Labor to move some of them out and make your job less. What have been the effects of the high interest rates on small business formations and failures, and what is the small business failure, bankruptcy rate now?

Mr. TROWBRIDGE. Mrs. Griffiths, I don't have those numbers. I would be very happy to supply them for the record.

Representative GRIFFITHS. Please do.

Mr. TROWBRIDGE. I know what one reads and what one hears, that the high interest rates have been particularly difficult for many people in the business community, housing being a prime example. But in all honesty, I don't know offhand what the rate of business failure is most recently. I can find out and will be glad to submit it to you.

(Tables below were subsequently supplied by Secretary Trowbridge:)

Interest rates and business failures, 1965–66

Year	Bank rates on short-term business loans in month preceding [1]	Number of business failures per 10,000 concerns [2]	Index of net business formation (1957–59=100)
1965:			
1st quarter	5.00	53.1	106.4
2d quarter	4.97	51.7	105.4
3d quarter	4.99	56.5	106.1
4th quarter	5.00	52.4	106.2
1966:			
1st quarter	5.27	48.3	109.4
2d quarter	5.55	47.5	106.9
3d quarter	5.82	56.6	103.8
4th quarter	6.30	55.1	[3] 102.0

[1] Average for 19 cities.
[2] Seasonally adjusted annual rate.
[3] October-November average.

NOTE.—Statistics of business formation and failures by size of business are not available. It is known, however, that the vast majority are small businesses.

Source: U.S. Department of Commerce, Survey of Current Business and Business Cycle Developments.

75-314—67—pt. 2——16

Bank credit to manufacturing corporations, by size of company—Percent changes in total outstandings

	September 1964 to September 1965	September 1965 to September 1966	June 1966 to September 1966
Short term:			
All companies	25.7	40.5	7.7
Smallest size class (assets under $1,000,000)	5.4	18.8	11.9
Due in more than 1 year:			
All companies	35.5	30.9	.3
Smallest size class	3.1	25.2	3.3

NOTE.—It appears that small manufacturers expanded their bank borrowings relatively more than large manufacturers during the period when credit was tightest. A possible explanation: small banks, which lend mainly to the smaller businesses, commonly keep their reserves well above the required minima, and their lending power was therefore not so much affected by the pressure on reserves in the latter half of 1966.

Source: U.S. Federal Trade Commission and Securities Exchange Commission, quarterly financial report.

Representative GRIFFITHS. If the East-West trade bill passed, what would be your anticipation about our share of the market?

Mr. TROWBRIDGE. I don't believe that the mere passage of the East-West trade bill and the implementation of commercial agreements through it, is going to have a tremendous effect on the total level of trade between the United States and the Eastern European Communist countries right away.

I think it will, first, provide the framework in which this trade can expand over a period of time, by in effect doing away with what is a differential in discriminatory trade treatment.

Secondly, I think it will show our business community that the Government does believe that the opening up of peaceful trade with this area of the world is in our national interest, and that they will then go out and develop some parts of this market.

There is a growing awareness, I think, in the American business community not only of the value from the national point of view of developing these peaceful contacts, but also that there is a sizable market in the Eastern European area at the moment being filled by the Japanese, by the West Germans, and by the Italians, by the French, by the United Kingdom.

Our businessmen surely, as good competitors, would like to be in that market and would go forward perhaps with more confidence if the bill were passed, and if we proceeded to implement these agreements.

I think we have to recognize that the pattern of trade which the Soviet Union and other Eastern European countries generally follow is one of bilateral balancing. They try to export as much as they import from a given country, whereas we tend to try to triangulate our trade.

The ability of the Soviet Union and the Communist countries to export to this country and to market in our competitive market economy is going to be crucial to the growth of their exports, and hence the level of our exports to them.

I think it would be good, frankly, to have some of our marketing methods and our competitive world known to the economy of the Soviet Union and to the Eastern countries. I think it would be very salutary to put them in the midst of it and see how they make out.

Representative GRIFFITHS Personally I think it is a shame driving around on Italian made tires, but I was told in England that 10 years later they have not made a single improvement, so you can sell them these improvements.

Chairman PROXMIRE. Congressman Rumsfeld?

Representative RUMSFELD. I have three or four questions. The President has made a proposal concerning the merger of the Department of Labor and the Department of Commerce. I might say parenthetically that I approach this in a very favorable frame of mind. As a member of the Government Operations Committee, which will review this reorganization plan, it strikes me that it might very well have a great deal of merit.

I would be interested to know, however, what your reaction might be to the counterproposal concerning the possibility of isolating out essentially economic functions and programs from a number of different agencies, and combining them into a Department of Economic Affairs. The problem comes up as to what the structure of the executive departments should be, and how we can best meet the problems of the country, and I am sure this was debated to some extent. Do you think this has merit, this counterproposal?

Mr. TROWBRIDGE. Well, actually, Congressman Rumsfeld, I think the basic proposal of the President, and as we are trying now to put some real meat on the bones, is that it makes a lot of sense. We are working hard on it right now. We hope to have the details of it available to discuss with you and other Members of the Congress in a short time.

The approach we are taking in implementing the President's proposal is not to build a holding company or a merged Commerce and Labor just the two Departments put together in some form.

We are approaching it really from the basis of what can we do to modernize, to pull together, to coordinate more effectively, to build a new Department in Government using Commerce and Labor Departments as they now exist as the base of it. But we have taken an inventory of other parts of the Government, other agencies, and other functions which they now carry out, and which would logically fit together with Commerce and Labor.

Representative RUMSFELD. Do you anticipate that some economic functions of other departments would be included in the proposed new Department?

Mr. TROWBRIDGE. I think so, yes. Our proposal is to try to pull together the logically related functions of Government in the economic development, manpower development, and economic analysis areas, and first of all we have to apply the criteria of logical fit. Can we put these things together and do they have a relation to each other?

Second, realistically can we propose this and get it approved. These are the tests we are trying to apply right now.

Representative RUMSFELD. I like to think if it is realistic it could be approved.

Mr. TROWBRIDGE. Yes, but everybody's definition of realism always isn't the same.

Representative RUMSFELD. Right. This same question of course came up when there was talk of creating a Department of Science and Technology, and I personally felt that would have been inadvisable;

that these problems do touch all aspects of Government, and that it would be far preferable to do what was done, to create an Office of Science and Technology in the Executive Office of the President to coordinate these types of functions in the existing agencies. I can see the merit in what the administration has proposed; namely, to merge these two Departments, to try and bring the functions that are easily brought in, but not to strip all economic function from the other departments necessarily.

Mr. TROWBRIDGE. Well, we hope to be able, as I say, to build on the basic building blocks of the two existing departments, and add to them in such a way as to get a very imaginative proposal, and one that is going to be one of consolidation of functions, and make the President's job a little bit easier in that he has got an awful lot of people reporting directly to him, and lots of conflicting voices that he has got to listen to. I think it would be better to have them under a roof where you can pull them together from the national viewpoint.

Representative RUMSFELD. Britain, of course, is making a strong bid to enter the Common Market. I get the feeling that they aren't terribly optimistic about entering within the immediate period, but that they are quite optimistic about the possibility of entering some time by 1970 or thereabouts, or somewhat before.

Let's assume that Britain does get in. What would be the short-run effect in 1 to 2 years on the United States, and the longer run effect, specifically say beyond 2 to 4 years?

Mr. TROWBRIDGE. Well, I think the short-run effect has to be measured really on the basis of how the Kennedy Round comes out, because if the United Kingdom joins with the Common Market she would presumably go through with the obligations of the Kennedy Round. The external tariff common to all countries would hopefully have been reduced by the Kennedy Round, and that our trade, or the trade barriers between us and them would be substantially reduced.

I think really we have approched this whole concept of a regional common market recognizing that there are going to be some additional tariff barriers and hurdles that our trade will have to overcome.

Representative RUMSFELD. What particular segments will be the hardest hit?

Mr. TROWBRIDGE. By the creation of the Common Market?

Representative RUMSFELD. By Britain's entry? What segments of our society would feel the greatest impact from this, on U.S. exports?

Mr. TROWBRIDGE. I find that a little hard to answer right offhand, Congressman. Could I ask my friend Mr. Robert McNeill to counsel me on that one or to make a comment?

Mr. MCNEILL. I was afraid, sir, he was going to do that. We honestly don't know what the answer to your question is.

In terms of U.S. exports, it is likely that in a short run there would be certainly no major adverse impact that would be discernible to us. In the long run, in terms of U.S. exports, we think it perhaps would be beneficial for Britain to enter the Common Market with all that that would mean for expansion of that market, the generation of increased income, and therefore provide a larger magnet for imports from this and other countries.

Representative RUMSFELD. You don't see any harmful effects to the United States short run or long term from this possibility of Great Britain entering into the Common Market?

Mr. McNeill. You are talking strictly about exports?

Representative Rumsfeld. Yes.

Mr. McNeill. We looked at this quite carefully back in 1961–62, when Britain was negotiating access into the Common Market, and at that time were not able to come up with any judgments that we would be severely affected in terms of the drop in our exports to the United Kingdom.

Representative Rumsfeld. Turning to the other possibility, let's assume that the reasons why some countries are not very eager to have Great Britain in the Common Market aren't economic but are political, and they can't be worked out, and Britain doesn't go in. What is your Department's attitude on the possibility of creating a free trade area composed of some of the more developed countries, not just in the Atlantic area but possibly also Japan and others?

Mr. Trowbridge. Are you suggesting a regional across-the-Atlantic free trade area kind of relationship?

Representative Rumsfeld. That is one possibility. However, ignoring Japan would be difficult, so, as I say, not just in the Atlantic but beyond.

Mr. Trowbridge. Well, our approach to this, I think, historically has been the hope that multilateral tariff negotiations, such as the Kennedy Round, are going to be a lot more advantageous than the proliferation of regional trading blocks and preferential treatment between them. Mr. McNeill may want to add something to that?

Mr. McNeill. If I may, Congressman, digress a little bit on the foreign policy objective of the United States in Europe, which basically is to bring together, as I understand the policy, the French and the German people, in a situation such as now exists of peace. Our postwar policy has been aimed toward that end.

Representative Rumsfeld. I wasn't asking you a foreign policy question.

Mr. McNeill. I understand. I want to start there and then go to the answer.

Representative Rumsfeld. My question is as to the economic impact.

Mr. McNeill. You would be negotiating for a free trade area, essentially, I suppose, for an economic purpose, which is what you have in mind. But the political implications of that would be quite serious, because it would involve turning somewhat away from Europe toward something else as the heart of Atlantic policy. By Europe I mean Common Market Europe, and that, I think, would be a very serious step that would have to be considered by the administration in any consideration of a free trade proposal.

Representative Rumsfeld. I am sure it would be. My time is up. I would like to ask one last question if I may?

Chairman Proxmire. You have unanimous consent. Go ahead, sir.

Representative Rumsfeld. This concerns the proposals that have been made recently to study the effect of the possible transition to the metric system. It is my recollection that the proposals didn't pass the Congress in the last session. Is the Department planning to pursue that this year? Will there be a message on that subject or a recommendation from the Department, do you know offhand?

Mr. Trowbridge. Congressman, I am searching my memory as to where that does stand. I know that we were very active on that question in the last session.

You are correct in that it did not get approved here. I believe that we continued to support the idea of such a study. Whether or not there are plans to reintroduce the idea, the proposal in this session, I am frankly not aware, but I will be glad to comment on that subsequently.

Representative RUMSFELD. I think that very likely this ties into this question of trade.

Mr. TROWBRIDGE. Yes, it does.

Representative RUMSFELD. I think it has a bearing on it, and I am further of the opinion that the fact that Congress has not specifically requested such a study should be no inhibition or prohibition on the Department of Commerce to undertake a study on the possible advantages or disadvantages of U.S. use of the metric system. At least a better understanding of what advantages or disadvantages might accrue to this country as a result of such a study. I would hope the Department would take a good look at it.

Mr. TROWBRIDGE. We certainly will.

(The following statement was later submitted for the record:)

THE METRIC SYSTEM AND INTERNATIONAL TRADE

The Department of Commerce has consistently supported the various bills that have been before the 87th, 88th, and 89th Congresses to authorize a comprehensive study of the advantages and disadvantages of increased use of the metric system of measurement in the United States. While the Department has not proposed such legislation, it strongly favors the enactment of appropriate bills for this purpose such as S. 441, recently introduced in the 90th Congress by Senator Clairborne Pell, and H.R. 3136, introduced by Congressman George P. Miller.

During the 89th Congress, the Assistant Secretary of Commerce for Science and Technology discussed the many important needs for a metric system study when appearing before the Senate Committee on Commerce on July 14, 1965, in support of S. 774. Similar testimony was presented to the House Committee on Science and Astronautics on August 2, 1965, when that committee held hearings on H.R. 2626 which was superseded by H.R. 10329.

On these occasions, special attention was directed to the pressing need for a better understanding of the extent to which disparities in systems of measurement between the United States and metric-using countries may constitute a barrier to our international trade. It was emphasized that there has been an increasing trend over the last few years in various other countries not only to make the metric system their legal system of measurement, but to prohibit the use of any other system. The announcement of May 25, 1965, by the British Board of Trade of that country's intention to adopt the metric system was cited as a particularly significant development in this general trend which may have an important effect upon American industry and our foreign commerce.

The Assistant Secretary also stressed our general lack of factual information needed to guide decisions in both Government and private sectors concerning increased use of the metric system in this country. Our limited understanding of the interaction between measurement systems and the increasingly important international product standards, which establish preferred sizes, shapes, and other physical characteristics of the articles of international commerce, was noted as one example of the many complex problems that should be investigated.

The Department of Commerce is fully convinced of the need for a broad and comprehensive study of this subject to be initiated as soon as possible. We currently are considering various means to assist and encourage industry toward voluntary self-examination with respect to some of these matters. Such activities by the Department might help to increase the awareness of American business and industry to the problems posed by the increasing world-wide use of the metric system, and might help to identify voluntary actions that can be taken in various industrial areas to adjust to this trend.

We strongly believe, however, that our national interest requires a much broader study of this very complex problem to produce factual information for the establishment of a national policy with respect to utilization of the metric system. This will require the full cooperation of industry, commerce, labor, science, consumers, and numerous other sectors of our society, and it will require the investment of significant Government resources in terms of manpower and money. We believe that the necessary national support for such an extensive and important study can only be assured through congressional endorsement and authorization. For this reason we strongly urge prompt enactment of the bills for this purpose that are currently before the Congress.

Chairman PROXMIRE. Senator Symington?

Senator SYMINGTON. Thank you, Mr. Chairman.

You mention tourism in your statement. The plan is still to have incentives for people to come over here as against any restrictions against the citizens of this country going abroad and spending over there, is that correct?

Mr. TROWBRIDGE. That is correct, Senator.

Senator SYMINGTON. Is there any contemplating of stipulating that our citizens use ships and airliners under the American flag?

Mr. TROWBRIDGE. Not as any particular rule or legal requirement. I think you are aware that as one of the techniques that we suggest to American companies, as they approach how they contribute to the balance-of-payments situation, is the use of American aircraft and flagships in the movement of their people and goods. This is a method rather than a requirement.

Senator SYMINGTON. Does the Department of Commerce believe that the 18-year continuing loss of gold—with the exception of 1957—is a serious matter?

Mr. TROWBRIDGE. Yes, it does, Senator.

Senator SYMINGTON. Tourism today is probably the greatest single antibalance-of-payments item, is it not?

Mr. TROWBRIDGE. At $1.8 or $1.9 billion, I think you are probably right, as a single element of the total picture.

Senator SYMINGTON. I am not sure, but believe so.

Mr. TROWBRIDGE. Yes, sir.

Senator SYMINGTON. You have said in your statement "We are ever mindful of the fact that voluntary programs are by no means a permanent solution." What would you see as a permanent, or semipermanent, solution to curbing the flow of investment dollars abroad to a reasonable level so as to improve our balance-of-payments position?

Mr. TROWBRIDGE. Well, of course our very real hope is that we won't need a permanent method of curbing investment outflow. We are hopeful that the stimulation of exports, the accumulation of earnings abroad and the use of those for reinvestment purposes, the borrowings abroad, these various features of our current program, will be continued by business.

We are particularly mindful that American investments abroad are a good thing, and our concern is how do we finance them.

Senator SYMINGTON. If the administration would come right out and say that actually it didn't make much difference whether we had adequate gold or not, that would be one thing; and it could be discussed with that premise. But each year, in all the years I have been interested in this subject, administration witnesses come down and say it is very serious matter, and they are going to correct it "next year." But they never do.

That is what worries me most. We have now about 10 percent of free nonmonetized gold available if we were called by these foreign citizens and their central banks. Even if we abandon the pledged gold reserve against outstanding Federal currency, we wouldn't have half the gold now needed, if there were a mass call.

The administration is the one saying it is a serious matter; but they don't seem to be able to do anything about it, sort of like Mark Twain and the weather.

We have been getting these hopeful statements year after year. The operations may be successful, but the patient continues to die.

What do you think of a recent proposal to impose some sort of tax on U.S. businesses abroad, as a means of defraying part of the cost of the Federal Government, protecting, promoting, and defending those private investments overseas.

American companies probably make 10 times as much off a barrel of oil out of the Middle East than from a barrel of oil out of Oklahoma or Texas. On the other hand, if it were not for all the money we spend maintaining a position abroad, defense, foreign aid, et cetera, there wouldn't be much chance of all this business continuing the way it continues today.

Again, with the premise we are steadily losing our gold, what would be your reaction to our putting some form of tax on those companies abroad as a means of defraying part of the cost.

Mr. TROWBRIDGE. Yes. I wouldn't be very enthusiastic about that idea frankly. I feel that the American position around the world is one of heavy engagement because we have what we consider to be national policy reasons. We have national security reasons for our troops in Europe.

We have some very real programs of integrated defense and integrated political action with our allies through treaties and so forth. I think these are the reasons we are maintaining a large defense posture at all.

Senator SYMINGTON. We have a lot of integrated programs with them, presumable mutually advantageous.

Mr. TROWBRIDGE. Right.

Senator SYMINGTON. Now in recent years all the developed countries of the world have increased their reserves and gold holding, Spain over 600 percent, France over 500 percent, West Germany some 482 percent; that is, all but the United States, and we have lost some 45 percent of our gold and reserves in the last 10 years. How long can we have these cooperative agreements with these other countries whereby they end up with heavily increased reserves and gold, and we end up with heavily decreased reserves and decreased gold, if it is a serious matter. The Treasury is always saying it is serious, and I take their word for it.

Mr. TROWBRIDGE. Well, sir, I certainly agree as to it being serious. I can't quite see though that the factor of our defense interests and defense expenditures abroad can be characterized as being necessary, and in fact in place, to protect American business investments, and therefore the business involved should pay, through a tax, for these defense activities.

Senator SYMINGTON. There is more to it than just defense, including all the loan and grant aid programs.

Mr. TROWBRIDGE. Sure.

Senator SYMINGTON. Let's take the shoe business, which we in Missouri know something about.

We make a tremendous number of shoes over here, on fine shoe machinery. The Japanese and the Italians pay but a fraction of what we pay our workers. We ship shoe machinery over there, which they pay for, and that helps the export-import ratio; but ultimately of course that comes to an end.

Also we ship the original machinery to the foreign affiliates of our own companies. But is there a point of diminishing returns when they will no longer seek such goods from the United States, instead will be purchasing locally? Have we made any studies about that?

Mr. TROWBRIDGE. Well, I couldn't quote you a particular study, Senator, but I am quite sure that this is a continually evolving thing. I think it is somewhat like the argument over whether computers were going to really stimulate economic development or put a lot of people out of work.

It seems to me that the truth of the computer industry is that it has developed a whole series of new industries and a whole series of new jobs, and I think that the American overseas investment can be looked at in a very similar way. Where in one industry there may be a point of no more return as far as American machinery goes abroad to make a product, but there is another industry starting up tomorrow that is going to need more machinery, or there is a third industry that is setting up an assembly plant that is going to use semiprocessed goods or materials from the United States.

This is a very dynamic situation. The overseas business world is one which is growing tremendously, as you well know, there are opportunities for American business around the world for sensible investments, which will be supported by increased exports, and we do have studies which show that in the year 1964, I think that we had a level of roughly $24 billion worth of exports, and about $6 billion of that was directly tied to exports of commodities, raw materials, and machinery, from parent companies in the United States to their affiliates abroad, supported from American investments.

Senator SYMINGTON. Our excess of exports over imports has been dropping pretty steadily.

Mr. TROWBRIDGE. It has over a couple of years.

Senator SYMINGTON. On page 26 you point out something quite intriguing; namely, that trade between the free world and Eastern Europe, including the U.S.S.R. is $12.5 billion, of which we do about $277 million, or about 2 percent of the total.

Mr. TROWBRIDGE. This is 1965, right.

Senator SYMINGTON. For some reason all other developed countries, politically, seem to be becoming more nationalistic, but we maintain political internationalism.

But these same developed countries buy and sell a lot of military and other equipment from the countries behind the Iron Curtain. Now at the same time we promote and continue our international relationships politically, we maintain a position which is quite nationalistic in our economic approach. Even though we defend a very large percentage of these countries, and finance a large percentage through this tremendous dollar printing of paper gold, they do all the Iron Curtain trade they want, and we do very little. We maintain internationalism politically, nationalism economically. They are working toward more nationalism politically, and internationalism economically.

I asked Secretary of Commerce Hodges and Secretary of the Treasury Dillon if there was any developed country in the free world except the United States that wasn' t doing its best to sell everything it could behind the Iron Curtain. The answer in both cases was no.

Mr. TROWBRIDGE. I think that is basically true.

Senator SYMINGTON. And so, from the standpoint of world trade. We are the only country that can't do a lot of things all other countries do. You mentioned that the President has clearly indicated he will seek authority to increase our East-West trade, to give our manufacturers an opportunity to get in on these tremendous new markets. When do you think that is coming up to the Congress?

Mr. TROWBRIDGE. The date of the submission I am not sure of, Senator. I am quite confident it will be along in a reasonably short time. There is of course the question of arranging the proper time for hearings and consideration by Congress. Chairman Mills has indicated that this will go forward.

To the best of my knowledge we have all intentions of proceeding as the President has outlined. Our hope is that we can present a very strong story of the need to use what I consider to be a dual truck policy in this whole area.

On the one hand we have our Vietnam commitments, we have our determination that aggression won't pay, but on the other, we maintain peaceful contacts, and we build those contacts and we use them as a pressure release valve, and I think this East-West trade area is going to be very useful.

Senator SYMINGTON. Mr. Chairman, my time is up. I would make this observation. The diehards who now oppose East-West trade are striking a telling blow against U.S. capitalism. We all know an essence of capitalism is competition. We all know too, that the way you get a price is to sell at a profit, and profit is the guts of capitalism. We all know, too, that volume is essential to low cost. Therefore, those people in this country who, because they don't like other countries' religion, color, or something—I have never been sure just what—don't like to trade with these hundreds of millions of people, whereas all the countries we finance and defend, France, Germany, Great Britain, Japan, Italy, are doing as much as they can to sell to these countries behind the curtain, and buy from them. It seems to me these diehards over here are striking a telling blow against the very concept of capitalism. I wish you the best of luck in presenting this problem; hope it will get by the Congress.

Mr. TROWBRIDGE. Thank you, Senator.

Chairman PROXMIRE. Mr. Widnall?

Representative WIDNALL. Thank you, Mr. Chairman.

Mr. Trowbridge, it is certainly a privilege to have you with us this afternoon.

Mr. TROWBRIDGE. Thank you.

Representative WIDNALL. Mr. Wirtz testified that the increase in productivity this year would be at or a bit below the 2.8-percent increase in 1966. You said in your statement which I just read, "The increase this year may be somewhat higher than 2.8 percent." How do you reconcile the difference?

Mr. TROWBRIDGE. The differences I think are very, very small, productivity rates being, I think, not the easiest thing to gage. The 1966 figure being 2.8, I think Mr. Wirtz may have been thinking in terms of 2.7 or 2.6, and I am thinking in terms of 2.9, so I don't think there is that much spread.

Representative WIDNALL. If they merge Labor and Commerce it will make no difference; is that the net gain?

Mr. TROWBRIDGE. We may come to the same numbers.

Representative WIDNALL. I am interested in your comments on tourism and the loss that we suffer each year in that connection. How much loss do we suffer each year in dollars through payments of social security and retirement benefits and other remittances overseas to both American citizens and non-American citizens? I think it is quite a substantial amount.

Mr. TROWBRIDGE. Congressman, I don't have those figures, but I would be very happy to try and submit them to you for the record as soon as I can get hold of them. I do know there are a number of commitments of different types for American citizens resident abroad, for veterans' agreements. Veterans' payments to the Republic of the Philippines would be an example of residual responsibilities which our Government has taken on.

I am sure that the amount of dollars that do flow out in compliance with these various programs is available. I don't happen to have them at the moment. I will be glad to submit them for the record.

Representative WIDNALL. I believe the last figures that I saw, they amount to hundreds of millions, and amount to a rather substantial outflow. You might submit those figures for the record, if they have not previously been submitted.

Mr. TROWBRIDGE. Yes, sir; I will be glad to get those.

(In response to the above question, the following information was supplied:)

Detail of U.S. Government pensions and other transfers, in the balance of payments, fiscal year 1966

	Millions
Total	$321
Pensions and retired pay:	
Social security (OASDI) and railroad retirement	161
Defense and Veterans' Administration	82
Civil Service	11
Other	2
Grants:	
Education and cultural exchange (Fulbright)	28
Research:	
National Institutes of Health	14
Other	13
Damage claims and miscellaneous	10

Source: U.S. Department of Commerce, Office of Business Economics, Balance of Payments Division.

Representative WIDNALL. Would you or the State Department have the figures on our counterpart funds accounts overseas?

Mr. TROWBRIDGE. The Department of the Treasury, if I am not mistaken, maintains records on those, and again I would be happy to get the latest accounting of those. They are quite substantial in certain countries, India, I believe Egypt, and some of the places where our agricultural sales have been particularly high.

(The following material was subsequently supplied for the record:)

The following three tables from *Special Analyses of the Budget of the United States*, pages 171, 173, and 175 show the foreign currency stocks now available to the United States and the current sources and uses of these.

TABLE L-1.—*Cash availability of foreign currencies*

[In millions of dollar equivalents]

	1966 actual	1967 estimate	1968 estimate
Currencies owned by the United States:			
For U.S. uses:			
Excess currencies	1,624	1,567	1,835
Nonexcess currencies	392	439	440
Subtotal for U.S. uses	2,017	2,006	2,275
For country uses	2,202	1,881	2,049
Amounts unfunded in Treasury accounts	−9	−54	−67
Total	4,210	3,835	4,257
Currencies held in trust	84	97	97

TABLE L-3.—*Summary of foreign currency transactions, U.S. uses*

[In millions of dollar equivalents]

	1966 actual	1967 estimate	1968 estimate
Cash balances brought forward:			
Excess currencies	1,345	1,221	1,464
Nonexcess currencies	91	61	66
Subtotal, cash balances brought forward	1,436	1,282	1,530
Collections:			
Public Law 480 sales	158	199	184
Foreign assistance programs (including special letters of credit)	116	144	143
Interest on public deposits	26	25	25
Other nonloan collections	55	79	81
Loan repayments (principal and interest):			
Public Law 480 loans	110	134	163
Foreign assistance loans (including Development Loan Fund)	142	152	160
Subtotal, collections	608	733	757
Net transfer to country use	−27	−10	−11
Total availabilities	2,017	2,006	2,275
Expenditures (deduct):			
Foreign currency expenditure authorizations	13	14	8
With dollar credits to—			
Foreign assistance programs (special letters of credit)	113	140	140
Miscellaneous receipts of the general fund	106	141	142
Commodity Credit Corporation, Agriculture	133	140	117
Other	15	41	42
Deposits for replacement currencies	−3		
Subtotal, expenditures [1]	409	476	450
Adjustments due to changes in exchange rates	−325		
Cash balances carried forward	1,282	1,530	1,826

[1] Excludes sales of country-use currencies, subject to later replacement, as follows: 1966, $4,200,000; 1967 $15,000,000; and 1968, $5,000,000.

TABLE L-8.—*Summary of foreign currency transactions—country uses*

[In millions of dollar equivalents]

	1966 actual	1967 estimate	1968 estimate
Balances brought forward	1,384	1,008	1,197
Collections:			
Public Law 480 sales	789	857	833
Foreign assistance program	2	6	8
Subtotal, collections	791	864	841
Net transfer from U.S. uses	27	8	11
Total availabilities	2,202	1,881	2,049
Expenditures (deduct):			
Public Law 480 country loans and grants	736	641	685
Public Law 480 loans to private enterprise	37	36	36
Other foreign assistance programs	12	8	10
Subtotal, expenditures	786	684	614
Adjustments due to changes in exchange rates	−409		
Balances carried forward	1,008	1,197	1,436

Representative WIDNALL. I certainly feel that in the instances where they are very substantial, there ought to be a reassessment and an attempt to recoup in someway, because the original contracts in connection with the counterpart funds——

Mr. TROWBRIDGE. I might add, Congressman, that we in the executive branch of the Government, when we look at the programs we have overseas, for instance, our trade promotion programs in the Department of Commerce, we asked for permission from Congress and received it to use as much counterpart funds, local currency as we can, for the expenses involved in setting up trade promotion activities in given countries where these counterpart funds exist. But we do have a conscious program to try and use them wherever possible and wherever legally feasible.

Representative WIDNALL. In your statement under "Travel promotion" you say:

In countries such as Mexico and Greece they invest more than $5 to attract each foreign investor. We spend 50 cents.

How do you break down the $5 that they spend, and how do they attempt to attract visitors in a different way than we do? Is there any major difference in the promotion?

Mr. TROWBRIDGE. I think the techniques are probably about the same. The difference is in the total amount of expenditures, the total amount of national effort they put behind their national tourist bureau. They do a good deal more in terms of overseas, what to them would be overseas foreign offices located in the key centers, to attract the tourist directly and to work with the travel agents organizing package tours in their countries.

They do have I think a good many more programs which are government sponsored, and government generated, such as package tours and facilities, making facilities available to incoming tourists at perhaps subsidized rates. Of the various techniques, I think the basic ones are advertising and sales promotion, but they certainly do have more expenditure per visitor than we do.

Representative WIDNALL. At one time people traveled overseas to see the difference in culture, the difference in costume, and an entirely different tour of the land than does the United States. Today we probably have the greatest scenery in the United States. We don't have the oldest buildings. We have bulldozed them out of existence.

We manage to get rid of any culture we have in many instances, but today the main competition it seems to me between lands is who has the newest Hilton hotel. Actually you travel from one country to another and this is all you see, the Hilton hotel. The rates are the same wherever you go.

Now what is the difference in approach? We have the scenery and they have the oldest buildings. Now what is it that is attractive? Everybody dresses the same today.

Mr. TROWBRIDGE. Well, Congressman, I think there are a couple of obvious hurdles that our travel promotion people have to face. One is distance and transportation costs. There are, I think, a lot of people who feel that the U.S. Travel Service, trying to operate on $3 million a year as far as the budget goes, is obviously limited in what it can do in promotion work.

The biggest appeal of this country is as you say, the tremendous expanse, the scenery, and excitement of watching this country at work.

I am encouraged by the way many of our travel industry have responded with things such as a bus ticket, on which a person with a passport from some other country can travel for I think 99 days for $99 anywhere in this country. Another program is affiliation between various trunk airlines, so that someone coming in can go almost anywhere in the country for a flat sum.

The travel industry has responded very substantially to the need to make it more economical to see the size of this country and all of the exciting things we have in it.

The travel service has done a lot of work in trying to stimulate neighborhood reception for people from other countries. You may have heard of this program called "Company's Coming," in the attempt to get a welcome mat laid out in each community. But there is no doubt that a lot of people around the world have the feeling that it is terribly costly, probably a mistaken image of the cost of seeing our country.

We do have great success in visitors from Canada, Mexico, and nearby areas, and in the growth in visitors to our country, and I think the growth has been particularly significant since the U.S. Travel Service started work several years ago. It has been very encouraging. We had the millionth visitor last year, for instance, the first time we have ever had that.

Representative WIDNALL. I think they have done a tremendous job, and they are doing it right now and it is very noticeable. To what extent is the foreign traveler to the United States limited by the amount of money they take out of various countries?

Mr. TROWBRIDGE. In Europe, except for the United Kingdom, which does have a limitation per person on the amount they can take out, I don't believe that there are any restrictions on foreign currency. Japan still limits their citizens I think to $500 per trip.

In Latin American countries, there may be differences between them. The OECD has tried to make it a universally accepted policy that there will be I think a $500 limit in cases where countries for balance-of-payments reasons have to restrict currency outflow. But the liberalization of this has been quite substantial in the last 5 or 10 years around the world.

Representative WIDNALL. We have succeeded to some extent in limiting the amount of goods brought in by American tourists from other countries which stops expenditure of dollars over there, but we certainly haven't limited the amount of dollars taken out of this country, and that is spent in other countries and kept there in these other countries.

Mr. TROWBRIDGE. That is quite true, sir.

Representative WIDNALL. I don't know that I would really want to suggest something like this, but certainly you have got every opportunity to spend thousands and hundreds of thousands of dollars overseas, without any limitation by the United States. You can't foresee any kind of reciprocal situation as far as the foreign countries are concerned.

Mr. TROWBRIDGE. Well, as I said in the statement here, we are basically trying to accentuate the positive when we look at this problem. It is a big one.

We have got a tremendous tourist gap, but we are faced with I think a fairly important principal, and that is the freedom of the American citizen to travel, and this administration has not tried to put limits on that freedom. We have somehow got to solve our problems, and if we can, keep that freedom at the same time.

Representative WIDNALL. Just one more question. If the British bid for the EEC membership fails, would the United States look favorably on promoting a trade area of those who are not members of the EEC? Did you go into that? I am sorry, I withdraw the question. My time is up.

Chairman PROXMIRE. Secretary Throwbridge, is the Department of Commerce studying methods by which the growth of our economy can be increased?

Mr. TROWBRIDGE. Yes, Senator, in many different ways.

Chairman PROXMIRE. What are these methods?

Mr. TROWBRIDGE. Well, I think the whole programing of the economic development administration, the attempt there to signal our areas which require stimulus for economic growth, job creation, new investment, public works, community action. I think there is a whole series of methods.

Chairman PROXMIRE. These are programs that have been passed. Congress has acted on them.

Mr. TROWBRIDGE. That is correct, sir.

Chairman PROXMIRE. I am talking about new programs.

Mr. TROWBRIDGE. We have a new program again approved, but a very recent one based on the Office of State Technical Services, the idea of using technology as a stimulus to economic growth. Our whole science and technology operation—

Chairman PROXMIRE. This is very good and I approve of that. I think that as President Johnson said, that was a real sleeper of the 89th Congress. It accomplished a lot, and that was kind of overlooked. You are talking about Senator Magnuson's bill?

Mr. TROWBRIDGE. That is correct, sir.

Chairman PROXMIRE. In addition to that you have the investment credit that was introduced a few years ago, and is coming back now we expect, and so on. I am talking about new ideas that we are looking forward to now.

We seem to be settling for a growth rate of only 4 percent, which we are told by the Department of Labor is not enough to sustain even the present level of employment or unemployment rate. I am wondering what new proposals we now are going to have to pick up our growth, other than the proposal of having an expansionary fiscal and monetary policy.

Mr. TROWBRIDGE. Well, Mr. Chairman, I would think that those are the really important tools to be used. I think it seems to me, in looking at this problem, that really Government has to set the framework in which economic growth comes, but it is the private sector that is going to do the job.

I personally tend to question the capability of the Government all by itself trying, through a series of programs, as well planned and defended as they might be, to solve all the problems. I think it is the job of Government to create that framework largely through monetary and fiscal policies, and let the business and labor communities get on with the job.

Chairman PROXMIRE. I understand that you have, that the Department of Commerce has a computer model of the U.S. economy. Would you tell us about that model, and whether or not you found it useful?

Mr. TROWBRIDGE. I would guess that you are talking about the input-output analysis that we have developed.

Chairman PROXMIRE. Yes.

Mr. TROWBRIDGE. I would like Assistant Secretary Shaw to comment on that. It is really a development in his part of the Department. I think it is a very exciting project and model, and we are currently bringing it more up to date, so it will be based on newer numbers. I would like Mr. Shaw to comment.

Chairman PROXMIRE. Mr. Shaw, before you do, let me say that I would like to know what that model shows for 1967 and what it shows as to the effect of the 6-percent surtax.

Mr. SHAW. Mr. Chairman, may I make several comments? First, I would like to correct one apparent misunderstanding, and that is that our goal is only 4 percent in real terms. That is a target for 1967. For the longer run, our goal, and I think the goal of others as well, would well be expressed as 4.5 percent or better than 4.5 percent, if we are to retain such goals.

With respect to these models, there are actually two sets of models. The first one to which Secretary Trowbridge referred is the input-output model, which is a structural model of the economy, and which basically, however, has to do with the past. We offer examples sometimes using coefficients in that model based on the data of several years back. We hope this year and next to update that particular model.

I think however, Mr. Chairman, the model to which you refer is our second model, which is an attempt to develop a series of equations which help us or should help us we hope get a better idea of what is likely to take place in the economy during the four quarters ahead.

My personal judgment as one in the forecasting business for many, many years, is that the use of models to date can be regarded as very helpful but nevertheless only as a supplement to good judgment, and that is the way in which we are presently making use of that model, which is in charge of the Office of Business Economics.

I might say as far as the 1967 period is concerned, the last results I saw of that model would come out with results not far from the judgment forecasts or projections that we have been discussing today.

Chairman PROXMIRE. By that you mean increase in the price level by 2.5 percent, unemployment of about 4.5 percent at the end of the year, and a growth of about 4 percent.

Mr. SHAW. Give or take a few tenths of a percent point in each case. I think we have to keep in mind here that when you are talking about the future, much less the present and the past, it is I think to some extent oversimplifying the situation to talk down to one-tenth of 1 percent.

Chairman PROXMIRE. We know it is not a crystal ball. It all depends on your estimates. Last year in December of 1965, one of the Governors of the Federal Reserve Board—not Mr. Martin obviously—told us they put the increase of the rediscount rate into a Brookings model and found that it increased the price level, not decreased it.

Mr. SHAW. May I comment on the second part of your question, Mr. Chairman, which had to do with the effect or possible effect of a tax increase on the outlook for 1967.

Chairman PROXMIRE. Right.

Mr. SHAW. I have not seen the results of the model of the Office of Business Economics. As a matter of fact, I am not sure whether that particular shift in equations has yet been run through. I have, however, seen several models, similar models developed outside the Government, some developed by individual industry firms, some the better known ones.

The ones that I have seen have indicated that the proposed tax, surtax increase of some 6 percent along with the remainder of the fiscal policy recommendations of the President, the difference between having that tax and not having that tax would not have a significant impact on the total demand in 1967.

Chairman PROXMIRE. That is very interesting. It will not have a significant effect on 1967?

Mr. SHAW. Not on 1967.

Chairman PROXMIRE. It might have it in 1968?

Mr. SHAW. Yes; the impact might have this in 1968.

Chairman PROXMIRE. Which is beyond what the crystal ball will show. You don't know what that will be?

Mr. SHAW. Yes, sir.

Chairman PROXMIRE. That is very interesting. Now let me ask this: You say, Mr. Trowbridge, that you expect in the second half of the year, defense spending will tend to ease off, the impact of defense spending will ease off, still at a very high rate, but that it won't be as stimulating as it has been or as it is now; is that correct?

Mr. TROWBRIDGE. You are referring to the statement "A tapering off in the rate of advance in defense purchases"?

Chairman PROXMIRE. That is correct.

Mr. TROWBRIDGE. Right.

Chairman PROXMIRE. Now taking a look at the situation in the last half of the year, we are going to have a tax increase which we have just been told will not have much effect on demand. If it has any effect, it would certainly be negative. At least that has been proposed. A slowdown in business investment because of the proximity of the resumption of the investment credit. We are going to have a slowdown in defense purchases.

You have indicated that we are going to have a profit, perhaps some profit squeeze. This will be true if the very large number of labor-management contracts are settled with the wage increases that we expect, and the difficulty for business to pass those on to the consumer.

On the other side we have only these factors; No. 1, a stepup in social security benefits. The testimony we had is that that is likely to have its main impact in increased demand for food, which is unlikely to be very inflationary, because food isn't too responsive on the demand side, production factors are more important, and possibly medical services. Also not demand sensitive.

Most of the elements in our economy, like home buying, automobile buying, won't be affected much by the increase in social security benefits.

And then No. 2, you are allowing the second biggest element in the latter half, a resumption of prosperity or at least some better conditions in homebuilding, in construction generally, because of lower interest rates.

Mr. TROWBRIDGE. Yes.

Chairman PROXMIRE. The testimony we had this morning was to me not very reassuring in that area. Chairman Martin indicated that there are many problems involved in getting at the long-term rate, bringing it down, and in doing much more than we have done on the short-term rate because of the international balance-of-payments situation. So under these circumstances, it would seem to me we have some pretty significant bearish elements in the second half of 1967, and the bullish elements are not very impressive.

Mr. TROWBRIDGE. Wouldn't you add, Mr. Chairman, to the bullish side of the equation the anticipated State-local government expenditures, which I think are projected to be at a higher level, whereas we say, "a tapering off in the rate of advance in defense purchases," it is most likely that those defense purchases still are going to be quite high.

Chairman PROXMIRE. But the advance is so important, because our whole economy is growing all the time, and our capacity to meet production improves every month, and improves so impressively, that unless the advance continues, we are likely to have even more slack in your resources.

Mr. TROWBRIDGE. I think there is some projection too as to the buildup of inventories, which at the end of 1966 was very high.

Chairman PROXMIRE. That is true, yes. The assumption there is that that will be taken care of in the first half of 1967. Why is that?

Mr. TROWBRIDGE. I think the projection is that the rapid or the tremendous buildup of inventories in the last quarter of 1966 will taper off, and in the first half of 1967. The resumption of an upswing though is projected in the second half, and I think this would be on the bullish side of the equation as well.

Chairman PROXMIRE. I know that that is the assumption, but why is it made? The Council of Economic Advisers has some conflicting evidence in their report.

They indicate that one of the reasons for the increase in inventory is because of goods in process expanding, because I suppose the impact of the Vietnam war is such that many of the things produced take 18 months or more to produce on the average, instead of 12 months. This obviously increases your inventory. Why would you have a very much different picture in the last half of the year on that?

Mr. TROWBRIDGE. On the last half or the first half?

Chairman PROXMIRE. Mr. Paradiso?

Mr. PARADISO. The picture would be different, Mr. Chairman, because in the last half we do expect a slowing down in the rate of defense expenditures, and this should not require the same degree of accumulation of raw materials and goods in process inventories as is the case in the last several quarters.

Similarly if we get a reduction in the rate of spending for capital goods, this should not require that kind of accumulation.

Now as we move into the second half of 1967, there are these stronger elements coming in. Nobody can say that social insurance benefits are going just for food. Generally I think they would go for nondurables and services, I agree, or not for durables.

So if we get an additional spurt beyond that which we would obtain with a normal rise in the personal income and higher employment, due to the increased social security benefits, in the nondurable goods area and services, this should require some additional inventories to support that higher rate of purchasing. Similarly if the housing picture changes——

Chairman PROXMIRE. Where do you see these increases coming?

Mr. PARADISO. For clothing? The food industry certainly increases its inventories. We see quite a bit of variation in that industry. All along the line that is so. In the drug area, in some of the service areas they will need some additional inventories to maintain a higher rate.

Chairman PROXMIRE. Aren't all of those inventories turned over a great deal faster than in durable goods?

Mr. PARADISO. They did turn over a good deal faster, but the level will rise. In other words, they get up to a higher level to support a higher level of purchasing.

In the housing case, I think the same thing is true, although their inventories are not very large. Nevertheless the housing picture I believe is going to turn around.

The amount of money available in the savings and loan associations is becoming much more normal in many areas. It isn't all the high interest rates. It is the availability of mortgage money which is a factor. And as we indicated earlier, the number of households is expected to accelerate this year in comparison with last year, and this should provide a stimulus to the housing industry later this year. I don't think we can pin it as to July or August, but sometime during this year there is bound to be some uptrend in the housing picture, which would have some influence on inventories.

Chairman PROXMIRE. I take it, Mr. Trowbridge—and Mr. Paradiso and anyone else that has a judgment on this—you would feel that it would be wise for the President and for the Congress to wait as long as we can before July 1 to make our decision on the surtax increase rather than move now.

Would you agree that we can get a clearer picture of the economy 90 days from now than we can now, and would you also agree that in the event in our best judgment the economy leveled off or was turning down, it would be unwise to impose a surtax?

Mr. TROWBRIDGE. Mr. Chairman, speaking for myself, I think that the flexibility in the President's proposal is a very wise thing. Obviously 90 days from now we will know a good deal more about how the economy is going. I think Secretary Fowler has indicated that the decision as to whether to proceed full speed with this proposal will get looked at again both by the administration and obviously by Congress.

To the effect that a tax surcharge would help take out some of the heat that we do think is coming along in the second half of the year, I would think it would be very wise to go ahead and put it on.

Chairman PROXMIRE. Mr. Trowbridge, meet Mr. Shaw. Mr. Shaw has told us it is not. Maybe I misinterpreted Mr. Shaw. I understood you to tell me that it would not have any effect on 1967.

Mr. SHAW. Mr. Chairman, I said the model indicated that. Second, what I meant to say, and if I didn't say it, I would try to make it doubly clear at the moment, that what the model said was not merely in terms of the proposed tax increase, but in terms of the whole fiscal package proposed by the President, and that includes the passage of the increased social security benefits.

Chairman PROXMIRE. What they are saying is that this is a washout.

Mr. SHAW. The reason quite clearly why the model seems to come out that way is that in the second half of 1967, the proposed increase in personal income taxes would be just about offset by the proposed increase in social security benefits, in the second half of 1967.

Chairman PROXMIRE. Now let me say that is the trouble with models. That is the trouble with macroeconomics. When you break it down and determine what effect the social security benefits have specifically in particular areas, and what effect the surtax would have in specific areas, you find quite a different picture. As I said, the increase in food purchases is going to be heavy. On the other hand I doubt if the surtax increase is going to diminish food purchases at all. On the other hand, the surtax increase is going to have some effect very possibly on automobile sales. It is going to have some effect conceivably in construction, although maybe we could debate that.

At any rate, it is not going to have the same effect at all, the surtax, as the social security benefits. That is why looking at it in the overall is likely to give a distorted picture. At any rate, in view of the facts that we have almost an unlimited capacity to produce food, we have been spending money hand over fist to keep our farmers from producing more; we can easily meet the increased demands for food. And I doubt if we can do very much about the increased demand for medical services by any kind of a tax. It is not going to cut it down. So, therefore, it would seem to me that the notion that you are going to get a tradeoff, a balance here, isn't very sound in terms of using our resources as much as possible, or in terms of maintaining price stability.

Mr. SHAW. Mr. Chairman, first let me say that I agree with Mr. Paradiso in his statement that the proposed benefits, if enacted, will be spent on a much broader spectrum of goods and services than just food alone and medical supplies alone. I think clothing and textile products will benefit. I think a whole host of consumer services will benefit.

On this second question, Mr. Chairman, which is a key question which you have raised several times this afternoon, this question of whether or not we are going to have capacity and resources to do much more than is apparently implied by the 4-percent rate of real growth, which the Council has set forth, I would only say that here again in my judgment we must avoid just looking at its overall totals. We have an economy today which is pretty close to full employment, perhaps not quite where some of us would like to see it, but nevertheless which also has a number of imbalances and distortions, and we have to consider those imbalances and distortions in determining where and how fast we can go during the next 12 months.

As I pointed out earlier, this 4 percent is a rate of growth which is proposed only for the next 4 months. I don't think the Council, I don't think any of the other agencies would in any sense argue with you that we should be aiming for a higher rate of growth than 4 percent over the longer run.

Chairman PROXMIRE. It is just not clear to me, it hasn't been made clear why 4 percent is all right now but it is not good for the long run and why 4.5 percent would be all right in 1968, 1969, and 1970, unless you are arguing that with the Vietnam situation which is unproductive, when we take people into the Armed Forces, while it is an essential and vital service they perform for national security, they don't produce anything for the economy. Is that the reason why 4 percent is——

Mr. SHAW. No, I think my argument would be based more on the hope and expectation that we have that some of the keen balances which are present in today's economy would not be present as we go out of 1967.

Chairman PROXMIRE. We always have to balance this, Mr. Shaw.

Mr. SHAW. Yes, but they usually are not quite as heavy or as distorted as they are at the present moment.

Chairman PROXMIRE. Let me just ask a couple of quick questitons.

Mr. TROWBRIDGE. Mr. Chairman, Mr. Paradiso had one comment.

Chairman PROXMIRE. Yes?

Mr. PARADISO. In arriving at a 4-percent rate of growth, basically you have to make some assumption with respect to what the productivity growth is going to be, what the increase in the labor force is likely to be, and on that basis, and of course, the rate of unemployment.

Now whether you get a 4-percent rate of growth or somewhat more for any year depends specifically on what you do with regard to your assumption about productivity. Therefore, if you assume that the productivity rate for 1967 is likely to be somewhat lower than 1966, and the number of entries into the labor force in 1967 is not likely to be as high as 1966, because the economy is not growing as fast as it did, you can derive a rate of growth which would be 4 percent and consistent with a 4-percent rate of unemployment.

Chairman PROXMIRE. Let me just interrupt Mr. Paradiso to say this is both circular and contradictory. It is contradictory because Mr.

Trowbridge told us the Department's position is that it would be better than 2.8. Is that correct or incorrect?

Mr. PARADISO. That is correct.

Chairman PROXMIRE. If you don't have a growth of more than 4 percent, you won't attract people into the work force. What attracts them into the work force is an expanding economy and a demand for people to come into it.

Mr. PARADISO. Well, when we are talking about a little more than 1966, as Mr. Trowbridge indicated, it is a question of a tenth of a point. However, if you assume that the rate of gain in productivity this year is not going to be 2.8 but 2.5, that the labor force growth is not going to be 1.8 million such as last year but only 1.6, then on the basis of those factors, you can derive a 4-percent rate of growth consistent with a 4-percent rate of unemployment. So the question is, what do you assume with regard to these crucial factors of labor force and productivity? That is the difference I think.

Chairman PROXMIRE. All right. I want to once again apologize to Mr. Rumsfeld. I won't take much longer.

In your statement, you make the favorable assumption that our trade balance, not the balance of payments but trade balance, will improve. I remember in 1964 and 1965 people were saying when we had this enormously beneficial balance of payments, but what has always struck me is the fact that we have such an overwhelmingly favorable balance of trade now, and our favorable balance of trade must be an unfavorable balance of trade for other countries and they must be striving desperately to have a favorable balance. Those countries are advancing and progressing. Those countries also have an economic situation now which seems favorable for improving their trade balance; that is, their unemployment is increasing somewhat. Their resources are more available than they have been. Under these circumstances it is realistic to assume that we can have an improvement in what is already a favorable balance of trade although not quite as favorable as it was a few years ago?

Mr. TROWBRIDGE. Well, the trade surplus which has gone down since 1964 from a level of about $6.9 billion, I believe, to 1965, 5.1; 1966 it was 3.8, a substantial drop, has of course been caused by this tremendous surge in imports as our absorptive capacity is there to buy from all parts of the world.

We foresee in 1967 continued strong demand for our exports in Japan, France, Italy, Canada, probably less so than last year in the sizable markets of the United Kingdom and Germany. In other parts of the world, it is hard to paint a very broad brush picture, but in the bigger markets, there are signs of continued expansion and high demand for our exports.

At the same time we foresee a reduced capacity utilization—you mentioned this 88-percent figure—more flexibility for the American producer to produce both for domestic and export. We foresee and hope for continued expansion of more American companies getting into the export business.

Now, on the import side, we foresee a reduction in the inventory accumulation, where imports are particularly strong or were last year, in the first half of the year, and we feel that the overall demand, which will be slightly down from last year, will represent itself in lower imports, or a lower rate of import growth.

Now many countries around the world do have an imbalance of trade with us, but they offset much of that trade balance with tourism receipts of investment flows. Take a country like Spain. Spain has substantial imbalance of trade with the United States, but the investment flows going forward, plus tourism, plus other invisibles, their balance of payments with us is, I think, if I am not mistaken, fairly close.

Chairman PROXMIRE. Can we expect to have a greater degree of balance in all these individual elements of the balance of payments? In other words, trade is likely to be less favorable perhaps in the long run. Our tourism we hope as the affluence of other societies improve and so forth is likely to be coming in closer balance. We hope we will be able to reduce the number of troops we have abroad. We hope this isn't perpetual. That has been a great drain on our balance of payments so as we do that shouldn't we be more accustomed to recognizing maybe a healthy long-term situation cannot have this very strongly favorable balance of payments we have had in the past, we are going to have to adjust this situation of our exports to imports?

Mr. TROWBRIDGE. It may well be. Certainly the $6.9 billion surplus level in 1964 probably reflects a very difficult situation for a lot of our trading partners, where they just didn't have the dollars coming from their exports to finance all of their trade. I think, though, that with our technological advantage, this gives us a very real competitive advantage in a lot of ways, and that we can expect our exports to stay in surplus. What the numbers are going to be——

Chairman PROXMIRE. But as we increase our capital exports and along with this export of American know-how so that we improve their efficiency and their amount of capital investment and their amount of technological progress, so that the end of that, the result is going to be a more efficient free world.

Mr. TROWBRIDGE. I think that is the long-term result, yes, of capital flows and technological transfers.

Chairman PROXMIRE. I am not saying it is bad. I am saying it is good. I am saying that, in my judgment it is something we ought to be accustomed to.

Mr. TROWBRIDGE. I do too.

Chairman PROXMIRE. And not single-mindedly constantly having a favorable balance.

Mr. TROWBRIDGE. I would say this, too, and as I said before, the transfer of the investment and the technology very often brings with it not only economic growth where located, but stronger continued follow-on exports of perhaps new commodities, new materials, but continued trade and expanded trade from the United States to the locale of the new plant.

Chairman PROXMIRE. I want to thank Congressman Rumsfeld for being so patient.

Representative RUMSFELD. On that point, can one assume that as that happened, as that progression took place, that the United States theoretically should be in position where they could then reduce some foreign assistance programs? While the favorable balance of trade lessened, wouldn't the balance of payments and the gold situation change for the better possibly as such programs were reduced?

Mr. TROWBRIDGE. I think so. I think you have to remember, though, that a great percentage now, and I think it is close to 90 percent of our procurement under the foreign aid programs, is tied to the United States. Your net loss factor there of the foreign aid program that may total in budget terms over $2 billion has considerably less outflow as far as dollars go.

Representative RUMSFELD. Yes, but I am unconvinced on that. In the first place, the foreign assisance programs total overall a lot more than $2 billion, and, in the second place, I am not persuaded that these programs do not have an effect on the gold situation and balance of payments overall. They do. They have to, even though it may be less than the total assistance figures.

Mr. TROWBRIDGE. Right, than the budget figures.

Representative RUMSFELD. I will grant that.

Mr. TROWBRIDGE. Yes.

Representative RUMSFELD. There was a question on which Mr. Paradiso made a comment. He said that you anticipated a slowing down of the rate of defense expenditures. Did you mean that or did you mean that you anticipated a slowing down of the rate of increase of defense expenditures?

Mr. PARADISO. It is a slowing down in the rate of increase.

Representative RUMSFELD. Of the rate of increase.

Mr. PARADISO. The rate of increase. I am sorry if I gave the other impression.

Representative RUMSFELD. How many years before you are going to be bringing that model before congressional committees to testify?

Mr. PARADISO. This model is still quite an experimental model. It is certainly for the Government. We don't want to put out any results from an econometric model which we haven't tested over a period, and there is still a considerable amount of research being done in getting much better relationships.

For example, two of the relationships that there is a great deal of work going on now are, what is a good relationship for inventories, and what is a good relationship for housing.

Representative RUMSFELD. And you are able to "war game" economic problems, is that right?

Mr. PARADISO. That is right. Once we are satisfied that we have had reasonably good results over a period of years, and these relationships stand up, then at that point we can say, "all right, here it is for public consumption," not before.

Representative RUMSFELD. Was this developed in the Department or contracted out?

Mr. PARADISO. No. This came about in the following way. Professor Klein, from the University of Pennsyvania, had been working on a very similar model for about 3 or 4 years. About 3 years——

Representative RUMSFELD. I don't need——

Mr. PARADISO. I will go very quickly. He gave it to us.

Representative RUMSFELD. So it was developed outside and brought in and adapted.

Mr. PARADISO. And brought into our office and we updated it and have worked on it since.

Mr. SHAW. May I add, Congressman——

Chairman PROXMIRE. Would you hold it for 1 minute, Mr. Shaw? I want you to hear this plug for Northwestern; it's a great institution.

Representative RUMSFELD. The chairman has a son there and the university happens to be in the 13th District of Illinois. They are working on simulators in connection with foreign policy and national security problems. I know there is a great deal of this going on in universities. That is the reason for my question. I was interested in seeing if there has been an exchange between groups in and out of government working on similar problems.

Mr. SHAW. I think we can say that the technicians of the Office of Business Economics do keep in close touch with the experts in the field. I merely wanted to add that I thought Mr. Paradiso was being a little bit modest about the Office of Business Economics. I think the model has been improved significantly since the time that we got it from the University of Pennsylvania, and Lawrence Klein.

Representative RUMSFELD. Mr. Shaw, in connection with this model, simulator or whatever it is, did you plug in to see whether or not there would be different effects depending on whether on the one hand the tax increase were adopted by the Congress, or on the other hand a comparable reduction in Federal expenditures was accomplished by the Government?

Mr. SHAW. I have not seen any recent plug-ins in the model so that I have to answer your question by saying that to my knowledge those have not been plugged in.

Representative RUMSFELD. Thank you. I am interested in this East-West trade question that Senator Symington brought up. I know it could take all day and I don't want to belabor it. It is late and I know you gentlemen have been hard at it. But let's consider your testimony. You made the comment that you can forsee substantial increases in our trade with Eastern Europe in goods and technology for peaceful uses.

Well, now, "goods and technology for peaceful uses." Who is to say what is the peaceful use of something? You can't know that. I can't know that. There have been those who during World War I, I recall, possibly it was Bernard Baruch, who said everything was strategic. Now I don't know that that is as applicable in an era of nuclear warfare, but the fact remains that it is difficult to draw a distinction. I will comment further on the reason for my mentioning that in a minute.

You say that you fully support the need for this authority that has been requested, and that you feel it will lead to worthwhile increases in peaceful trade.

Do you favor trade, just to explore this for a minute, by the United States with North Vietnam?

Mr. TROWBRIDGE. No, I do not.

Representative RUMSFELD. Right. Do you favor it with China?

Mr. TROWBRIDGE. No.

Representative RUMSFELD. Of course not. And this points up the communications problems we are having on this difficult question. You don't want to trade with North Vietnam, but not for economic reasons. For economic reasons you would favor trade with North Vietnam or China, if you were thinking only of economics, but you are not. You are plugging in some political and military considerations.

To try to argue the concept of East-West trade on purely economic bases is not going to result in a thoughtful dialog on the subject.

I was impressed with Senator Symington's comment about U.S. nationalistic approach to some extent with respect to economic question and U.S. international approach in other areas such as political and military matters. Yet the basic difference of opinion cannot be swept away with the kinds of comments that are in your statement, and I appreciate that your statement wasn't intended to exhaust the East-West trade question. Yours was a much broader subject, so I am certainly not being critical.

But they can't be swept away that simple. The difference of opinion that I sense in this country and to some extent among Members of Congress boils down to a difference in viewpoint as to the nature of the threat that exists in the world, and a difference in viewpoint as to the effect on that threat by increased East-West trade. One of the fundamental problems is that it is a difficult question to deal with in a broad way, because it seems to me that what is or is not desirable economically, politically, militarily, varies from country to country, from commodity to commodity, and sometimes from year to year. Therefore, I have trouble buying the argument that one must be for East-West trade or that one must be against East-West trade, because I believe one must look to the country and look to the commodity and look to the political and military and economic framework at the time that a decision is being made.

It would seem to me that we are going to have a more constructive dialog on this subject if the arguments are not based purely on economics, when the opposition is coming from people who recognize the economic advantages, but who are concerned more about the potental political and military disadvantages. Rather, the arguments must show specifically what we would gain economically in exchange for what we might be losing in terms of some potential political or military problems in the future.

Some argue, saying that the Communist countries are going to get the commodities anyway, from Britain, Japan, or from some other country. They further argue that therefore we should trade and get the economic benefits. Well, that has some merit economically, and it does eliminate one of the problems politically and militarily, but it doesn't solve the question because of the fact that the answer to it might be, well, why isn't this country exerting a little more pressure leadership in the world to try to develop support and cooperation from other nations, so that in the event a situation does develop with respect to a specific country or a specific commodity at a specific time, we could encourage other nations to see that they don't get it, instead of just throwing up our hands and saying they are going to get it anyway.

It reminds me of the story about the village where there was mud in the streets and the people who walked along the curb would get spattered with mud every time a cart went by. So the city fathers met and decided to work this out reasonably. They passed an ordinance saying that every time a cart came by everyone had to line up along the curb so they would all get sprayed with mud equally.

This has been a lengthy comment on a subject on which I need a great deal more information, but I would like to see a considerably more precise and thoughtful discussion on this subject in the country by the administration. We are ultimately going to find the right posture for this country in the coming months only if we have such a discussion. I have not been terribly impressed with what I have heard thus far. Again, I don't mean your statement. I feel you have made a very fine statement here today, and I very much enjoyed your comments and responses to questions. I am referring to the administration generally.

Mr. TROWBRIDGE. Thank you, Congressman. I might comment briefly. There is no question the definition of the word "peaceful" or the definition of the word "strategic" is one of the toughest things in this whole argumentation.

We who have the Export Control Act responsibilities, in looking on these things on a case-by-case basis as we do, wrestle with these definitions all the time. I had a personal experience some time back which might illustrate the difficulty.

One day on a hillside in Korea a Chinese soldier threw a grenade in my direction. It didn't go off. I took it apart. I was curious. I looked in the handle, pulled something out. It was a piece of newspaper with gunpowder used as a fuse. I opened the newspaper and it was from Sacramento, Calif. That wasn't strategic as newspaper, but it sure felt strategic when I opened it up. The end use very often determines the problem here.

I think when we talk machine tools, are machine tools strategic or are they peaceful? Well, I happen to think that if the Soviet Union decides to go into the automobile industry in a big way, and devote very large resources to the creation of a private-automobile kind of economy, with roads and with repair shops and service stations and all the other things, I think this kind of development is the kind of use of their resources that is probably very good, from our point of view. I would rather see them creating that kind of consumer-goods economy than using it for strategic purposes. And for that reason I think we could and should sell them machine tools to go into a plant to make automobiles.

This is the kind of case-by-case determination that you come down to very often, and often this difficulty of semantics and determining really what the word means and what the end use is is a very real part of the problem, and I think we do have to talk this out.

We tend—we, the United States—tend to look at this question in the economic and political context. When it comes to our export controls we are a member of an international group that has decided upon a list of items. We have a second list which is our own unilateral control list, and we review that to see how realistic it is, but it is considerably more than the internationally agreed list.

We do work with basically the NATO allies group, to see to it that items on the international list are up to date, are added if we can convince them that this is a new element that really is strategic and should be controlled, or as they become less and less important, the opinion is we ought to take them off, to agree to taking them off. But these is the effort to work with our allies, to get a certain community approach as far as exports go.

I think we are going to hear a lot more about this whole question of trade contacts. I think there are some economic advantages. We are losing business in the competitive trade field. I think indeed there can be, if we can develop the kind of trade contacts which are long term, some very good political results out of this, too.

Representative RUMSFELD. I suppose there are instances in history that show both ways.

Mr. TROWBRIDGE. Yes.

Representative RUMSFELD. We had pretty extensive trade relationships with Cuba.

Mr. TROWBRIDGE. Yes.

Representative RUMSFELD. So it can be argued both ways. I agree with you the contact in and of itself can be favorable and helpful rather than harmful and unfavorable. With that I will conclude.

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

Thank you, Mr. Secretary. This has been very enlightening and an informative day for me. You did a fine job, and I certainly very much appreciate your excellent comments and statement.

Mr. TROWBRIDGE. Thank you very much, Mr. Chairman.

Chairman PROXMIRE. The committee will reconvene Wednesday, February 15, to hear Walter Heller in the morning at 10 o'clock and Arthur Burns in the afternoon at 2 o'clock.

(Whereupon, at 4:25 p.m., the committee adjourned until February 15, 1967, at 10 a.m.)