FULL EMPLOYMENT AND BALANCED GROWTH ACT OF 1978

HEARINGS

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

NINETY-FIFTH CONGRESS

SECOND SESSION

ON

Amendment No. 1703

TO

S. 50

TO ESTABLISH AND TRANSLATE INTO PRACTICAL REALITY THE RIGHT OF ALL ADULT AMERICANS ABLE, WILLING, AND SEEKING TO WORK TO FULL OPPORTUNITY FOR USEFUL PAID EMPLOYMENT AT FAIR RATES OF COMPENSATION; TO COMBINE FULL EMPLOYMENT, PRODUCTION, AND PURCHASING POWER GOALS WITH PROPER ATTENTION TO BALANCED GROWTH AND NATIONAL PRIORITIES; TO MANDATE SUCH NATIONAL ECONOMIC POLICIES AND PROGRAMS AS ARE NECESSARY TO ACHIEVE FULL EMPLOYMENT, PRODUCTION, AND PURCHASING POWER, TO RESTRAIN INFLATION; AND TO PROVIDE EXPLICIT MACHINERY FOR THE DEVELOPMENT AND IMPLEMENTATION OF SUCH ECONOMIC POLICIES AND PROGRAMS, AND FOR OTHER PURPOSES

MAY 8, 9, AND 10, 1978

Printed for the use of the Committee on Banking, Housing, and Urban Affairs

U.S. GOVERNMENT PRINTING OFFICE

30-454 O WASHINGTON : 1978

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

WILLIAM PROXMIRE, Wisconsin, *Chairman*

JOHN SPARKMAN, Alabama
HARRISON A. WILLIAMS, Jr., New Jersey
THOMAS J. McINTYRE, New Hampshire
ALAN CRANSTON, California
ADLAI E. STEVENSON, Illinois
ROBERT MORGAN, North Carolina
DONALD W. RIEGLE, Jr., Michigan
PAUL S. SARBANES, Maryland

EDWARD W. BROOKE, Massachusetts
JOHN TOWER, Texas
JAKE GARN, Utah
H. JOHN HEINZ III, Pennsylvania
RICHARD G. LUGAR, Indiana
HARRISON SCHMITT, New Mexico

Kenneth A. McLean, *Staff Director*
Jeremiah S. Buckley, *Minority Staff Director*
Steven M. Roberts, *Chief Economist*
Paul Freedenberg, *Minority Professional Staff Member*

CONTENTS

CHARTS AND TABLES

FULL EMPLOYMENT AND BALANCED GROWTH ACT OF 1978

MONDAY, MAY 8, 1978

UNITED STATES SENATE,
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS,
Washington, D.C.

The committee met at 2:40 p.m. in room 5302, Dirksen Senate Office Building, Senator William Proxmire (chairman of the committee) presiding.

Present: Senators Proxmire, Sparkman, Sarbanes, Brooke, and Schmitt.

OPENING STATEMENT OF CHAIRMAN PROXMIRE

The CHAIRMAN. The committee will come to order.

Today we begin 3 days of hearings on the Humphrey-Hawkins bill, which is now known as the Full Employment and Balanced Growth Act of 1978. There are several differing versions of this legislation, but all of them have as their main element the establishment of economic goals to attain both full employment and balanced growth and a mechanism for the formulation of economic policies that work toward the achievement of those goals.

The Senate Human Resources Committee has just recently completed their work on this legislation. The Banking Committee intends to move ahead with consideration of the legislation as soon as possible.

The Humphrey-Hawkins bill makes the reduction of unemployment the single most important objective of national economic policy. It sets a target rate for unemployment of 4 percent for the total civilian labor force by 1983, with the associated goal of 3 percent unemployment among adults. The importance of achieving these goals certainly cannot be overstated. We have 6 percent unemployment today, a vast improvement over a year ago, but still far too high. We have almost 6 million people still seeking work.

We have had 32 years of experience with the Employment Act of 1946, which had "maximum employment" as one of its objectives. While we can point to the many successes of economic policy under the Employment Act, it is time to be a little more specific in the statement of economic goals so that policy can be made in a more consistent and coordinated manner.

The Employment Act of 1946 also has as one of its economic objectives "maximum purchasing power." This goal needs to be clarified in the Humphrey-Hawkins bill. I have submitted an amendment to the Humphrey-Hawkins bill that makes it clear that the Congress believes it is desirable, necessary, and feasible to achieve full employment and price stability together. The amendment establishes an interim goal for inflation of 3 percent or less to go along with the interim numerical goals the bill already contains for unemployment. Both the numerical goals for unemployment are for the fifth year after enactment of the legislation.

Further, because of the possibility of changing economic conditions, the President could alter these numerical goals beginning with the third economic report following approval of the legislation.

The 3 percent inflation goal for 5 years from now is desirable and has a reasonable chance to be achieved. Some will argue that the 3 percent goal is too high. While I agree that 3 percent inflation is too high, higher than anyone would like, I do not think we would have a reasonable chance of doing better than that within 5 years. It is crucial that established goals have a reasonable chance of being achieved if they are useful.

Others will argue, of course, that we cannot get the inflation rate down to 3 percent within 5 years. In fact, they may argue that we cannot get inflation down to that low level ever again.

I reject that. It is very easy, perhaps far too easy, to close our eyes to inflation and to avoid the hard problems. It is too easy for the Congress to pass legislation authorizing ever increasing appropriations and to create new programs that require new expenditures. That cannot be done continually without causing some inflation—our resources are limited.

Unfortunately, it is very difficult to get the Congress to reduce expenditures. It is clear, however, that some discipline needs to be imposed.

We must also realize that in the past, tight monetary policies by the Federal Reserve have been the main continuously used policy tool aimed at reducing inflation.

However, tight money too often results in excessively slow economic growth and loss of jobs because monetary policy alone cannot stop an inflationary spiral without stopping the economy. I would hope that neither the Congress nor the Federal Reserve Board want to see that happen, and that the established inflation goal will lead to the development of realistic anti-inflation economic policies.

The role of the Federal Reserve in the whole policy process is critical. The bill requires the Federal Reserve to comment on the President's numerical economic goals and to indicate how their monetary policies relate to them. This is very important.

However, the Federal Reserve has to explain its policies in a meaningful way; they have to relate them to the economy. The announcement of monetary aggregate growth rate ranges is far from sufficient to understand the policy intent of Federal Reserve actions or the strategies the Federal Reserve has in mind in different economic settings. Unless economic policies by the Federal Reserve and the rest of the government can be better understood and coordinated, the objectives of the Humphrey-Hawkins bill will be very hard to attain.

OPENING STATEMENT OF SENATOR SCHMITT

Senator SCHMITT. I have a statement to include in the record of the hearing if permissible.

I would just like to remind the committee and the witnesses, as to what I think is fairly factual, and, that is, the basic causes of inflation. Although there is argument about the relative proportions of these causes, I think, it is generally agreed that they all contribute.

First, is the growth of money supply, which is greater than the rate of growth of the Gross National Product.

I think, in most economists' minds, this is the principal cause of inflation today. Then there is the size of the Federal deficit, which, of course, directly controls the amount of Federal borrowing at the marketplace. This in turn affects the interest rates, which, in turn, are related to the money supply. Only if interest rates were affected, then that would have an inflationary component.

Then there is the basic decrease in productivity of both labor, management and industry as a whole that we have seen over the last decade or so, and there are numerous causes for that, not the least of which is excessive taxation of the productivity sector of our economy. By productivity sector, I mean workers and business alike, and then, there is the present situation, hopefully temporary, but with our present policies, maybe not, which is cartel pricing of energy, brought on by our unfortunate dependence on imports of petroleum from foreign sources.

And then, finally excessive regulation, regulation in excess of what is necessary to provide the society with the appropriate standard quality of life.

In the case of the growth in money supply, I agree with the chairman. I think there is a great deal we can do. I think that over a 5-year period, we probably could bring our money supply rate of growth into rough coincidence with the rate of growth of the gross national product. Chairman Burns has talked about that.

I think Chairman Miller roughly believes that now.

At any rate, I think an attempt to decrease the rate of growth of money supply over an average of a year, by about a half percent a year, could provide a steady decrease in the inflation rate.

We have to realize there is an 18 to 24 months lag in the effect of the money supply on the inflation rate, so we can't become too impatient as we try to tackle that particular problem.

I think the chairman could also agree that the size of the Federal deficit could be decreased. I personally believe we could have chopped $10 billion out of the Federal deficit this year, instead of what appears to be a $5 billion cut, at least according to the first budget resolution.

Taxes, I think we also can decrease. I think it is a mistake to believe that a one-shot, 1-year tax cut is going to have a great effect. I think it's got to be a permanent tax cut so that people and business can judge the future expenditures that they will make only on the basis of the money available to spend.

The only answer to breaking the back of the OPEC cartel, which is controlling our price of energy right now is to have production, domestic production, and increased efficiency on the domestic level that will, in fact, create our own supply, rather than being dependent on them.

Finally, the only answer to excessive regulation is that increased congressional responsibility and reduction of oversight has to occur. We have got to begin to realize very rapidly that there is too much regulation and we are going to have to, not only avoid creating new regulation, but start to cut back on what we have already created.

I look forward, Mr. Chairman, to the comments of our witnesses today and for the remainder of these hearings and I hope to be able to participate in them in entirety.

Thank you very much.

We are pleased to have as our first witness, Representative Joseph Fisher from Virginia, who is also a highly regarded economist, with a fine record.

The CHAIRMAN. I understand Congressman Fisher is likely to have votes in the House and I think maybe out of courtesy to Congressman Fisher, if the other panelists would permit we would like to go ahead with his testimony, then if we have questions for him, to proceed with that and then dismiss him so he can get back.

STATEMENT OF JOSEPH L. FISHER, REPRESENTATIVE IN CONGRESS FROM THE STATE OF VIRGINIA

Mr. FISHER. Thank you very much, Mr. Chairman.

I appreciate this opportunity and I have prepared something perhaps you can put in the record and I will just speak briefly from it.

The CHAIRMAN. You have a very short statement so we welcome that.

Mr. FISHER. Mr. Chairman, I may be the only economist, only living economist who has worked for Leon Keyserling and Arthur Burns.

Senator BROOKE. And survived.

Mr. FISHER. And survived. I think a friend of each.

At any rate I have a few comments to make on the matter before you.

First, the bill that passed the House in March by a large margin, really, was a far cry from the original Humphrey-Hawkins bill of more than a year ago, and a far cry from what many persons around the country still think it is.

Essentially it is a statement of intention to reduce the unemployment rate to 4 percent and so on over a period of several years by advancing a coordinated set of policies, programs.

There is nothing binding or mandatory in the bill. No actions would automatically take place on failure of the unemployment rate to reach a goal.

Instead, a process will be set in motion. The bill sets forth quite a number of purposes, as passed by the House. Targets for employment as well as unemployment. For real income, for productivity, then there were numerous other targets or goals set forth in amendments.

In the end, the bill became a whole collection of worthy objectives, including special attention to veterans, handicapped, capital formation, 100-percent price parity in agriculture, national defense, anti-inflation matters, budget balancing emphasis and so on. A veritable catalog of good intentions.

But even with all this extra baggage, the central emphasis and purpose remains: to establish goals and a program to cut unemployment. And because the central emphasis remained, I was pleased to vote for the bill.

I would have preferred a much simpler, shorter, more direct bill than finally passed in the House.

And two essentials of a good bill in my judgment are more emphasis on jobs and reducing unemployment with coordinated programs to move the national economy in this direction; and second, the addition of reducing inflation as a major purpose of the bill. Not lost among 8 or 10 other objectives.

I would have also preferred to eliminate all numerical statements of goals, both for unemployment and inflation. Not to mention the 100-percent parity for farm prices. Once it seemed the 4-percent unemployment rate was going to be retained in the bill, I supported a 3-percent inflation rate goal as well, because I think these two ought to be retained in some correlative position of importance. The reason I don't think the numerical goals mean all that much, are these: suppose, for example, that there is enacted a 4-percent unemployment rate goal. In that case, one kind of President and Congress, let us say, very much on the conservative side, would probably recommend tax cuts and program cuts in an honest belief that that would best achieve the 4-percent goal. Perhaps, the opposite kind of President and Congress would recommend, well, let's say, tax cuts and program increases by way of moving toward the 4 percent.

In short, any particular President could recommend from a wide range of taxes and programs what he thought would achieve the objective. Any particular Congress would have equally wide range of choices of measures to consider. So, I don't think the quantities make that all much difference.

It is the interpretation of them that would count. In the final 2 or 3 minutes I would like to indicate how I think the anti-inflation component of, if you like, a revision of—an addition to the Employment Act of 1946, might be worked out.

Because I think this is the language, the weakness, the shortcoming of the bill that we sent you from the other body.

I am not entirely sure whether it ought to be added into this bill, but I think it is important, and if not done in this bill, ought to be done separately.

Here are the three things that I would propose by way of a building up of the anti-inflation side of the picture. First, I would advocate establishing anti-inflationary wage and price guidelines so that compliance efforts can be pursued with reference to something we know about.

The jawboning and arm twisting that has been set in motion is good, so far as it can go, but I think there are severe limitations on how far it can go.

Therefore, I would urge taking this additional step even though at the moment it is not all that popular.

Second, I propose developing an effective process for achieving compliance with guidelines. This process could involve perhaps a borrowing from the way we handle labor disputes. A very clear statement that guidelines have been exceeded or threatened to be exceeded, development of objective factfinding, a persuasion, bargaining, mediation if agreed to, arbitration, all set out in a process that would be understood ahead.

Then, third, I would propose, and this is something like the Humphrey-Hawkins bill, I would propose by going forward a coordinated set of measures for achieving the inflation reduction goals. These would include fiscal, monetary, regulatory, and other measures.

I have spelled this approach out some in an attachment which I have submitted to you, and I would like to go more into each one, but unfortunately, the bell has rung. What I would have said would have been along the line of how to set the guidelines, and I have indicated in a very general form, an approach to this, and similarly, more about the process by which Government and labor management would engage in order to hold to the guidelines.

I hate to do this, Mr. Chairman, but could I be excused to go vote?

The CHAIRMAN. You certainly can be. We certainly appreciate it. Thank you very much.

Senator Brooke has an opening statement.

Senator BROOKE. Thank you, Mr. Chairman.

I ask unanimous consent that my statement appear at the beginning of the hearing.

The CHAIRMAN. Without objection.

OPENING STATEMENT OF SENATOR BROOKE

Senator BROOKE. Mr. Chairman, I am pleased that we are continuing our hearings on the Humphrey-Hawkins Full Employment Act of 1978. Indeed, the unemployment statistics dictate we in the Senate give this bill our full support. Our support will indicate we will not accept an unemployment rate which hovers around 6 percent.

When translated into human terms, those statistics represent approximately 6 million Americans who are ready, able, and willing to work. But for circumstances beyond their control, they have been unable to do so. The dislocation, degradation, anxiety, and the great waste of human resources that account for the high unemployment rate is tragic. We must not be deceived by Labor Department statistics which tell us in absolute numerical terms, more Americans are working today than ever before.

As we all know, the current technique of gathering unemployment statistics substantially understates the magnitude of the problem by failing to take account of those who have given up the search for meaningful employment or have accepted part-time positions. A real assessment of the problem would include those categories of unemployed and underemployed, and also those individuals who are working in menial jobs which do not fully utilize their skills or abilities.

Therefore, it is incumbent upon us in the Congress to initiate measures that will commit our Nation to the solution of this pervasive problem.

Humphrey-Hawkins is such a measure. It is a simple, yet meaningful step toward full employment, and coordinated economic growth. It is not a public works bill. Indeed, the emphasis of this bill is to promote the expansion of private sector jobs. This is an approach which I have consistently advocated.

For the permanent jobs, the ones that carry with them promise of advancement, promotion, and personal fulfillment do not come down from Washington. Rather, they are in the private sector. By adopting this approach, Humphrey-Hawkins may actually reduce the burden placed on federally funded programs. But at the same time, it will permit the Federal Government to adopt policies which will provide opportunities, for poor and disadvantaged persons who have previously been ignored.

For the first time they will have opportunity for meaningful, gainful employment. Certainly this will have a salutary effect on both the economy and our Nation.

However, this bill also recognizes the principle that when the private sector is unable to cope, the Government should be the employer of last resort. In its present form, the bill resorts to the remedy of public employment only after measures to stimulate private sector growth have been exhausted.

We expect and believe massive public employment programs will be unnecessary, and I believe the currently underutilized private sector has the potential to generate sufficient jobs to absorb great numbers from the unemployment rolls.

The key is to stimulate growth, and in order to stimulate such growth, the bill mandates coordinated economic policy.

This is an initiative that is long overdue. All too often the various segments of our government charged with economic policy operates as separate entities rather than as a cohesive unit. This approach produces a multiplicity of economic formulas which results all too often in fiscal and monetary policies at odds with each other.

Therefore, the Humphrey-Hawkins bill directs the Federal Government, including the President, Federal Reserve Board, and Congress to design and coordinate short- and long-term strategies to promote full employment and balanced growth.

Humphrey-Hawkins is not a revolutionary bill. Rather, it is a sensible and well-planned approach to solving one of the Nation's most debilitating problems. I would hope, at the completion of these hearings, my colleagues will join in the support of this important legislation.

I thank you, Mr. Chairman, and I look forward to the testimony of this very distinguished panel.

The CHAIRMAN. Now what we are going to do is to, although we have four very distinguished panelists, any one of whom we could listen to and learn a great deal from, in view of the fact that we have four, if you gentlemen don't object too much, we will run along here.

The first 9 minutes will be green, the next 1 will be yellow, and the next will be please stop.

Our first panelist—we will do the same thing, running with the Senators when they are asking questions. But before we begin let us insert in the record at this point a letter and statement from Senator Muriel Humphrey.

[The letter and statement follow:]

UNITED STATES SENATE,
COMMITTEE ON GOVERNMENT AFFAIRS,
Washington, D.C., May 12, 1978.

Hon. WILLIAM PROXMIRE,
Chairman, Committee on Banking, Housing and Urban Affairs, United States Senate, Washington, D.C.

DEAR MR. CHAIRMAN: I appreciate this opportunity to present my views on the Full Employment and Balanced Growth Act of 1978. The attached testimony explains why I believe this proposal is of great importance to our nation and to our citizens.

I have also attempted to explain my reasons for opposing the addition of a specific numerical inflation goal to the bill itself. If my testimony appears long, it is because I feel a heavy responsibility, as the principal sponsor of this measure, to clearly and fully explain my reasons for opposing such an amendment.

I want you to know that I am very grateful for the priority you have assigned to consideration of the Humphrey-Hawkins Bill in your Committee. I understand the many important proposals with which you must deal. But, I am convinced that the long-term impact of this measure on our economy and on the quality of national economic decisions will fully justify the timely attention you have given to this bill.

As you know, passing the bill is my first priority in the Senate, as it was Hubert's. I know that he would be as personally appreciative, as I am for your prompt action and support.

Sincerely,

MURIEL HUMPHREY.

TESTIMONY OF SENATOR MURIEL HUMPHREY

These hearings mark the final phase of Congressional Committee consideration of the Full Employment and Balanced Growth Act of 1978, the so-called Humphrey-Hawkins Bill. After several years of study, debate, modification and Congressional consideration, I believe that Humphrey-Hawkins now is ready for final Congressional approval. The tireless work of Gus Hawkins, Hubert Humphrey, and many, many others in Congress, the Carter Administration, and in the public have produced legislation that is urgently needed. Moreover, it will substantially improve our nation's ability to maintain a growing economy with high levels of employment and reasonably stable prices.

After extensive hearings and much debate the House of Representatives passed the Full Employment and Balanced Growth Act of 1978 on March 16, by a vote of 257 to 152. On May 3, the Senate Human Resources Committee approved this legislation by a vote of 13–2. In the Senate there is growing bi-partisan support for passage of this important measure. When I reintroduced the Humphrey-Hawkins bill on February 23, 1978, it was co-sponsored by 26 of our Senate colleagues, including our distinguished Majority Leader, Senator Robert Byrd. This legislation also has been fully endorsed by President Carter who has assigned priority status to its passage this year. It has been strongly supported by a broad coalition of church, farm, labor, women's, civil rights, community and small business groups representing many millions of Americans. I believe that this support demonstrates the strong feeling in the country that this legislation is needed.

The Humphrey-Hawkins Full Employment Bill amends the Employment Act of 1946. It makes the commitment to high levels of production and employment contained in that measure more specific. It builds on the experience of the last 30 years to articulate a new strategy for achieving full employment and provides the policies and procedures needed for its achievement.

It also recognizes that inflation is a major national economic problem and assigns high priority, in law, *for the first time*, to the achievement of reasonable price stability. The Employment Act of 1946 was mute on the question of inflation. The authors and supporters of Humphrey-Hawkins are acutely aware of the dangers of inflation to the well being of all our people. And, while the major emphasis of this legislation is on reaching full employment and the strategies for doing so, this legislation reflects a firm commitment to reaching our employment goals in ways that do not contribute to increased inflation. I will discuss the anti-inflation provisions of the bill later in my testimony.

In my opinion, and that of many others, the Full Employment and Balanced Growth Act of 1978 must be ranked among the most important legislative proposals now before Congress. I believe it should occupy this position because it makes the goal of achieving and sustaining full employment, while holding inflation to reasonable levels, the permanent centerpiece of national economic policy.

Furthermore, it provides a major improvement in the way in which economic policy decisions are made. It requires that economic policy be designed to achieve specific, flexible, short and long-term numerical goals for economic performance. It also establishes the procedures our Government will use to carry out its efforts to meet these goals in a consistent, comprehensive, long-term and focused manner.

In effect, the bill is an absolutely essential first step toward ending the appalling tragedy and waste that successive and increasingly severe recessions have imposed on the workers of our nation and their families. It is not a panacea for our economic problems. There are no miracle cures. But, I am convinced that it will make all of us much more able to ameliorate the economic problems that periodically and predictably buffet our economy and our citizens. It provides the rational framework without which progress in unlikely to be made. This is why its passage is indispensable.

This legislation was born out of the frustration of millions of Americans with an economic system that repeatedly failed to live up to its full potential and to provide all our citizens who are willing, able and seeking work with opportunities to be usefully employed at decent wages. It is not our free enterprise system which has failed. Rather, the failure rests with the inability of our nation's economic policy decision makers—in Congress, in the Executive Branch, in the Federal Reserve System—adequately to determine the state of the economy, to decide on what government policy should be, and then to act in a decisive, coordinated with sustained way, to reach our nation's economic goals.

Under its provisions, the bill has the real potential to put an end to the faltering, too little and too late initiatives that have characterized government's after-the-fact response to recessions. The bill would rationalize the coordinate comprehensive fiscal and monetary policies and programs in order to make full employment and stable growth the permanent centerpiece of policy formation. It sets forth the specific goal of reducing overall unemployment to four percent of the labor force within five years following enactment. It establishes the procedures by which the Administration, Congress and the Federal Reserve Board will participate in the formulation of policies and programs to carry out the purposes of this Act.

I am very pleased with the version of the bill reported by the Senate Human Resources Committee and commend it to the members of this Committee for their study. As approved, the bill requires the President, each year, to propose short and medium term goals, covering a five year period, for employment, unemployment, production, productivity, real income and inflation together with the policies and programs required to reach these goals. The Federal Reserve would annually report its intended monetary policy and state its relationship to the economic goals proposed by the President. The Senate and House Committees on Banking, Housing and Urban Affairs would be responsible for recommending any action Congress might consider following up on the Federal Reserve Board Report.

A revised Title III of the Humphrey-Hawkins Bill provides a workable and reasonable process for Congressional consideration of the President's proposal. It also provides the impetus and mechanisms for more comprehensive debate on national economic policy, as it relates to the Federal Budget, each year. I am pleased with this revised Title III as it emerged from the Senate Human Resources Committee.

Primary emphasis throughout the bill is placed on establishing and sustaining the economic climate necessary to enable the private sector of our economy to provide most of the job opportunities needed to reach full employment. This is where most people are working and should be working. This also is where most new jobs should be created. Incentives for business and industry and existing Federal community development, public works and facilities, job training and public service programs would be temporarily utilized to fill any gap that might exist between the job creating performance of the private sector and our interim employment targets.

If it becomes necessary, in order to reach the employment goals of the bill, the President is required to propose job creating programs to provide lower pay and skill employment opportunities for those who cannot otherwise find work. Such a proposal could be made no sooner than the third year following enactment and it would be subject to the normal Congressional authorization and appropriations processes. Clearly it is better for society and for the individuals themselves to be paid for their work rather than for idleness.

To provide needed flexibility, the President, in the event of unforeseen circumstances, could propose that the specific fifth year employment goals of the legislation be modified. This step could not be taken sooner than the third year following enactment and it too would be subject to Congressional action.

As I mentioned earlier in my testimony, the Full Employment and Balanced Growth Act of 1978 is an amendment to the Employment Act of 1946. As such, it is focused on policies and procedures needed to improve substantially the employment, production and real income performance of our economy. However, unlike the Employment Act of 1946, it clearly recognizes the critical importance of maintaining reasonable price stability. In fact, it establishes reasonable price stability as a major objective of our nation's economic policy.

In further recognition of the problem of inflation the bill, as passed in the House and approved by the Senate Human Resources Committee, requires that a specific numerical goal for prices be included each year in the President's Annual Economic Report to the Congress. This numerical goal, for each of the five years included in the Economic Report, would be accompanied by the specific policies and programs the President recommends for achieving this goal. This inflation goal and the comprehensive policies needed to achieve it would be subject to the same discussion and debate in the Congress as would exist for the other economic goals contained in the President's Economic Report.

In addition, the bill includes a set of significant and specific anti-inflation measures which the President would be required to consider each year in developing the Economic Report. These anti-inflation measures would include:

Establishing a price monitoring system;

Developing and implementing programs designed to meet shortages of labor, capital and materials in tight markets;

Eliminating unnecessary or counterproductive government regulations;

Encouraging increased productivity on the part of both labor and management; and

Strengthening competition and vigorously enforcing our nation's anti-trust laws.

The entire bill is based on the recognition that targeted employment efforts will be required if we are to achieve the employment objectives of the bill without aggravating the problems of inflation.

While the Humphrey-Hawkins Bill elevates the concern over inflation to national priority status for the first time in law, while it provides a set of policies and procedures designed to move toward the achievement of full employment in a manner consistent with reasonably stable prices, while it includes a more specific annual focus on reducing inflation and requires annual inflation goals covering five years and the comprehensive anti-inflation policies to achieve these goals, and while it includes a set of measures that should be part of an effective anti-inflation program, it is not, nor was it designed to be, in and of itself, a complete and comprehensive anti-inflation proposal.

It requires that such a comprehensive program be developed and submitted to Congress each year. It requires that specific annual numerical inflation goals, consistent with the proposed anti-inflation program, covering a five year period, also be presented to Congress by the President each year. Such a comprehensive proposal might well be expected to deal in detail with such non-employment related inflation factors as international and domestic energy policy, foreign agricultural policy, deregulation of various major sectors of our economy, and much more.

I fully recognize the need to develop such a comprehensive anti-inflation policy and am hopeful that given the legal requirement to do so in this bill, the Congress and the President will redouble their efforts to develop such a policy in a timely manner. Humphrey-Hawkins provides the legislative basis for great strides toward full employment in a manner consistent with stable prices. It mandates the development of a comprehensive anti-inflation program as described above. It is, in my view, a very rational approach to dealing effectively with both the problem of unemployment and the problem of inflation.

I look forward to working with the Administration and my colleagues in Congress toward a comprehensive and effective approach to ameliorating the severe problem of inflation which continues to plague our economy.

The House of Representatives and the Senate Human Resources Committee have approved the procedure described above under which the President includes specific numerical inflation goals, covering a five-year period, each year as part of his Economic Report. These goals would then be considered by the Congress. Such a procedure is supported by the Carter Administration as well as by the sponsors and supporters of the bill. It is our hope that this procedure will be considered and accepted by the Senate Committee on Banking, Housing and Urban Affairs.

Some members of Congress have proposed the addition of a specific, long-term, numerical goal for inflation to the Humphrey-Hawkins Bill. Such a proposal, which is opposed by the Carter Administration, a number of prominent economists and the sponsors and supporters of the bill was considered in Committee and on the floor of the House of Representatives. In each case this proposed amendment to the Humphrey-Hawkins Bill was voted on and rejected.

As my support for the House passed inflation proposal indicates, I am not opposed to establishing specific numerical inflation goals. On the contrary, I have supported an amendment which requires the President to set an inflation goal each year for five years and to submit it to Congress for its consideration. It would be included in the President's Annual Economic Report right along side his unemployment goal and other goals. However, under this procedure the goal would have to be accompanied by a comprehensive anti-inflation policy that the President believes will enable us to reach the goal.

I am opposed to an arbitrary inflation goal that is simply hung on the Humphrey-Hawkins Bill and not accompanied by a comprehensive anti-inflation policy that can credibly be approved by Congress as sufficient to reach the goal that is proposed.

At this point in my testimony I would like to discuss in more detail the reasons for my opposition to adding an arbitrary anti-inflation goal to this bill.

First, as described in detail above, the current bill has been very carefully designed to elevate the concern for inflation in our nation's laws and to move toward achieving full employment in a non-inflationary way. The focus on targeted employment creation, for example, is based on the recognition that this is a necessity if we are to achieve full employment with reasonable price stability.

Second, the unemployment goals in the bill have been stretched out after a great deal of discussion and study, from three percent within 18 months in the 1974 bill to four percent within five years in the current bill, to assure that adequate time was provided to reach this goal without creating inflationary pressures. This view on the achievability of this goal without generating inflation is shared by the Carter Administration, many prominent national economic policy oriented economists, and the sponsors and supporters of the bill. We should bear in mind that the present goal would require a reduction in the unemployment rate of only two percentage points over the next five years.

Third, I would suggest that those whose concern for inflation may override their concern for unemployment consider the costs of such a policy. A recent analysis prepared by the Council of Wage and Price Stability found that constricting the growth of aggregate demand through traditional policies to dampen the economy does more harm to the economy in general than any good that is ever achieved in reducing inflation. The Council found that this kind of approach to reducing inflation by one percent necessitates the loss of $100 billion in production and 2.5 million jobs. In this vein, Arthur Okun, of the Brookings Institution, found that a one percentage point increase in unemployment is associated with a decrease of three percentage points in GNP. This amounts to a $60 billion decrease in real GNP. The loss in tax revenue and the increase in Federal spending associated with a one percentage point increase in unemployment in approximately $20 billion.

Fourth, the inclusion of a specific, arbitrary, long-term, numerical inflation goal, as a part of the legislation itself, would invite suspension of the unemployment goal whenever inflation increased, regardless of the cause of the particular inflationary surge being experienced. In other words, even if the cause was totally unrelated to efforts to reduce employment. I am afraid that an arbitrary inflation goal would be used to postpone action to reach full employment, based on the discredited notion of a trade-off between unemployment and inflation.

30-454 O - 78 - 2

No one who witnessed the high unemployment and high inflation performance of our economy during the past recession should continue to believe in a firm trade-off, yet many still do. And, despite the views regarding the trade-off held by some proponents of this amendment, many will see these goals as simple trade-offs in the future. We should not do anything in Humphrey-Hawkins which would encourage continuation of this erroneous and simplistic perception of economic activity.

Regardless of how clearly some members of Congress have rejected the Phillips-Curve ideology, such is not the case in many parts of the government and of the private sector. Many influential people, witness the response to the last three recessions, still believe that the best way to fight inflation is to increase unemployment.

With or without Humphrey-Hawkins the rate of inflation may be substantial at times in coming years. As I have said, we believe the bill will move us toward full employment without generating inflation. We must prevent setting up a situation in which inflationary pressures, generated by factors unrelated to our pursuit of full employment, lead to a policy response which diverts or halts our effort to provide our citizens with productive jobs. Establishing a specific arbitrary numerical inflation goal in the bill itself would, I fear, encourage such misguided action.

Fifth, many of the causes of inflation appear to be beyond the reach of standard economic policies. The unemployed workers whom Humphrey-Hawkins is designed to help are all within our borders. Moreover, over 20 years of experience indicate that policies and programs of the Federal government can have a direct and positive impact on the problem of unemployment.

Our experience on the prices side is quite different. OPEC pricing decisions on energy supplies or weather conditions affecting the size of the grain harvest in the Soviet Union or Canada, to use just two examples, can have a tremendous inflationary impact on our economy and one over which we appear to have very little control at present. Furthermore, the Federal Government's experience in dealing with such inflationary pressures in recent years gives us little reason for confidence that we now have an effective approach to preventing inflationary pressures from such sources.

Sixth, the proposals to include an arbitrary, long-term, specific numerical inflation goal in the bill itself, so far proposed, to my knowledge, do not include a specific and comprehensive program for its achievement. Unlike the unemployment goal which is accompanied by a detailed strategy for its achievement, and required action to achieve it, the inflation goal is simply proposed as an appendage to the existing bill. I believe that it is incumbent on anyone who would add such a goal to the Humphrey-Hawkins Bill to provide the comprehensive program needed for its achievement as part of the amendment with at least as much specificity as is the case for the unemployment goal. Such a comprehensive anti-inflation policy should be developed with great care and an inflation goal consistent with such a program should then be proposed. This requires extensive development, discussion, debate and consideration by the Administration and each House of Congress on its own merits. And, this exact procedure will be followed under the provisions included in Humphrey-Hawkins as amended in the House and by the Senate Human Resources Committee.

Frankly, I am afraid that including this arbitrary goal will give the impression of a significant action to reduce inflation when none has in fact been taken by this amendment. As a result, the pressure that is building throughout the nation for a comprehensive and effective attack on inflation may be reduced. This would be a most unfortunate consequence, one which the sponsors of the amendment certainly do not intend, and it should be avoided. Moreover, the credibility of the Congress with the public would be further eroded by establishing such a goal without the policies, strategies and programs needed to achieve it.

As you know, the Humphrey-Hawkins Bill has been criticized by some as a goal without a method for its achievement. I believe this charge is without merit and that it has been convincingly refuted. However, if an arbitrary inflation goal is added without a method for its achievement, this addition to the bill could certainly be challenged on the same basis.

Seventh, while some organizations representing business may agree with this amendment, there are a number of business people who have expressed serious concerns about including a specific long-term inflation goal in Humphrey-Hawkins. They believe that such a proposal raises disturbing possibilities regarding the role of government in achieving the inflation goal. In their view, such a goal could lead to its interpretation as a guideline for price behaviour. They feel that, unlike other provisions of the bill, this addition could lead to serious governmental interference in millions of private sector market decisions. Rather than building business confidence, such an effort, they believe, could lead to conflict and uncertainty regarding future economic activity.

The Full Employment and Balanced Growth Act of 1978 is not a final solution to our economic problems. It will only be effective if we work conscientiously to carry out its full intent. However, it does present our government with a rational procedure to determine the priority needs of our economy and to develop a consistent and comprehensive response to those needs. In doing so, we can achieve and sustain the goals of the legislation.

By their very nature the goals of full employment and stable growth will be difficult to reach and hold. But what other real alternatives are open to us? Do we continue to stumble from recession to recession and accept the appalling burden such circumstances impose on millions of our people, or do we embark on the coordinated effort prescribed in the bill and use its goals to define the direction in which we must move and the progress we make in doing so?

As challenging as they are, I believe the goals can be reached. The real question, I believe, is whether the government of this nation has the will and the courage to make the effort. If this Committee reports a strong Full Employment and Balanced Growth Act, free of weakening amendments, it will have gone a long way toward answering that question in the affirmative and charting a new course of full employment, full utilization of all our resources and reasonably stable prices for America for decades to come.

The CHAIRMAN. Our first witness is a very distinguished economist and former member of the Federal Reserve Board. I think you served 8 years and, of course, the Federal Reserve has enormous influence on what happens to the success or failure of the Humphrey-Hawkins bill, so we are delighted to have Dr. Andrew Brimmer.

STATEMENT OF ANDREW BRIMMER, PRESIDENT, BRIMMER & COMPANY, INC.

Dr. BRIMMER. Thank you, Mr. Chairman, members of the committee. I was delighted to receive the invitation to appear before this committee.

Three questions were put to me, two of which dealt explicitly with the Federal Reserve and the third with the need for an explicit inflation target as a part of the legislation.

I have responded to each of those questions in the prepared statement. I would hope that the statement could be made a part of the record.

The CHAIRMAN. Yes. It will be printed in full in the record without objection.

[The complete statement follows:]

BRIMMER & COMPANY, INC. | Economic and Financial Consultants
SUITE 916 (202) 466-3474 | 1201 CONNECTICUT AVENUE, N.W.
WASHINGTON, D. C. 20036

For Release on Delivery
Monday, May 8, 1978
2:30 PM (EDT)

MONETARY POLICY AND THE HUMPHREY-HAWKINS BILL

Testimony By

Andrew F. Brimmer

President

BRIMMER & COMPANY, INC.

Economic and Financial Consultants

Before the

Committee on Banking, Housing and Urban Affairs

UNITED STATES SENATE

Washington, D. C.

May 8, 1978

MONETARY POLICY AND THE HUMPHREY-HAWKINS BILL

Testimony By

Andrew F. Brimmer*

Mr. Chairman, I was pleased to accept your invitation to appear before this Committee to present my views on the "Full Employment And Balanced Growth Act of 1978," also known as the "Humphrey-Hawkins Bill." I was asked to comment on:

(a) "... The Federal Reserve's role in achieving the policies set forth in the legislation ...;"

(b) "... Possible need for an expanded dialogue between the Federal Reserve and Congress ...;"

(c) "... The need for an explicit inflation target to go along with the unemployment target of 4 per cent for 1983."

I will address each of these issues in turn. Before turning to that task, let me say briefly that I believe the general objectives of the Humphrey-Hawkins Bill are desirable - although I have had (and still have) some reservations about several of its features. If one can navigate through the bill's 30 major sections, a central aim shows through: Expressed briefly, the Humphrey-Hawkins bill would make the reduction of unemployment the single most important objective

---

*Dr. Brimmer is President of BRIMMER & COMPANY, INC., a Washington, D.C.-based economic and financial consulting firm. From March, 1966, through August, 1974, he was a Member of the Board of Governors of the Federal Reserve System.

of national economic policy. It would establish a numerical unemployment rate of 4 per cent for the civilian labor force as a whole and 3 per cent for adults (defined as those 20 years of age and over). These goals would have to be met over a five-year period -- presumably by 1983. Another important goal -- although not stated quantitatively -- is a significant reduction in the extremely high unemployment rates among young people, members of minority groups, and others on the margins of economy.

The thinking behind the bill assumes that the private sector will be the primary source of the jobs needed to achieve the specified goals. However, it would also mandate that the Federal Government use its various economic policy instruments for the same purpose. These would include fiscal policy (setting targets for both revenue and expenditures) as well as increased spending -- where necessary -- on training and public service jobs. Moreover, the Federal Reserve System would be required to give explicit consideration to the unemployment goals in its conduct of monetary policy. While the revised draft recognizes that inflation is also a serious problem, the fundamental focus remains on the reduction of unemployment.

As the several versions of the bill were evolving, I expressed some reservations about a number of its provisions. These reservations included doubts about the wisdom of legislating specific numerical targets as a way of defining national economic policy goals; the heavy reliance on public sector jobs as a vehicle for reducing unemployment, and the lack of sufficient emphasis on the need to check inflation. I still hold some of these reservations, but the bill which was adopted by the House of Representatives on March 16, 1978 (H.R. 50), goes a long way toward meeting some of my concerns. The proposal made by the Chairman of this Committee (Amendment No. 1794), calling for the inclusion of a specific target (3 per cent) to which we should try to reduce the rate of inflation by 1983, would be a further improvement.

In addition, I believe more specific guidelines are required to enhance the dialogue between the Congress and the Federal Reserve System to assure that monetary policy makes its contribution to the achievement of the goals of the Humphrey-Hawkins bill.

Specific Provisions Relating to Monetary Policy

I have summarized in Chart I the key provisions relating to monetary policy contained in H.R. 50 (passed by the House) and S. 50 (pending before the Senate). It will be noted that several provisions are common to both versions of the bill, but a number of crucial differences

CHART I. Summary of "Full Employment and Balanced Growth Act of 1978" Relating to the Federal Reserve System (Section 108 - Monetary Policy)

Provision	Version of Bill	
	H. R. 50 (Passed by House)	S. 50 (Pending before Senate)
1. Board of Governors of the Federal Reserve System shall submit to Congress:		
(a) Within one month after the transmission of the Economic Report		X
(b) An independent statement setting forth the Federal Reserve's intended policies for the year ahead;		X
(c) And their relationship to the short-term goals set forth in the Economic Report.		X
(d) An independent statement setting forth the Federal Reserve's intended policies for the year ahead;	X	
(e) And their relationship to		
(1) the short-term goals set forth in the Economic Report;	X	
(2) medium-term trends in employment, production, and prices for the 3 calendar years subsequent to the 2 years referred to in the bill.	X	

Provision	H. R. 50	S. 50
2. The House Committee on Banking, Finance and Urban Affairs and the Senate Committee on Banking, Housing and Urban Affairs.		
(a) shall consult with representatives of the Board of Governors concerning the Board's and the Federal Open Market Committee's intended policies, and	X	
(b) Each of these Committees shall submit to the Joint Economic Committee a report containing their views and recommendations with respect to the Federal Reserve's intended policies.	X	
3. Thereafter, the Congress shall take such action as it deems necessary to insure closer conformity to the purposes of the Act.	X	X
4. Nothing in the Act shall be interpreted to require that policies proposed by the Board of Governors of the Federal Reserve System be followed if the Board of Governors and the Federal Open Market Committee determine that they cannot or should not be followed because of changing conditions.	X	

also stand out. These specific provisions are set forth in Section 108 of both H.R. 50 and S. 50.

In general, the Federal Reserve would be required to identify for Congress -- explicitly -- the monetary policies it intended to pursue for the year ahead. It would also have to explain its perception of the relationship between those policies and the short-term and medium-term goals specified in the Act. This assessment would have to be made soon after the Economic Report is submitted to the Congress each year. The traditional oversight committees of the Congress would have the responsibility to explore with the Federal Reserve representatives the content and implications of the central bank's independent statement of its objectives and to weigh their compatibility with the national economic goals set forth in the Act. Finally, the Federal Reserve would retain the flexibility needed to modify its policies as circumstances change.

Through reference to other provisions, Section 108 assigns a specific role to the Federal Reserve in the pursuit of the goals the Act seeks to achieve. The central bank is called upon to "...transmit to the Congress an independent statement setting forth its intended policies for the year ahead ..." The Act does not suggest the contents of this statement nor the types of subject matter it should cover. However, the section seems to imply that the Board should express its intentions with respect to those policies which will govern the growth of the monetary aggregates and credit conditions during the first year of the five-year period by which the full employment and price stability targets are to be achieved. (I will comment below regarding my own views as to the contents of the statement the Federal Reserve would be required to submit).

The short-term goals (for the calendar year of the Economic Report and the year following) to which monetary policy is to be related are "... full employment, production, and real income, balanced growth, adequate productivity growth, full parity of income for farmers, reasonable price stability, and proper attention to national priorities ..." These goals are to be achieved as rapidly as feasible. The medium-term goals (for the 3 calendar years subsequent to the 2 years referred to above) are to be expressed by the President as annual numerical targets to be achieved by the fifth year following adoption of the legislation. Again, the interim numerical unemployment goal is an unemployment rate of not more than 3 per cent for adults aged 20 and over and not more than 4 per cent for the entire civilian labor force (including those workers aged 16 and over).

However, in the case of the Federal Reserve Board, the Act seems to require only that the latter explain the relationship of monetary policy to "... medium-term trends in employment, production, and prices for the 3 calendar years subsequent to the 2 years referred to ..." in defining the short-term goals.

I believe this is a wise position, since it would be extremely difficult for the Federal Reserve to make detailed projections of goals for the expansion of money and credit over such a distant period. By their very nature, the instruments of monetary policy (mainly the discount rate, open market operations, and changes in reserve requirements) must be used over a fairly short time horizon. Moreover, because of its flexibility, monetary policy can be modified fairly quickly as basic economic conditions change. So, it would be unwise to immobilize this tool of economic stabilization by attempting to link it rigidly (which probably could not be done anyway) to targets with a running time of 3 to 5 years.

General Provisions Relating to Monetary Policy

In a number of other sections of the proposed legislation (of which H.R. 50 is the most exhaustive version), the role of the Federal Reserve and its management of monetary policy are stressed explicitly or incorporated by reference. Taken together, these provisions and citations present a comprehensive view of the part which the nation's central bank is expected to play in the achievement of the goals set forth in the Act.

In the section on General Findings, the bill declares that aggregate monetary and fiscal policies alone have been unable to achieve full employment. Nor will they be able to do so in the future. Consequently, the attainment of the Act's objectives will be facilitated by the establishment of explicit short-term and medium-term economic goals and by improving coordination among the President, the Congress, and the Board of Governors of the Federal Reserve System.

The Act seeks "... to provide an open process under which economic goals and policies are proposed, reviewed, and established; and to provide for yearly review of national economic policies to ensure their consistency with these goals to the maximum extent possible ..." (under-scoring added).

I interpret the intent of these requirements to mean that the Congress recognizes that monetary policy (even in combination with fiscal policy) has carried more of the burdens of economic stabilization than it could effectively handle -- without imposing seriously adverse consequences for certain sectors. Thus, as indicated by other sections of the Act, specific and especially targeted policies and programs are needed to supplement the tools of aggregate demand management. At the same time, the Federal Reserve is being called upon to participate in an open process of policy formulation and to coordinate its own efforts with those of the President and Congress to assure that the various policies reinforce each other.

In an important finding underlying a key provision of the Act, Congress "...declares that inflation is a major national problem requiring improved ... fiscal and monetary management ..."as well as improvements in a number of other Federal policies. Also, "...the Congress finds that sole dependence upon fiscal or monetary policies or both to combat inflation can exacerbate both inflation and unemployment. The Congress determines that fiscal and monetary policies which are utilized prudently and in conjunction with specific targeted policies dealing with structural measures are badly needed..."

From the above references, I draw the following conclusion: In the campaign to check inflation, monetary policy has a positive contribution to make. In the conduct of monetary policy, the Federal Reserve can -- and must -- support the overall objectives of achieving full employment. However, that role is less direct than the part the central bank can play in the effort to abate inflationary pressures.

In another basic provision, the Act mandates that the Federal Government, in the pursuit of full employment, must rely initially and primarily on the private sector for the creation of jobs The success of this policy will depend fundamentally on the promotion of private investment and capital formation. The latter presupposes that the availability of money and credit must be adequate -- and its cost must be appropriate -- to finance the capital expenditures businessmen will want to make. Here, also, the role of the Federal Reserve -- manifested through its influence on credit and interest rates -- is crucial.

So, in general, while Section 108 of the Act is specifically devoted to monetary policy, other provisions will affect the responsibilities of the Federal Reserve System in a number of ways. In my judgement, on balance, these are constructive provisions, and their adoption should enhance the role of the central bank in the formulation and implementation of national economic policy.

Need for Expanded Dialogue Between the Federal Reserve and Congress

Let me now turn to the second issue I was asked to address: Is there need for an expansion of the dialogue between Congress and the Federal Reserve? My answer is yes.

In fact, I have held this position for quite some time, and I have so testified before the Committee. In the Spring of 1976 (Hearings: Third meeting on the Conduct of Monetary Policy, May 4, 1976, pp. 44-46), I made a proposal aimed at enhancing Congressional oversight over the management of monetary policy. I have attached as Appendix I to my statement today an excerpt from that testimony which spells out in detail the substance of the suggestions I made two years ago. With the passage of time, and in light of steps Congress has taken in the interval, I would modify some of those recommendations. However, I would still stress the central theme.

Last November, the Chairman of this Committee introduced a bill "...that would improve Congressional oversight of monetary policy, provide additional information on monetary policy for the Budget Committees of the Congress, and foster better coordination of monetary and fiscal policies...". Specifically, that bill would have required the Federal Reserve Board to consult with Congress at semi-annual hearings before this Committee (and its counterpart in the House of Representatives) during which the following information would be presented:

> "...(1) the Board of Governors' and the Federal Open Market Committee's objectives and plans with respect to the ranges of growth or diminution of monetary and credit aggregates for: (A) the current fiscal year during which the hearing is held; and (B) the next fiscal year beginning not more than eight months from the date of the hearing;
>
> "(2) the Board of Governors' and the Federal Open Market Committee's estimate of the levels of employment, production and prices for the end of the periods referred to in paragraph (1) that are consistent with such objectives and plans; and
>
> "(3) an explanation of the reasons for any revisions to the objectives and plans disclosed during the previous hearings pursuant to this section."

The specifications set forth above are generally the same types of information which I believe the Federal Reserve Board should be called upon to present in its statement relating to monetary policy that would be required by Section 108 of the bill currently before the Congress. I believe that the present draft legislation does not need to be amended, but the legislative record should show that the Federal Reserve's statement of objectives and plans is expected to include some measure of credit as well as of the money supply -- however the latter is defined. I think it is unfortunate that, in formulating the goals of monetary policy, so much weight has been given to targets for the growth of the monetary aggregates. I personally would prefer to see more (but not exclusive) attention devoted to the behavior of interest rates. However, since the Federal Reserve does operate within a monetary aggregates framework, the inclusion of some reference to credit is desirable.

I also think the System should be required to spell out its expectations with respect to the behavior of the real economy (that is, output, employment and prices) as well as its objectives for the monetary aggregates. In my own proposal advanced two years ago, I suggested that the Federal Reserve's staff economists -- taking the FOMC's targets as given -- should spell out the technical implications of the monetary policy goals adapted by the FOMC. These staff projections

30-454 O - 78 - 3

are already being made, and they could be adapted for this purpose. However, I would modify this suggestion at this time. Since that idea was advanced, the dialogue between Congress and the Federal Reserve has moved forward a great deal. Under the Federal Reserve Reform Act of 1977 (which succeeded House Concurrent Resolution 133), the Federal Reserve Board reports to the Congress quarterly on its 12-month targets for the monetary aggregates, giving weight to "... past and prospective developments in production, employment, and prices."

Moreover, the recently appointed Chairman of the Federal Reserve Board, in appearing before this Committee on April 25, 1978, went well beyond the reporting requirements of the statute adopted last year. After discussing recent economic and financial developments, and following the presentation of the FOMC's money supply targets, he then shared with the Committee his:

> "...own views about the outlook for the economy in quantitative terms. (His) personal expectation is that, over the year ending with the first quarter of 1979, real GNP probably will increase in a 4-½ to 5 per cent range, the unemployment rate probably will drop into the 5-3/4 to 6 per cent area, and the GNP price deflator is likely to rise by 6-3/4 to 7-1/4 per cent. It is hardly necessary to add that quantitative projections, such as these, are subject to considerable margins of uncertainty Necessarily they have to be re-evaluated on the basis of incoming economic data and changing conditions here and abroad."

The above statement represents an innovation in the content of the dialogue between Congress and the Federal

Reserve. While the quantitative forecast for the economy was presented as the personal views of the Chairman, it is reported to reflect the concensus of the FOMC as well. It is also my understanding that the Congress can expect to receive similar projections in the future

The language of the bill introduced by the Chairman of this Committee last year indicated that the Board and FOMC "... shall maintain long run growth of the monetary and credit aggregates commensurate with the economy's long run potential to increase production, so as to promote effectively the goals of maximum employment, stable prices, and moderate long term interest rates." I support the explicit statement of the goals of monetary policy as expressed here. The test of monetary policy should be its effectiveness in promoting the growth of output and employment in the context of price stability. I recognize that the achievement of these goals will always be difficult, but the fundamental objectives of monetary policy -- and not purely short-term variations in the monetary aggregates -- should be kept in view.

If language of this type were to be included in the legislative record -- given the new willingness of the Federal Reserve to present at least the key elements of a quantitative forecast -- it would be possible for the Congress to enhance its ability to monitor monetary policy. For example, this Committee could ask its staff to work out independently the implications (including the implications for interest rates) of the targets for the monetary aggregates and the economic forecast presented by the Federal Reserve during the latest quarterly appearance before Congress. (To undertake this assignment, the staff may have to be enlarged somewhat, and the computer resources of the Congressional Research Service may have to be used). The staff report resulting from this inquiry could serve as the basis of a series of questions that could be addressed to the Federal Reserve. The latter's representative would be expected to respond to these questions during the next quarterly appearance before the Congress. I would anticipate that the central bank would be reluctant to discuss the outlook for interest rates, but the overall quality of the dialogue would be enhanced.

I also believe that the Federal Reserve should provide an explanation of the reasons for any revisions made with respect to its previously expressed goals. In addition, a clear account should be given of any significant deviation from the targets it expected to achieve over the time horizon previously projected.

In conclusion, I believe the legislative record relating to the current bill should emphasize the objective of improving coordination of monetary and fiscal policies. It should avoid preoccupation with the details and mechanics of monetary management -- while seeking to enhance the oversight role of Congress.

Need for Explicit Inflation Target

The third question I was asked to discuss is this: Should the Humphrey-Hawkins bill contain a specific numerical target for inflation? My answer is yes.

The Amendment introduced by the Chairman of the Committee would accomplish this objective. Specifically, the proposal would define the phrases "rate of inflation" and "reasonable price stability," as used in the bill, to mean "...the rate of change or level of the consumer price index, as set forth by the Bureau of Labor Statistics, U. S. Deparment of Labor." It would also quantify the inflation target set in the bill by adding to the medium-term goals "...and to reduce the rate of inflation to 3 per centum or less." Finally "...upon achievement of the 3 per centum inflation goal, each succeeding Economic Report shall have the goal of further reducing the rate of inflation toward zero. Policies to achieve the inflation goal shall be designed so as not to impede the achievement of the unemployment goals."

I believe the above language should be added to the bill. In general, I think it is not desirable to attempt to reduce complex economic policy objectives to numerical specifications. While goals should be stated clearly, the implementation of policies designed to achieve them requires considerable flexibility and imagination. The promulgation of rigid rules limits the exercise of judgement that is needed in the administration of public policy.

However, since the medium-term unemployment targets in the bill have been expressed in quantitative specifications (and there is clearly little likelihood of changing this aspect of the legislation), it is well to follow a similar course with respect to the inflation goal. Otherwise, the commitment to fight inflation may get less emphasis than the seriousness of the problem would justify.

I agree that the present language of the bill relating to inflation is an improvement over that contained in the original Employment Act of 1946. That language asserted "... that it is the continuing policy and responsibility of the Federal Government ... to promote maximum employment, production, and purchasing power." The present language of the Humphrey-Hawkins bill setting the inflation goal calls upon the Federal Government to "... promote full employment (and other goals) ... and reasonably stable prices ...". The latter reference to the goal of price stability is more explicit than the earlier reference to "maximum purchasing power." However, the inflation target should be made even more definitive, and the proposed amendment would serve that purpose.

The prospects for inflation over the next five years are by no means bright, and the implementation of the employment policies mandated by the Humphrey-Hawkins bill will put further upward pressure on prices. This appears to be likely despite the emphasis in the measure on overcoming structural limitations and the use of especially targeted training and employment programs.

The framers of the Humphrey-Hawkins bill are clearly counting on the private sector to generate the bulk of the new jobs. In BRIMMER & CO., we have estimated that (given the outlook for the growth of the national economy), between 1977 and 1983, the civilian labor force may expand from 97.3 million to 107.5 million, a gain of 10.2 million persons. During the same period, total employment may rise by 11.4 million (from 90.4 million to 101.8 million). The level of unemployment might decrease by 1.2 million (from 6.9 million to 5.7 million), cutting the unemployment rate from 7.1 per cent to 5.3 per cent.

If this projected 5.3 per cent rate is to be cut to 4 per cent, an additional 1.4 million jobs would have to be found -- which would hold the unemployment level to 4.3 million in 1983. For the private sector to accomplish this task, gross national product (GNP) would have to expand in real terms at an average annual rate in excess of 5 per cent during the next five years. Such a pace would be considerably above the long-run growth trend which is somewhat less than 4 per cent.

If sustained for such a long period of time, this above-trend rate of growth in GNP would push output close to the limits of production capacity and stimulate substantial inflationary pressures in an economy in which the general price level might already be rising at an annual rate close to 6 per cent. Consequently, the inflationary potential of the public policies required to implement the Humphrey-Hawkins bill suggests that it would be wise to specify a numerical target for the anti-inflation goal included in the measure.

Of course, it will be difficult to achieve a 3 per cent rate of inflation over the next five years, and the probability is high that we will fall short of the goal. The reason is clear: over the long-run, the basic rate of inflation is closely related to the rate of increase in compensation per hour worked in excess of the rate of improvement in productivity. Currently, compensation per hour is rising at an annual rate close to 9 per cent, and productivity is increasing at a rate just over 2 per cent. Consequently, the underlying rate of inflation is in the neighborhood of 7 per cent. Over the next five years, compensation may rise somewhat more slowly, and productivity may advance somewhat more rapidly. Nevertheless, it is unlikely that either trend will change dramatically. As a result, for a number of years, we will probably face a rate of inflation that is quite high when judged in terms of historical experience.

For these reasons, the bill ought to contain an explicit target for the anti-inflation goal.

- o -

Appendix I

EXCERPT FROM TESTIMONY

By

Andrew F. Brimmer

Before the

Committee on Banking, Housing, and Urban Affairs

United States Senate

May 4, 1976
pp. 44-46

CONGRESSIONAL ASSESSMENT OF MONETARY POLICY

At this point, I want to focus on ways in which the Congress can improve its monitoring of monetary policy. To this end, the following steps should be taken:

1. A joint House-Senate staff should be established to assess and monitor Federal Reserve monetary policy.
2. The Federal Reserve should be required to submit its Annual Report to Congress by approximately the same period set for the President's Budget Message and Annual Economic Report.

3. As a basis for Congressional hearings, the Federal Reserve Board should be required to do the following:

(a) Present a review of its performance compared with the monetary policy objectives it had set for itself the previous year.

(b) Present a projection of the targets for the monetary aggregates adopted by the FOMC for the coming year.

4. Taking the FOMC's targets as *given*, the Federal Reserve Board's staff should be required to perform the following tasks:

(a) Develop projections (one year ahead) of output, employment, unemployment, and prices *implied* by the monetary policy the FOMC has adopted.

(b) Project the flows of funds in major sectors of the economy, *implied* by the staff's forecast.

(c) Discuss the *range* and *configuration* of interest rates *implied* by the staff's projections.

(d) This effort should result in a staff report to accompany the Board's report to Congress.

5. On the basis of the FOMC's monetary policy targets and the Federal Reserve Board's staff report, the joint House-Senate staff should provide its *own* assessment of material submitted by the Federal Reserve.

6. In making its assessment, the Congressional staff should interview *in person* each Member of FOMC.

Each of these recommendations can be amplified further.

Joint House-Senate Staff.—Members of Congress serving on the banking committees which oversee the Federal Reserve System (as well as members of the Joint Economic Committee) should have a professional staff with the resources and technical capacity to monitor monetary policy. In establishing the Congressional Budget Office, Congress took a vital—and long-needed—step to equip itself to understand and control the budget of the United States. No longer is the Congress heavily dependent on information and analyses submitted by the Executive Branch of the Federal Government. Such a move is also needed in the case of monetary policy. As matters stand now, the gap between the Congress and the Federal Reserve with respect to staff resources and technical capacity is wide indeed. Steps ought to be taken promptly to narrow the margin. To some extent, the present staffs are able to perform this task. However, a significant amount of strengthening is also needed.

Federal Reserve's Annual Report.—The Annual Report of the Federal Reserve Board should reach the Congress during the same period in which the President's Budget Message and Economic Report are submitted. The Congress needs to have all three documents in hand before it can make informed judgements with respect to the requirements of national economic policy. Currently the Budget Message and Economic Report are normally available by mid-February. However, it may be April or May before the Federal Reserve's Annual Report is submitted to Congress. If the Board's entire Report is not available early in the year, a detailed accounting of its conduct of monetary policy and a general statement of its plans for the year ahead should be provided.

Statement of Monetary Policy Objectives.—For the last year—in response to Congressional mandate—the Chairman of the Federal Reserve Board has been appearing at six-month intervals before each of the Congressional oversight committees to explain the System's conduct of monetary policy. On these occasions, he has presented the range of targets set by the FOMC for the growth of selected monetary aggregates for four quarters ahead. These periodic reports contain a great deal of information on financial developments and the performance of the economy in recent quarters. (A quarterly report prepared by the Board's staff and presented to Congress contains an even greater amount of historical data.)

Yet, there is little or no expression of the expectations held by the Federal Reserve Board or the FOMC with respect to the economic outlook and prospective financial developments. This deficiency should be remedied.

To accomplish this end, I propose the following:

1. When the Chairman of the Federal Reserve Board appears before Congress early in the year, he should present a review of the FOMC's performance with regard to the monetary policy objectives it had set for itself the previous year. A full explanation should be given for any significant deviation of results from stated goals.

2. The Chairman should also present a projection of the targets for the monetary aggregates adopted by the FOMC for the coming year. These aggregates should include some measure of bank credit as well as of the money supply, however narrowly (M_1) or broadly (M_2) defined. Along with this projection, the Chairman should be asked to provide—on behalf of the FOMC—an exposition of the reasons why the targets adopted are thought to be adequate.

3. Taking the FOMC's targets as given, the Federal Reserve Board's staff should be required to spell out in some detail the technical implications of the monetary policy goals adopted by the FOMC. The Board's staff should concentrate on working out the economic and financial consequences which might be expected to follow—if the stated objectives were to be achieved. This task should include projections of output, employment/unemployment, and prices—on a quarterly basis for at least one full year. Specifically, the projection should include most of the items shown in Table 1 describing the expected behavior of the economy in real terms. In addition, the staff should project the flows of funds (perhaps on a semi-annual basis) through the major sectors of the economy which may be associated with the contours of economic activity sketched below.

The staff projections discussed here are currently being done. While the results are not made public, economists outside the Federal Reserve are thoroughly familiar with the techniques employed by the Board's staff. In fact, many former staff members have been employed by private institutions (such as banks and brokerage firms as well as research organizations) with the specific purpose of tracking and interpreting Federal Reserve activity.

Finally, the Board's staff should discuss the range and configuration of interest rates implied by the staff's projections. This effort should result in a staff report to accompany the Board's Report to Congress.

Here it must be emphasized again that the Board's staff is being asked to undertake a technical and professional assignment. They are not being asked to make independent judgments regarding the proper role of monetary policy. Some observers might argue that it is difficult—if not impossible—to distinguish between the staff's analysis of the consequences of policy decisions and the giving of policy advice. I would not accept such an argument. The excellent performance of the staff of the Congressional Budget Office in this regard provides convincing evidence that it can be done. It might also be argued that the staff's analysis and conclusions will be taken as proxies for the judgments and expectations of the FOMC itself. I recognize this risk, but I believe it is worth taking.

After all, the Federal Reserve System does share—on a delegated basis—the Constitutional authority given to Congress to "coin money and regulate the value thereof." Thus, the Congress must look to the Federal Reserve for guidance as to the general consequences which might be expected to follow from the Board's exercise of that shared responsibility. Since the Board and the FOMC are reluctant to engage publicly in economic forecasting, it should be willing to have the staff present its professional judgments.

4. Once the Congress has received the FOMC's projection of its monetary policy targets—along with the Federal Reserve Board's staff report—the joint House-Senate staff (whose establishment is recommended) should provide for the Congress an independent assessment of the material submitted. Since the Congressional staff would have been monitoring monetary policy in any case, it should be able to perform this assessment without much delay. In making its assessment, the Congressional staff should interview in person each Member of the FOMC. These views of individual Members would then be a part of the record available to the Congress when it undertakes its own review of the adequacy of monetary policy.

Dr. BRIMMER. Thank you very much.

Before turning to the response to the particular questions, let me make it clear that I think the objectives of the Humphrey-Hawkins bill are desirable—although I have had and still have some reservations about several of its features.

Now, as the bill was going through the several phases which have brought it before the Senate, and as passed by the House, I have been concerned about the wisdom, among other things, of including a quantitative target for the unemployment rate. I have also been concerned about the reliance on public sector jobs and vehicles for reducing unemployment, and I have been concerned about the lack of sufficient emphasis on the need to check inflation.

The bill that is now before the Congress, as passed by the House, still needs some modification, and I would suggest one of these is the inclusion of a specific target for the rate of inflation.

The proposals made by the chairman of this committee strike me as appropriate, and I have some suggestions as to why we should include a 3-percent target.

Mr. Chairman, given the limitation of time, I would address myself first to the question of the provision of the bill related to the Federal Reserve and the role the Federal Reserve might play in the implementation of the Humphrey-Hawkins bill objectives.

I have summarized on pages 4 and 5 of my statement, the major features of the bill that related directly to the Federal Reserve. I have followed those comments with some observations with respect to general provisions of the bill, which also have some important implications for the Federal Reserve.

Finally, I talk about the need to expand the guidelines with respect to the Federal Reserve and bylaws for the Federal Reserve, and I do that before I get to the need for the target.

Before I do that, I concentrate on the need for S. 50, H.R. 50 passed the House and S. 50 is pending before the committee. If you look down the column on the chart on pages 4 and 5, you will notice that the sections relating to the Federal Reserve are quite similar, although they are not identical.

As far as I am concerned, the most crucial distinction between the House-passed version and the bill as pending in the Senate is the following: you will note that the House bill spells out much more fully the expected response of the Federal Reserve in terms of the way it is supposed to look upon the report submitted by the President each year, and the way the Federal Reserve is supposed to coordinate its own efforts to help achieve the efforts of the bill. The way to spell out, the way the House version does, and the way the Senate version does not.

I think it is also crucial, however, to recognize that the task before the Federal Reserve is quite different than the task before the administration and Congress.

Thus the Federal Reserve, once it established a set of goals and objectives for the 2, 3, to the 5 year, we have to review those, and the House version makes it possible, quite explicitly, for the Federal Reserve Board and the committee to review the target and the goals it sets and to modify them as the goals change.

I think that is an important point. However, both versions of the bill do make it clear that the Federal Reserve, while it is to run an independent monetary policy, is called upon to coordinate its activities explicitly with the rest of the Congress. That is an innovation and the bill ought to have that provision to make certain that the Federal Reserve understands it is expected to do that.

The bill also spells out—the House version does—the kind of response expected with respect to the targets.

I will argue later that I would have preferred no new numerical targets in any case, but as long as they are there, then it ought to be clear what kind of statement the Federal Reserve is expected to make with respect to those targets, and the House version again makes that clear.

The Senate version does not.

Now, Mr. Chairman, the most important feature of the bill is scattered through a number of various places in the legislation. What I tried to do on page 8 through 11 in my statement, is to pull together the various segments of the bill, that would have a direct—more or less direct impact on the conduct of monetary policy, and I have tried to suggest there what kind of response the Congress already expects the Federal Reserve to make under the bill, as those various provisions are brought to bear.

It is clear that the legislation does not anticipate the monetary policy and fiscal policy will continue to carry the disproportionate burden of stabilization efforts which they have carried in the past.

As I read the draft legislation, and the House-passed bill explicitly—that is an explicit innovation.

I would like to see that, and I hope it remains that.

The act, however, also calls upon the Federal Reserve to engage in an open process, as a part of the rest of the Government, to make certain that monetary policy is consistent with the rest of the national stabilization policies to promote the economic growth and reduce unemployment.

That provision is wise and ought to be supported.

The bill in general relates monetary and fiscal policy as a part of overall Government policy.

One objective of the bill is to promote full employment through the expansion of private capital investment and formation.

In that concept the role of the Federal Reserve is crucial. The Federal Reserve clearly will have to make certain that the availability of money and credit is sufficient, and the cost of money, interest rate, is appropriate to finance the kind of investment the business community would want to make. That too is an important provision.

I hope it would be included.

Mr. Chairman, I was next asked to address myself to the question of the need for improved dialog with the Federal Reserve, that is, dichotomy with the Federal Reserve. I deal with that question on pages 11 through the top of 17.

Let me summarize this quickly by saying that, in my judgment, there is already a great deal of dialog between the Congress and the Federal Reserve. Over the last 2 years, since the current resolution is being enforced, and that was later done also by the Federal Reserve

Act of 1977, the Federal Reserve appears before Congress four times a year, twice before each of the Banking Committees.

It presented a substantial amount of information which the record shows it did not have a few years ago, and that information can be used as a basis for building further communication between the Federal Reserve and the Congress.

In the text of my statement, I have a suggestion for the way that can be done. Time does not permit me to go into it in detail, but I would be delighted to respond to it during the question and answers.

Finally, Mr. Chairman, with respect to the question of a guide for the inflation target: As I said at the outset, I believe the 3-percent target is appropriate. It ought to be included in the legislation as a part of the legislation.

I would prefer no quantitative targets, either for unemployment or for employment or for inflation.

If the target for unemployment, a quantitative one can be eliminated, it should be.

If not, the 3-percent target ought to be added, and I would defend those propositions in questions and answers, if you wish.

The CHAIRMAN. Thank you very much, Dr. Brimmer.

The next witness is a very distinguished economist, chief economist with the Chamber of Commerce of the United States, and a man of very considerable experience.

We are delighted to have Dr. Jack Carlson.

STATEMENT OF JACK CARLSON, CHIEF ECONOMIST, CHAMBER OF COMMERCE OF THE UNITED STATES

Dr. CARLSON. Thank you very much, Mr. Chairman. I, too, would like to submit my written statement for the record.

The CHAIRMAN. Without objection, it will be printed in full in the record.

[Complete statement follows:]

STATEMENT
on
THE FULL EMPLOYMENT AND BALANCED GROWTH ACT (S.50)
before the
SENATE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
for the
CHAMBER OF COMMERCE OF THE UNITED STATES
by
Dr. Jack Carlson
May 8, 1978

I am Jack Carlson, Vice President and Chief Economist of the Chamber of Commerce of the United States. On behalf of nearly 72,000 members of the National Chamber, I am pleased to testify on The Full Employment and Balanced Growth Act (S.50). Also, I am pleased to have Dr. Paul Reardon, Senior Chamber Economist, with me to respond to your questions.

POSITION

Although S.50, the Humphrey-Hawkins bill, has been improved since early 1977, the National Chamber is unable to support the bill in its present form. The bill promises too much. It is symbolic. To many people, it symbolizes boom-bust fiscal overstimulation and accelerating inflation. Meaningless or overly ambitious policy declarations should be the wave of the past not the wave of the future.

Our lack of support for S.50 in its present form is not because of opposition to its underlying economic objectives nor the objectives of the Employment Act of 1946, which S.50 would amend. On the contrary, American business strongly supports these broad objectives of the bill:

- "to foster and promote free enterprise"
- "to promote maximum employment, production and purchasing power"
- "to promote price stability", and
- "high rates of capital formation."

Our disagreement is with the way the bill proposes to achieve these objectives. The Senate or House bill requires by legislation:

- achievement of an unrealistic 3% adult unemployment rate and 4% overall unemployment rate within five years, which in turn would cause higher inflation, at least 5% higher prices, higher taxes, at least $1,600 for the average U.S. family, and runs the risk of actually creating fewer jobs because of the greater risk of a recession;
- reliance on statistical measures that are in the process of being changed by the National Commission on Employment and Unemployment Statistics;
- a goal of 100% of parity in farm prices by 1983 (H.R. 50), which according to the Agriculture Department could cause 3% higher prices and a loss of real family income of $170;
- government price speculation through food and mineral stockpiles;
- steps threatening the independence and flexibility of the Federal Reserve Board at a time when inflation is increasing and the dollar is depreciating against other key currencies;
- wages of public-subsidized jobs higher than the minimum wage and higher than wages of unsubsidized and fully productive workers earning near the minimum wage. This would encourage workers to leave lower paying but productive jobs for the higher paying but make-work public jobs, thereby hurting small businesses and imposing an unfair and unnecessary burden on taxpayers; and
- an inflexible and cumbersome economic policy process whereby a one-house veto could overturn the President's five-year unemployment goals.

<u>Comments on the Bill's General Findings</u>

The General Findings section of the bill follows a negative theme on the performance of the American economy. The Findings Section emphasizes the problems of our economic system without sufficiently recognizing its many strengths.

30-454 O - 78 - 4

The Humphrey-Hawkins bill is biased toward government oversight and intervention in private decision-making. Humphrey-Hawkins symbolizes the view that the Federal government must intervene in the economy through national goal setting and goal implementation. In order to monitor deviations from national goals, the Federal government would need to more closely observe individual firms and industries. This principle is made explicit in the bill where it calls for closer monitoring of prices and wages (and other economic indicators) in particular industries.

In Findings Section 2(b)(1), the bill declares that unemployment causes inflation. This is unusual economic reasoning. To follow it through we must conclude that by reducing unemployment to 3% for adults in 1983 we would thereby reduce inflation. Recognized economic studies have found just the opposite relationship between inflation and the unemployment rate as currently measured.

How Has the American Economy Performed?

The two-fold role of business in our market economy is to provide the goods and services consumers demand and jobs for people willing and able to work. Business has been highly successful in producing both.

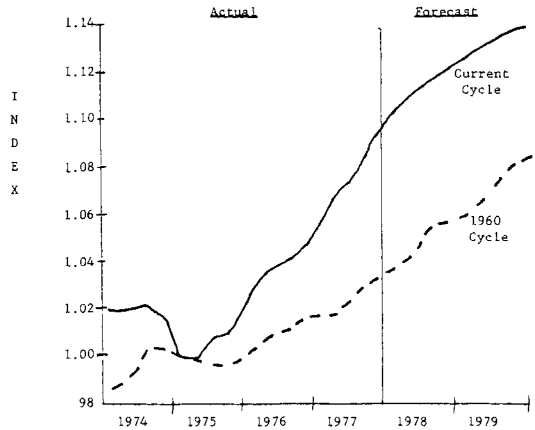
In regard to employment, the economy has created 38.6 million new jobs since 1946 when the original Employment Act was passed, over 12.6 million jobs since the first quarter of 1975 which was the trough of the last economic cycle, and over 3.9 million during the last 12 months. More than five out of six of these new jobs were created in the private sector.

This growth in employment is above the most comparable economic recovery in the last 25 years (see Graph 1).

GRAPH 1

EMPLOYMENT DURING
ECONOMIC RECOVERIES

(1975:1=1.0)

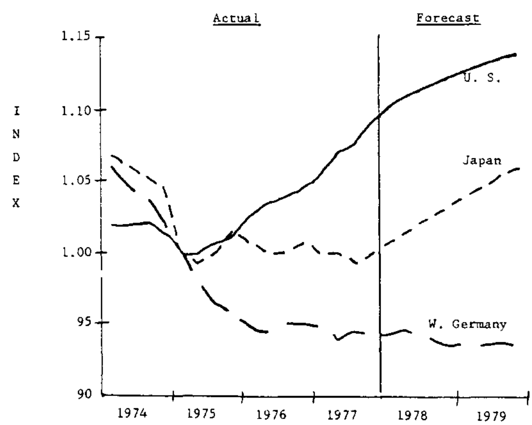


Also, the United States has been (and is forecast to continue to be) much more successful in creating jobs than other major industrial countries (see Graph 2).

GRAPH 2

EMPLOYMENT OF
U. S. AND OTHER INDUSTRIAL COUNTRIES
DURING ECONOMIC RECOVERIES

(1975· 1=1.0)



The market oriented U.S. economy has provided more jobs as a proportion of the population in recent months than at any other time in U.S. history. The level of employment today is greater than during any of the so-called "full-employment" years since World War II: 58.4% of the population now employed with about 6.0% unemployment compared with less than 55.7% employed during years with unemployment at or below 4% (see Table 1).

TABLE 1

EMPLOYED AND UNEMPLOYED
AS A PROPORTION OF TOTAL POPULATION

	April 1978	Average of Ten Years With Unemployment at or Below 4%
Employed	58.4%	55.7%
Armed Forces	1.3%	2.5%
Unemployed (seeking work)	3.7%	2.1%
Not Employed or Seeking Work (Labor Reserve)	36.5%	39.7%
Total	100%	100%

Source: U.S. Dept. of Labor, Unemployment Situation, April 1978; Geoffrey H. Moore, National Bureau of Economic Research; the "full employment" years are 1947, 1948, 1951, 1952, 1953, 1966, 1967, 1968 and 1969.

In recognition of this outstanding performance and expectation for the future, a more explicit general finding committing the Government to preserving the market economy instead of hobbling it would be helpful. Such a statement could be inserted in Sec. 2 (General Findings) as follows:

> The Congress further finds that the American enterprise system, operating under the Constitution and laws of the United States, has produced a higher standard of living, greater economic opportunity and social justice than that found in any major industrialized nation and that it is the purpose of this Act to achieve the goals enumerated herein by encouraging those federal actions which strengthen the effectiveness of the private

enterprise system while at the same time dealing sensitively and compassionately with those individuals who have been adversely affected by the dynamics of economic life.

Employment Growth

The record and the prospect of employment growth is ignored in the bill. It focuses purely on unemployment statistics. It considers only 3.7% of the working age population that are unemployed to be important, not the currently 58.4% that are employed. This is a rather limited view of employment opportunities. The fact that the economy created about 4.1 million new jobs in 1977 and 3.9 million during the last 12 months is as important as the fact that unemployment fell by 886,000 in the same period.

Unemployment and Structural Change

Moreover, the slow decline of the unemployment rate in this recovery while jobs are being created at all-time record rates reflects a major change in the economy from past periods of time. This change is caused by:

(1) A heavy influx of women and teenagers in the labor force who voluntarily quit or change jobs more often and cause the overall unemployment rate to be higher than 10 or 20 years ago.

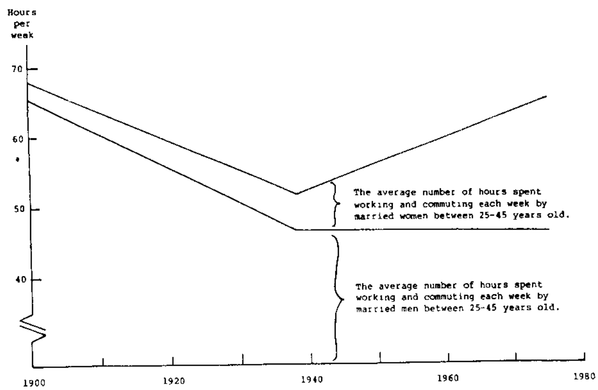
(2) Much higher income security (unemployment, food stamps and welfare) benefits which reduces the incentive to accept newly created jobs and causes some potential workers to remain nominally unemployed for eligibility purposes, such as the 2 million employables receiving aid for dependent children.

(3) The fact that unemployment is far less a hardship because of a larger proportion of families with two or more workers today. In part, this is illustrated by the increasing hours spent working by married women in addition to the hours spent working

by married men. If either a working husband or wife becomes temporarily unemployed, the other offers a buffer against hardship that was not available in the past (see Graph 3).

GRAPH 3

CHANGING WORK HOURS OF MARRIED MEN AND WOMEN



Source Dr John Haldi "The Impact of New Work Schedules on Business" 1977

For these and other reasons, I do not know many economists who feel that a 4% unemployment rate is realistic today or in the 1980's. This is in sharp contrast to the appropriateness of a 4% unemployment rate in the mid-1950's. The Carter Administration shares this assessment. The President's FY 1979 Budget states on page 41: "The unemployment rate at high employment is estimated to be 4.9% currently and to decline to 4.7% by 1983. These rates are consistent with a 4.0% rate in 1955, adjusted for changes in the composition of the labor force towards groups that typically experience higher rates of unemployment." The Congressional Budget Office identifies a rate of growth that "is optimistic by historic standards" 1/ so that the unemployment rate can decline to 4.5% in 1983.

1/ Statement of Alice M. Rivlin, Director, Congressional Budget Office, before the Joint Economic Committee, December 5, 1977.

Such a rate of growth in the private sector would have to rely on a very rapid growth of business fixed investment. In today's economic climate, that rate has not yet materialized.

S.50's requirement for a 4% unemployment rate within five years is not feasible. Broad economic policy such as fiscal and monetary measures may achieve 4-3/4% to 5½% unemployment rates with inflation below double-digit rates. To go below these unemployment rates would result in even higher rates of inflation or require special job programs. If public sector jobs were relied upon to lower the unemployment rate from 5% to 4%, you may quickly estimate that only one million new jobs would be required. However, new workers drawn in by new job opportunities would also seek jobs, perhaps another one million more, or a total of about two million. 2/ At $9,000 for each job, the federal budget would have to increase by $18 billion, much larger than the FY 78 Comprehensive Employment and Training Act manpower budget, or the equivalent of $300 additional taxes for the average American family. The reduction in hardship through creation of public sector jobs, particularly jobs for casual supplementary earners, may not be as great as the additional hardship imposed upon American families who would pay the increased taxes.

Changing Definition of Unemployment

Unemployment statistics are imprecise, so much so that the Congress and the President have established a Commission on Employment and Unemployment Statistics to recommend ways to improve such statistics:

> The Commission's specific mandate, as set forth in the law is to "identify the needs of the nation for labor force statistics and assess the extent to which current procedures, concepts and methodology in the collection, analysis and presentation of such statistics constitute a comprehensive, reliable, timely and consistent system of measuring employment and unemployment and indicating trends therein. (January 11, 1978)

2/ This may be a conservative estimate. Eli Ginzberg recently estimated that there are up to 17 million potential job seekers who might enter the labor force under favorable conditions. Scientific American, Nov. 1977, p. 50.

Even if the Commission only makes recommendations as modest as the last Commission did in 1962 to improve employment statistics, the definitions and standards for measuring unemployment and employment will likely change. Such changes could cause the current statistics of unemployed teenagers to drop from a 15% unemployment rate to 10% or rise to 20%, depending upon inclusion of voluntary Armed Forces or changes in minimum number of hours worked each week.

For this reason, among others, it would be unwise to place in legislation a 4% unemployment goal because the definition is about to be changed and affect the degree of hardship associated with a current rate of 4%.

The 4% Unemployment Target

The 3% adult unemployment five year goal and the 4% overall unemployment five year goal are twenty years out of date and unrealistic. Studies by Professor Philip Cagan of Columbia University, Robert E. Hall of MIT, testimony by Charles Schultze, then of The Brookings Institution, in 1976 and, more recently, a comprehensive study completed by Professor R.A. Gordon for the National Commission for Manpower Policy conclude that the 4% and 3% targets are not feasible by 1983. An attempt to achieve this could result in fewer jobs and higher inflation. The likely result with even above-average economic policies would cause 1.5 billion fewer jobs and 5.2% higher prices than would occur otherwise. With average economic policies, the drive to achieve the Humphrey-Hawkins unemployment goal could result in losing 2.3 million jobs and adding 5% to inflation by triggering a typical recession. Even with an ideal growth path and economic policies, Humphrey-Hawkins' goal would cause at least 6% higher inflation and $1,657 higher taxes for the average family. Below average policies and trends could cause much higher inflation and much lower job growth. The impact on the citizens of each State would vary based on labor force composition, unemployment, composition of industry and average family taxable incomes (see Table 2).

TABLE 2

ECONOMIC IMPACT OF HUMPHREY-HAWKINS
EMPLOYMENT OBJECTIVES BY 1983

(Change in levels from stable growth trend)

	Likely Results 1/		Ideal Stable Growth 3/		Typical Recession 2/	
	Inflation (%)	Jobs (1000's)	Inflation (%)	Taxes ($77/Family)	Inflation (%)	Jobs (1000's)
UNITED STATES	5.2	-1,460	6.0	1,657	5.0	-2,300
Alabama	4.0	-22	4.7	1,286	3.9	-35
Alaska	8.6	-3	9.9	2,731	8.2	-4
Arizona	4.8	-17	5.6	1,544	4.6	-27
Arkansas	4.0	-14	4.6	1,269	3.8	-22
California	5.8	-152	6.7	1,837	5.5	-240
Colorado	5.3	-21	6.2	1,702	5.1	-33
Connecticut	6.1	-21	7.0	1,936	5.8	-33
Delaware	6.0	-4	7.0	1,922	5.8	-7
Dist. of Columbia	6.8	-11	7.8	2,156	6.5	-17
Florida	4.8	-62	5.6	1,545	4.7	-98
Georgia	4.6	-36	5.3	1,477	4.4	-57
Hawaii	6.7	-6	7.7	2,125	6.4	-9
Idaho	4.5	-6	5.2	1,441	4.3	-9
Illinois	6.1	-72	7.0	1,935	5.8	-113
Indiana	4.8	-36	5.6	1,540	4.6	-57
Iowa	5.2	-20	6.0	1,654	5.0	-32
Kansas	5.3	-16	6.1	1,693	5.1	-25
Kentucky	4.1	-22	4.8	1,314	4.0	-34
Louisiana	4.5	-23	5.2	1,446	4.4	-37
Maine	4.1	-7	4.7	1,309	4.0	-10
Maryland	5.8	-28	6.7	1 864	5.6	-44
Massachusetts	4.9	-37	5.7	1,573	4.7	-58
Michigan	5.2	-58	6.0	1,648	5.0	-91
Minnesota	5.3	-28	6.1	1,687	5.1	-44
Mississippi	3.7	-15	4.3	1,191	3.6	-24
Missouri	4.8	-32	5.6	1,544	4.7	-51
Montana	4.7	-5	5.4	1,490	4.5	-8
Nebraska	5.5	-12	6.3	1,747	5.3	-18
Nevada	5.6	-5	6.4	1,780	5.4	-8
New Hampshire	4.7	-6	5.5	1,511	4.6	-9
New Jersey	6.0	-47	6.9	1,900	5.7	-74
New Mexico	4.0	-8	4.6	1,265	3.8	-12
New York	5.8	-110	6.7	1,846	5.6	-173
North Carolina	4.2	-41	4.9	1,355	4.1	-64
North Dakota	5.4	-4	6.2	1,722	5.2	-7
Ohio	4.7	-73	5.4	1,496	4.5	-114
Oklahoma	4.4	-13	5.1	1,412	4.3	-29
Oregon	4.8	-17	5.6	1,540	4.6	-27
Pennsylvania	5.1	-75	5.9	1,630	4.9	-118
Rhode Island	5.2	-6	6.0	1,655	5.0	-9
South Carolina	4.2	-20	4.9	1,343	4.0	-32
South Dakota	4.5	-5	5.2	1,445	4.4	-8
Tennessee	4.2	-32	4.8	1,338	4.0	-51
Texas	5.1	-91	5.8	1,611	4.9	-144
Utah	6.4	-9	7.4	2,045	6.2	-14
Vermont	4.4	-3	5.0	1,388	4.2	-5
Virginia	5.4	-37	6.2	1,707	5.1	-59
Washington	5.4	-22	6.2	1,713	5.2	-35
West Virginia	4.1	-10	4.8	1 313	4.0	-16
Wisconsin	5.2	-32	6.0	1,649	5.0	-50
Wyoming	5.2	-3	6.0	1,649	5.0	-5

1/ Assumes a 20% probability of the TRENDLONG0378 assumptions occurring during the next 5 years, and an 80% chance of the CYCLELONG0378 assumptions occurring.

2/ Data Resources, Inc. CYCLELONG0378 (Spring 1978) simulation was used as the cyclical growth case. In this simulation, which depicts a business cycle scenario similar to the pre-1973 experience with a recession in 1982, unemployment rates were forecasted at 5.8% in 1980, 5.0% in 1981, 6.1% in 1982, and 7.1% in 1983. Consumer prices in CYCLELONG0378 grew at 5.9% in 1980, 7.0% in 1981, 7.4% in 1982, and 6.1% in 1983.

3/ Data Resources, Inc. TRENDLONG0378 (Spring 1978), which assumes few unpredictable shocks and the right combination of fiscal and monetary policies, was used as the stable growth simulation to achieve the Humphrey-Hawkins unemployment objectives. In this simulation, DRI forecasted unemployment rates of 6.0% in 1980, 5.7% in 1981, 5.7% in 1982, and 5.3% in 1983. Consumer prices in the TRENDLONG0378 simulation grew at annual rates of 5.8% in 1980, 5.5% in 1981, 5.2% in 1982, and 5.0% in 1983. The Humphrey-Hawkins unemployment objectives were achieved by lowering the unemployment rate below what would otherwise occur from the stable growth trend estimated by DRI. Humphrey-Hawkins unemployment objectives were assumed to be 5.6% in 1980, 5.1% in 1981, 4.6% in 1982, and 4.0% in 1983. Under these unemployment assumptions, consumer prices grew at 6.0% in 1980, 6.3% in 1981, 6.6% in 1982, and 7.3% in 1983.

In order to reduce the likelihood of adverse impacts from an overly ambitious or economically unfeasible goal, Congress should delegate the responsibility for determining short term and intermediate term numerical economic goals to the President with adjustment allowable each year.

For the above reasons we recommend that the provisions in S.50 requiring achievement of the 4% unemployment rate within five years be deleted and that the President or subsequent Congresses be allowed to assess the appropriate rate for that time based on changing characteristics of the labor force, changing incentives to work, and changing definitions of employment and unemployment.

Section 304 in Title III of the bill reported by the Human Resources Committee on May 3, 1978 makes the 3% adult unemployment rate and 4% overall unemployment rate even more binding on the President. That section would enable the Congress to overturn a President's decision to modify the numerical goal after three years with a one-house veto. The constitutionality of a one-house veto is questionable and the President needs flexibility in setting goals for economic policy. Section 304 should be deleted.

Economic Impact of Government Actions

The Federal government has often ignored the goal of high employment while apparently seeking other objectives. The Administration has supported and the Congress has enacted laws that slow down the creation of jobs for persons willing and able to work. For example, during 1977 the Administration recommended legislation that could have caused a loss of 2.1 million jobs in gross terms by 1979 and even larger job losses in the 1980's (see Table 3, line 11).

However, the Congress has rejected or not acted on some of the Administration's recommendations; consequently, the job loss would be 0.8 million by 1979. After adjusting for the fact that one job might be eliminated by two separate bills, the net job loss would be 203,000 by 1978, 844,000 by 1979, 1,445,000 by 1980 and 2,516,000 by 1985. These estimates do not include the job reducing impact of Clean Air and Clear Water amendments and other legislation that affects the economy but has yet to be measured. Nor does it include job-reducing results of numerous new regulations imposed during 1977. Consequently, these conservative figures should be considered as underestimates of the job-destroying results of federal actions during 1977.

TABLE 3
ECONOMIC IMPACT OF THE CARTER ADMINISTRATION'S PROPOSALS
AND CONGRESSIONAL ENACTMENT OF LEGISLATION DURING 1977
(Change in Levels: 1978-1985)

	EMPLOYMENT Gains (+) or Losses (-) (Thousands of Jobs)			
	1978	1979	1980	1985
ENACTED:				
(1) Economic Stimulus	502	206	103	100
(2) Minimum Wage	-605	-1230	-1815	-1926
(3) Social Security Taxes	0	-108	-305	-1284
(4) Farm Support	-108	-109	-110	-111
(5) Federal Pay Increases	-102	-110	-110	-209
(6) Gross Impact of Enacted 1977 Legislation	-313	-1350	-2236	-3430
(7) Net Impact of Enacted 1977 Legislation	-203	-844	-1445	-2516
PROPOSED AND PENDING:				
(8) Energy Taxes	-110	-549	-735	-1890
(9) Regulation of Intrastate Natural Gas	-50	-105	-156	-215
(10) Labor Law Reform	0	-109	-202	-703
(11) Gross Impact of Administration's Proposed and Still Pending Legislation	-473	-2114	-3329	-6148
(12) Net Impact of Administration's Proposed and Still Pending Legislation	-307	-1331	-2164	-4488

Source: Dr. Jack Carlson and George Tresnak, United States Chamber of Commerce, Forecast and Survey Center; Data Resources, Inc. and Chase Econometrics Modelling and Data; The National Planning Association Data.

Price Stability

Removal of the requirement for a legislated numerical goal for unemployment would reduce the apparent inflationary bias of S.50. No numerical goal for price stability was included.

Unequal treatment of price stability and unemployment may give the appearance that the Congress fails to recognize that reduction of unemployment to low levels through the powerful tools of monetary and fiscal policies will result in high and accelerating inflation; subsequently when efforts are made to slow inflation, unemployment will increase and defeat the employment objective. Public policy should consider both unemployment and price stability.

S.50 would be strengthened if the price stability goal-setting process were placed on a completely equal footing with the unemployment goal-setting process. Also, the qualifier "reasonable" ought to be deleted.

Regarding the 3% Inflation Amendment

Amendment 1794 introduced by Senator Proxmire would add an interim five year goal of a 3% increase in the new Consumer Price Index. If the bill still contains the 3% adult unemployment and 4% overall unemployment goals, then we would recommend inclusion of the 3% inflation target. A far better means of reducing the inflationary bias in the bill would be removal of numerical targets of any kind, allowing officials to set targets as circumstances warrant in the future.

Elimination of inflation should be an objective supported by the Federal government on all occasions, not just during the narrow deliberations of this bill or any other single bill. This has not been the case. For example, during 1977, the Administration proposed legislation that would have 2.2 percentage points to the inflation during 1978 in gross terms (see Table 4, line 11).

The legislation passed by the Congress would add 1.8 percentage points to the inflation rate in gross terms, and, after adjusting for the effect of overlapping policies, will add a "net" 0.8 percentage points to the inflation rate in 1978 and 1.8 percentage points by 1979. So, while the Administration forecast consumer price inflation of 6.1% for 1978, it would have been only 5.3% had the Federal government not enacted cost-push inflationary measures (see Table 4).

These estimates do not include cost-push inflationary policies enacted prior to 1977 but effective in 1978, such as the social security tax increase January 1978, and increases in regulations, such as new clean air and water regulations. When these are included, government is causing 2 percentage points acceleration in inflation.

Government Economic Stockpiles

Proposed Government price speculation in food and mineral stocks is an unnecessary intrusion into the private sector and, importantly, Federal efforts in the past have proven to be poorly timed and more hurtful than helpful. Food stockpiles for humanitarian purposes and mineral stockpiles for strategic purposes can be justified, and have been established by separate legislation. An open invitation for the Government to speculate in commodities on economic grounds should not be enacted. Nor should a harassing or burdensome new reporting system be initiated.

In particular, Title I, Sec. 109 (amending Sec. 9 of the 1946 Act) subsection (1) calling for "an effective information system . . ." and subsection (3) calling for "establishment of stockpiles of agricultural commodities and other critical materials to help stabilize prices . . ." should be deleted.

Regarding Federal Reserve (FRB) Reporting (Section 108)

This section causes great concern among business people everywhere. The Joint Economic Committee (JEC) 1978 Joint Economic Report calls for improvements in fiscal and monetary policy coordination. The Report urges the Congress to assure that monetary and fiscal policies do not work at cross

TABLE 4

CHANGES IN INFLATION
BECAUSE OF THE CARTER ADMINISTRATION'S PROPOSALS
AND CONGRESSIONAL ENACTMENT OF
LEGISLATION DURING 1977

(Change in Levels: 1978-1985)

	Inc. (+) or Dec. (-) in Consumer Prices (Percent)				Gain (+) or Loss (-) Purchasing Power for Average Family ($1977)			
	1978	1979	1980	1985	1978	1979	1980	1985
ENACTED:								
(1) Economic Stimulus	0.1	0.2	0.2	0.2	-30	-59	-62	-72
(2) Minimum Wage	1.1	2.0	2.7	2.7	-298	-554	-764	-830
(3) Social Security Taxes	0.0	0.1	0.3	0.3	0	-40	-93	-104
(4) Farm Support	0.4	0.5	0.6	0.8	-119	-148	-183	-261
(5) Federal Pay Increases	0.1	0.1	0.2	0.2	-38	-41	-50	-75
(6) Gross Impact of Enacted 1977 Legislation	1.8	3.0	4.1	4.4	-485	-842	-1153	-1342
(7) Net Impact of Enacted 1977 Legislation	0.8	1.8	2.5	3.0	-222	-501	-713	-908
PROPOSED AND PENDING:								
(8) Energy Taxes	0.4	1.6	2.8	4.5	-119	-454	-803	-1393
(9) Regulation of Intrastate Natural Gas	0.0	0.0	0.1	0.4	0	0	-34	-126
(10) Labor Law Reform	0.0	0.6	1.3	3.7	0	-152	-353	-1138
(11) Gross Impact of Administration's Proposed orPending Legislation	2.2	5.2	8.4	13.1	-604	-1448	-2343	-3999
(12) Net Impact of Administration's Proposed or Pending Legislation	1.0	3.1	5.2	8.8	-276	-862	-1452	-2719

Source: Dr. Jack Carlson and George Tresnak, United States Chamber of Commerce, Forecast and Survey Center; Data Resources, Inc. and Chase Econometrics Modelling and Data; The National Planning Association Data.

purposes. The Report asserts JEC concern with the development of a rational monetary-fiscal strategy.

To facilitate this strategy the JEC wants the FRB to report to Congress in a more detailed, quantitative and disciplined fashion than even that required in the language of S.50 or existing law. "This reform", the Report asserts, "would ensure that monetary and fiscal policies aim at the same goals rather than work at cross purposes as has happened all too frequently in the past."

In his report to the Congress on April 25, 1978 FRB Chairman Miller said that "the (FRB Open Market) Committee remains firmly committed to a gradual reduction in monetary growth over time to rates more nearly consistent with reasonable price stability." The strong language of the JEC Report regarding the need for a coordinated fiscal-monetary policy strategy may suggest to many financial decisionmakers that a Congressional view as to appropriate current monetary policy should overrule the existing decision of the FRB Open Market Committee on bringing down the rate of growth of the money supply.

The inherent danger in this JEC language is that it suggests to many people that the Congress should set quantitative targets for growth of the money supply. This could mean that such targets would be politically determined and might not be the kind of targets which can be made operational without inducing harmful side effects. Foreigners who hold balances of up to $400 billion might be led to expect higher inflation and a depreciating dollar as a result of this political means of selecting monetary growth targets. They might then reduce the dollar commitments in their financial portfolios. This could have disastrous effects on world trade as nations moved further into protectionist measures against the balance of payment deficits caused by a cheaper dollar.

Therefore, there is a real danger that politically determined monetary growth targets would be unrealistically high and have a self-fulfilling inflationary impact by affecting the expectations of workers, investors, financial decisionmakers and others.

Congress has wisely assigned the responsibility for determining monetary policy to an independent body.

Inclusion of a balance of payments goal among the list of numerical annual targets to be submitted by the President would indicate consistency among the various targets and the foreign sector.

Regarding Congressional Review of the President's Economic Report (Title III)

Our major concerns with this section as reported by the Senate Human Resources Committee on May 3, 1978 are its amendment of the Budget process, and the JEC objectives of having the Congress sign-off on the President's annual numerical targets for several economic indicators. We believe it is preferable for a legislative body to assign responsibility to others for selecting operational numerical targets. The House vote on the 100% farm parity goal in H.R. 50 compared to its vote on the Emergency Farm Bill verifies our concern in this respect.

The House added the 100% farm parity goal by a vote of 264 to 150. Then, on April 12, the House voted down by 150-268 the Emergency Farm Income bill (H.R. 6782) which had passed in the Senate by a vote of 49 to 41. The House vote on April 12 was the mirror image of its easy vote on the economic goal barely one month before. There is no better example than this of the disparity between voting on numerical economic goals in a legislature and voting for large expenditures and action to achieve the goals. We prefer that all numerical goals be dropped from this bill.

Regarding Budget Discipline

The second concern relates to S.50's ignoring the discipline that the concurrent resolution on the federal budget and the entire budgeting process required by the 1974 Budget Control Act imposes on the Congress. Individuals in the market economy are disciplined in their spending decisions by their limited incomes, and by their limited ability to borrow in the context of relentless market forces. Congress can discipline itself only through a process. Since 1975 Congress has had such a process and Title III threatens to weaken it at precisely the worst possible time. With a $53 billion deficit budgeted in the third year of an economic recovery and with the dollar having declined by more than 17% against the Swiss Franc and by 10.4% against the German Mark in the last seven months, we need the discipline of our budget process more than ever.

We urge that no amendment be made to Section 305 of the Budget Control Act regarding "Provisions relating to the Consideration of Concurrent Resolutions on the Budget." We cannot support any weakening of the budget process discipline for the purpose of introducing "soft" statements on economic goals.

Regarding Section 402(b) on Wages

Section 402(b) directs the President to insure that any person in any job utilizing funds provided even in part under this Act shall be paid not less

30-454 O - 78 - 5

than the pay received by others performing the same type of work for the same employer.

This would apply to many structural employment policies and in particular it would apply to the reservoir jobs recommended to the President in the bill.

Table 5 demonstrates what reservoir jobs for the unskilled would cost in the public sector. Wages for park laborers range from $3.25 per hour in Cleveland, Ohio to $5.68 per hour in Seattle and Chicago. Wages for refuse collectors range from $3.93 per hour in Atlanta to $7.16 per hour in Chicago.

TABLE 5

MEDIAN HOURLY WAGES IN MUNICIPAL GOVERNMENT

CITIES	Occupations				
	Janitors, porters & cleaners	Laborers Class A	Laborers Class B	Park Laborers	Refuse Collectors
Cleveland, Ohio	$3.59	---	$4.34	$3.25	$4.89
Kansas City, Missouri	3.71	3.54	3.12	----	4.69
Atlanta, Georgia	3.35	4.10	3.09	3.78	3.93
Seattle, Washington	4.76	5.90	5.30	5.68	7.04
San Diego, California	4.49	4.79	----	4.68	----
Chicago, Illinois	5.45	7.95	----	5.68	7.16

Source: U.S. Department of Labor, Bureau of Labor Statistics Municipal Government Wage Surveys for each of the above cities. (Class A laborers use power tools and Class B laborers do not.)

According to a Bureau of Labor Statistics survey comparing municipal government salaries to private industry salaries, janitors, porters and cleaners working for government earn 10% higher wages than those doing the same work in the private sector in Atlanta, 22% higher in Chicago, and 8% more in San Diego and 4% more in Seattle, 7% less in Cleveland and 6% less in Kansas City.

Therefore, as Section 402(b) is written, the law will mandate that janitors, porters and cleaners working on public service jobs in Atlanta, Chicago, San Diego and Seattle be paid higher wages than available to the comparable employee in the private sector.

An unweighted average of the wages on Table 5 indicates an average wage to be paid on jobs covered by this bill in the neighborhood of $4.73 per hour, or $9,838 per year. This is higher than the 1977 average hourly earnings for wholesale and retail trade ($4.28 per hour), a sector of the economy with almost 15 million employed workers.

Clearly, even a cursory overview of the wage standards of this bill demonstrates that employees will be drawn away from small businesses into the public service employment sector or many small businesses will have to raise their wages to compete with municipal government wages as programs to achieve the bill's 3% adult unemployment and 4% overall unemployment targets are implemented.

We urge that this prevailing wage requirement be deleted from the bill.

Regarding Farm Parity

The House bill (H.R. 50) sets a new goal of 100% of parity in farm commodity prices by 1983. Achieving this goal would add to inflation and unemployment -- and it would lower output and incomes of Americans. To accomplish 100% of parity in farm prices would require mandatory government controls over farm production and would result in government planned scarcity, vulnerability to export controls and a lack of world confidence in the availability of U.S. farm exports.

The Agriculture Department, in a March 3, 1978 Issue Briefing Paper, has estimated that 100% of parity in 1978 would reduce national economic growth (GNP) by ½% a year -- at an annual cost of more than $10 billion. This is equivalent to a $170 loss of income for the average American family. The loss would be greater by 1983 in the larger economy at that time.

The Agriculture Department also estimated that 100% of parity would increase consumer prices by 3%. This would result in a $400 loss of purchasing power for the average family, if its income did not adjust to the price changes. Consumers would have less to spend on other products. Consequently, employment in the economy would decline by about one-half million.

The Agriculture Department estimates that 100% of parity would raise farm incomes by $20 billion, although at a great cost to the market system for agriculture. If parity is achieved through government subsidies, this would be equivalent to increasing taxes for the average family by $335.

SUMMARY

While we support the objectives of the bill, we believe that its declaration of policy and goals are biased toward inflation. The bill would impose rigid goals on the President. The President needs greater flexibility to adapt policies to changing economic circumstances. The 3% adult unemployment goal and 4% overall unemployment goals are unreasonable and inflationary. The bill reflects a continuing attempt to reduce the independence of the Federal Reserve System. The process for Congressional Review of the President's economic goals and Report would weaken the discipline of the budget process. The wage levels specified in Section 402 would result in more costly jobs programs and unwarranted competition by government with small business for unskilled workers. Implementation of the (H.R. 50) 100% of parity goal by 1983 would be highly inflationary, disruptive of the market process and could cause renewed political efforts to reduce agricultural exports.

The bill has not been amended as we had urged.

Implementation of highly stimulative fiscal and monetary policies plus large scale spending increases on structural jobs programs would be inflationary. Inflation would rise to rates considerably higher than those of early 1978. There would be a much greater chance of recessions from such policies. If a recession occurs there would be fewer jobs and higher unemployment than if economic growth had not been accelerated as the bill requires. Average family real income would be lower and inflation and unemployment higher if supercharged economic growth results in a sharp economic downturn.

Dr. CARLSON. I would also like to identify myself with the broad economic objectives of the bill, to foster free enterprise, purchasing power, promote price stability and high rates of capital formation.

Certainly, I think most Americans could support those objectives.

However, the specific way of going about to achieve those does raise problems, and that is why the National Chamber recommended changes in both the House and the Senate, to the legislation in both bodies. First, we strongly recommend removing a numerical unemployment goal, particularly a 4-percent overall and 3-percent adult unemployment goal. This I frankly feel, given the tradeoffs that would have to be made, is unachievable.

Like Senator Brooke, I do think we should look for things that are somewhat achievable, especially those that can be achievable with real jobs, productive jobs, in the private sector, and I don't think 4-percent or particularly the 3-percent adult numerical unemployment goal is achievable.

I would much rather have the process to identify the numerical goal for each year's or for several years ahead, but in that process not to have it in concrete in legislation.

Clearly, almost any reputable economist, I know, I apologize, I should say the majority, would clearly think going to 4 percent requires a tremendous tradeoff in inflation or does require a lot of relatively unproductive jobs, public sector jobs. This does reduce somewhat the 4.7 percent 1983 noninflationary unemployment rate cited in the 1979 OMB Federal Budget documents. Other people have shown that that rate is closer to 5¼ percent. In fact, the current Chairman of the Council of Economic Advisors, Charles Schultze, testified before the Congress a couple of years ago and indicated once you start going down to a 5½ percent unemployment rate, you do initiate inflationary pressures and go up (Congressional Record May 27, 1976, pp. E 2920–22).

If that is the case, you go to public sector jobs at $9,000-plus per job, (CETA Public Service Employment cost and consistent with sec 402 of S.50) you are talking about a considerable increase of expenditures there and the taxes that pay for that, or you have to suffer the inflationary consequences. Also putting in concrete a 4-percent numerical unemployment goal is assuming we have a perfect definition for it. The Congress and administration set up a National Commission of Unemployment and Unemployment Statistics; and, being a member of that Commission, I can assure you that the definitions do change the numerical value, and I think it would be much wiser for the Congress to wait and see what better definitions are and therefore determine those goals from those different definitions than going into concrete now as to what 4 percent may be with the current definition and the current definition is generally felt to be defective.

I agree with Senator Brooke's comments again, efficiency measures, referring to unemployment and unemployment and certainly any new measures would have to address some of those issues, so having a numerical goal, put in law, I think would clearly be a mistake.

Senator Proxmire brought out the asymmetry that exists with no numerical goals for price stability and clearly the logic could be arranged. If you think both are available, then they both should have the same force of law. If you put one in the law you should have the other. However, I would prefer not to have the numerical goal in law or the inflation goal in law, but have it developed by the process, through the administration and Congress, as each year goes along, but if you were to choose one, also overly ambitious and equally difficult, and I would say, infeasible, 2 percent would be one that could match up well with the 4-percent unemployment and 3 percent for adult males.

We create a problem of inflexibility with the 4-percent objective or, if you legislate a 3-percent objective for the inflation rate by one-House veto of a change in the goal required in your current law.

Either House can veto a President's proposed change in the interim goals we must have (sec. 304, S. 50). Consequently you are locking yourself perhaps more into bad definitions, and perhaps bad objectives over the longer run by making it very difficult for Presidents or Congresses to go ahead and change the objectives they have.

As Congressman Fisher pointed out, I too have looked at choices of policy, tax cuts, spending increases or other alternatives or mixes of those to see what it would cost in the next 5 years. I can't see us getting to a 4 percent overall unemployment rate without a minimum of 2 million public sector jobs at $9,000 each. You are talking about $18 billion or about $300 per average family increase in taxes. Also you run a substantial risk of recession higher than you would otherwise have, and we normally have recessions over a 4- or 5-year period of time in the postwar period anyway, but it would be higher, because you would be asking for a higher tuning of the economy.

Paradoxically, you could run up with a job loss, as identified in S. 50.

In another area, the subsidized jobs wages, being equal to or greater than other workers' wages and not limited to minimum wage, I think is a mistake. You have the circumstances that a person who is in a fully productive job paying less would, in effect, be enticed to go into a less productive job, financed or subsidized by the Government, or you would have the situation of a taxpayer who would be at a lower income subsidizing a higher-paying job than he receives. Many workers in the huge retail trade sector for example would subsidize public service workers earning more than their own wages. This is a redistribution of income up the income ladder, so I argue you ought to limit the jobs of last resort to the minimum wage.

I do hope, too, that you would strike out the 100 percent of parity in farm products in the House bill and not put one in on the Senate side.

The Department of Agriculture has identified that is worth 3 percentage points in the Consumer Product Index.

In the gross national product it is about half a percentage point slower real growth or $170 loss of income for the average family. Also I suggest if you go ahead with the legislation you provide some sort of sunset provision.

I think this deserves that kind of treatment, just as other laws deserve that kind of treatment.

My last point, I would disagree with Congressman Fisher in terms of his suggestion to add to the legislation wage and price guidelines and compliance or Government negotiated prices and wages as an amendment. As an amendment, I think that would be a mistake.

If the changes that we have suggested are not made, then we have to stand in opposition to the bill.

The CHAIRMAN. Thank you very much, Dr. Carlson for your concise and effective presentation.

Our next witness is an old friend of all of the Senate committee, and a man who has served this Government a long, long time—in Harry Truman's administration, as Chairman of the Council of Economic Advisors and many other capacities, highly esteemed as an economist, Mr. Leon Keyserling.

STATEMENT OF LEON H. KEYSERLING

Mr. KEYSERLING. Mr. Chairman and members of the committee, I must say that I feel a little depressed.

The discussion thus far has covered some very interesting points, but really hasn't stressed at all adequately what this bill is all about.

Now, the chairman was kind enough to give me credit for being old enough to have worked with Harry Truman. Actually, I got here in March 1933. During the 45 years that I have worked with Government policy I have been reminded of a story of Napoleon at the Battle of Austerlitz, his greatest victory. Before the battle, one of his marshals came up to him and said, "You are opposed by two armies, the Prussians and the Russians. Each has a general, and you are going to win, because one good general is better than two bad generals."

And Napoleon said, "No, I am going to win because one bad general is better than two good generals."

In my 45 years in Washington, I have come to believe that this story illustrates what this bill is all about. We have had many economic policies which I am willing to call good. But we have never had a unified policy, except during World War II. We have had policies and programs, but we have never had a unification of policy or program. We have had spur-of-the-moment decisions. We have had emergency legislation. But we have not put it all together.

I can't imagine any time when this was more acutely true than now. We operate a system where, with all due respect, a President proposes and the Congress evaluates and disposes. And how can the Congress cease to be concerned about the changes, and I am not being critical of anyone in particular, the inconsistencies, the partial remedies, the short range views, that have come to be the hallmark of the policies of a great Nation which can do better and needs to do better?

Now, let me run quickly through my experience, and then point out how the Humphrey-Hawkins bill deals with this problem of policies but no policy, programs but no program.

The big issue is not the relative weight to be attached to inflation and unemployment.

I regard this as asking, what is more important, for a man to keep his liver or to keep his heart?

They are both parts of the same human body, and they surely relate, and both must function well for the total body which they both serve to do well.

Let me next cite some of the inconsistencies in national policies which I have experienced.

I came down here during the start of the New Deal, and many wonderful things were done.

But why didn't we recover fully until World War II?

Because we took one step in one direction and another step in another direction. We plowed under the pigs at the same time people were starving and needed to be fed. We sought to increase production and authorized restraints which reduced production. We pilloried businesses at the same time that we asked for expansion. I can go on ad infinitum.

Then we got in World War II. We then applied a business principle, equally applicable to Government in war and peace. You have to have objectives which you state quantatively—the family does, the business does, Federal Government should—then you have to adjust policies to objectives, and you have to put the policies together so that each relates to each other, and you have to quantify them all. We accomplish miracles by doing that during World War II.

People say, well, we are not in a war anymore.

Well, if we learned a better anesthesia method during the war, we don't abandon it when the war is over.

Surely, we don't need the high tax we had during World War II, we don't need the kind of controls we had then, but the simple principle of how much more the American economy can do by putting things together than by flying blind is applicable for the long term, in peace no less than in war.

I think we applied that lesson pretty well under President Truman, who was a good administrator. I think he put things together, I think he made a good economic record. I don't want to belabor that point. But in the main, in the main over the last 25 years, we have combined a very bad average record for the American economy with a failure to put policies together, a failure to budget the economy, while we talk about budgeting the budget and the budget's a part of the economy.

Let me give some specific areas, bringing you right up-to-date. We talk now about how unemployment is lower than it was 2 months ago. And how it is lower than it was 2 years ago. You know what that is like? That is like watching a man out in the water whose head is bobbing up and down as he struggles, and every time he comes up you say, "oh, his head is up again, we can stop worrying about him." That is not the problem now.

The real problem of our economy today is not short-range. It is the long range problem of getting out of the troubled waters of 25-year duration. It is not the one day problem of a banana seller on the street. It is the long range problem of a great Nation. That is why the Humphrey-Hawkins bill requires a 5-year approach.

Near the peak of this recovery, and I think we are near the peak now, our unused resources are higher than at 2 of the troughs of the 5 recessions that we have had in the last 25 years. Is that a real recovery?

Or does calling it a real recovery represent a failure to adjust for the stage of the business cycle, just as we adjust data seasonally to get a true picture of longer range trends?

So we can't meet this problem by saying, oh, we are over the hump, the head is bobbing up again.

The economy has been in a long-term retreat from the great source of its wealth and strength, the full use of its resources, for 25 years. And my charts 1 and 2 show that, adjusting for cyclical factors, we have gotten worse and worse off on a chronic basis. Each recovery has been more aborted, each recovery has been shorter, and each one has carried us less upward. It is pointless and irrelevant to guess whether the unemployment rate will be 6 percent or 5.6 percent by the end of 1978. The vital pont is that we are headed toward a continuation of the rollercoaster economic performance, continuation of the long-term retreat from full resource toward another recession bigger than the last one.

Let me give a second example of the inconsistent and conflicting policies. They relate to the matter of how we have approached the problem of economic stabilization. We have approached it mostly through tax reduction.

But you know what it's been like?

It's a blunderbuss method. "If the economy is tight, let's restrain it. If the economy is slack, let's stimulate it." But here's the way we have done it. We have done it, like a fellow driving up to a gasoline station and saying, "fill her up." When the attendant says, "shall I pour the gas into the cooling system and the water into the tires and the oil into the gas tank," the economists within the Government say, "what difference does it make? Haven't you heard of Lord Keynes?"

This is not responsive to the way the economy works. The economy gets into trouble because there are imbalances, defects in the structure, in the structure of the labor force, in the structure of the fiscal and monetary arrangements, in the distribution of national income, and when you seek to fill it up you can't just fill it up. You have to ask, "where is the trouble and where should we apply stimulus and where should we apply restraints? How do we have a selective program that responds to a complex economy which is out of kilter?"

I have illustrated these points in my charts. It's a pity I don't have the time to go through them. Among other things, I show that all of the tax reductions we have enacted since 1964 have meticulously and increasingly attempted to fill her up without examining where to do the pouring.

On net balance, these tax reductions have made the distribution of income more regressive. They have applied relative help to the various sectors of the economy which has fed the fat and starved the lean. I am not talking from the equalitarian point of view or idealistic or reformist point of view. I am talkng simply in terms of the realities of how the economy works and what has happened after each tax reduction. Each one, because we did not put things together under a consistent set of goals and policies, gave the economy a shot in the arm for a brief spell, but for the longer run augmented the economic imbalances which brought on another stagnation and then another recession. This is why we so much need to put things together, to have related goals, and to reexamine goals and policies year by year. We did that during World War II and the Korean War, and I know how we did it. And I know how we got unemployment down to 2.9 percent and inflation down to 0.8 percent at the same time by 1953.

But nobody wants to set up a Department of Experience in the Government, which is the department we now need.

What happened, why did it happen, what can we learn from it?

You read all the reports on what we ought to do now. They say, "we have had the five cycles, how did we get into them? We got into them because of inflation." That is far too simple. There was not inflation before most of the recessions; there was before some of them.

There was no inflation before the Great Depression, nor before the 1953 or 1957 recessions. So what is the real explanation of the downturns? The real explanation is imbalances in the structure.

During the Korean war we had a selective program, we said what is the goal for investment, what is the goal for consumption, what is the goal for public outlays, why do we need to stimulate some lines of shortages and at the same time and restrict other things? We cured imbalances, treated maladjustments, and brought things into compatible relationships.

We adopted a maturity that has some relationship to the American economy. We haven't done much of that since.

Now, I come finally to the matter of the inflation question, which was raised. I said at the beginning, you have a heart and a liver, and the proper functioning of both are equally important. You know the greatest single trait of American economy policy in the last 25 years is that we have oscillated from day to day between saying one is more important or the other is more important. They are equally important, equally essential, they interrelate. But not recognizing that they interrelate we haven't looked at the empirical evidence for the last 25 years, which gives the key to the main, although not the only solution to the problem of inflation. For the main key to the solution of inflation is to have the economy operating close to the optimum and not stagnating.

I have traced through in separate charts, and increasingly nobody has challenged it, there is a positive correlation, a positive correlation between a lower level of unemployment and a lower level of inflation. This is proposition No. 1.

Now, I agree with the chairman entirely, that we should have in this bill a quantitative goal, a series of quantitative goals, for the reduction of inflation, integrated with the other parts of the economy. I would add to the section of the bill that deals with the goals for productivity and for employment and for production and purchasing power a specific requirement that the President and the Congress every single year, every single year, the President would have to set a quantitative goal for employment reduction and for inflation reduction and the Congress under this procedure would have to review it each year and Congress can modify the President's program.

I think you should have a goal every year for each of the bills as enacted by the House, and as reported by the Senate.

The only thing that concerns me, Mr. Chairman, and I don't say this by way of argumentation, the only thing that concerns me is the putting of the unemployment-reduction goal and the inflation reduction goal together in the way which supports a continuation or the attempted trade-off of the two. Anything that puts a goal in this bill for the reduction of inflation that didn't impose or permit a trade-off between unemployment and inflation would be workable. Any thing that doesn't, would be a repeat of the most disastrous mistake that we have made in national economy policy for many a year.

Furthermore, I see a human difference between the unemployment problem and the inflation problem.

I think employment is an end, and prices a means. Lower unemployment is always desirable. Lower prices may or may not be, at any given time, depending upon a variety of factors, including the relationship of price trends to other trends.

I think Congress must determine what amount of unemployment will be allowable in the United States. I don't know whether Congress could determine 5 years from now whether the rate of inflation should be 3 percent or 4 percent or 2 percent. I think they can join with the President each year in defining that goal on a pragmatic basis.

I am sorry my time is up. I don't want to overdo it, but I get back to the main theme.

This bill has every provision in it for imposing the discipline of goals, a series of interrelated objectives and annual testing of whether we are meeting the goals through the policies being used. Therefore, the argument that the bill doesn't have anything in it because you could do this anyway, is spurious; everybody could drive less than 55 miles an hour without a speed limit. Everybody could have prosperity without any taxation and without spending for if the economy operated perfectly—but under a free society, we need laws to channel people into the doing of what they otherwise have not done.

The Employment Act of 1946 did not require anything we could not have done anyway. But, as the chairman said, that act achieved a lot, and we have learned a lot and can do a lot more and I think this bill focuses on the things we need to do, to apply the discipline, the quantification, the interrelationships, and the planning. Not planning of whole economy, however. This bill doesn't ask the Government to assume any function it doesn't already have, in the categories of taxation, monetary policy, fiscal policy, structural policies, Federal Reserve policy, farm policy. These are all going to stay in Washington.

The bill simply provides as to the things that you, the Government, do, not the policies of the private economy, as to the policies you do, put them together, evaluate them, quantify them, study them year by year and have a participation of the President and the Congress so we don't continually have a system, really, of checks and no system of balances.

Thank you.

[Complete statement of Dr. Keyserling follows:]

TESTIMONY OF LEON H. KEYSERLING, CHAIRMAN, COUNCIL OF ECONOMIC ADVISORS TO PRESIDENT TRUMAN. PRESIDENT, CONFERENCE ON ECONOMIC PROGRESS

Mr. Chairman and Members of the Committee: The measure before you is comprehensive and detailed. But to save time, and to try to be most helpful, I shall concentrate upon its unifying and central purpose, which is frequently overlooked and which I deem to be of utmost importance.

LACK OF COHESION AND STEADFASTNESS IN USE OF POLICIES

This central purpose is to bring more discipline and effectiveness into national economic policy by substituting longer-range analysis and action for a series of disconnected fits and starts in response to the seeming problems of yesterday, today, or the next few months; to provide more effective use of past experience as a guide to current decisions; to substitute greater consistency of action for actions which are all to frequently uncorrelated, inconsistent, or even at cross-purposes; to develop a closer connection between the goals sought and the means used, with the means continuously evaluated in terms of progress toward the goals; and, in the relationship between the Executive and Legislative Branches, to accent processes which, under our system of checks and balances, find a better apportionment between the two, so that excessive resort to the checks does not result in stalemate and frustration.

IGNORING THE CHRONIC, LONG-RANGE NATURE OF OUR ECONOMIC TROUBLES

In order to set forth the seriousness and duration of these problems, let us use the current economic situation and the attempts to deal with it as an example of the first difficulty I have mentioned, the undue substitution of short-range for long-range analysis and policy. We hear and read on all sides that the rate of unemployment was lower last month than two months ago or two years ago; then we speculate whether it may be still lower next month or a year from now, and thus mask the nature of the chronic problem. For we have been in a chronically weakening economic situation for a quarter century since 1953. The average annual real growth rate has been phenomenally low by historical tests and in terms of our potentials; we have been experiencing a "roller-coaster" economic performance, and are now in the fifth cycle of stagnation, recession, and inadequate upturn, with the trough of each recession and the peak of each recovery tending to leave us with more disuse or wastage of human and other production resources than the previous troughs and peaks. At the current stage of the recovery movement, the percentage rate of our unused resources is not only higher than at the peak or near peak of any previous recovery movement, but higher than at the trough of three of the five previous recessions. This chronic retreat is a staggering fact, and the failure to recognize its current significance is like watching a struggling person in deep water and cheering each time his head bobs above the surface. The validity of my conclusions that we are challenged by a chronic or long-range rather than a temporary difficulty is supported by my Charts 1 and 2.

INADEQUATE RESPONSE TO COSTS OF THE CHRONIC RETREAT

The failure to recognize the chronic or long-range rather than the temporary or short-range problem to be dealt with arises in large part from failure to focus upon the economic, civil, and social costs of the chronic or long-term retreat from that full utilization of our production resources which is the ultimate source of our wealth and progress. Conservatively estimated, the forfeitures resulting from neglect or misdirected policies during the quarter century include almost 5.3 trillion 1977 dollars worth of total national production and more than 72 million man-, woman- and teenager-years of unemployment in excess of reasonably full employment. For the details of this, see my Chart 3. This is the core explanation of all of the other difficulties with which we have been struggling unsuccessfully because we treat them in isolation and not in their broader setting. The vast and growing gaps between full employment and full production on the one hand, and actual economic performance on the other hand, explain during the past 25 years a forfeiture of far more than a *trillion* dollars in public revenues at all levels at existing tax rates. With these revenues in hand, we could have served far more adequately some of the great priorities of our national needs depending upon public outlays, which we all know we should be serving better but feel that we cannot afford to serve better. And at the same time, we would not be confronted with the huge and rising Federal Budget deficits to which we attribute so many of our difficulties, including the inflationary problem. The intimate connection between the chronic malaise of the economic performance and the chronic and alarming increase in the Federal deficit is illustrated on my Charts 4 and 5.

MISMANAGING THE CAUSAL RELATIONSHIP BETWEEN UNEMPLOYMENT AND INFLATION

Undoubtedly, the best example of our failure to examine cause and effects is our hesitant and inconsistent treatment of the problem of unused resources and inflation, respectively. One month we say that unemployment is the top priority problem, and the next month we say that it is inflation. And year after year, we have tried deliberately, in the name of the so-called "trade-off," to solve or ameliorate one problem by restraining vigorous attention to the other problem. Nothing could be a more poignant illustration than this of the constant improvisations and redirections of emphasis which neglect the longer-range and compelling empirical evidence in the great laboratory of the U.S. economy in action. Indeed, the empirical evidence has now become compelling, over the past quarter century to date, that the inflation rate tends to be lowest when the economy is close to or at reasonably full resource use, and tends to be highest when the percentage rate of unused human and other production resources is highest. This is revealed on my Charts 5 and 6.

One explanation of this is that the shortages—in medical care, housing, energy, food supply, etc.—in consequence of resort to an economy of scarcity rather than abundance are inflationary per se. Another even more important reason is that an economy operating close to full resource use has much lower costs per unit of output, and therefore much less impulse to increase prices per unit, than an economy operating inefficiently at far below the optimum rate of progress. Similarly, an automobile driving 25 miles an hour burns more gas per mile than one driving 45–50 miles per hour, even though it is also true that driving at the excessive speed of 90 miles per hour burns more gas than at 45. Many of the economists who have observed correctly that an excessively expanding economy exacerbates inflation have not noticed that an economy expanding much too slowly, or in stagnation or recession, also exacerbates inflation.

The ratio of the productivity growth rate to the rate of real economic growth, as shown on my Chart 7, is the best single example of the fallacy of the "trade-off," and of the profound inflationary pressures exerted by holding the economy far below full resource use. The actual record shows the great spurt in productivity when, immediately after the recent recession, the real economic growth rate was moving upward very rapidly, and the sharp decline in the productivity rate later on when the real economic growth rate declined sharply. But developments in the first quarter of 1978 are most telling of all. As the real economic growth rate became negative, the productivity growth rate dropped so sharply that the clamor again rose that this increased per unit business cost was highly inflationary and thus again made inflation a greater problem than unused resources. In consequence, the clamor again arose that programs designed to stimulate the economy should be reduced or postponed. But I ask this question: When a continuing slow-down in the rate of real economic growth for two years or so, accentuated in first quarter 1978, causes as has usually been the case a sharp increase in inflationary pressures and the forecast of another recession next year if not late this year, is it not inconsistent to try to cure the inflation by running still greater risks of a perpetuation of the slow-down and still another recession? The way we are now behaving, that sixth recession, and possibly a progressively severe one, is in the cards within a year or so.

A FULLY OPERATING ECONOMY IS THE MOST POWERFUL ANTI-INFLATIONARY WEAPON.

I do not raise these questions to argue the relative importance of reducing unused resources and reducing inflation. That is an arid and misplaced argument. We have always done best on both fronts when we pursued the two goals simultaneously with full vigor, and always done worst on both fronts when we played off one against the other. Without pride, I can state that we did best on all fronts, weighting each factor properly, and particularly viewing the trends from the first year to the last, during the seven years when I was Vice Chairman and then Chairman of President Truman's Council of Economic Advisers (in the face of domestic and international difficulties greater than any confronted since) as illustrated on my Chart 5.

Let me offer two simple explanations of this record, which I believe so relevant today. There was consistency rather than conflict in President Truman's economic policies, partly because he was a student of our history, and partly because he was a good enough administrator to rely primarily upon one top expert in any given field at any given time and to fire him when he was dissatisfied—instead of having five top experts at the same time advising the President, the Congress, and the public on their conflicting views on economic policy. The second reason for this success of President Truman, domestically speaking, was this: Although he was not afraid of a vigorous anti-inflation program per se, and even had the courage to increase taxes and impose direct controls when these were necessary during the large-scale Korean war (entirely different from the current situation), he nonetheless insisted always that the most successful weapon against inflation and toward amelioration or solution of all our other problems was calling forth what we then called the "great non-secret weapon of the U.S. economy," its unrivaled capabilities for real growth in production, employment, and wisely channeled distribution.

Having thus called attention to some of the outstanding departures from a long-range and empirical approach which have brought us to where we are now and where we are trending in the long run, I want to run quickly through some other examples of the same errors and their consequences during the 45 years of my intimate connection with national economic policies, both from within the Government and from without.

COSTS OF INCONSISTENT AND UNCOORDINATED POLICIES DURING THE NEW DEAL

During my years in the New Deal from 1933 to 1939, I was impressed by the human responsiveness and long-range reform values of some of the measures adopted. Simultaneously I recognized, albeit under circumstances more excusable than today, the excessively experimental, improvised, and *ad hoc* nature of many of the so-called recovery policies, and their inconsistencies one with another. We slaughtered pigs and plowed under crops while trying to feed the hungry. The N.R.A. was a curious compound of seeking to reduce unemployment while winking at some of the restraints upon competition which in fact impeded expansion of production. We had policies and programs, but no unified policy or program. We pleaded with business to expand, even while we pilloried big business for political advantage. We sought to accelerate the economy by more public spending, but did not think seriously of lowering the tax burden; we did threaten imposition of more taxes, and we imposed some unnecessary restrictions upon business along with some necessary reform. All this does much to explain why recovery was so partial until we became the arsenal of democracy in 1939–1940.

THE AMAZING RESULTS OF CONSISTENT AND INTEGRATED POLICIES DURING WORLD WAR II

During World War II, by accident or design, we adopted policies which resulted in unexpected miracles of achievement. These may be quickly summarized. We established quantitative and interrelated long-term goals, and geared policies to their achievement. We did not try to stimulate or retard the whole economy at once, but selectively focused upon areas needing stimulation and areas needing restraint. We quantified goals for the component parts of the economy, recognizing that sustained and optimum progress depended upon balanced relationships among the components, instead of throwing blunderbuss or aggregate programs against the economy at large. And we were able to maintain reasonable public support, and reasonable commity between the Executive and the Congress, because what we were doing was clear, consistent, and explainable.

I have never claimed that what happened during World War II remained entirely pertinent later on. Equally high rates of taxation and analogous use of the direct controls and allocations have not been needed. Equivalent intrusion of the Government upon the private economy became unwarranted. But it does not follow that we were at all well advised not to learn enough from the economic performance record of World War II to recognize that, while the Government should do much less, it should not start to fly blind. It should not substitute, in its own traditional efforts, inconsistency for consistency, random improvisation for some long-range planning, and purely defensive anti-inflation and anti-recession efforts for positive pro-prosperity goals and programs.

Near the end of World War II, in 1944, I wrote a prize-winning essay in the Pabst Post-War Employment Contest, which formed an important basis of the Employment Act of 1946. Essentially, it summarized the criticisms and the concrete approached which I have just outlined. And during the first years under the Employment Act, that is during the Truman years which I have already discussed, we were relatively successful because we rejected the idea that it was proper for national economic policies to go off half-cocked just because we were no longer trying to shoot up half of the rest of the world.

TICKING OFF THE SALIENT POLICY ERRORS DURING A QUARTER CENTURY

Unfortunately since 1953, except for a heartening period during 1961–1966, we have reverted to the old errors of commission and omission, and in the long run the process seems to have been gaining force. Quickly, I will attempt to catalogue the most important examples of this.

First, I have already detailed the errors of and the tragic results of playing off the restraint of inflation against the restoration of a fuller used economy and vice versa. I will not dilate further on that point.

UNDERESTIMATING OUR POTENTIALS AND NEEDS

Second, by not setting long-range and interrelated goals in terms of our productivity and labor force growth potentials, we have greatly underestimated the size of the job to be done, and thus policies have been inadequate as well as misdirected. Such unintegrated goals as we have set have hardly related to the true productivity growth potential under favorable economic policies, a matter to which I have already called attention on my Chart 7. By selling America short, we have shortchanged ourselves.

LACK OF ATTENTION TO BALANCED ECONOMIC DEVELOPMENT

Third, and by far the most important of all, we have assumed that we can properly stimulate or retard the economy by aggregate or blunderbuss fiscal or monetary policies, throwing weight in one direction or another without regard for the structural or interrelationship problems requiring different types of attention to different components of the economy, on the investment side, the consumption side, the public outlays side, and the tax side. These have increased the imbalances in the long run, and made inevitable another stagnation and recession after each period of aborted and inadequate recovery. The record shown on my Chart 1 speaks for itself.

The best example of this error is illustrated by my Chart 8, a demonstration for 1961–1977 which could be shown equivalently for other periods. Both the periods of inadequate upturn and the periods of stagnation followed by recession have been marked by severe imbalances between the rate of real growth in investment in the plant equipment which add to our ability to produce, and the real growth rate in ultimate demand, in the form of private consumption and public outlays combined, which provides the markets for the increased production potential. Sometimes one side has grown too fast relative to the other, while at other times one side has grown too slowly relative to the other, regardless of whether one or both sides have grown too fast or too slowly in absolute terms. Yet our efforts to stimulate or restrain have been thrown recklessly at the economy as a whole, without regard for the imbalances which needed to be corrected. And thus the "roller-coaster" performance has been aggravated by the national policies designed to correct it.

THE INDISCRIMINATE USE OF REPEATED TAX REDUCTIONS

Fourth, the best example of this imbalanced use of remedial efforts has been the repeated use of tax reduction. This is not because tax reduction does not have its proper uses, but rather because it has come to be regarded as the solution of all our problems, and because it has been used without proper selectivity and focus. A few examples of this appear to me essential.

Most economists and other analysts would agree that some moderate improvements in the nationwide distribution of income on a progressive basis would be highly desirable on purely economic grounds, and are unanswerably needed on social and equitable grounds. Many costly Government spending programs are directed toward these ends. But meanwhile, our repeated tax-cutting has moved in the opposite direction, especially when one considers the long-term trends in the distribution of income as shown on my Chart 9, and considers also my Chart 10 setting forth some very surprising information about the highly regressive imposition of the total tax burden in the United States. In the latter connection, my Chart 11, covering the period 1945–1963, my Chart 12 covering

1963–1973, and my Charts 13 and 14 covering the President's current tax proposals, all demonstrate very clearly this disconcerting fact: Measuring tax reduction properly by its percentage effect upon after-tax or spendable income, the net consequences of these tax reductions in their entirety are highly regressive. And looking at the relationships between the tax reductions intended directly to stimulate total investment and those intended directly to stimulate consumption, as shown on my Chart 15 applicable to 1971 tax cuts (characteristic of other tax cuts in varying degrees), and most recently with regard to the President's current proposals as demonstrated by my Chart 16, all of these tax reductions could hardly be defended on the basis of any analysis—hardly attempted in fact—of appropriate goals for the economy and the balanced requirements for their attainment.

INDISCRIMINATE TAX REDUCTION VS. SELECTIVE USE OF TAX REDUCTION AND SELECTIVE RESORT TO INCREASED PUBLIC INVESTMENT

Fifth, because we have substituted political ease of action for successful consequences, we have stopped differentiating between the value of indiscriminately applied tax reductions and the value of a selective combination of tax reductions and increased public investment when it is agreed that the economy needs stimulation. Yet common sense must dictate, and studies by the Congressional Budget Office and many others have confirmed, that in some cases properly selective increases in public outlays (as distinguished from the sometimes careless increase in outlays almost continually in process) would create more private investment and more jobs, be far less costly to the Federal Budget per unit of success in substituting resource use for idleness and waste, and come far closer to paying off in terms of economic and social priority needs. I am not here to argue as to the proper choice between tax reduction and increased public outlays; I am merely saying that a Federal Government with a Budget in the neighborhood of half a trillion dollars cannot continue to afford its confirmed reluctance to deal systematically with this issue.

THE PERVERSE CONSEQUENCES OF THE PREVALENT MONETARY POLICY

Sixth, the prevalent monetary policy is an extreme example of all of the errors thus far detailed. When borrowed money is one of the most commonly used of all commodities, especially by the average consumer, State and Federal Governments, and small- and middle-size business, how can it be anti-inflationary rather than inflationary to deliberately engineer the fantastic increases in interest rates during the past quarter century, now being lifted again, as illustrated by my Chart 17? How can adequate public-priority investment be safely financed, and how can the huge Federal deficit which is asserted to be a major cause of inflation be reduced, when the endless increases in interest rates are imposing the huge and increasing toll upon the Federal Budget, as shown on my Charts 17 and 18? Can we absorb these inflationary costs forever? And how can the chronic increases in the gap between full employment and full production on the one hand, and actual economic performance on the other hand, be decreased rather than increased when all of the empirical evidence shows a marked positive correlation between the tightening of the money supply and a sharp diminution in the rate of real economic growth, as shown on my Chart 19? I do not herein suggest in detail what changes are needed in the prevalent monetary policy. But I do insist that, unless the Congress exerts some appropriate role in the general supervision of the Fed to bring it into better accord with the avowed intentions and efforts of the President and the Congress, all other policies to reduce unemployment, promote real growth, and restrain inflation will spend themselves in vain.

BRINGING THE EXECUTIVE BRANCH AND THE CONGRESS INTO BETTER ACCORD

Seventh, and finally, in the correction of these salient errors of omission and commission in national economic policy for so many years, we need to strive toward an improved commity of effort between the Executive Branch and the Congress, not by departing from a system of checks and balances, but rather by bringing less stalemate and a more balanced effort into the proceedings through practical changes in accepted procedures.

30-454 O - 78 - 6

HOW S. 50 EMBODIES THE LESSONS OF EXPERIENCE

This leads up to my conclusions as to how the bill now before you, generally known as the Humphrey-Hawkins proposal, draws directly and honestly upon the empirical record; and how the bill seeks to motivate and facilitate the needed redirections in national economic thought and action, not by telling the private economy what to do, but instead by reorienting and reconstructing what the Government itself does—in areas where the Government has been acting and must continue to act. We need not reach for the moon to reshape the whole economy; it will be a wonderful first step to reshape what the Government does, because it so powerfully affects the whole economy, and because this is within the easy scope of the Chief Executive and the Congress.

(1) The bill provides for an integrated, quantified, and consistent set of long-range and medium-term goals, which all experience has shown to be the sine qua non for proper adjustment of national policies.

(2) The bill provides for an annual test, joined in by the President and the Congress, as to whether the policies actually put into effect are moving adequately toward the goals, and toward revision of these policies if they are not.

(3) The bill properly sets a quantified goal and timetable for the reduction of unemployment. This is an all-embracing economic and human consideration, which it becomes the primary responsibility of the Congress itself to define, because leaving that definition to the Executive Branch has done nothing but promote tolerance of higher and higher levels of unemployment with devastating effects upon fundamental economic performance and also upon the rate of inflation. But in aid of the mandated goal and timetable for the reduction of unemployment, the bill properly leaves the choice of a wide variety of specified programs and policies to the President and the Congress year by year. Pragmatically, nothing else could work, and in the very nature of our Government nothing else could really be attempted.

(4) The bill imposes strict mandates against the deliberate contrivance of highly unused production resources in a self-defeating effort to restrain inflation in this manner so discredited by experience. Nonetheless, the bill as approved by the House and reported by the Senate Committee on Human Resources mandates annual quantitative goals for the reduction of inflation until reasonable price stability is achieved and maintained.

(5) The bill mandates against the continued use of blunderbuss fiscal and monetary policies, whether spending or taxation, or interest rate or credit policies, and mandates in favor of the selective use of these policies in relationship to quantified goals for balanced economic development, tested and revised from year to year by the President and the Congress.

(6) The bill, in extremely moderate fashion, opens the way for some Congressional supervision of the Federal Reserve—without militating against its proper independence—in order that monetary policy not be alien to the declared purposes and actual policies of the Congress itself.

(7) The bill mandates a closer consideration of the respective relevance of the use of the tax and spending policies of the Federal Government, measured in terms of effective results as reviewed year by year.

(8) The bill establishes a set of national priorities, to be built into the structure of the entire effort. This is responsive to the millions of words of talk but woefully little real effort since the launching of the first Sputnick in 1957, that we should reorder our national priorities in consonance with the needs of the economy and the needs and aspirations of the American people.

(9) The bill expands and builds upon the gains made—insufficient though these have been—through the Budget Act of 1974. It does this by restraining the tendency to look at the Budget and the well-being of the Budget as a thing in itself, and instead sets the management of the Federal Budget within the context of the performance of the entire economy and the Budget's effects upon the latter. After all, Mr. Chairman and Members of the Committee, the Federal Budget is not an end in itself, but the prime instrument for calling forth the full use of our optimum potentials and the restraint of inflation.

(10) The bill in Title III (and I am speaking here of the version of Title III reported recently by the Senate Committee on Human Resources and, as I understand it, agreed to by the leadership of the Budget Committees of the Senate and the House as well as other primary interested parties in the Senate and the House), institutes a vastly improved procedure for unifying and

improving economic and financial policy, through improved cooperation and united efforts by the President and the Congress.

Mr. Chairman and Members of the Committee, the enactment of S. 50 will not hasten the achievement of the millenium. But it combines sensible and national procedures, in my view the inevitable product of long and hard experience, toward achieving what we all want and can achieve. There is nothing impractical in the bill. The bill is novel and enterprising, measured against the efforts and results of the years I have reviewed, but goodness knows every knowledgeable person has been calling for a recasting of efforts which simply have not been producing the essential results. However, the bill is neither novel nor risky, in terms of what we all, at long last, should have learned from long and costly experience. I therefore urge prompt enactment of this vital measure, in some respects the most significant and potentially useful one put before the Congress on the domestic economic front during the past generation or longer. Moreover, the bill provides explicitly for reformulation of its approaches as further experience reveals the need.

We have all heard the assertions that "all that the bill proposes could be done without its enactment." That is true of a substantial portion of the most necessary legislation on the books. People could drive less than 55 miles per hour without legal speed limits. People could pay decent wages without being prohibited from paying substandard wages. People receiving fair incomes during their working lives, and saving prudently, might exist decently in their declining years without social insurance. Good housing and adequate health services for all, at costs within their means, could be provided without a long history of useful Congressional action—with still more needed. Fair competitive conditions for all business, large and small, and avoidance of monopolistic misdeeds, could be maintained without aid of law. Hypothetically, we could have a full and equitable economic society without taxation or public spending. We could avoid the ravages of inflation without any public action. But we have not done nearly all that we could and should without a popular consensus written into law; and we know that we will not.

Likewise, the right to be employed at useful work for fair pay could have been universal and continuous without the Employment Act of 1946. And everything done under that Act, during 30 years, could have been done without it. Nor did that Act, read line by line, provide explicitly, nor provide the funds for, a single job. Yet, despite many disappointments and shortfalls, we all know that the 1946 Act has immeasurably improved national economic policies, broadened the citizens' understanding of economic affairs, and helped mightily to avoid cyclical disturbances of the severity we suffered regularly—and not just once—before World War II. By the same token, after thirty-two years of additional experience, the hour has struck to try through new legislation to do much better, as a necessary condition to actually doing much better. And "if we would guide by the light of reason, we must let our minds be bold."

THE "ROLLER-COASTER" ECONOMIC PERFORMANCE: ECONOMIC GROWTH RATES, 1922-1929, 1941-1945, AND 1947-1977

(Uniform Dollars)

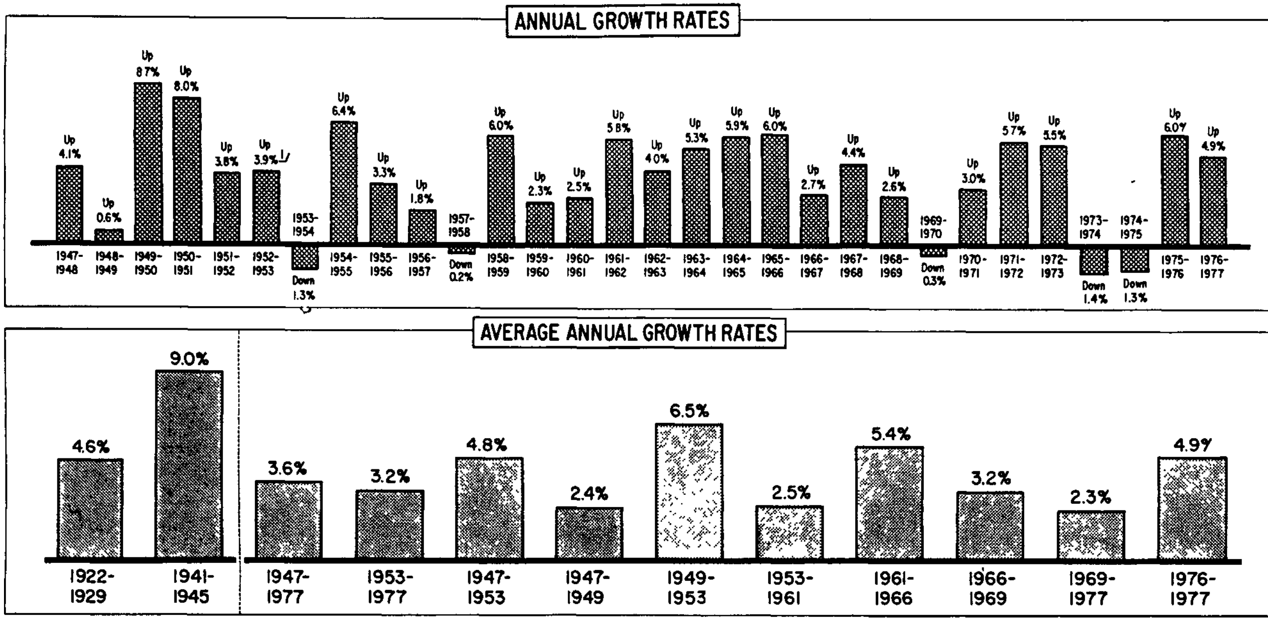
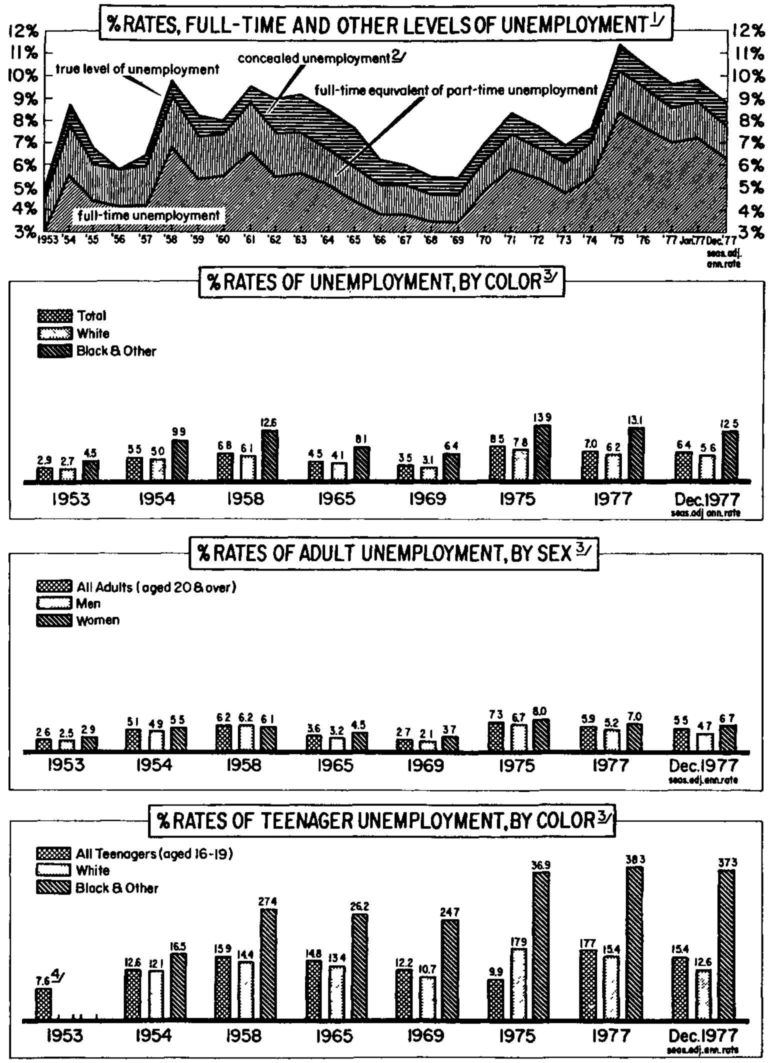


CHART 1

1/ Recession during part of period. There were five recessions, 1953-1977, but some were entirely within one year, and began and ended in different years.

CHART 2

UNEMPLOYMENT, % RATES & DISTRIBUTION, 1953-1977



1/ In deriving these percentages, the officially reported civilian labor force is augmented by concealed unemployment. Thus, some of the rates for full-time unemployment are very slighly lower than in the official reports of full-time unemployment.

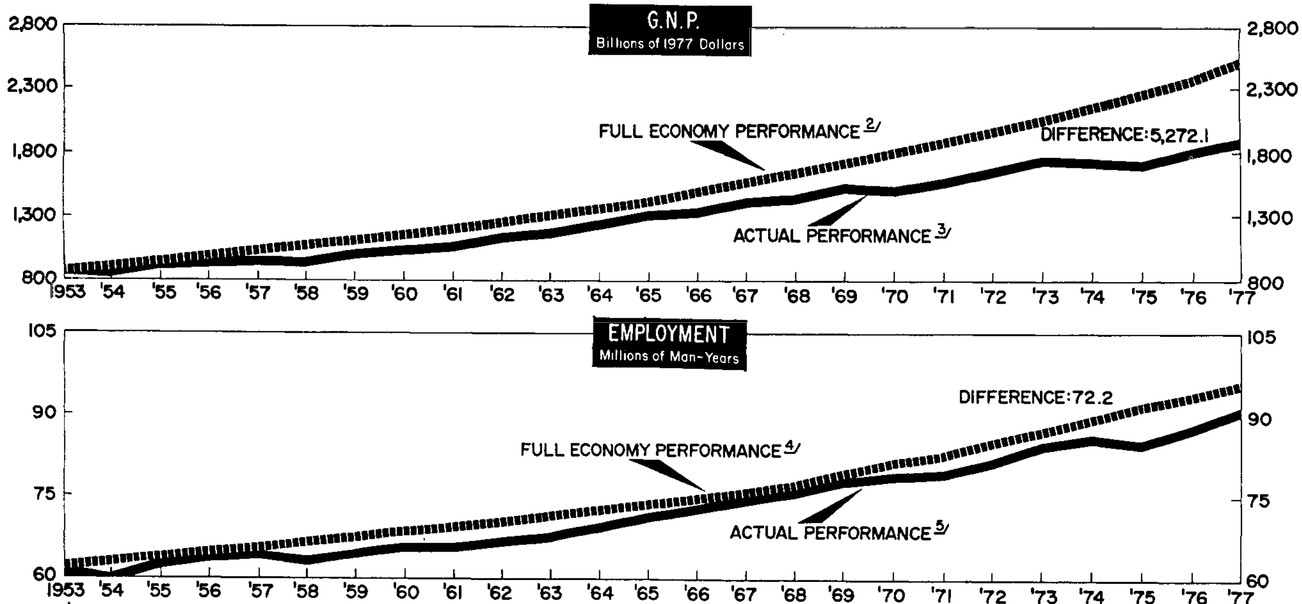
2/ Withdrawals from labor force, due to scarcity of job opportunity

3/ Officially reported concept of full-time unemployment.

4/ Distribution by color unvailable

Note: Some totals affected by rounding.

COST OF DEPARTURES FROM FULL ECONOMY, 1953-1977 1/

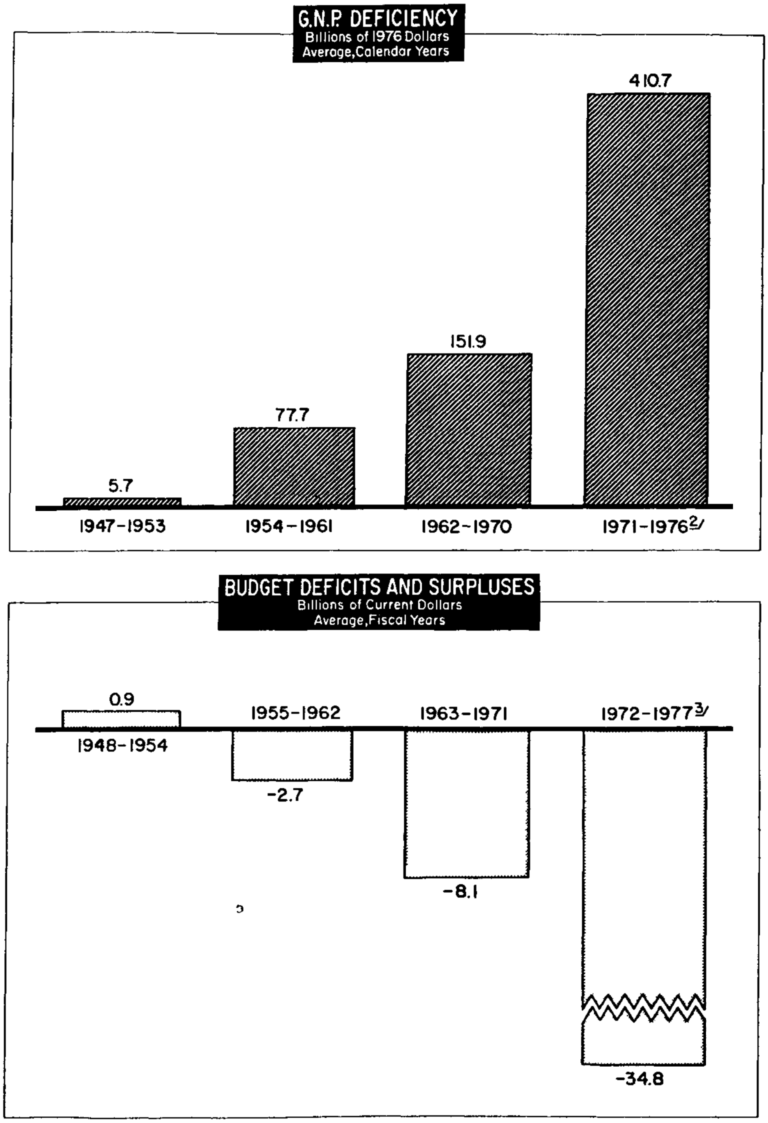


1/ 1977 estimated.
2/ Real average annual growth rate of 4.4 percent.
3/ Real average annual growth rate of 3.2 percent, the 1953-1977 average.
4/ Average true level of unemployment of 4.1 percent, or 2.9 percent full-time unemployment.
5/ Average true level of unemployment of 7.7 percent, or 5.3 percent full-time unemployment.
Basic Data: Dept. of Commerce; Dept. of Labor

CHART 3

CHART 4

G.N.P. DEFICIENCIES[1] AND BUDGET DEFICITS



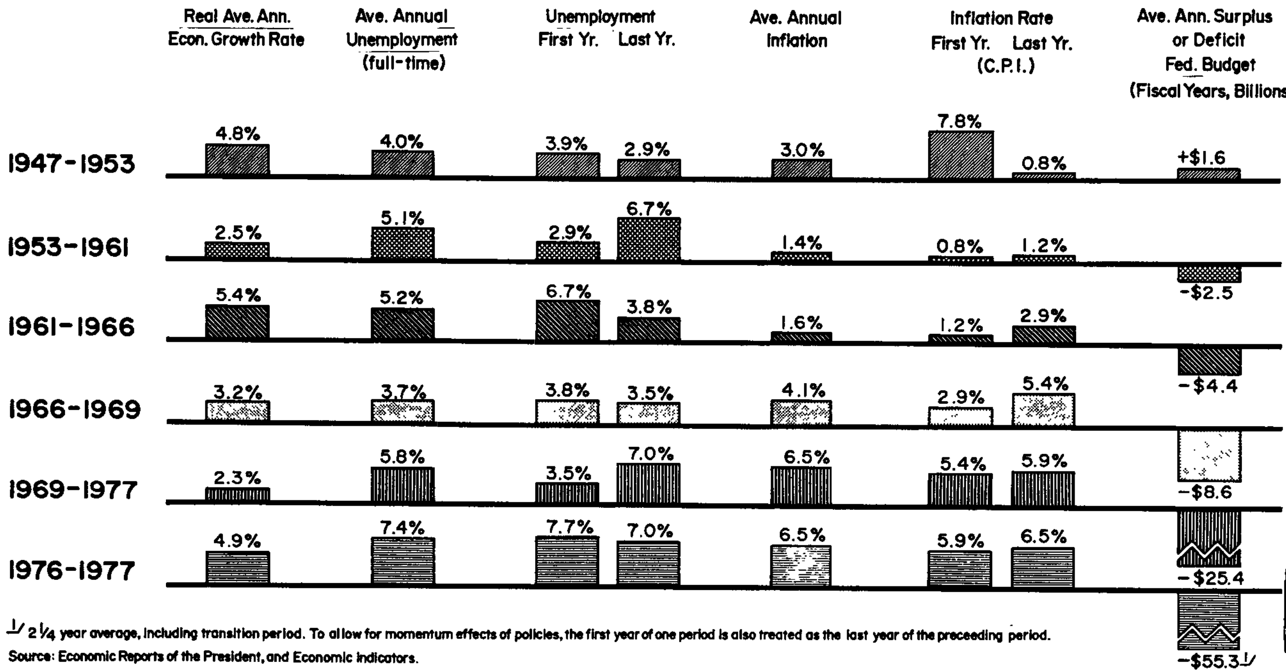
[1] Production deficiencies represent differences between actual production and production at full economy rate of growth Projections from 1946.

[2] 1976 estimated.

[3] 1977 estimated

Source: Dept. of Commerce; Office of Management and Budget, for actual figures

REAL ECONOMIC GROWTH RATES, EMPLOYMENT & UNEMPLOYMENT, INFLATION, AND FEDERAL BUDGET CONDITIONS, DURING VARIOUS PERIODS, 1947-1977[1]



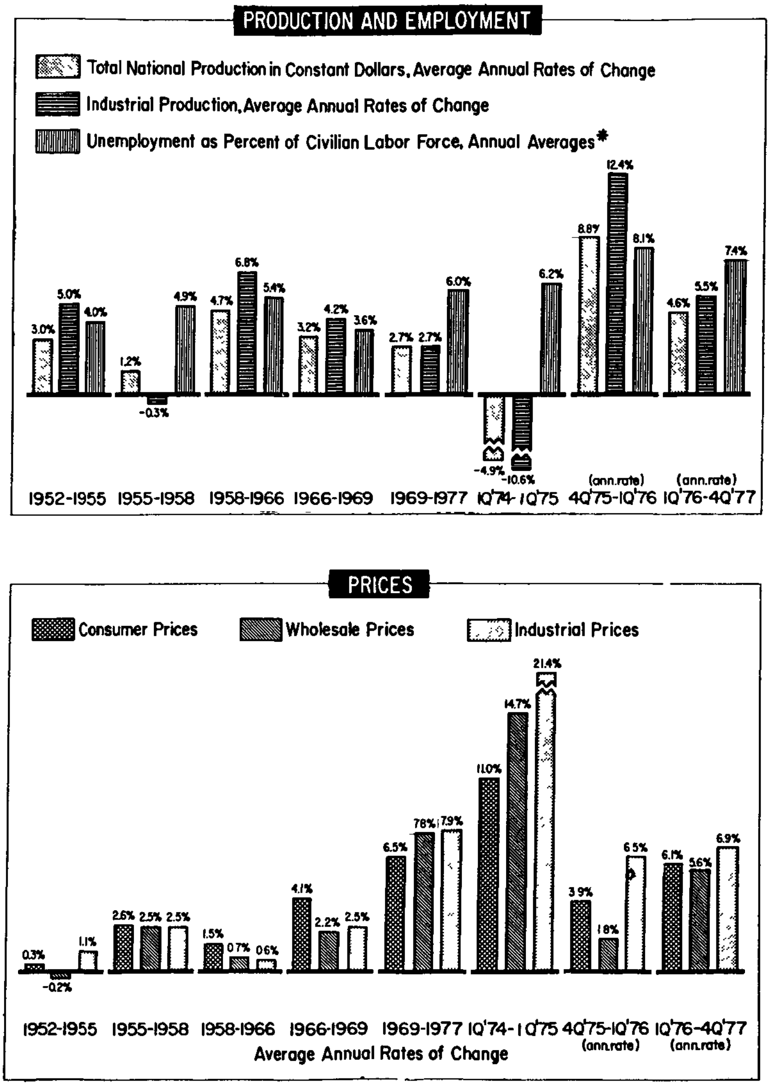
[1] 2 1/4 year average, including transition period. To allow for momentum effects of policies, the first year of one period is also treated as the last year of the preceding period.

Source: Economic Reports of the President, and Economic Indicators.

CHART 5

CHART 6

RELATIVE TRENDS IN ECONOMIC GROWTH UNEMPLOYMENT, & PRICES, 1952-1977



*/ These annual averages (as differentiated from the annual rates of change) are based on full-time officially reported unemployment measured against the officially reported Civilian Labor Force.

Source: Dept. of Labor, Dept. of Commerce, & Federal Reserve System

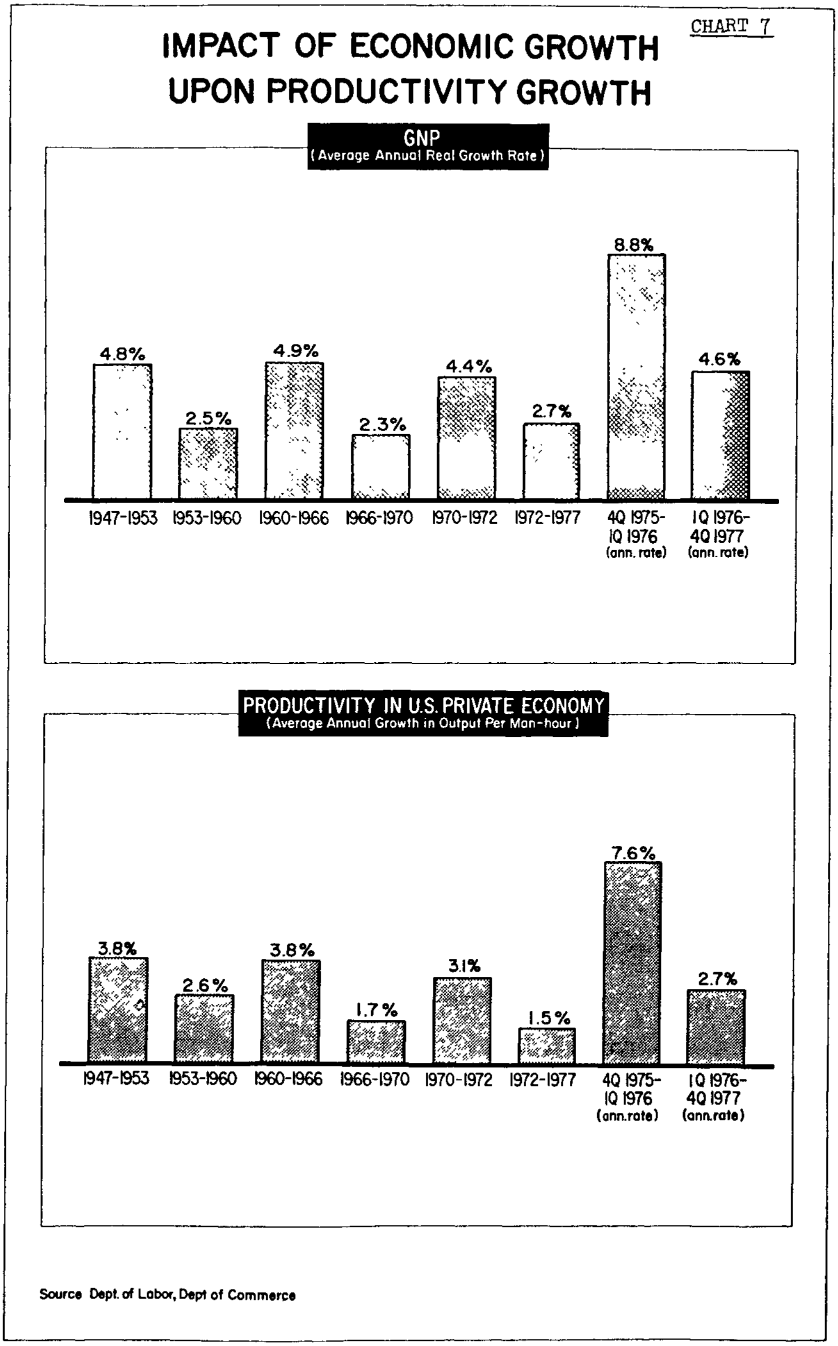
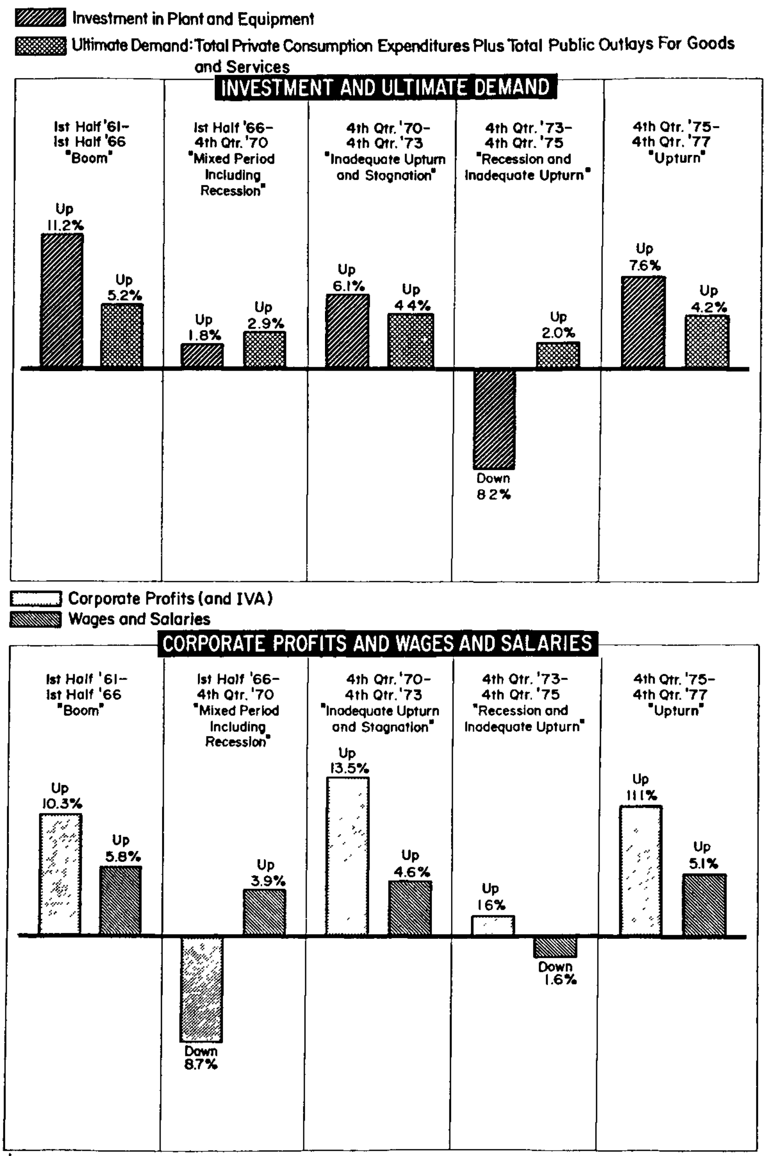


CHART 7
IMPACT OF ECONOMIC GROWTH
UPON PRODUCTIVITY GROWTH
GNP
(Average Annual Real Growth Rate)
4.8%
2.5%
4.9%
2.3%
4.4%
2.7%
8.8%
4.6%
1947-1953
1953-1960
1960-1966
1966-1970
1970-1972
1972-1977
4Q 1975-
1Q 1976
(ann. rate)
1Q 1976-
4Q 1977
(ann. rate)
PRODUCTIVITY IN U.S. PRIVATE ECONOMY
(Average Annual Growth in Output Per Man-hour)
3.8%
2.6%
3.8%
1.7%
3.1%
1.5%
7.6%
2.7%
1947-1953
1953-1960
1960-1966
1966-1970
1970-1972
1972-1977
4Q 1975-
1Q 1976
(ann.rate)
1Q 1976-
4Q 1977
(ann.rate)
Source Dept. of Labor, Dept of Commerce

CHART 8

COMPARATIVE GROWTH RATES, 1961-1977[1]

(Average Annual Rates of Change, in Uniform Dollars)



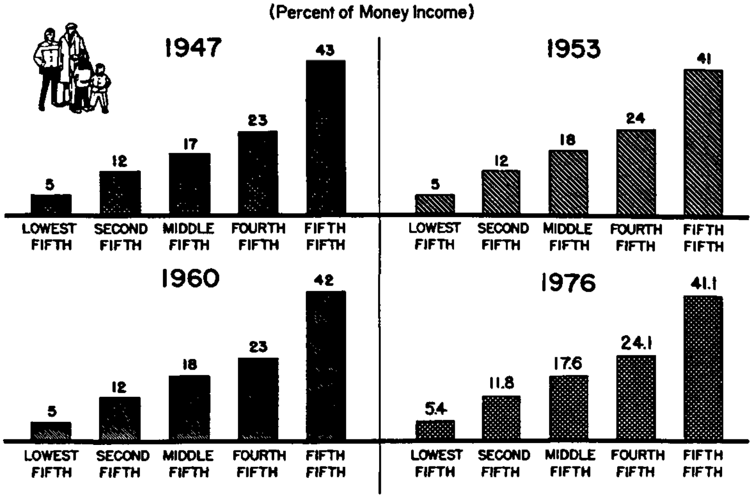
[1] 1977 estimated

Basic Data: Dept. of Commerce

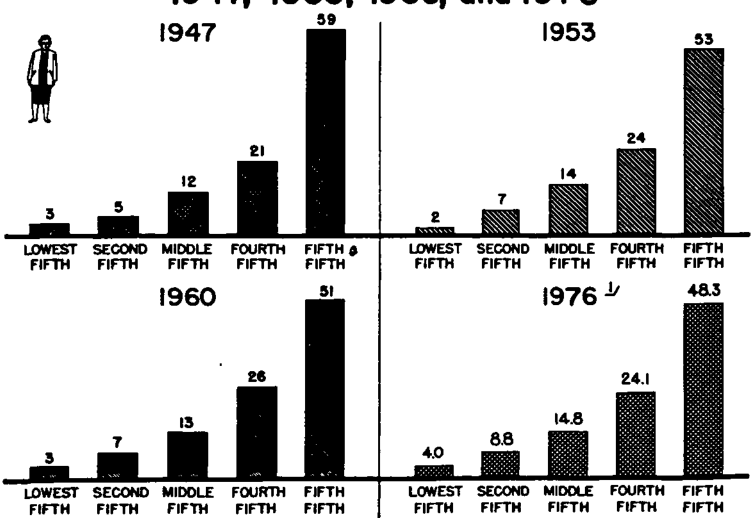
CHART 9

SHARE OF FAMILIES IN TOTAL FAMILY INCOME BY QUINTILES, 1947, 1953, 1960, and 1976

(Percent of Money Income)



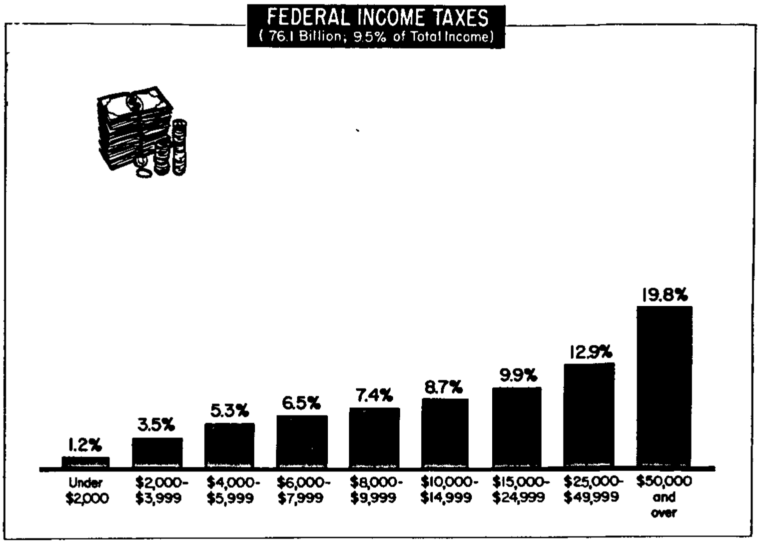
SHARE OF UNATTACHED INDIVIDUALS IN TOTAL INCOME OF UNATTACHED INDIV., BY QUINTILES, 1947, 1953, 1960, and 1976

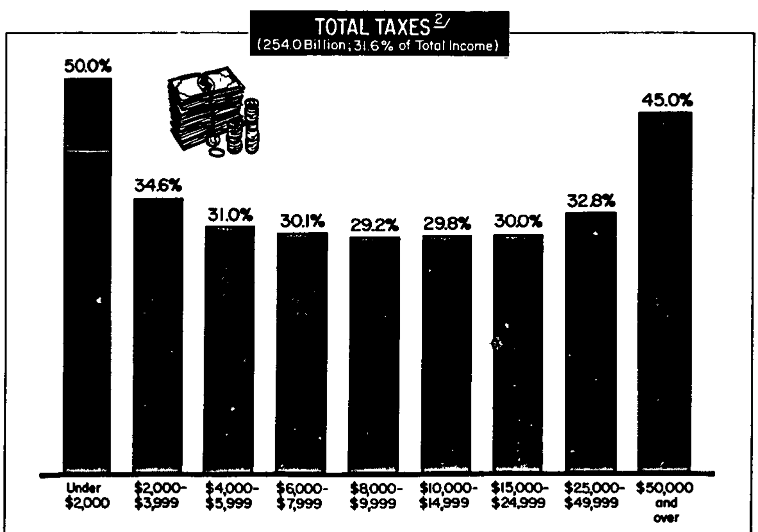


1/ Latest year available.
Data: Bureau of the Census.

CHART 10

TAXES PAID AS PERCENT OF INCOME, U.S. 1968[1]





1/ Income relates to total income of all persons in the adjusted money income classes shown. Total income is adjusted money income, plus imputed income, less direct taxes, plus retained corporate earnings, plus taxes minus transfer payments, plus realized capital gains.

2/ Includes the following Federal and State and Local taxes: Individual income, estate and gift, corporate profits, and social security. Also includes Federal excise and customs taxes, and State and Local sales taxes, motor vehicle licenses, property taxes, and miscellaneous other taxes.

Basic Data: Dept. of Commerce, Bureau of the Census

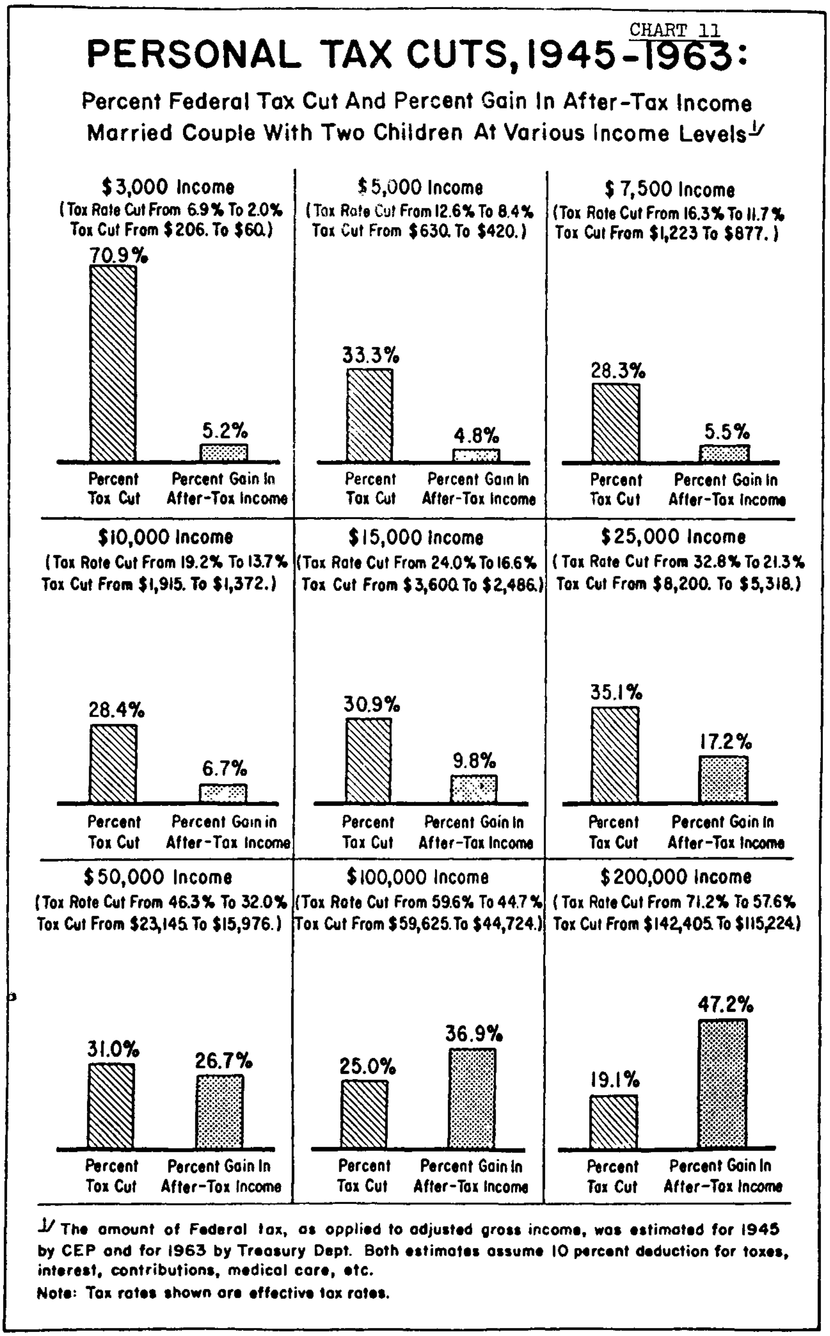
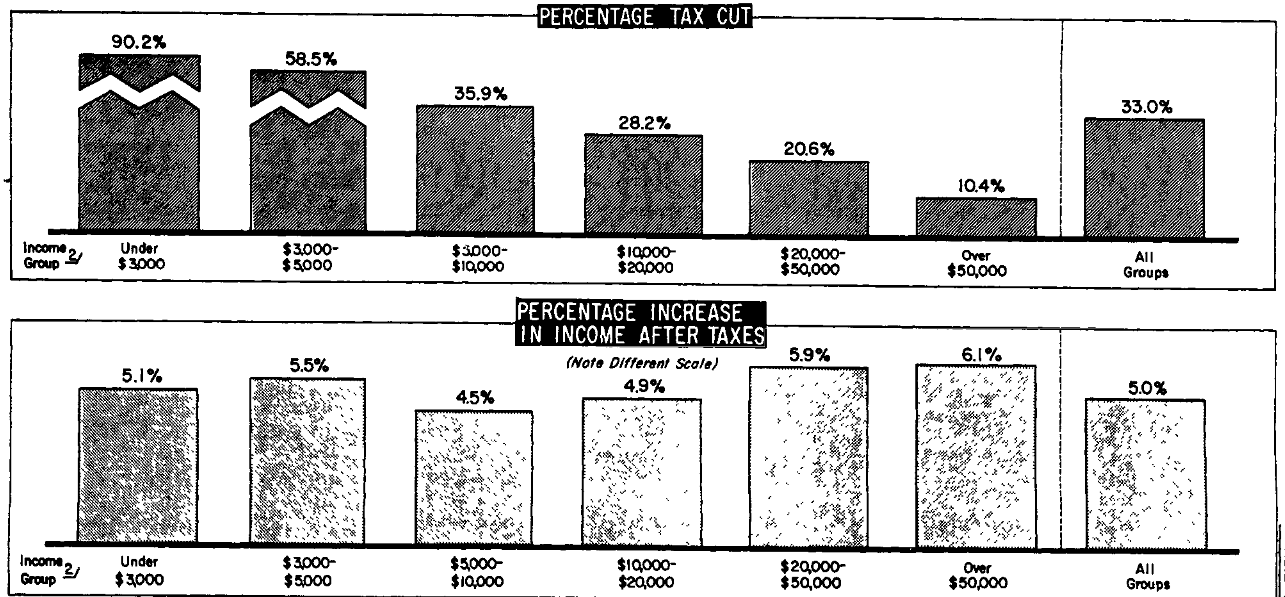


CHART 11
PERSONAL TAX CUTS, 1945-1963:
Percent Federal Tax Cut And Percent Gain In After-Tax Income
Married Couple With Two Children At Various Income Levels 1/
$3,000 Income
(Tax Rate Cut From 6.9% To 2.0%
Tax Cut From $206. To $60.)
70.9%
5.2%
Percent Tax Cut
Percent Gain In After-Tax Income
$5,000 Income
(Tax Rate Cut From 12.6% To 8.4%
Tax Cut From $630. To $420.)
33.3%
4.8%
Percent Tax Cut
Percent Gain In After-Tax Income
$ 7,500 Income
(Tax Rate Cut From 16.3% To 11.7%
Tax Cut From $1,223 To $877.)
28.3%
5.5%
Percent Tax Cut
Percent Gain In After-Tax Income
$10,000 Income
(Tax Rate Cut From 19.2% To 13.7%
Tax Cut From $1,915. To $1,372.)
28.4%
6.7%
Percent Tax Cut
Percent Gain in After-Tax Income
$15,000 Income
(Tax Rate Cut From 24.0% To 16.6%
Tax Cut From $3,600. To $2,486.)
30.9%
9.8%
Percent Tax Cut
Percent Gain In After-Tax Income
$25,000 Income
(Tax Rate Cut From 32.8% To 21.3%
Tax Cut From $8,200. To $5,318.)
35.1%
17.2%
Percent Tax Cut
Percent Gain In After-Tax Income
$50,000 Income
(Tax Rate Cut From 46.3% To 32.0%
Tax Cut From $23,145. To $15,976.)
31.0%
26.7%
Percent Tax Cut
Percent Gain In After-Tax Income
$100,000 Income
(Tax Rate Cut From 59.6% To 44.7%
Tax Cut From $59,625. To $44,724.)
25.0%
36.9%
Percent Tax Cut
Percent Gain In After-Tax Income
$200,000 Income
(Tax Rate Cut From 71.2% To 57.6%
Tax Cut From $142,405. To $115,224.)
19.1%
47.2%
Percent Tax Cut
Percent Gain In After-Tax Income
1/ The amount of Federal tax, as applied to adjusted gross income, was estimated for 1945 by CEP and for 1963 by Treasury Dept. Both estimates assume 10 percent deduction for taxes, interest, contributions, medical care, etc.
Note: Tax rates shown are effective tax rates.

CHART 12

PERCENTAGE TAX CUT AND PERCENTAGE INCREASE IN INCOME AFTER TAX, VARIOUS INCOME GROUPS, 1963-1973 [1]



1/ Effects due to changes in personal tax under Revenue Act of 1964, Tax Reform Act of 1969, and Revenue Act of 1971 (H.R. 10947, as reported by the House-Senate Conference Committee, excluding the effect on personal taxes of removing the first year convention under the Asset Depreciation Range system)

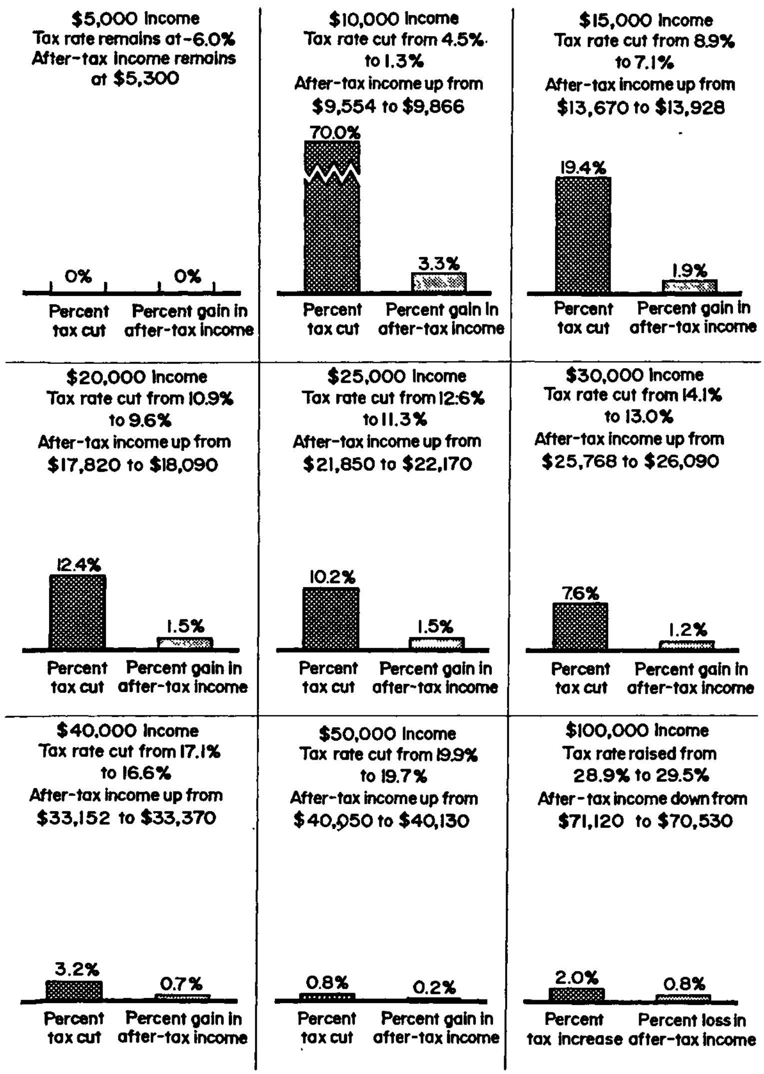
2/ Adjusted gross income class.

Basic Data: House Ways and Means Committee and Senate Finance Committee Reports, and Congressional Record

CHART 13

ADMINISTRATION PROPOSAL, PERSONAL TAX CUTS IN '79 EXCLUDING SOCIAL SECURITY (FICA) TAX CHANGES

Percent Tax Change and Percent Change In After-Tax Income
Married Couple with Two Children at Various Wage Income Levels 1/

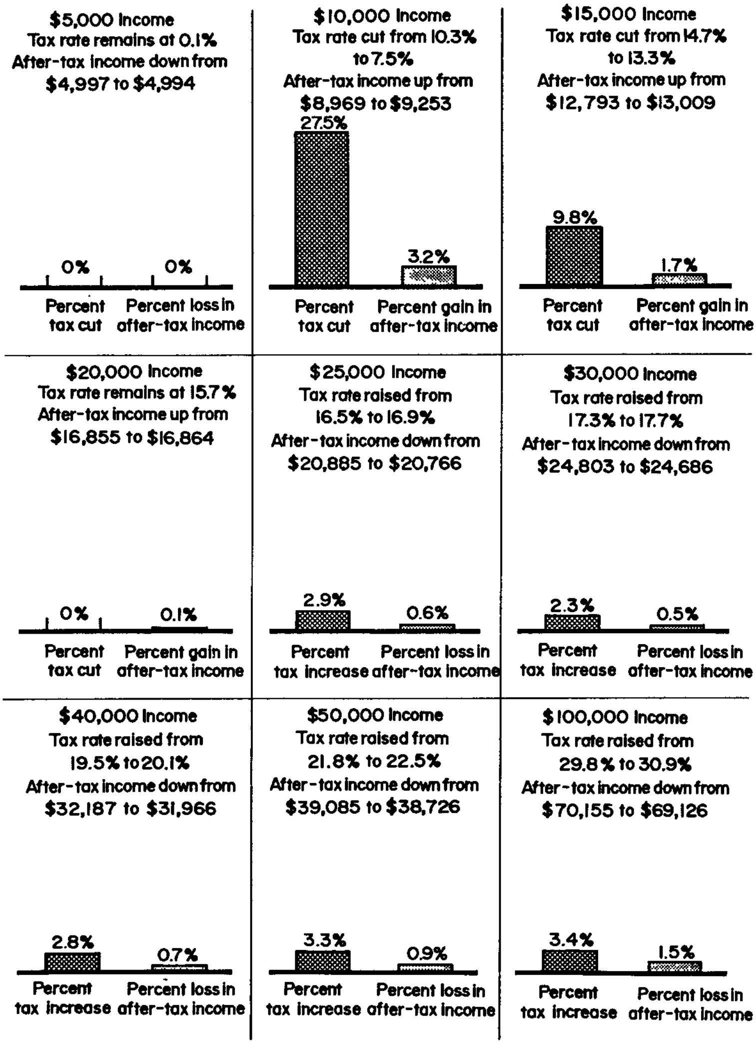


1/ One wage earner; deductible expenses assumed at 20 percent of income.
Source: Department of the Treasury, Office of Tax Analysis

CHART 14

ADMINISTRATION PROPOSAL, PERSONAL TAX CUTS IN '79, INCLUDING SOCIAL SECURITY (FICA) TAX INCREASES

Percent Tax Change and Percent Change in After-Tax Income
Married Couple with Two Children at Various Wage Income Levels 1/



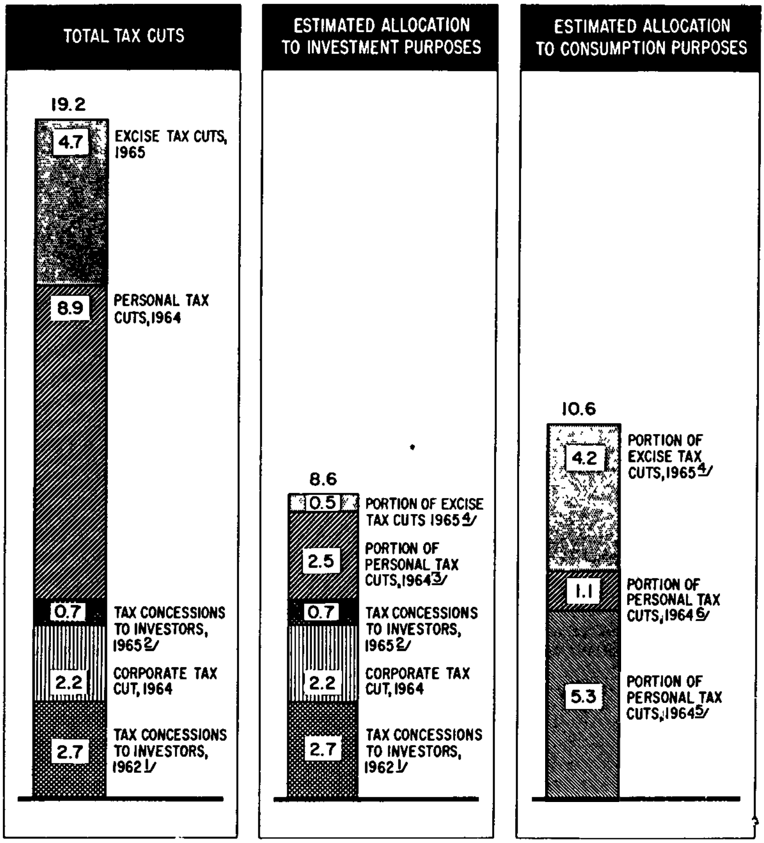
1/ One wage earner; deductible expenses assumed at 20 percent of income; FICA tax calculated under prior law rate and base for 1977 (5.85% and $16,500) and present law rate and base for 1979 (6.13% and $22,900), employees' share only.

Source: Department of the Treasury, Office of Tax Analysis

CHART 15

ALLOCATION OF TAX CUTS, 1962–1965: INVESTMENT AND CONSUMPTION PURPOSES

(Billions of Dollars)



1/ Through Congressional & Executive Action

2/ Through Executive Action

3/ Estimated portion of personal tax cut, for those with incomes of $10,000 and over, which they would save for investment purposes.

4/ Based on estimates of excise tax cuts passed on to consumers through price cuts.

5/ Personal tax cuts for those with incomes under $10,000.

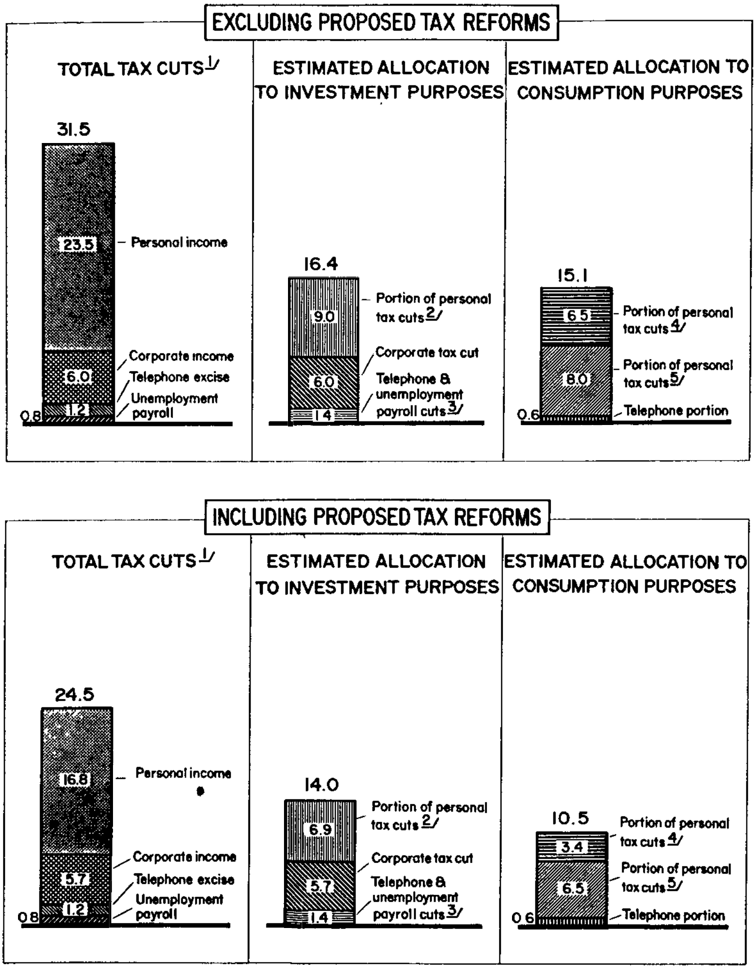
6/ Estimated portion of personal tax cuts for those with incomes of $10,000 and over, which they would spend for consumption.

Note: Estimates of excise tax reduction allocation by C.E.P. (amount might be passed on to consumers by price reductions.) However, a large portion of this did not go to low income consumers.

CHART 16

ESTIMATED DIVISION--PROPOSED TAX CUT BETWEEN CUTS FOR INVESTMENT PURPOSES AND CUTS FOR CONSUMPTION PURPOSES

(Effects on Calendar 1979 Tax Liability)



1/ Total tax cuts for calendar 1979, as estimated by Department of the Treasury.

2/ L.H.K. estimate of portion of personal tax cuts for those with incomes of $15,000 and over

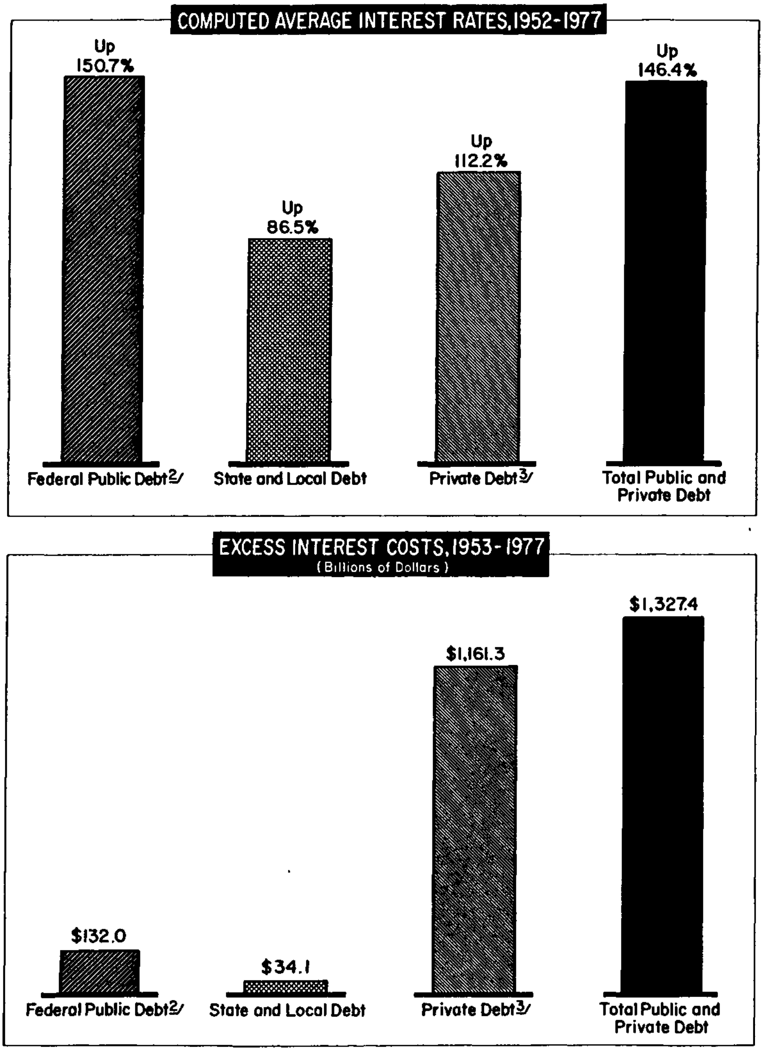
3/ L.H.K. estimate of portion of telephone excise cut going for investment.

4/ L.H.K. estimate of portion of personal tax cuts for those with incomes of $15,000 and over which would be spent for consumption.

5/ L.H.K. estimates of personal tax cuts for those with incomes under $15,000.

CHART 17

INCREASES IN AVERAGE INTEREST RATES, AND EXCESS INTEREST COSTS DUE TO THESE INCREASES, 1952-1977 1/



1/ 1976-1977 estimated.

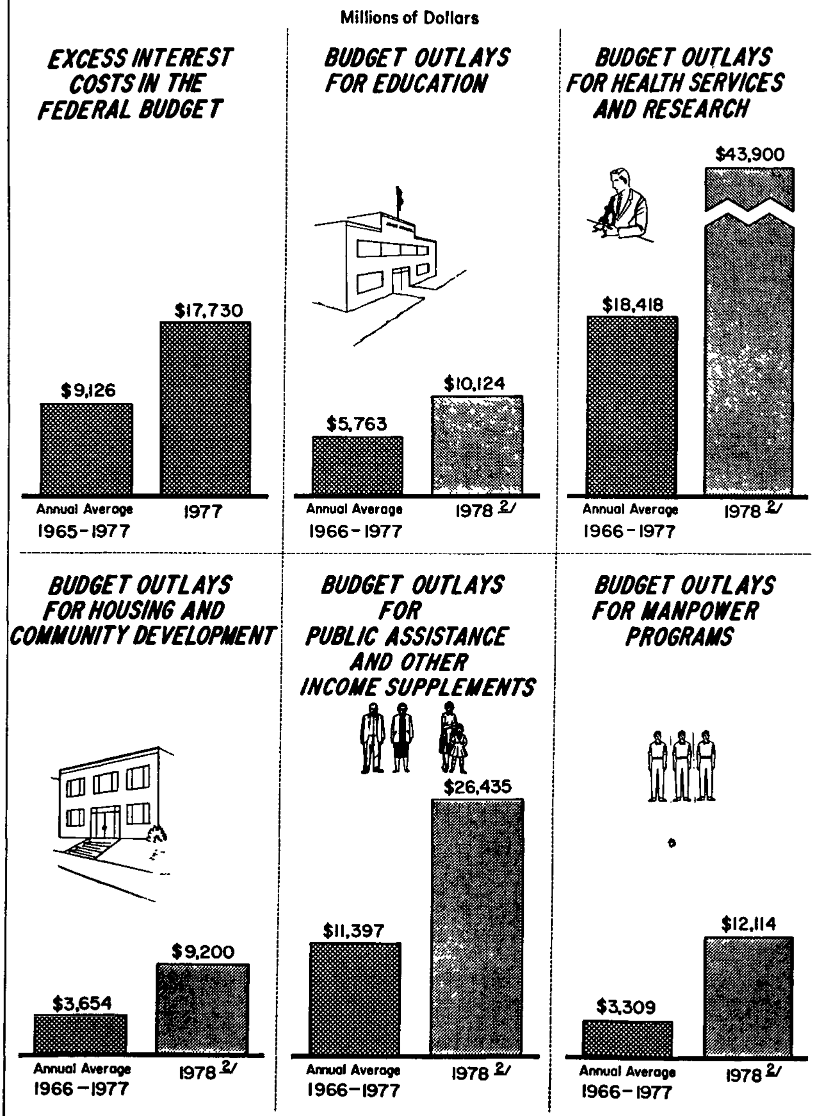
2/ Includes net foreign interest.

3/ Computed as a residual by subtracting Federal Government and state and local debt from total public and private debt. Includes debt of federally-sponsored credit agencies.

Source: Dept. of Commerce; Economic Report of the President

CHART 18

EXCESS INTEREST COSTS IN THE FEDERAL BUDGET 1965-1977 CONTRASTED WITH OTHER COSTS FOR SELECTED BUDGET PROGRAMS [1]

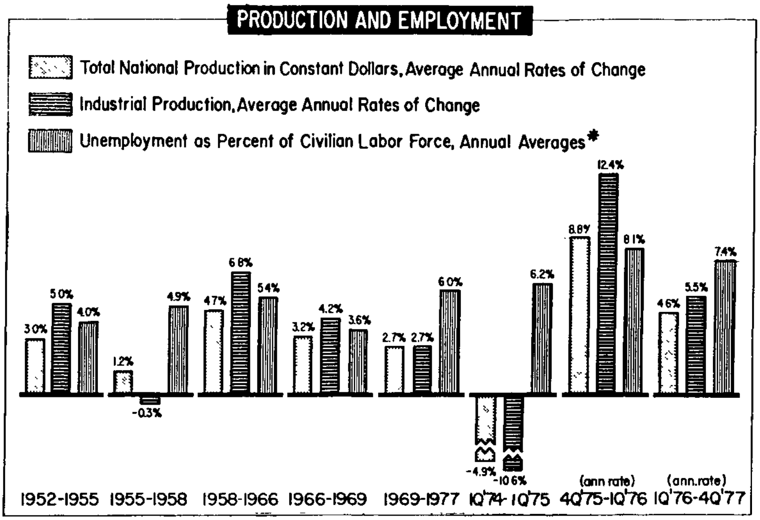


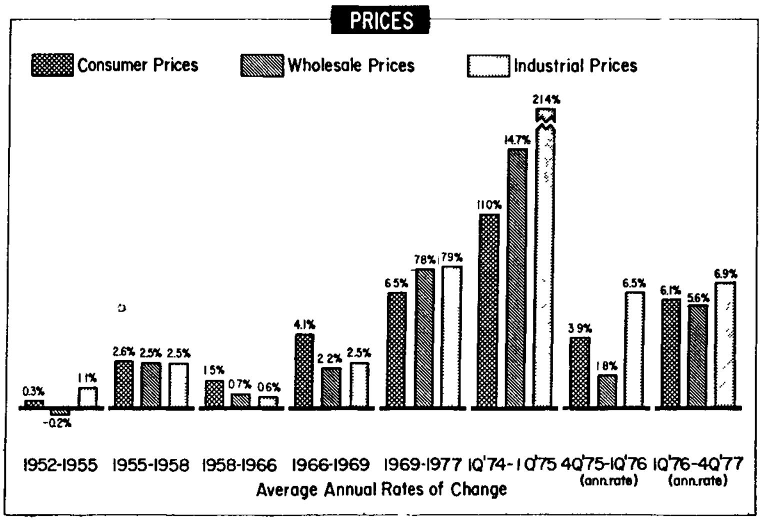
1/ Interest costs, calendar years; budget outlays, fiscal years. 1977 interest costs and 1978 budget outlays estimated.

2/ Proposed in fiscal 1978 Budget of President Carter, as revised November 11, 1977.

CHART 19

RELATIVE TRENDS IN ECONOMIC GROWTH UNEMPLOYMENT, & PRICES, 1952-1977





*/ These annual averages (as differentiated from the annual rates of change) are based on full-time officially reported unemployment measured against the officially reported Civilian Labor Force.

Source: Dept of Labor, Dept. of Commerce, & Federal Reserve System

The CHAIRMAN. Thank you very much, Dr. Keyserling for a very powerful and serious statement.

Our final witness is also a veteran of the New Deal, and so forth, Robert Nathan, came to Washington, I think also in 1933.

Mr. NATHAN. That's right.

The CHAIRMAN. And also served in a number of top economic policy positions, recognized then as a boy wonder, and I guess he still is. We will be happy to print your statement as well as Dr. Keyserling's, and the other statements in full in the record.

[The complete statement of Mr. Robert Nathan follows:]

STATEMENT OF ROBERT R. NATHAN, PRESIDENT, ROBERT R. NATHAN ASSOCIATES, INC.

Mr. Chairman and members of the Committee: Thank you for this opportunity to discuss S. 50, the "Full Employment and Balanced Growth Act of 1978." This legislation, as moderate as is its content, may well prove to be the most important contribution to the sustained economic progress of the United States made since the Employment Act of 1946.

The Employment Act of 1946 was adopted because of the great economic losses to the nation and the extreme hardships suffered by tens of millions of Americans during the Great Depression, and because we had considerably enhanced our understanding of economic problems and policies as a result of both the recovery measures of the 1930's and the mobilization plans, policies and performance during World War II.

It is no accident that we have suffered no major depression in the third of a century since the end of World War II. Never before have we enjoyed such a long period without extremely costly booms and busts. True, we have had six recessions during these years and we still have not fully recovered from the sharpest and longest recession since the 1930's. Nevertheles, tremendous progress has been made in preventing and moderating business cycles. This is attributable in no small measure to the Employment Act of 1946 and to the roles played by the Council of Economic Advisers and the Joint Economic Committee, both of which were provided for in that legislation.

In addition to what we learned from the programs designed to recover from the Great Depression and about our economy in successfully mobilizing our resources for World War II, we further learned much from the formulation and application of new economic policies and programs since the enactment of the Employment Act of 1946. Unfortunately, our learning curve has not kept pace with our expectations and our standards. In the past few years we have also gained experience from dealing with various aspects of budgetary issues in the Congress as a result of the legislation that established the Congressional Budget Office and the House and Senate budget committees.

What continues to be seriously lacking is an institutionalized arrangement which will serve to maximize the prospects not only for analyses of economic problems but, more importantly, for the formulation of coordinated plans, policies and programs essential to the improved performance of our economy.

The Annual Economic Report of the President, which incorporates the Annual Report of the Council of Economic Advisers, plus the reports of the Joint Economic Committee of the Congress, have contributed immeasurably to our understanding and to valuable dialogue on most of the nation's key economic issues. However, there has been no parallel in the articulation of plans and policies and programs that can contribute to the solution of our economic ills. The above reports make some recommendations but do not provide the needed economic policies and programs and plans which would lead to coordinated and fruitful legislation and executive actions.

The most important single contribution of the Humphrey-Hawkins legislation is the requirement for the President of the United States to submit annually to the Congress not just an analysis of economic issues but also coordinated plans and programs and policies designed to deal contructively and positively with the problems that plague the economy. It is a new dimension in our kit of economic tools and processes. As one who has been concerned with economic planning for the past 40 or more years, I am greatly impressed by the benefits that can come to a private enterprise system from intelligent and careful planning. Having been closely associated with those who strived to bring recovery from the Great Depression, having served as Chairman of the Planning Committee of the War Production Board, having held the post of Deputy Director of the Office of War Mobilization and Reconversion, and having served in advisory capacities in formulating economic plans in many developing nations of Asia, Latin America and Africa, I feel certain that planning is essential and useful and can contribute invaluably to the economic progress of the United States.

I know many of the opponents of this Bill. They are generally not dissimilar to those who opposed the Employment Act of 1946. They are almost paralyzed with fear of the potential harm that they envisage coming from economic planning by some conjured up zealots against private enterprise, rather than with the benefits that planning by largely competent and patriotic executive and legislative officials and their staffs can bring to business, labor, agriculture and consumers.

Had the "let nature take its course" and the "rely entirely on the marketplace" philosophies of the early 1930's continued, I am not at all confident that the free enterprise system would have survived the Great Depression. Certainly without planning our mobilization of resources for World War II would have been far less successful. Similarly, had it not been for the Employment Act of 1946 we may very well have regressed to major booms and busts and jeopardized private enterprise.

The present economic world is ever more complex and offers more challenges as well as new opportunities compared with pre-World War II years and with the first quarter of a century following World War II. In the present difficult environment we have performed poorly. We now seem to be making less rather than more progress. We continue to suffer peacetime inflation unprecedented in America's history. We face energy crises which seriously threaten the nation's economic independence. The once cherished dollar has become an unstable currency. We have experienced high levels and persistent unemployment. The concept of work as the principal source of income and support is being eroded. Liberal trade policies are under increasing attack, in part because of unemployment. Many of our cities are in serious financial trouble. Many sectors of the economy are stagnant. Our industries lag in modernizing their facilities and in expanding capacity to meet new market opportunities. There seems to be a lack of confidence that vigorous economic growth will be restored. Productivity trends have been disappointing, thus pushing up unit labor costs. Higher costs of imports attributable to the falling value of the dollar serve to aggravate the rate of inflation. Our economic performance generally has not been good by almost any modern standard.

It is against this background that I find it hard to understand the rationale of the opponents of the Humphrey-Hawkins Bill. I can only attribute that opposition to a lack of confidence that America can solve the multitude of problems it now faces—that it can do a better job in overcoming unemployment, in reducing inflation, in solving our energy problems, in expanding and modernizing our productive capacity, in improving our cities, in once again restoring substantial growth in productivity and in coping with a variety of other key problems which we have failed to address constructively in a comprehensive and balanced manner.

The business community—at least if we listen to its strident spokesmen—is generally against this legislation. Yet, when performances of individual enterprises and individual companies are as bad as the performance of our economy has been over the past decade, and management does not come forward with more effective plans and programs to improve that performance, they are fired by the board of directors or the board members are voted out of office by the shareholders.

Successful business inevitably engages in planning. It must plan programs to overcome failures and to broaden the areas of success. It must plan for new products and new markets. I know of no large business which does not plan ahead for several years, which does not up-date these plans from time to time and which does not take these plans into consideration in making decisions.

Yet when it comes to the government, those same corporate officers who require their subordinates to prepare corporate plans and programs manifest a degree of irrational fear, if not terror, of government planning. They equate planning in government with regimentation, but they know good planning is good business in their corporations. Basically, they must have a lack of confidence in our political and economic system. Government is our biggest business and it needs planning to improve its effectiveness and its efficiency.

In essence, I strongly favor this legislation because of the improvement it can bring in our economic performance. The benefits arising out of more coordinated economic plans, policies and programs can greatly outweigh even the remotest possible disadvantages.

We are not going to solve the problems of unemployment and inflation by resorting to a soft economy as the way to restore price stability. We are not going to solve our energy crisis by totally relying on the marketplace. We are not going to strengthen the dollar without reducing our huge and growing reliance on imports of oil and without making progress in the fight against inflation. We are not going to give a sense of participation and rewards to our youth without improving the economic environments in our cities and expanding job opportunities. We are not going to strengthen our water and air environmental qualities compatible with our resources and our values without coordinated policies.

These are merely illustrative of some of the areas and issues on which we need to focus not only better analyses and understanding, but also on planned and programmed policies and actions that can be debated and discussed by the Congress, by business, by labor, by economists, by engineers, by farmers, by state and local officials and by opinion makers throughout the nation. Attacking each problem separately is better than doing nothing, but it is not nearly as effective as having a total perspective within which policies and programs can be developed and adopted in a cohesive and coordinated approach.

Requiring the President to submit economic plans and policy proposals and programs annually, covering the next five years, by no means assures that these plans or policies or programs will be adopted. Congress still will have the responsibility to evaluate these proposals and to come to final decisions on legislation. Facts can be analyzed, policies formulated and reviewed, inconsistencies confronted and reconciled, priorities established and implementation carried out more productively than is now done. I believe that with specific plans and policies submitted by the Administration, the prospects will be greatly enhanced for not only more constructive and beneficial determinations by the Congress but, most important, these determinations can be inter-related within a coordinated and positive planning environment.

In addition to the basic issue of planning and the responsibility placed upon the President, this legislation entails a great many specific issues. I shall not attempt to deal with all of these specifics, but shall confine my comments to two important considerations. One concerns the matter of responsibilities of the Federal Reserve Board and the other to the setting of a specific quantitative goal on inflation.

Concerning the Federal Reserve, I agree with the basic objective of assuring independence to the Federal Reserve in its recurring monetary decisions and actions rather than subjecting the Board's operations to control by either the Executive branch or the Legislative branch of the government. The Board requires considerable latitude in the exercise of its authority with respect to money supply and credit considerations. On the other hand, the Federal Reserve Board is a public institution and part of the government. It should be called upon to fit its activities into a framework which encompasses the basic economic objectives set forth in this legislation.

As already stated, the trade-off concept between unemployment and inflation is subject to grave questions. In today's world a soft economy is not an effective or desirable path to curbing inflation. In fact, unemployment and idle capacity have tended to reduce productivity and to increase unit costs and intensify inflation. A contractionist monetary policy by the Fed may be totally inconsistent with the plans and policies set down by the President and the Congress to fight both inflation and unemployment simultaneously. Yet a totally independent posture for the Fed could serve to undermine efforts of the President and the Congress to pursue these policies. Of course, to the extent that executive and legislated policies were to ignore the prevalence of inflation, the Federal Reserve might be forced to pursue tight money to prevent overheating the economy. But the Federal Reserve should be required to submit plans and to be bound basically to perform in harmony with the goals and objectives set forth in this legislation.

What is being legislated in the Bill is the provision of a process and a procedure for economic planning, for formulating economic policies and for proposing economic programs that will serve the best interests of the nation. The Federal Reserve should definitely be involved in this process. It is not an entity which serves only as a residual actor on the economic scene. In planning for the coming years, monetary policy must be an important part of the total economic policy package that should come before the Congress.

In essence, what I am urging is to require the Fed to be involved not only in the setting of monetary policies but also broad economic goals and policies. It should be assured considerable latitude to exercise its week to week and month to month influence on money supply and on credit terms within the framework of the objectives set for it in this Bill and consistent with the annual policy determinations made by the President and the Congress.

The other principal point to which I want to address the Committee concerns the establishment of a specific quantitative goal on inflation. The simplistic conclusion that there is a direct trade-off between unemployment and inflation is damaging and costly. In my judgment, the use of a quantitative goal on the rate of inflation along with a quantitative goal on the percentage of unemployment would tend to cause more and more people to pursue the trade-off concept. Rather, what is needed is a continued effort to achieve lower levels of unemployment and lower levels of inflation simultaneously and compatibly. Of course, at some high point of capacity utilization the goals of price stability and high employment will be incompatible. But I believe that the setting of quantitative goals for both will serve to yield higher than tenable levels of both unemployment and inflation because it will lead to a greater tendency to rely on unemployment and idle productive facilities to fight inflation.

I certainly favor the strongest possible statement of objectives in the legislation calling for substantial reductions in the rate of inflation. I would urge that we try to get back to one to two percent increases in prices. Inflation is a cancer on the economic body of the United States and it must be eradicated. How soon and how fast this can be done will depend on what kinds of measures and steps we take to fight inflation other than through unemployment.

The Wright amendment adopted in the House of Representatives bill calls upon the President to set annual goals over the foreseeable years in the pursuit of price stability. This means that there will be annual goals for prices and that would be far preferable, in my judgment, than the setting of a price goal in the legislation.

I testified on August 3rd of last year before this Committee in reference to S. 1542, which provided for extending the authority of the Council on Wage and Price Stability. I offered suggestions on what to do about inflation. Measures against inflation are needed even more today than a year ago. The government must be involved in fighting inflation through every feasible measure short of direct controls.

The American people are adamant in their determination to stop the ravages of inflation. Most people would prefer controls to inflation. I think that we can lower the pace of price increases without broad price and wage controls and without relying on unemployment. It will not be easy and rhetoric alone will not succeed. The appointment of Barry Bosworth as Chairman of the Council on Wage and Price Stability is the most encouraging thing that has happened on the inflation front in a long time. If he is given the support he needs and if the President puts the full force of the prestige of his office behind the war on inflation, we can make progress toward real price stability.

I urge the favorable votes by this Committee and the full Senate in favor of this important and timely legislation.

Mr. NATHAN. Thank you. I will be as brief as I can, summarizing three points.

The first point has to do with the general formulation and the content of the bill in its broadest perspective. I came to Washington, I think, 4 months after Leon Keyserling in the summer of 1933, and having been involved in the thirties with people that were directly concerned with the recovery from the recession, the great depression, I agree with Leon Keyserling that was a rather ad hoc, grab as grab can, inconsistent sort of set of programs, but nonetheless, it was in rather considerable degree successful.

Second, I had the privilege of working as chairman of the Planning Committee of the War Production Board, where we did the planning for the mobilization for the war.

I say if we hadn't had that kind of planning we could have never achieved the degree of success that was achieved, whether it was war or not war. It was an organized, integrated effort.

We had reconversion in trying to plan for going back to peacetime, and I have had the privilege also of working since the end of World War II in many, many less developed countries of the world, and I myself feel that those that try to put together some meaningful, intelligent program, and efforts to use their resources in a constructive manner are the ones that made the greatest progress, and ones that failed in the planning directions are the ones that lagged furthest behind. This was not inconsistent with the private enterprise sector.

One can argue a great deal about Korea, and Korea's civil liberties, but when it comes down to economic programing and developing, that country had by far the most outstanding progress of any country on the economic front since the end of World War II. It was programed and planned, and it was primarily in the private enterprise system and not in public enterprises, but they did have programs and policies and institutions that made sense and led to something.

Now, here in the United States, I agree that the Employment Act of 1946 has been a great contributor to the fact we haven't had any major booms or busts, but you never lived in a society that is changing in its goals, and the objectives changed and I think the Humphrey-Hawkins bill offers that kind of opportunity, as modest as it is.

If there is any belief that we don't need a more integrated coordinated, meaningful set of policies and programs, then I say, let's look at the miserable inflation of the last decade.

Let's look at the energy program. I hate to say this, but in just another few months, we have a 5-year anniversary, a celebration, so to speak, of the embargo, in October of 1978, and what have we accomplished in those 5 years in terms of economic independence of the United States in the energy area? Almost nothing. We have the weakest dollar we have had almost in memory, in economic recorded memory.

High employment, 3 years after we passed the controversy of the recession, restrictive trade policies emerging all over the lot, messes in the cities, lagging investment in the private sector, and lagging productivity, and yet, we are not trying to put the package together.

I think the Humphrey-Hawkins bill is the real ingredient whereby we will at least have a chance. There is nothing in this bill which directs any specific legislation or results in any specific activity, but it does try to provide us a framework within which we can try to make this economy more effective.

Now, having emphasized that, I would just say one thing, that this is not a bill to regiment the economy, it is not a bill to discourage the private sector, I think it will encourage investment in the private sector, not a deficit bill or public works bill, but to try to stimulate investment productivity and provide private employment.

There are two specifics that are discussed here today, one has to do with the Federal Reserve. Basically, I agree with Andy Brimmer's position that the Fed ought to fit within the overall context. After all, the Federal Reserve Board needs a high degree of independence because of the nature and character of the activities, of its techniques and devices and procedures, but when it comes down to goals and objectives, there is no doubt it is part of the Government and that it ought to fit into the Government in terms of its goals and overall policies.

Where I disagree strongly with Brimmer and Carlson is on the specific goal for inflation.

I believe that a specific goal on unemployment is necessary. We have had experience, we know what we can do, and I think to try to put down two goals, specify side by side in my judgment, is almost certain to lead to what is not appropriate, namely, a tradeoff between unemployment and inflation.

That does not mean that there is not a point, where Charlie Schultze might be right, as 5 percent or 4.9 percent or 4 percent, is not a given. It depends upon what we do about inflation, and what we do about unemployment, what we do about employment. I think it would be unfortunate if we sat here in the context of 1978's failure to deal with the inflation problem, in a vigorous, dynamic way, except through unemployment which has not worked.

If we stay in that area, then of course, the tradeoff of 6 maybe 7 or 8 percent unemployment is needed to adjust price stability, but I would like to see us shoot for inflation of 1 percent or 1½ percent as we first had in the first half of the 1960's, and with declining unemployment, but unemployment is something we have had experience about, we know about jobs, we know about investment, we know about stimulation, but I hazard to say here, in the face of my associates at this table, we don't know a heck of a lot about the inflation and various elements and factors causing it.

We know very little about the weakness in the marketplace, which permits us to get into such a high degree of inflation, in spite of such labor resources and ideal production capacities. We have to set an approach, a set of policies and principles working on the inflation rate.

I think it is appropriate, as Mr. Keyserling said, let the goals be set each year, and then adopt the policies and plans that will be here to achieve those programs. But I think fundamentally, to put in a 3-percent bite, I would rather see it two, if you are going to put that in, I am convinced that you enhance the probability of this tradeoff which hasn't worked, and which Keyserling stated, demonstrated, I think very impressively, is not going to continue to work.

I believe what we ought to do is not set a long-term goal within this on the inflation front, but call for annual goals, and annual policies and programs to achieve it.

Now, just one final word.

This economy is now far more complex than it was in 1946, when we adopted the unemployment rate, we are far more interrelated and dependent and I believe most of the nations in the world are engaging in the kind of programs we need here. Unless we go after inflation, go after unemployment, go after energy replacement, go after the liberalized trade policy, increased investment in productivity, I think we are in dire trouble. Therefore, I strongly urge the adoption, support by this committee of the act and also I would hope that the specific goal of inflation will be left off, because I think it will do nothing but tend to give us more unemployment and more inflation.

The CHAIRMAN. Well, gentlemen, I want to thank all of you. You certainly made a good, constructive, helpful record for us, for considering this legislation.

Let me start off with you, Mr. Nathan, since you explicitly, directly and indefatigably rejected any notion of an inflation goal. Leon Keyserling said the inflation goal should not be a 5-year goal but an annual goal, and so his position is somewhat different than yours. Today, right now, at this moment, as you know, we have been able to reduce unemployment. It is still too high as I said. It's been reduced. It is down to 6 percent. Inflation has been heating up, the finished goods index, which may be the best index available, indicates that that particular reflection of inflation suggested in the first 4 months of this year we had annual inflation of about 12 percent. The Gallup Poll indicated 42 percent of the people thought inflation was our No. 1 problem now, above all other problems, and unemployment was 11 percent. Whether we like it or not this is on the front burner now. We are concerned with inflation. The President has come forward with an inflation program that is detailed, some people think it is not enough and others think it is all we can do under the circumstances. In my amendment that I am offering, I directly, explicitly confront that tradeoff problem and I think no matter what we put in Humphrey-Hawkins, you will have that tradeoff concern. One, that Congress is going to be thinking about, Presidents are going to be thinking about and the public, business, and others.

Let me read you these two short sentences, one sentence, as a matter of fact: "Policy to achieve the inflation goal shall be designed so as not to impede the achievement of the unemployment goal."

Now, I could change that maybe, modify it, but it was particularly to recognize that there should not be a policy that would attempt to hold down prices to the expense of those thrown out of work. I have tried to confront that by wording my amendment in that way.

What is your response?

Mr. NATHAN. Well, you know, Mr. Chairman, the very fact that figures are given in the public polls, which is No. 1 and which is not, I think just puts it right on this tradeoff concept.

I like your words, if we are going to have an inflation goal I would like to see the goal of, the goal should not be at the expense of lower levels of employment.

I don't think the rise in recent months has anything to do with excess demand. I think we have some problems in the marketplace in this economy and I wish the U.S. Chamber of Commerce would find out what it is that is functioning so badly.

How is it, when you have 7 million cars being produced, prices rise faster than when there are 11 million? There is something wrong in the marketplace and I think we need a hard look at it.

I think we have to have a strong program.

I say in my statement here, I think the best thing that has happened is the employment of Perry Bosworth. He's a dynamic, hard-working guy and if he can get President Carter to move in and work with labor and management, I think we can break this inflation spiral, by not sitting back and——

The CHAIRMAN. I agree Bosworth is a fine appointment, but Bosworth is saying over and over again, we aren't doing enough. Inflation will be much worse unless we have the guts to act.

Dr. George Perry, whom I think we all recognize is an eminent economist in this area was quoted in the New York Times on Saturday as indicating he thinks the drop in unemployment has already affected wage settlements and wage increases to a point where they are going to have an effect on prices that will be adverse. Of course, Dr. Perry is no automatic knee-jerk reactionary. He's a very fine economist, very thoughtful and careful, so we are already in a position with 6 percent unemployment, where competent people are looking for this tradeoff. There's no way we can make it go away. It would seem to me, it is best to confront it, put it right into the act.

And I also require that you adopt policies that will not be at the expense of reducing unemployment.

Mr. NATHAN. That is hard to reconcile.

The CHAIRMAN. Maybe it is.

But otherwise it seems to me, you will have the same kind of enforcement experience we had in our housing goals. We set housing goals of 26 million starts over 10 years, beginning in 1968. That was my amendment. We didn't come within 20 percent of it, and with Government-assisted housing starts we had 6 million. We got only 45 percent. Pitiful performance, so just by putting it in law to achieve it, unless you recognize the inhibiting factors that are likely to lie in the way, and require Congress and the President to confront that, too.

Mr. NATHAN. I would certainly hope that the President with the help of the Council on Wage and Price Stabilization, Mr. Bosworth or whoever else can be brought in, will work jointly with labor and management because you can't get wages held down without some constraint on prices, and you can't get it on the other side, and I don't think the marketplace will do it without 7 or 8 or 9 percent unemployment.

We have to do a lot more on the anti-inflation front than we have been doing.

The CHAIRMAN. Dr. Keyserling, then Dr. Carlson.

Mr. KEYSERLING. I shall talk a little more about the magnitude of the injuries due to unemployment and those due to inflation, and I don't think they are comparable, but I will try to make that succinct.

When we say that only 6 to 8 percent are hurt by unemployment, that is for the birds. Because the unemployment is merely an index of the performance of the whole economy. That rate of unemployment correlates with a demonstration I have here, that since 1953 this economy has thrown down the gutter irretrievably, more than $5.3 trillion worth of production, representing the conservative estimated difference between actual production and reasonably full production and full use. That loss is to all, private and public, economic and social.

As for inflation, everybody knows that everybody is aware of it, but everybody isn't hurt by it. The housewife goes into one of the food emporiums, who have unconscionably jacked up their prices with no relationship with what is happening to farm prices or anything else and whose profits soar. They are not hurt by inflation the same as the housewife. The lender who collects inflated interest rates is not hurt by this inflation of money costs to the borrowers.

Prices are a means. Employment is an end. Corroborating what Bob Nathan said, we know a lower level of unemployment is always desirable; nobody can argue that 5 percent of people thrown in the streets with nothing to do is better than 3. But we don't know, except on a year-by-year pragmatic basis, what the ideal price level is. You can't find an economist that has taken the position that we would have been better off if prices were absolutely stable. That is not true of any economy.

It is a matter of degree. I will say this, I think Senator Proxmire knows from exchanges we have had, I am rather flexible on this. I think that the basic objection to a quantitative inflation goal is giving any sanctimonious support to the view that you are going to use unemployment as a means of stopping inflation, and while I am not prepared to say that the 3-percent goal in 1983 is nearly as good as the annual pragmatic goal I am talking about, I would be certainly prepared to say that if such 3-percent goal can be accompanied by an absolute watertight categorical requirement in the bill, that it shall not be sought by any modification whatsoever of the responsibility of getting down to 3 and 4 percent unemployment by 1981, that would certainly be a very ameliorating feature of any 3 percent by 1981 unemployment goal.

Dr. Carlson. Let me make a comment; a lot of the inflation we have seen has come from discretionary acts of Government. Minimum wage, increases in social security. Barry Bosworth of the Council on Wage Price Stability says 1½ percent of the acceleration in inflation is coming from this source, and our estimate is 2 percent.

The feature of this cost-push element is it tended to make labor more intensive, and we are in fact causing some of the unemployment problems because of the increased minimum wage and social security. We have increased the tradeoff level, some people argue, by a couple of percentage points, let alone the other increases.

We are making many people unemployable by pricing them out of the market.

The Chairman. I have to go to the floor. I will ask Senator Sarbanes to chair. Senator Brooke would next be in turn.

Senator Brooke. Thank you. Do you see any danger in the bill compromising the Federal Reserve Board, Dr. Brimmer?

Dr. Brimmer. I see no danger that the bill would compromise the Federal Reserve Board. I can see a danger, if the bill tried to prescribe in detail the conduct of monetary policy—there would be that danger. In my statement I address myself to the limitation which I would like to see, to keep the focus on the right element, not on the specific constructions of the Fed.

I would say in the last couple of years, the dialog between the Congress and the Fed has grown quite different.

For example, to provide some guidance for the Congress and administration, the Federal Reserve needs to say, the first year of this bill's operation, more about its own goals with respect to unemployment and prices and not simply be content with the forecast for the money supply. The bill will call on the Fed to do that. At least the House version would.

The Senate version does not. At the same time, the Federal Reserve itself has moved toward sharing with the Congress, more information about its own expectations. I was personally surprised and pleased to see the Chairman of the Federal Reserve appear before this committee on April 25 and share with this committee what he called his personal expectations about pricing. As a matter of fact, that statement which I summarized on page 14 of my statement, reflected the consensus of the Federal Marketing Committee. So the Fed has gone some distance toward opening up and giving indications on where they expect the economy to go and by implication, the kind of monetary policy they think would be appropriate to sustain that effort.

As the bill is now addressed, I think it would be quite acceptable to the Federal Reserve.

Senator BROOKE. The backers of this bill feel many of the Nation's problems can be attributed to the lack of economic coordination of the various branches of the Government. What are your views? What is your reaction to that?

Dr. BRIMMER. I think the lack of coordination—by the way, there has been a lack of coordination, I think. But I do not look upon coordination and planning to mean the same thing. Detailed, indicative planning, in my judgment, goes well beyond the requirements of this bill or in fact the requirements of the country.

So more coordination is acceptable, but very frankly, if you are coordinating bad policy, then the economy would be worse off. So I would hesitate to say let's put the emphasis on coordination. I would be concerned about the contents.

While I have an opportunity, may I indicate one thing I would like to do, if the committee would permit. I took seriously the chairman's request to me, and I addressed myself to three questions, two about monetary policy, and a third about inflation. I did not address myself in my statement to a number of implications of this bill. I have done so in another context.

I would hope that the committee would permit me to supply for the record my own analysis, a somewhat more comprehensive analysis of the consequences of the Humphrey-Hawkins bill.

Senator SARBANES. I think it would be helpful to have that analysis, Dr. Brimmer. Without objection, it is so ordered.

Dr. BRIMMER. Thank you very much.

[The paper referred to follows:]

BRIMMER & COMPANY, INC. | Economic and Financial Consultants
SUITE 916 (202) 466-3474 | 1201 CONNECTICUT AVENUE, N.W.
WASHINGTON, D. C. 20036

For Release on Delivery
Monday, January 30, 1978
2:00 pm (EST)

ECONOMIC GROWTH AND STRUCTURAL UNEMPLOYMENT

Remarks By

Andrew F. Brimmer
President

BRIMMER AND COMPANY, INC.
Economic and Financial Consultants

Before the General Session on
Structural Unemployment

THE WHITE HOUSE CONFERENCE

ON

BALANCED NATIONAL GROWTH AND ECONOMIC DEVELOPMENT

Sheraton-Park Hotel
Washington, D.C.
January 30, 1978

30-454 O - 78 - 8

ECONOMIC GROWTH AND STRUCTURAL UNEMPLOYMENT

By

Andrew F. Brimmer*

Since the topic of this General Session is quite broad ("Structural Unemployment: Should We Move People to Jobs or Jobs to People"), I thought it wise to impose upon myself an initial boundary to the subject matter I would try to cover. Moreover, because of the time limitation for each participant, I also thought it wise to spell out in writing and as carefully as possible some of the key background elements which I believe should be explained in a search for ways to reduce structural unemployment.

Given my own professional experiences (which have been mainly in the area of national economic policy rather than in the development or management of manpower programs), when I accepted the invitation to participate in this General Session, I indicated that I would attempt to provide a macro-economic perspective on the challenges we face (and the opportunities open to us) in the effort to create jobs for disadvantaged workers. The agenda for this program identifies a number of experts who have first-hand experiences gained through front-line contact with -- and daily struggles to overcome -- the

---

*Dr. Brimmer is President of Brimmer and Company, Inc., a Washington, D.C.-based economic and financial consulting firm. From March, 1966, through August, 1974, he was a Member of the Board of Governors of the Federal Reserve System.

obstacles which impede the employment of labor market participants with few saleable skills. I can make little or no contribution to that part of the agenda.

The key elements which I believe should receive consideration are discussed in subsequent sections of these remarks. The highlights can be summarized here:

- A fundamental pre-condition for the success of any specially-targeted program to cope with structural unemployment is a vigorous and sustained expansion in overall economic activity. A sluggish economy (even if recessions are avoided) is a harsh and inhospitable soil for the cultivation of jobs for the hard-to-employ.

- The strategic role of economic growth in the generation of jobs is clearly demonstrated by the experience over the last decade and a half. The 16 years ending in 1977 were divided equally between eight years of sustained economic expansion and eight years of recession, inflation, and stagnation. The effects on jobs stand out sharply: the first half of the period was one of expanding jobs and declining unemployment. The second half was one of slow growth in jobs and sharply rising unemployment.

- Against this background, the Carter Administration's proposed $25 billion tax reduction for individuals and businesses represents a wise move. Without such action, the American economy would face a "growth recession" in 1979 -- meaning a rise in real gross national product less than the 4.0 per cent necessary to prevent an increase in unemployment.

- Whenever we focus on structural unemployment there is no way to avoid an explicit appreciation of the distressing situation among blacks as a group, and not simply among black teenagers. During the 1973-75 recession, blacks had to bear a disproportionate share of the burden of increased unemployment. Moreover, during the last 33 months of economic recovery, blacks have gotten a smaller fraction of the added jobs compared with their relative position in the labor market. Over the same period, the level of unemployment among blacks actually rose slightly, while total unemployment declined noticeably.

- In preparing programs to attack structural unemployment, it is necessary to keep in mind a number of changing demographic characteristics of the civilian labor force, since these will have an impact on the competition for jobs in the years ahead. For example, over the last decade and a half, a dramatic rise in the participation of both women and teenagers in the labor force has aggravated unemployment. However, over the next several years, as the shadow of the 1960's drop in birth rates is cast into the 1970's and 80's, the youth population will decline. The result will be a slight lessening in labor market pressures following from fewer teenagers seeking jobs. The effect on labor markets of increased job-seeking by women will also moderate somewhat over the remainder of this decade. But, on balance, the above-average participation of both women and teenagers in the work force will continue to make it hard to reduce structural unemployment.

- Another long-run trend which must be kept in mind is the differential rate of growth in population, jobs and money income in central cities compared with the suburbs in major metropolitan areas. As is generally recognized, over the last decade and a half, most central cities have experienced an absolute decline in population. But a substantial number of these cities have also had a relatively larger absolute decline in the number of jobs. The net effect has been a clear tendency for the cities to fall behind relative to the suburbs.

- Among many persons concerned with structural unemployment, a considerable amount of hope is being attached to the Humphrey-Hawkins bill, which aims at a significant reduction in the excessively high level of unemployment over the next five years. However, my assessment of the potential impact of the proposal leads me to be less optimistic than most of the bill's proponents.

- In particular, too much hope is being placed on the expected expansion of public service jobs. Instead, we must look to greater efforts to increase openings on private payrolls.

- In this regard, it is clear that private employers will need some kind of Federal Government subsidy to help off-set the extra costs of hiring any significant number of marginal workers. If the $400 million of subsidy recently recommended by the Carter Administration were used with imagination, perhaps 252,000 entry-level jobs could be created. The same amount spent on public service jobs may generate only 44,000 new openings.

- In addition, private employers will also need inducements to locate production, distribution and service facilities in central cities -- from which many firms are continuing to migrate. Liberalized use of the investment tax credit could help to off-set the extra costs of making investment expenditures in these areas.

Each of the above conclusions is amplified in the rest of these remarks.

Economic Growth and Employment

The strategic role of economic growth in generating jobs shows through clearly in the statistical evidence tracing changes in output and employment during the last decade and a half. The longest sustained expansion in economic activity in the post World War II period occurred during the eight years 1961 - 1969. As shown in Table 1 (attached), over these years, gross national product corrected for inflation (real GNP) rose at an average annual rate of 4.5 per cent. The civilian labor force climbed by 10.3 million; employment rose by 12.2 million, and the number of unemployed workers dropped by 1.9 million. These figures represented annual average rates of change of 1.7 per cent; 2.1 per cent, and 6.0 per cent, respectively. Over these eight years, the overall unemployment rate decreased from 6.7 per cent in 1961 to 3.5 per cent in 1969.

Even more striking was the decrease in long-term unemployment (27 weeks and over). In 1961, there were 804 thousand persons in this category -- representing 17.1 per cent of total unemployment of 4,713 thousand. By 1969, the number of long-term unemployed had shrunk to 133 thousand and accounted for only 4.7 per cent of total joblessness -- which in turn had fallen to 2,832 thousand.

In sharp contrast, between 1969 and 1977 (also a period of eight years), real GNP expanded at an average annual rate of 2.7 per cent -- far below the historical trend of approximately 3.6 per cent over the 30 years ending in 1977. The reasons for this relatively poor performance of the national economy were a mixture of inflation, recession, and stagnation -- partly caused by a five-fold jump in the price of oil but also aggravated by a combination of inappropriate monetary and fiscal policies. In this environment, the civilion labor force continued to expand -- climbing by 17.0 million. However, the number of jobs rose by only 13.1 million, and unemployment jumped by 3.9 million. These figures represented average annual rates of change of 2.4 per cent; 1.9 per cent, and 11.5 per cent, respectively. During this second eight-year period, the overall unemployment rate rose from 3.5 per cent to 6.9 per cent of the civilian labor force.

The impact of these trends on the long-term unemployed was predictable. Between 1969 and 1977, this category of joblessness rose by 813 thousand to 946 thousand. Last year, the latter figure was equal to 14.0 per cent of total unemployment -- which in turn had climbed to 6,772 thousand.

In summary, the last decade and a half of American economic history can be divided equally between eight years of sustained economic expansion and eight years of recession, inflation, and stagnation. The effects on jobs stand out sharply: the first half of the period was one of expanding jobs and declining unemployment. The second half was one of slow growth in jobs and sharply rising unemployment.

What is the lesson to be learned from the foregoing experience? It is unmistakable: a sustained, high level of real economic growth is a necessary underpinning for any program to create jobs for the disadvantaged.

What are the prospects for economic growth and employment in the years ahead? At this juncture, the outlook is uncertain -- since the outcome depends substantially on the fortunes of the Carter Administration's tax reduction-tax reform proposals announced on January 21, 1978. In broad terms, the Administration recommended a net reduction of $24.5 billion of Federal income taxes paid by individuals and businesses. This figure is the result of tax reductions amounting to $33.9 billion partly offset by increases of $9.4 billion recommended under the heading of "tax reform." Individuals would receive about $16.8 billion (over two-thirds) of the net tax reductions, and $5.7 billion (just under one-quarter) would benefit the business sector. The remaining $2.0 billion would represent a reduction in excise taxes on telephones and the repeal of the recently enacted increase in unemployment insurance taxes. The tax reductions would become effective in fiscal year 1979 -- which begins October 1, 1978.

The Administration explained that one objective of the proposed tax reduction is to spur economic growth -- which in turn would create extra jobs and speed the reduction in unemployment. The expected impact of the proposals in this regard can be seen in Table 2, (based partly on estimates prepared by the Council of Economic Advisors (CEA). It will be noted that the CEA concluded that, in the absence of a tax cut, the growth rate of real GNP would be about 4.3 per cent from the fourth quarter 1977 through the fourth quarter of 1978. Though 1979, the rate would ease off to 3.8 per cent and then increase to 4.9 per cent through the end of 1980. If the tax reductions become law according to the recommended schedule, the growth rates for real GNP may be lifted to 4.7 per cent through the fourth quarter of both 1978 and 1979 and to 5.0 per cent through the end of 1980.

Expressed in terms of overall economic performance, the tax reductions are expected to lift real output by $20.9 billion above the level it might otherwise reach. Moreover, the added stimulus would help to avoid a "growth recession" in 1979 -- meaning a rise in real GNP of less than the 4.0 per cent necessary to prevent an increase in unemployment.

If the cut in taxes does not materialize, the overall unemployment rate (which averaged 6.8 per cent in the final quarter of 1977) may decline to 6.3 per cent by the end of this year. The same rate may prevail in the fourth quarter of next year, and the rate might decline only slightly to 5.9 per cent by the end of 1980. With the tax reductions in place, the unemployment rate may decline steadily to 6.2 per cent at the end of this year; to 5.8 per cent in the final quarter of 1979, and to 5.3 per cent by the end of 1980.

The level of employment is also expected to rise as the economy responds to the stimulus of tax reduction. By the end of 1978, an extra 70,000 jobs may have been created. As the full impact of the tax cut benefits are registered, about 700,000 additional jobs would be available at the end of 1979. The number would be up to 900,000 by the close of 1980.

Finally, the fiscal stimulus is expected to generate a larger increase in output (1.4 per cent) than in the rate of inflation (0.5 per cent). Thus, on balance -- and judged in terms of the impact on economic growth and employment -- the proposed tax reduction is clearly desirable.

Differential Employment Experiences: Black vs. White

At this point, we can turn to a discussion of the differential job experience of black and white workers in recent years. In general, during the 1973-75 recession, blacks had to bear a disproportionate share of the burden of increased unemployment. Moreover, during the last 33 months of recovery, they have gotten a smaller fraction of the added jobs compared with their relative position in the labor market. Over the same time period, the level of unemployment among blacks actually rose slightly -- while total unemployment declined noticeably.

The major dimensions of labor market trends can be traced in Table 3, showing changes in the civilian labor force, employment, and unemployment, by color, sex and age from March, 1975, through December, 1977. These months mark the recovery of the economy from the 1973-75 recession -- a recovery which began in the Spring of 1975.

These data document the fact that -- so far in the recovery -- blacks have not participated in the job rebound as fully as have whites. Between March, 1975 and last December, the total civilian labor force rose by 7.5 per cent; the corresponding figures for blacks and whites were 13.0 per cent and 6.8 per cent, respectively. During the same period, total employment expanded by 10.0 per cent; black employment climbed by 14.9 per cent, and jobs held by whites rose by 9.4 per cent. However, the growth in the black labor force (13.0 per cent) almost equaled the rise in black employment (14.9 per cent). Consequently, over this 33-month period, the number of blacks without jobs rose by 1.8 per cent -- while total joblessness among whites declined by 23.2 per cent.

Reflecting these mixed trends, the total unemployment rate (which had been 8.5 per cent in March, 1975) had decreased to 6.4 per cent in December of last year. The rate last month for whites was 5.6 per cent. The unemployment rate for blacks in December was 12.5 per cent -- (only slightly below the 13.9 per cent registered when the national economy reached the bottom of the last recession.

In every demographic category, black unemployment rates by December of 1977 had fallen proportionately less than was true of their white counterparts. The extent to which black unemployment has decreased less during the recovery can be seen in the behavior of the black-white unemployment ratio. In March 1975, the overall ratio was 1.78. For youth, it was 2.26; for adult males 1.85, and for adult females 1.49. By December, 1977, the overall ratio had climbed to 2.23; the ratio for youths was was 2.96; for adult males 2.22, and for adult females, 1.90.

Further insights into the deterioration of blacks' position in the labor market over the last 33 months can also be gotten from the data in Table 3. These figures show blacks as a percentage of the civilian labor force, employment, and unemployment, by color, sex, and age in March, 1975; December, 1976, and December, 1977. By comparing their employment and unemployment percentages with their share of the civilian labor force, one can get a rough impression of the extent of the short-fall in blacks' participation in the recovery. For example, in March, 1975, blacks represented 11.3 per cent of the labor force; they held 10.6 per cent of the jobs, and they accounted for 18.6 per cent of the total unemployment. Thus, in the Spring of 1975, blacks had a "deficit" of 0.7 percentage point in their share of jobs and a "surplus" of 7.3 percentage points in their share of unemployment. Similar calculations are made for blacks by sex and age.

Using these calculations, one can trace the progressive deterioration in blacks' position over the last 33 months. By December of last year, their overall job deficit had risen to 0.8 percentage points, and their burden of surplus unemployment had climbed to 11.4 percentage points. The same pattern of deterioration is evident among all categories of black employment.

These mixed -- and distressing -- black-white employment patterns must be kept in mind as the quest is pursued to expand job opportunities for the disadvantaged.

We can now turn to an assessment of several long-run trends in the labor force and employment patterns. These will have a direct bearing on the magnitude of the structural unemployment problem in the future.

<u>Long-Term Labor Force Trends</u>

Over the last decade and a half, the growth of the civilian labor force has reflected a number of fundamental changes in the nature and extent of participation by both women and teenagers. As is generally known, the changing composition of the adult population (which in turn is a reflection of variations in birth rates) is a principal determinant of the potential size of labor force. The high birth rates recorded in the aftermath of World War II -- combined with the greatly expanded participation of women in the labor market -- have caused the civilian labor force to increase rapidly -- at a rate averaging over 2 per cent per year since 1960. On the other hand, the drop in the birth rate during the 1960's and early 1970's will cause a slackening in the rate of labor force expansion during the rest of this decade. For example, the population 16 to 19 years old (the youth component of the civilian labor force) rose by 1.3 per cent in 1975. However, this population group increased 0.8 per cent in 1976, and by 0.1 per cent in 1977. But, as the shadow of the 1960's drop in birth rates is cast into the 1970's, the 16 to 19-year-old population will decline by 0.2 per cent in 1978; by 0.6 per cent in 1979, and by 1.1 per cent in 1980.

During the last decade and a half, teenagers accounted for a sizable fraction of the rise in the civilian labor force. For instance, between 1960 and 1977, the civilian labor force rose by 29.3 million persons. About 4.5 million of this increase (or 15.4 per cent) was accounted for by teenagers. As a result, teenagers rose from 7.0 per cent of the labor force in 1960 to 9.5 per cent in 1977. The low job attachment of these young adults and their slow absorption into the labor market have combined to lift the aggregate unemployment rate well beyond what it would have been in the absence of the demographic changes noted above. Moreover, the labor force participation rates of youths 16 to 19 years old declined steadily from the late 1940's until the early 1960's. Following this period, participation rates began to rise, and the uptrend was still evident through last year. This turnaround also expanded the youth component of the civilian labor force. But, as mentioned above, this bulge in the youth population has just about passed through the labor market, and the youth component of the labor force should diminish from here on.

The effect on labor markets of increased job-seeking by women will also moderate slightly over the remainder of this decade. However, women will continue to account for a sizable fraction of the rise in the labor force. In 1977 women constituted 36.8 per cent of the total labor force compared with 30.4 per cent in 1960. But over this 17-year time span, the number of adult women in the civilian labor force rose by 15.2 million. This represented 52.0 per cent of the total rise over this period. The quickened participation of women in the labor force has coincided with a decrease in the fertility rates to 1,862 births per 1,000 women in 1974 compared with a peak of 3,767 in 1957. Data compiled by the U. S. Census Bureau suggest that birth expectations are now averaging two per family -- suggesting a continuation of low birth rates. With less time devoted to child-raising, women entered the labor force in increasing numbers during the last two decades. Looking ahead, however, it now appears that the rise in women's participation in the labor force will be at a somewhat reduced pace.

Trends in Population, Manufacturing Employment, and Money Income in Metropolitan Areas

In searching for the best means to attack structural unemployment, we should also keep in mind a number of fundamental long-run trends which have had an adverse effect on job opportunities for blacks and other marginal groups in the economy. This set of trends involves the differential rates of growth in population, jobs, and money income in central cities compared with the suburbs of our major metropolitan areas. As is generally recognized, over the last decade and a half, most central cities have experienced an absolute decline in population. A substantial number of these cities have also had a relatively larger absolute decline in the number of jobs. The net effect has been a clear tendency for the cities to fall behind relative to the suburbs.

To enhance understanding of these trends, data relating to population, income, and manufacturing employment were assembled for 26 leading metropolitan areas (SMSA's) in the United States. For the most part, these SMSA's were ranked according to the population of their central cities in 1973. In each case, the SMSA was divided between central city and suburbs. Population and money-income figures for 1960 are shown in Table 4. The same data for 1973 are shown in Table 5. Manufacturing employment for 1963 and 1972 is presented in Table 6. Changes in each central city's share of population, manufacturing employment, and money income between 1960 and 1973 are shown in Table 7. Figures showing the size of the black and working-age population in the selected central cities in 1960 and 1970 are recorded in Table 8. Changes in both population categories over that decade can be traced in Table 9.

A number of insights can be drawn from these statistics. For this purpose, the data in Table 7 are particularly instructive. Again, these figures show changes in the central city's share of population, manufacturing employment, and money income in each of these selected metropolitan areas between 1960 and 1973. All of the 26 central cities shown (except Memphis, Tennessee) lost population compared with the total metropolitan area. In other words, during the 13-year period the suburbs grew at a much faster rate than did the central cities. The same general pattern prevailed with respect to manufacturing employment. In this instance, two of the central cities (Indianapolis, Indiana and Phoenix, Arizona) increased their share of factory jobs in their respective SMSA's. San Antonio, Texas expanded manufacturing employment at the same rate as the suburbs. In the remaining 23 cities, a decline was recorded in their relative share of factory jobs. The trend of money income paralleled the trend of population and employment. Only Indianapolis and Memphis succeeded in expanding money income originating in the central city at a faster rate than was recorded for the SMSA as a whole.

Moreover, most central cities saw their share of total SMSA money income decline at a faster rate than their share of total population. In other words, while the typical central city lost population, its relative share of factory jobs and other opportunities for its citizens to earn income shrank even faster than the decline of total SMSA popolation. This meant that the central cities were left with a relatively weaker economic base than was the case at the beginning of the 1960's.

Along the same lines, the figures in Table 9 show that in all of the 26 central cities (except Phoenix, Arizona) the black population increased as a percentage of the total. The relative changes were particularly striking in Detroit, Baltimore, Washington, D. C., Cleveland, and St. Louis. In the case of Washington, D. C. (where blacks already represented 54 per cent of the total population in 1960), the increase lifted blacks' share of the total to over 71 per cent. In Detroit, Baltimore, New Orleans, and St. Louis, blacks represented over 40 per cent of the population in 1970. In Atlanta the proportion was 51 per cent. (In passing, by 1975, blacks represented more than half of the total population in several of the cities named.)

With respect to the working-age population in these cities, another important trend stands out. The number of cities which showed an increase in the working-age population as a percentage of the total (12) just about equals the number showing a decline in this ratio). However, virtually all of the relative decline in the working-age population occurred in the older industrial cities of the Northeast and South. In sharp contrast, the cities which gained in working-age population compared to the total were the relatively young and rapidly growing cities of the West and Southwest. These tend to be the same cities which experienced a relatively smaller decrease in their shares' of factory jobs and money incomes compared with their surrounding

30-454 O - 78 - 9

suburbs.

The lesson to be learned from a review of the statistics presented above is quite clear: the older central cities in the industrial heartland of the nation are finding it increasingly difficult to compete for jobs to support their population. Moreover, a rising proportion of the latter is being made up by blacks and members of other minorities groups. Since the latter find it difficult to compete for jobs under any circumstance, they are finding it particularly hard to get jobs in local labor markets that are growing more slowly -- or actually declining -- compared with the nation as a whole. So, when attention turns to the question of structural unemployment, a major focus has to be on the country's mature urban areas.

Against this background of long-term trends, we can look more closely at one of the most widely-supported proposals to reduce structural unemployment over the years ahead. The proposal is embodied in the Humphrey-Hawkins Bill.

Expected Impact of the Humphrey-Hawkins Bill

Among many persons concerned with structural unemployment, a considerable amount of hope is being attached to the Humphrey-Hawkins Bill -- which aims at a significant reduction in the excessively high level of unemployment over the next five years. The draft legislation (sponsored by the late Senator Hubert H. Humphrey and Representative Augustus F. Hawkins of California) has been modified sufficiently to attract the endorsement of President Jimmy Carter. Since the bill has the support of the

Democratic leadership in Congress as well as of organized labor, it probably will be enacted before the end of 1978.

Given this prospect, one ought to ask whether the faith that is being placed in the measure is justified. My own assessment of the potential impact of the proposal leads me to be less optimistic than most of the bill's proponents.

Expressed briefly, the Humphrey-Hawkins bill would make the reduction of unemployment the single most important objective of national economic policy. It would establish a numerical unemployment rate of 4 per cent for the civilian labor force as a whole and 3 per cent for adults (defined as those 20 years of age and over). These goals would have to be met over a five-year period -- presumably by 1983. Another important goal -- although not stated quantitatively -- is a significant reduction in the extremely high unemployment rates among young people.

The thinking behind the bill assumes that the private sector will be the primary source of the jobs needed to achieve the specified goals. However, it also would mandate that the Federal Government use its various economic policy instruments for the same purpose. These would include timely reductions in income taxes for both individuals and businesses -- as well as a sizable increase in spending on training and public service jobs. Moreover, the Federal Reserve System (which influences interest rates and regulates the availability of money and credit) would be required to give explicit consideration to the unemployment goals in its conduct of monetary policy. While the revised draft recognizes that inflation is also a serious problem, the fundamental focus remains on the reduction of unemployment.

Rationale Behind Proposal

The motivations which gave rise to the Humphrey-Hawkins bill are easily understood: unemployment among blacks and other marginal groups has risen persistently in the last three years, while joblessness in the nation generally has decreased somewhat as the economy recovered from the 1973-75 recession. As noted above, between March, 1975, and December, 1977, the civilian labor force rose by 6,937 thousand, and the black labor force climbed by 1,354 thousand -- representing 19.5 per cent of the total rise. Over the same period, the number of jobs in the economy expanded by 8,382 thousand, of which 1,328 thousand (or 15.8 per cent) went to blacks. As a result, the level of unemployment in the economy as a whole dropped by 1,445 thousand, and for whites the decrease came to 1,471 thousand. But joblessness among blacks rose by 26 thousand.

Reflecting these mixed trends, the total unemployment rate (which had been 8.5 per cent in March, 1975) had decreased to 6.4 per cent in December of last year. The rate for whites was 5.6 per cent (vs. 7.8 per cent in March, 1975), and the rate for blacks was 12.5 per cent (vs. 13.9 per cent in March, 1975). Moreover, the unemployment rate for black teenagers was 37.3 per cent last December, compared with 12.6 per cent for white youths. In March, 1975, the rates were 40.3 per cent and 17.8 per cent for black and white teenagers, respectively.

Under these circumstances, reaching the Humphrey-Hawkins objectives will be a difficult task. Apparently no firm Federal Government estimates have been made of the number of additional jobs that will have to be created if the goals are to be fulfilled. In late November, 1977, Secretary of Labor Ray Marshall suggested that, during the five years ending in 1983, at least two tax reductions of a minimum of $20 billion each plus 1.0 million extra public service jobs will be required to get the overall unemployment rate down to 4 per cent. Under the existing 1973 Manpower program, 700,000 public service jobs have already been funded, and the new Youth Employment program introduced last year by the Carter Administration authorized another 300,000 public service jobs. The work requirements of the Administration's welfare reform scheme would necessitate 700,000 openings on public payrolls, and the original draft of the new urban policy called for an additional 300,000. These figures add up to 2 million public service jobs by the early 1980's -- about double the present number.

But, as mentioned above, the framers of the Humphrey-Hawkins bill are clearly counting on the private sector to generate the bulk of the new jobs. In BRIMMER & CO., we have estimated that (given the outlook for the growth of the national economy) between 1977 and 1983, the civilian labor force may expand from 97.3 million to 107.5 million, a gain of 10.2 million persons. During the same period, total employment may rise by 11.4 million (from 90.4 million to 101.8 million). The level of unemployment might decrease by 1.2 million (from 6.9 million to 5.7 million), cutting the unemployment rate from 7.1 per cent to 5.3 per cent.

If this projected 5.3 per cent rate is to be cut to 4 per cent, an additional 1.4 million jobs would have to be found -- which would hold the unemployment level to 4.3 million in 1983. For the private sector to accomplish this task, gross national product (GNP) would have to expand in real terms at an average annual rate in excess of 5 per cent during the next five years. Such a pace would be considerably above the long-run growth trend which is somewhat less than 4 per cent.

If sustained for such a long period of time, this above-trend rate of growth in GNP would push output close to the limits of production capacity and stimulate substantial inflationary pressures in an economy in which the general price level may already be rising at an annual rate close to 6 per cent. Consequently, the inflationary potential of the public policies required to implement the Humphrey-Hawkins bill militates against its mandates being pursued as vigorously as its advocates anticipate.

Moreover, the budget cost of sustaining 2 million public service jobs is another factor working against this approach. No precise figures are available on the anticipated cost of the program. However, the U.S. Department of Labor estimates that in late 1977 each public service job costs about $9,000. Thus, even without allowing for the effects of inflation over the next five years, the 2 million public service jobs would cost at least $18 billion. Given the Carter Administration's expressed determination to restrain the growth of Federal spending, it seems highly unlikely that it would request an appropriation of this magnitude -- or spend the funds if they were voted by Congress over the Administration's opposition.

In conclusion, both the inflationary potential and the budget cost of the Humphrey-Hawkins bill suggest that its goals are not likely to be pressed with a great deal of vigor. So, while the measure will undoubtedly continue to attract support, its advocates ought to scale down somewhat the overall employment benefits they expect to flow from its passage.

Additional Measures to Reduce Structural Unemployment

The evidence presented in the foregoing discussion has convinced me that little real headway will be made in the reduction of structural unemployment if heavy reliance is placed on public sector jobs. Instead, we must look to greater efforts to expand openings on private payrolls. After all, the vast majority of American jobs is found in the private arena rather than in the public sector. For example, in October, 1977, there were 82.9 million persons on nonagricultural payrolls. Of this number, 67.6 million (81.5 per cent of the total) were in private employment, and 15.4 million (18.5 per cent) held public sector jobs. Among the latter, Federal Government employment stood at 2.7 million (3.3 per cent), and State and local governments accounted for 12.6 million (15.2 per cent) of the total.

Unfortunately, however, while the incidence of structural unemployment is most acute among blacks, the latter have historically depended relatively more heavily on the public sector for employment than was true of the labor force as a whole. This has been especially true of those in professional positions. For instance, although blacks represented about

10 per cent of total nonfarm workers in private industry in 1974, they accounted for 16 per cent of all civilian employees in the Federal Government. Moreover, while Federal employment represented 2.8 per cent of the total jobs in the economy in 1974, about 4.8 per cent of the blacks in civilian jobs were on the Federal payroll.

As we focus on the expansion of job opportunities in the private sector, it is clear that employers will need some kind of Federal Government subsidy to help off-set the extra costs of hiring any significant number of marginal workers. The Carter Administration apparently recognizes this point. The fiscal year 1979 budget submitted to Congress last week contains $400 million for this purpose. Unfortunately, there was no indication of how the funds are to be used nor of the number of additional jobs expected to result from the expenditure. However, even a brief analysis suggests that one ought to be reserved in estimating the probable impact.

If one assumes that the subsidized private sector jobs would be at the entry level and paid the present minimum wage ($2.65 per hour), the annual payment to an employee working a 40-hour week would amount to $5,512. The employer would have some additional out-of-pocket costs -- which might run as high as 15 per cent of the payment to the worker. This factor would raise the total annual cost to $6,339 per job. Of course, there is no way to estimate how large a subsidy an employer would require to induce him to offer such a job. But given the prospect that such a new worker's productivity is likely to be substantially below that of the average employee, the necessary subsidy may be as large as 25 per cent of the firm's cost. If this ratio were applied, the needed subsidy would be in the neighborhood of $1,585 per job. At this rate, the $400 million in President Jimmy Carter's budget would help to generate about 252,000 extra jobs.

This last figure should be contrasted with the number of jobs which might result if the $400 million were spent to create public service jobs. As noted above, an official in the U.S. Department of Labor recently estimated that such jobs on the public payroll might cost about $9,000 each. At this rate, the $400 million would finance about 44,000 openings -- a figure less than one-fifth of the number that may result from using the funds in the private sector.

If private firms were asked to provide an additional 252,000 jobs, partly with Federal Government assistance, the impact on each employer would not be very great. For example, in 1975, the 500 largest industrial corporations in the United States had 14,413,000 employees -- an average of 28,826 per firm. If these 500 firms alone were asked to provide the extra 252,000 jobs, each would have to absorb about 504 additional workers. This latter figure would represent around 1.7 per cent of the average number of employees on the payroll of each of these largest corporations. Clearly, they could manage such a task -- and, in fact, go far beyond such a modest request.

In addition to subsidies for new entry-level jobs, private employers will also need inducements to locate production, distribution, and service facilities in central cities. It was shown above that such cities are being left with a dispropor-. tionate share of total metropolitan populations, compared with the number of job opportunities in their respective metropolitan areas. On the other hand, the growing migration of firms -- and the jobs they offer -- from central cities to suburbs reflects real incentives (such as lower taxes, less crime, and greater availability of skilled workers). If central cities are to compete successfully for such employers, the latter must be offered strong incentives to remain -- or to return.

One such inducement might be found in allowing firms to draw down -- or assign -- a large proportion of the unused investment tax credits (ITC) many of them have accumulated -- if they establish job-creating facilities in central cities.

In 1972 (the latest year for which U.S. Treasury figures are available), American corporations claimed $3.8 billion in new investment tax credits (against $62.8 billion of investment outlays eligible for the ITC). They already had $2.7 billion in carryovers from previous years -- making a total of $6.5 billion in credits that could have been used. However, in that year, these firms claimed only $3.0 billion of the total available -- leaving unused $3.5 billion (or 53.8 per cent of the total).

Businesses do not use all of their ITC eligibility for a variety of reasons -- the main one of which appears to be the lumpiness of capital expenditures relative to taxable income (the ITC can be used to offset only 50 per cent of tax liability). A substantial part of the unused credits will eventually be drawn down, but some portion will expire. So, in one sense, such unused credits would be "wasted." Alternatively, firms which cannot use such credits before they are scheduled to expire might be allowed to assign their potential claims to another business who could use them to help off-set the costs of investment expenditures -- provided the latter was made in central cities or other areas suffering from a substantial amount of structural unemployment. The extra budget costs of such a proposal would not be very large -- certainly no larger than the potential loss in tax revenue to which the U.S. Treasury is already exposed if firms elect to claim the tax off-set for investment in suburbia or other vigorously growing areas. The extra administrative burden of this approach to the management of the ITC would not be particularly heavy -- since the Treasury Department has already accumulated considerable experience in administering the ITC with differentiations on the basis of varying standards of eligibility.

In the meantime, this type of linkage of the ITC to specific investment targets might enable central cities and other needy locations to turn in a somewhat better performance in attracting job-creating facilities.

TABLE 1. Growth of Output and Employment, 1961-69 and 1969-77

Category	1961	1969	1977	Changes 1961-69	Changes 1969-77	Average Annual Growth (Per Cent) 1961-69	Average Annual Growth (Per Cent) 1969-77
Gross National Product (Billions, 1972 Dollars)	$755.3	$1,078.8	$1,337.2	$323.5	$258.4	4.5	2.7
Civilian Labor Force (Thousands)	70,459	80,734	97,741	10,275	17,007	1.7	2.4
Employment (Thousands)	65,746	77,902	90,969	12,156	13,067	2.1	1.9
Unemployment (Thousands)	4,713	2,832	6,772	- 1,881	3,940	- 6.0	11.5
Long-Term(27 week & over) (Thousands)	804	133	946	- 671	813	- 14.0	70.0
Unemployment Rate (Per Cent)	6.7	3.5	6.9	- 3.2	3.4	----	----

Source: Calculated in BRIMMER & COMPANY on the basis of data from U.S. Department of Commerce, Bureau of Economic Analysis and U.S. Department of Labor; Bureau of Labor Statistics.

TABLE 2. Economic Impact of Carter Administration's Tax Proposals, Fourth Quarter 1977 Through Fourth Quarter, 1980.

Category	1977 IV	1978 IV	1979 IV	1980 IV
Gross National Product (Billions, 1972 Dollars)	$1,361.5	---	---	---
NO TAX Cut				
Growth Rate	---	4.3	3.8	4.9
Real GNP		$1,420.0	$1,474.0	$1,546.2
TAX Reduction				
Growth Rate	---	4.7	4.7	5.0
Real GNP	---	$1,425.5	$1,492.5	$1,567.1
Difference: Real GNP		$ 5.5	$ 18.5	$ 20.9
Unemployment Rate				
NO TAX Cut	6.8	6.3	6.3	5.9
Tax Reduction	6.8	6.2	5.8	5.3
Employment Gain from Tax Reduction (Thousands)	---	70	700	900
Increase in Inflation Rate (Percentage Point)	---	0.0	0.3	0.5

Source: Calculated by BRIMMER & COMPANY, based on data from U.S. Department of Commerce, Bureau of Commerce, Bureau of Economic Analysis and Council of Economic Advisers.

TABLE 3. Changes in the Civilian Labor Force, Employment, and Unemployment by Color, Sex, and Age, March, 1975 - December 1977 (Number in Thousands)

Category	March, 1975 Number	March, 1975 Per Cent	December, 1976 Number	December, 1976 Per Cent	December, 1977 Number	December, 1977 Per Cent	Change: March, 1975-December, 1977 Number	Change: March, 1975-December, 1977 Per Cent	Change: December, 1976-December, 1977 Number	Change: December, 1976-December, 1977 Per Cent
CIVILIAN LABOR FORCE										
Total	92,018	100.0	95,963	100.0	98,955	100.0	6,937	100.0	2,992	100.0
16-19	8,754	9.5	8,957	9.3	9,369	9.5	615	8.9	412	13.8
Male 20 & over	50,592	55.0	52,081	54.3	53,158	53.7	2,566	37.0	1,077	36.0
Female 20 & over	32,672	35.5	34,925	36.4	36,428	36.8	3,756	54.1	1,503	50.2
WHITE										
Total	81,631	88.7	84,854	88.4	87,214	88.1	5,583	80.5	2,360	78.9
16-19	7,844	8.5	8,019	8.3	8,310	8.4	466	6.7	291	9.8
Male 20 & over	45,422	49.4	46,624	48.6	47,542	48.0	2,120	30.6	918	30.7
Female 20 & over	28,365	30.8	30,211	31.5	31,362	31.7	2,997	43.2	1,151	38.4
BLACK										
Total	10,387	11.3	11,109	11.6	11,741	11.9	1,354	19.5	632	21.1
16-19	910	1.0	938	1.0	1,059	1.1	149	2.2	121	4.0
Male 20 & over	5,170	5.6	5,457	5.7	5,616	5.7	446	6.4	159	5.3
Female 20 & over	4,307	4.7	4,714	4.9	5,066	5.1	759	10.9	352	11.8

TABLE 3. (continued) Changes in the Civilian Labor Force, Employment, and Unemployment by Color, Sex, and Age, March, 1975 - December 1977
(Number in Thousands)

Category	March, 1975 Number	March, 1975 Per Cent	December, 1976 Number	December, 1976 Per Cent	December, 1977 Number	December, 1977 Per Cent	Change: March, 1975-December, 1977 Number	Change: March, 1975-December, 1977 Per Cent	Change: December, 1976-December, 1977 Number	Change: December, 1976-December, 1977 Per Cent
EMPLOYMENT										
Total	84,240	100.0	88,451	100.0	92,622	100.0	8,382	100.0	4,171	100.0
16-19	6,993	8.3	7,253	8.2	7,928	8.6	835	11.1	675	16.2
Male 20 & over	47,247	56.1	48,882	55.3	50,696	54.7	3,449	41.2	1,814	43.5
Female 20 & over	30,000	35.6	32,316	36.5	33,998	36.7	3,998	47.7	1,682	40.3
WHITE										
Total	75,299	89.4	78,828	89.1	82,353	88.9	7,054	84.2	3,525	84.4
16-19	6,450	7.7	6,641	7.5	7,264	7.9	814	9.7	623	14.9
Male 20 & over	42,660	50.6	44,044	49.8	45,590	49.2	2,930	35.0	1,546	37.0
Female 20 & over	26,189	31.1	28,143	31.8	29,499	31.8	3,310	39.5	1,356	32.5
BLACK										
Total	8,941	10.6	9,623	10.9	10,269	11.1	1,328	15.8	646	15.6
16-19	543	0.6	612	0.7	664	0.7	121	1.4	52	1.3
Male 20 & over	4,587	5.5	4,838	5.5	5,106	5.5	519	6.2	268	6.5
Female 20 & over	3,811	4.5	4,173	4.7	4,499	4.9	688	8.2	326	7.8

TABLE 3. (continued) Changes in the Civilian Labor Force, Employment, and Unemployment by Color, Sex, and Age, March 1975 - December 1977
(Number in Thousands)

Category	March, 1975		December, 1976		December, 1977		Change: March, 1975-December, 1977		Change: December, 1976-December, 1977	
	Number	Per Cent	Number	Per Cent	Number	Per Cent	Number	Per Cent	Number	Per Cent
UNEMPLOYMENT										
Total	7,778	100.0	7,512	100.0	6,333	100.0	-1,445	100.0	-1,179	100.0
16-19	1,761	22.6	1,704	22.7	1,441	22.7	-320	22.1	-263	22.3
Male 20 & over	3,345	43.0	3,199	42.6	2,462	38.9	-883	61.1	-737	62.5
Female 20 & over	2,672	34.4	2,609	34.7	2,430	38.4	-242	16.8	-179	15.2
WHITE										
Total	6,332	81.4	6,026	80.2	4,861	76.7	-1,471	101.9	-1,165	98.8
16-19	1,394	17.9	1,378	18.3	1,046	16.5	-348	24.1	-332	28.2
Male 20 & over	2,762	35.5	2,580	34.4	1,952	30.8	-810	56.1	-628	53.3
Female 20 & over	2,176	28.0	2,068	27.5	1,863	29.4	-313	21.7	-205	17.4
BLACK										
Total	1,446	18.6	1,486	19.8	1,472	23.2	26	-1.9	-14	1.2
16-19	367	4.7	326	4.4	395	6.2	28	-2.0	69	-5.8
Male 20 & over	583	7.5	619	8.2	510	8.0	-73	5.0	-109	9.2
Female 20 &	496	6.4	541	7.2	567	9.0	71	-4.9	26	-2.2

30-454 O - 78 - 10

TABLE 3. (continued) Changes in the Civilian Labor Force, Employment, and Unemployment by Color, Sex, and Age, March 1975 - December 1977 (Number in Thousands)

Category	March, 1975		December, 1976		December, 1977		Change: March, 1975-December, 1977		Change: December, 1976-December, 1977	
	Number	Per Cent	Number	Per Cent	Number	Per Cent	Number	Per Cent	Number	Per Cent
UNEMPLOYMENT RATE										
Total		8.5		7.8		6.4		-2.1		-1.4
16-19		20.1		19.0		15.4		-4.7		-3.6
Male 20 & over		6.6		6.1		4.7		-1.9		-1.4
Female 20 & over		8.2		7.5		6.7		-1.5		-0.8
WHITE										
Total		7.8		7.1		5.6		-2.2		-1.5
16-19		17.8		17.2		12.6		-5.2		-4.6
Male 20 & over		6.1		5.5		4.1		-2.0		-1.4
Female 20 & over		7.7		6.8		5.9		-1.8		0.9
BLACK										
Total		13.9		13.4		12.5		-1.4		0.9
16-19		40.3		34.8		37.3		-3.0		2.5
Male 20 & over		11.3		11.3		9.1		-2.2		-2.2
Female 20 & over		11.5		11.5		11.2		-0.3		-0.3

Source: Calculated by BRIMMER & COMPANY from U.S. Bureau of Labor Statistics data.

TABLE 4. Population and Money Income in Selected Metropolitan Areas: Central Cities, vs. Suburbs, 1960

	S M S A	CENTRAL CITY			SUBURBS			TOTAL SMSA			
		POP. (Thousands)	PER CAPITA INCOME	TOTAL INCOME (Millions)	POP. (Thousands)	PER CAPITA INCOME	TOTAL INCOME (Millions)	TOTAL POP. (Thousands)	TOTAL INCOME (Millions)	CENTRAL CITY AS PER CENT OF TOTAL POP.	CENTRAL CITY AS PER CENT OF TOTAL INCOME
		(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
1.	NEW YORK, N.Y.	7,781	$2,306	$17,943	2,912	$2,734	$7,962	10,693	$25,905	72.8	69.3
2.	CHICAGO, ILLINOIS	3,550	2,293	8,140	2,670	2,662	7,108	6,220	15,248	56.3	53.4
3.	LOS ANGELES, CA.	2,823	2,603	7,348	3,215	2,453	7,886	6,038	15,234	46.8	48.2
4.	PHILADELPHIA, PA.	2,002	1,875	3,754	2,340	2,272	5,316	4,342	9,070	46.1	41.4
5.	DETROIT, MICH.	1,670	2,005	3,348	2,092	2,261	4,730	3,762	8,078	44.4	41.4
6.	HOUSTON, TEXAS	938	2,062	1,934	480	1,735	833	1,418	2,767	66.1	69.9
7.	SAN FRANCISCO, CA.	1,107	2,596	2,874	1,540	2,516	3,875	2,647	6,749	41.8	42.6
8.	BALTIMORE, MD.	939	1.866	1,752	864	2,063	1,782	1,803	3,534	52.1	49.6
9.	DALLAS, TEXAS	679	2.219	1,507	439	1,906	837	1,118	2,344	60.7	64.3
10.	SAN DIEGO, CA.	573	2,301	1,318	459	2,054	943	1,032	2,261	55.5	58.3
11.	SAN ANTONIO, TEXAS	587	1,427	838	128	1,937	248	715	1,086	82.1	77.2
12.	WASINGTON, D.C.	763	2,406	1,836	1,312	2,432	3,191	2,075	5,027	36.8	36.5

TABLE 4. (continued) Population and Money Income in Selected Metropolitan Areas: Central Cities, vs. Suburbs, 1960

S M S A	CENTRAL CITY			SUBURBS			TOTAL SMSA			
	POP. (Thousands)	PER CAPITA INCOME	TOTAL INCOME (Millions)	POP. (Thousands)	PER CAPITA INCOME	TOTAL INCOME (Millions)	TOTAL POP. (Thousands)	TOTAL INCOME (Millions)	CENTRAL CITY AS PER CENT OF TOTAL POP.	INCOME
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
13. INDIANAPOLIS, IND.	476	$2,031	$ 967	440	$2,179	$ 959	916	$1,926	52.0	50.2
14. MILWAUKEE, WISC.	741	2,105	1,560	537	2,305	1,238	1,278	2,798	58.0	55.8
15. CLEVELAND, OHIO	876	1,856	1,626	1,033	2,693	2,782	1,909	4,408	45.9	36.9
16. MINNEAPOLIS, MINN.	796	2,218	1,766	685	2,178	1,492	1,481	3,258	53.7	54.2
17. MEMPHIS, TENN.	497	1,651	821	177	1,220	216	674	1,037	73.7	79.2
18. PHEONIX, ARIZONA	439	2,013	884	224	1,741	390	663	1,274	66.2	69.4
19. BOSTON, MASS.	697	1,919	1,338	1,898	2,363	4,485	2,595	5,823	26.9	23.0
20. NEW ORLEANS, LA.	627	1,740	1,091	279	1,673	467	906	1,558	69.2	70.0
21. ST. LOUIS, MO.	750	1,801	1,351	1,354	2,192	2,968	2,104	4,319	35.6	31.3
22. SEATTLE, WN.	557	2,664	1,484	550	1,989	1,094	1,107	2,578	50.3	57.6
23. COLUMBUS, OHIO.	471	1,885	888	283	2,310	654	754	1,542	62.5	57.6
24. DENVER, COLO.	493	2,275	1,122	435	2,050	892	928	2,014	53.1	55.7
25. MIAMI, FLA.	291	1,838	535	643	2,101	1,351	934	1,886	31.2	28.4
26. ATLANTA, GA.	487	1,934	942	529	1,918	1,015	1,016	1,957	47.9	48.1

Source: Calculated in BRIMMER & COMPANY on the basis of data from the U.S. Department of Commerce, Bureau of the Census and from the Advisory Commission on Intergovernmental Relations.

TABLE 5. Population and Money Income in Selected Metropolitan Areas: Central City vs. Suburbs, 1973

SMSA	CENTRAL CITY Pop. (Thousands)	CENTRAL CITY Per Capita Income	CENTRAL CITY Total Income (Millions)	SUBURBS Pop. (Thousands)	SUBURBS Per Capita Income	SUBURBS Total Income (Millions)	TOTAL SMSA Total Pop. (Thousands)	TOTAL SMSA Total Income (Millions)	Central City As Per Cent of Total Pop.	Central City As Per Cent of Total Income
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
1. New York, New York	7,646	$ 4,309	$ 32,947	3,763	$ 5,088	$ 19,146	11,409	$ 52,093	67.0	63.2
2. Chicago, Illinois	3,172	3,984	12,637	3,829	4,975	19,049	7,001	31,686	45.3	39.9
3. Los Angeles, CA.	3,091	4,569	14,123	3,832	4,419	16,934	6,923	31,057	44.6	45.5
4. Philadelphia, PA.	1,861	3,678	6,845	2,944	4,394	12,935	4,805	19,780	38.7	34.6
5. Detroit, Mich.	1,386	3,817	5,290	2,804	4,736	13,280	4,190	18,570	33.1	28.5
6. Houston, Texas	1,296	4,128	5,350	856	3,896	3,335	2,152	8,685	60.2	61.6
7. San Francisco, CA.	1,033	4,762	4,919	2,110	4,964	10,174	3,143	15,093	32.9	32.6
8. Baltimore, MD.	877	3,595	3,153	1,250	4,517	5,646	2,125	8,799	41.3	35.8
9. Dallas, Texas	815	4,432	3,612	788	4,055	3,195	1,603	6,807	50.8	53.1
10. San Diego, CA.	757	4,215	3,191	712	3,876	2,760	1,469	5,951	51.5	53.6
11. San Antonio, Texas	756	2,892	2,186	175	4,430	775	931	2,961	81.2	73.8
12. Washington, D.C.	733	4,901	3,592	2,219	5,809	12,890	2,952	16,482	24.8	21.8
13. Indianapolis, Ind.	728	4,104	2,988	407	3,931	1,600	1,135	4,588	64.1	65.1
14. Milwaukee, Wisc.	690	3,809	2,628	726	4,628	3,360	1,416	5,988	48.7	43.9
15. Cleveland, Ohio	678	3,160	2,142	1,327	4,773	6,334	2,005	8,476	33.8	25.3
16. Minneapolis, Minn.	669	4,141	2,770	1,159	4,467	5,177	1,828	7,947	36.6	34.9
17. Memphis, Tenn.	658	3,562	2,343	129	2,982	385	787	2,728	83.6	85.9
18. Phoenix, Arizona	631	4,118	2,598	495	4,092	2,026	1,126	4,624	56.0	56.2

TABLE 5. (continued) Population and Money Income in Selected Metropolitan Areas: Central City vs. Suburbs, 1973

SMSA	CENTRAL CITY Pop. (Thousands)	Per Capita Income	Total Income (Millions)	SUBURBS Pop. (Thousands)	Per Capita Income	Total Income (Millions)	TOTAL SMSA Total Pop. (Thousands)	Total Income (Millions)	Central City As Per Cent of Total Pop.	Income
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
19. Boston, Mass.	$ 618	$ 3,678	$ 2,273	2,122	$ 4,617	$ 9,797	2,740	$ 12,070	22.6	18.8
20. New Orleans, LA	573	3,319	1,902	509	3,544	1,804	1,082	3,709	53.0	51.3
21. St. Louis, MO	558	3,292	1,837	1,785	4,179	7,460	2,343	9,297	23.8	19.8
22. Seattle, WN	552	4,545	2,509	830	4,228	3,509	1,382	6,018	39.9	41.7
23. Columbus, Ohio	540	3,547	1,915	406	4,376	1,777	946	3,692	57.1	51.9
24. Denver, Colo.	515	4,560	2,348	847	4,428	3,751	1,362	6,099	37.8	38.5
25. Miami, Fla.	353	3,592	1,268	1,016	4,635	4,709	1,369	5,977	25.8	21.2
26. Atlanta, GA	451	3,903	1,760	1,046	4,631	4,844	1,497	6,604	30.1	26.7

Source: Calculated in BRIMMER & COMPANY on the basis of data from the U.S. Department of Commerce, Bureau of the Census and from the Advisory Commission on Intergovernmental Relations.

TABLE 6. Manufacturing Employment in Selected Metropolitan Areas: Central Cities vs. Suburbs, 1963 and 1972 (Number in Thousands)

SMSA	1963 Central City	1963 Suburbs	1963 Total SMSA	1963 Central City As Percent of SMSA	1972 Central City	1972 Suburbs	1972 Total SMSA	1972 Central City As Percent of SMSA
1. New York, NY	927	220	1,147	80.8	757	233	990	76.5
2. Chicago, Illinois	509	352	861	59.2	430	479	909	47.3
3. Los Angeles, CA	313	433	746	42.0	320	460	780	41.0
4. Philadelphia, PA	265	271	536	49.4	203	295	498	40.8
5. Detroit, Michigan	201	293	494	40.7	180	359	539	33.4
6. Houston, Texas	77	32	109	70.6	105	55	160	65.6
7. San Francisco, CA	92	104	196	49.9	69	112	181	38.1
8. Baltimore, MD	104	87	191	54.5	91	99	180	50.6
9. Dallas, Texas	86	24	110	78.2	107	46	153	69.9
10. San Diego, CA	49	11	60	81.7	45	20	65	69.2
11. San Antonio, Texas	21	3	24	87.5	28	4	32	87.5
12. Washington, D.C.	22	28	50	44.0	19	36	55	34.5
13. Indianapolis, Ind.	70	46	116	60.3	93	30	123	75.6
14. Milwaukee, Wisc.	119	75	194	61.3	106	94	200	53.0
15. Cleveland, Ohio	169	111	280	60.4	131	138	269	48.7

TABLE 6. (continued) Manufacturing Employment in Selected Metropolitan Areas: Central Cities vs. Suburbs, 1963 and 1972 (Number in Thousands)

SMSA	1963 Central City	1963 Suburbs	1963 Total SMSA	1963 Central City As Percent of SMSA	1972 Central City	1972 Suburbs	1972 Total SMSA	1972 Central City As Percent of SMSA
16. Minneapolis, Minn.	110	54	164	67.1	109	82	191	57.1
17. Memphis, Tenn.	43	4	47	91.5	54	6	60	90.0
18. Phoenix, Arizona	29	12	41	70.7	52	20	72	72.2
19. Boston, Mass.	83	210	293	39.5	59	214	273	21.6
20. New Orleans, LA	31	18	49	63.3	29	26	55	52.3
21. St. Louis, MO	129	131	260	49.6	98	158	256	38.3
22. Seattle, WN	84	38	122	68.9	48	61	109	44.0
23. Columbus, Ohio	66	14	80	82.5	62	27	89	69.7
24. Denver, Colo.	38	32	70	54.3	42	53	95	44.2
25. Miami, Fla.	19	24	43	44.2	26	60	86	30.2
26. Atlanta, GA	52	44	96	54.1	48	68	116	41.4

Source: Calculated in BRIMMER & COMPANY on the basis of data from the U.S. Department of Commerce, Bureau of the Census and from the Advisory Commission on Intergovernmental Relations.

TABLE 7. Changes in Central City's Share of Population Manufacturing Employment, and Money Income in Selected Metropolitan Areas, 1960-1973 (Percentage Points)

SMSA/CENTRAL CITY	Population (1960-1973)	Manufacturing Employment (1963-1972)	Money Income (1960-1973)
1. New York, NY	- 5.8	- 4.3	- 6.1
2. Chicago, Illinois	- 11.0	- 11.9	- 13.5
3. Los Angeles, CA	- 2.4	- 1.0	- 2.7
4. Philadelphia, PA	- 7.4	- 8.6	- 6.8
5. Detroit, Michigan	- 11.3	- 7.3	- 12.9
6. Houston, Texas	- 5.9	- 5.0	- 8.3
7. San Francisco, CA	- 8.9	- 11.8	- 10.0
8. Baltimore, MD	- 10.8	- 3.9	- 13.8
9. Dallas, Texas	- 9.9	- 8.3	- 11.2
10. San Diego, CA	- 4.0	- 12.5	- 4.7
11. San Antonio, Texas	- 0.9	0.0	- 3.4
12. Washington, D.C.	- 12.0	- 9.5	- 14.7
13. Indianapolis, Ind.	- 12.1	+ 15.3	+ 14.9
14. Milwaukee, Wisc.	- 9.3	- 8.3	- 11.9
15. Cleveland, Ohio	- 12.1	- 11.7	- 11.6
16. Minneapolis, Minn.	- 17.1	- 10.0	- 19.3
17. Memphis, Tenn.	+ 9.9	- 1.5	+ 6.9
18. Phoenix, Arizona	- 10.2	+ 1.5	- 13.2
19. Boston, Mass.	- 4.3	- 17.5	- 4.2
20. New Orleans, LA	- 16.2	- 11.0	- 18.7
21. St. Louis, MO	- 11.8	- 11.3	- 11.5
22. Seattle, WN	- 10.4	- 24.9	- 15.9
23. Columbus, Ohio	- 5.4	- 12.8	- 5.7
24. Denver, Colo.	- 15.3	- 10.1	- 17.2
25. Miami, Fla.	- 5.4	- 14.0	- 7.2
26. Atlanta, GA	- 17.8	- 12.7	- 21.4

Source: Calculated in BRIMMER & COMPANY on the basis of data contained in Tables 4, 5, and 6.

TABLE 8. Black and Working Age Population in Selected Central Cities, 1960 and 1970
(Number in Thousands)

	1960					1970				
		Black Population		Working Age Population			Black Population		Working Age Population	
Central City	Total Population	Number	Per Cent of Total	Number	Per Cent of Total	Total Population	Number	Per Cent of Total	Number	Per Cent of Total
1. New York, NY	7,781	1,089	14.0	4,803	61.7	7,894	1,674	21.2	4,712	59.7
2. Chicago, Illinois	3,550	813	22.9	2,099	59.1	3,366	1,101	32.7	1,930	57.3
3. Los Angeles, CA	2,823	344	12.2	1,674	59.3	3,174	524	16.5	1,904	60.0
4. Philadelphia, PA	2,002	529	26.4	1,177	58.8	1,948	655	33.6	1,113	57.1
5. Detroit, Michigan	1,670	483	28.9	964	57.7	1,511	660	43.7	844	55.9
6. Houston, Texas	938	215	22.9	534	56.9	1,232	317	25.7	711	57.7
7. San Francisco, CA	1,107	158	14.3	679	61.3	1,077	221	20.5	671	62.3
8. Baltimore, MD	939	326	34.7	539	57.4	905	420	46.4	507	56.0
9. Dallas, Texas	679	129	19.0	391	57.6	844	210	24.9	490	58.1
10. San Diego, CA	573	34	5.9	341	59.5	696	53	7.6	423	60.8
11. San Antonio, Texas	587	42	7.2	305	52.0	654	50	7.6	349	53.4
12. Washington, D.C.	763	411	53.9	474	62.1	756	538	71.2	462	61.1
13. Indianapolis, Ind.	476	71	14.9	267	56.1	744	134	18.0	413	55.5

TABLE 8. (continued) Black and Working Age Population in Selected Central Cities, 1960 and 1970
(Number in Thousands)

Central City	1960 Total Population	1960 Black Population Number	1960 Black Population Per Cent of Total	1960 Working Age Population Number	1960 Working Age Population Per Cent of Total	1970 Total Population	1970 Black Population Number	1970 Black Population Per Cent of Total	1970 Working Age Population Number	1970 Working Age Population Per Cent of Total
14. Milwaukee, Wisc.	741	62	8.4	424	57.2	717	105	14.6	403	56.2
15. Cleveland, Ohio	876	205	23.4	503	57.4	750	288	38.4	419	55.9
16. Minneapolis, Minn.	796	20	2.5	452	56.8	744	30	4.0	424	57.0
17. Memphis, Tenn.	497	184	37.0	274	55.1	623	243	39.0	346	55.5
18. Phoenix, Arizona	439	21	4.8	239	54.4	581	28	4.8	325	55.9
19. Boston, Mass.	697	63	9.0	411	59.0	641	104	16.2	377	58.8
20. New Orleans, LA	627	233	37.2	354	56.5	593	267	45.0	329	55.5
21. St. Louis, MO	750	214	28.5	426	56.8	622	254	40.8	333	53.5
22. Seattle, WN	557	25	4.5	305	54.8	584	38	6.5	356	61.0
23. Columbus, Ohio	471	77	16.3	273	58.0	539	100	18.6	317	58.8
24. Denver, Colo.	493	30	6.1	278	56.4	514	47	9.1	299	58.2
25. Miami, Fla.	291	65	22.3	181	62.2	334	76	22.8	202	60.5
26. Atlanta, GA	487	187	38.4	287	58.9	496	255	51.4	292	58.9

Source: Calculated in BRIMMER & COMPANY on the basis of data from the U.S. Department of Commerce, Bureau of the Census, and from the Advisory Commission on Intergovernmental Relations.

TABLE 9. Changes in Black and Working Age Population as Percentage of Total Population in Selected Central Cities, 1960 - 1970 (Percentage Points)

	CENTRAL CITY	BLACK POPULATION	WORKING AGE POP.
1.	NEW YORK, N.Y.	7.2	-2.0
2.	CHICAGO, ILLINOIS	9.8	-1.8
3.	LOS ANGELES, CA.	4.3	+0.7
4.	PHILADELPHIA, PA.	7.2	-1.7
5.	DETROIT, MICH.	14.8	-1.8
6.	HOUSTON, TEXAS	2.8	+0.8
7.	SAN FRANCISCO, CA.	6.2	+1.0
8.	BALTIMORE, MD.	11.7	-1.4
9.	DALLAS, TEXAS	5.9	+0.5
10.	SAN DIEGO, CA.	1.7	+1.3
11.	SAN ANTONIO, TEXAS	0.4	+1.4
12.	WASHINGTON, D.C.	17.3	-1.0
13.	INDIANAPOLIS, IND.	3.1	-0.6
14.	MILWAUKEE, WISC.	6.2	-1.0

TABLE 9. (continued) Changes in Black and Working Age Population as Percentage of Total Population in Selected Central Cities, 1960-1970 (Percentage Points)

	CENTRAL CITY	BLACK POPULATION	WORKING AGE POP.
15.	CLEVELAND, OHIO	15.0	-1.5
16.	MINNEAPOLIS, MINN.	1.5	+2.0
17.	MEMPHIS, TENN.	2.0	+0.4
18.	PHEONIX, ARIZONA	0.0	+1.5
19.	BOSTON, MASS.	7.2	-0.2
20.	NEW ORLEANS, LA.	7.8	-1.0
21.	ST. LOUIS, MO.	12.3	-3.3
22.	SEATTLE, WN.	2.0	+6.2
23.	COLUMBUS, OHIO	2.3	+0.8
24.	DENVER, COLO.	3.0	+1.8
25.	MIAMI, FLA.	0.5	-1.7
26.	ATLANTA, GA.	13.0	0.0

Source: Calculated in BRIMMER & COMPANY on the basis of data contained in Table 8.

Senator BROOKE. Now, Mr. Nathan, economist Herb Stein has argued 4 percent is an unrealistic figure used for unemployment. Stein proposes 7 percent.

A study by Professor Philip Cagan of Columbia proposes, I think, said 6 percent.

How do you feel about those estimates?

Mr. NATHAN. I think 7 percent or 6 percent represents an abdication of responsibility. In other words, to say, let the unemployment go up, don't worry about whether people have jobs, first of all, if you would associate that kind of defeatism with a welfare program, I think in 2 or 3 or 4 years we'll be seeing 9 or 10 percent as an acceptable level because you go into a continuing process of undermining the whole concept of work as your primary source of income, in an effort to really provide people with opportunity to earn income.

I think basically what Herb Stein is saying, if you just get enough unemployment, wages will go down; and if wages go down, prices will slow down; then the economy will really stabilize. I think it is an utter ignoring of the deficiencies in the marketplace. A totally unrealistic expectation with a lot of unemployment you get a reduction in inflation. I think one ought to look at Keyserling's chart, over the years—I am not talking about 20 percent unemployment, but when you have higher, you have lower productivity and more inflationary pressure. I think what Herb Stein is doing, is resigning himself to walking away and the marketplace will take care of it. I think if we followed Herb Stein's policies——

Senator BROOKE. You don't—what do you think will happen?

Mr. NATHAN. I think we would have 9 or 10 percent unemployment in a few years.

Senator BROOKE. The German example, is often cited as a model for the United States to emulate. The Federal Republic has combined low rates of unemployment with low rates of inflation since the war, as a matter of fact. Do you feel that this is a valid comparison?

Mr. NATHAN. You have two problems. One is the problem of measurement and the definitions do have some differences, but I think you have a completely different sort of economic environment in the Federal Republic of Germany and you also had in Japan until quite recently, where the German labor force is far more resigned to whatever sort of public decisions are made to abide by them. I think that Germany has gone through, as did Japan, a tremendous concentration on investment, a tremendous focusing on exports as the driving, motivating force, and by and large, I think the labor there, unlike in the United States, has said, well, we would rather have a little more total, even though we have a smaller share, and I don't think this is the kind of situation which will prevail here.

Second, Senator Brooke, I don't think it is going to prevail in Germany endlessly either.

Dr. BRIMMER. May I comment on that, please?

Senator BROOKE. Yes.

Dr. BRIMMER. We have been doing some work on the parity of inflation, in Germany, Japan, United States, as well as other countries. Several things that stand out I would like to mention.

First of all, aside from the differences in definition between unemployment and employment, which Mr. Nathan mentioned, Germany is faced with a labor force that is growing more slowly than the rate of growth of potential capacity aside from labor. Germany's population is actually declining or leveling off.

Second, Germany over the years has had a great advantage of being able to export its unemployment physically, by sending the best workers back home. Under EEC arrangement, after the 5-year residence requirements, they can no longer do that as readily as in the past, but they have been able to reduce their unemployment by not redoing the work permits, and the worker went back to Turkey, Spain, Portugal, and so on.

I don't wish to belittle the German effort, but I suggest it is qualitatively quite different from ours.

The CHAIRMAN. Dr. Carlson, Andrew Leonard argues that the Federal deficits of recent years are not the cause but the result of the Nation's economic problems. How would you react to that argument?

Dr. CARLSON. I would agree that during the last 2 years the size of the deficit has not been the spur to acceleration of inflation. The largest portion of the deficit in a recession is shortfall of revenues.

I would, however, have to admit that the fiscal 1979 deficit by increasing from $45 billion last year to $53 billion this year and to maybe $60 billion next year is certainly the wrong trend at this late stage of an economic recovery and it could well be demandful inflation will remove that fiscal policy we see.

Senator BROOKE. Irving Bluestone of the UAW stated in his testimony that the union was flatly opposed to any numerical inflation goal being included in the bill and the House refused to include it in its amended version, as you are aware. Do you think such a numerical inflation goal should be a part of this bill?

Dr. CARLSON. I would argue the process should determine the goals, period, and no goals should be put in legislation either. Either in unemployment or inflation.

However, if you go with the numerical value on the unemployment side, I would argue it is preferable to have a numerical value, even though probably impossible on the inflation side.

Senator BROOKE. Couldn't have one without the other, but you would prefer neither.

Is that correct?

Dr. CARLSON. That is correct.

Senator BROOKE. Dr. Keyserling, do you think it will ever be possible to return to the good old days, during the period, let's say, from 1952 to 1957, when we had both a low rate of inflation and low rate of unemployment?

Mr. KEYSERLING. I don't think the low rate of inflation and low rate of unemployment were merely coincidental. I think the low rate of inflation flowed from the low rate of unemployment. Let's get to the connection between that and your other question, about the deficits. If you look at my charts 4 and 5, I have been interested in this for a long time. There is no question about it that, short of a situation like World War II, when you were burning up half of the product for nondomestic purposes, you can't construct any realistic model for the American economy in action which combines full employment with a big Federal deficit. Full employment automatically removes the deficit and high unemployment automatically creates the deficit, and for those who say that the huge deficit is the main cause of inflation, then they have also to say that high employment is a high cause of inflation because the high unemployment creates the huge deficit.

I have some question as to whether a big Federal deficit creates inflation when the economy is very slack, but if I admit it, I am talking about the dichotomy in their argument, which is a byproduct of all of this confusion and conflict in economic policy that this bill will at least begin to get around by requiring them to do their homework.

Now, let's look at the chart on the Truman administration. You say the happy old days. You know what, every year since—first of all I have had to listen to a lot of things, I have had to listen to the fact that I am an inflationist when the administration I was a part of reduced inflation from 7.8 percent to 0.8 percent and I have had to listen to the point that I am for unbalanced budgets, when the administration I served was, despite the Korean war, the only one which achieved an average surplus in the Federal budget. We simultaneously reduced unemployment to 2.9 percent.

Well, we are now told, the good old days, things were different then, you are talking about the past, all the problems are more difficult now. Nonsense. What is more difficult now?

The Korean war was bigger, relative to the size of the economy, than the Vietnam war.

Western Europe was in far worse shape then than at any time since.

The accumulated savings of World War II, released after the war, when the production assets that would have supported them were blown up in support of the war, were a greater inflationary pressure than at any time since. But the policies were different. We ought to learn from that. The first thing we can learn, if we look at my charts, one by one, there hasn't been anything in American economics more rigorously confirmed by empirical experience than the relationship between a lowering of unemployment and a lowering of inflation.

Let's take the beginning of this year 1978, and I will show you the inconsistency in policy. What happened right after the end of the last recession about 3 years ago? The economy began to grow at a real annual rate of about 9 percent productivity. Productivity went up tremendously fast. And the inflation rate slowed down very fast. Later on as the real growth rate slowed down, the productivity rate slowed down, and the inflation rate speeded up. Then, in 1978, in the first quarter of this year, the real economic growth rate went down to zero, or it was negative. In other words, we had a minirecession in the first quarter of the year. And inflationary pressures began to take on new vigor.

When we had a minirecession, the productivity growth rate went almost down to zero. So you read in the papers and you hear the Chairman of he Federal Reserve saying, look, the great problem now is inflation, because the zero productivity growth rate and its high per unit costs are inflationary so we have to forget about the stimulative program, we have to slow down on it, we have to discard it because the problem is inflation.

But the inflation aggravated because it was the reversal of the economy toward a minirecession that brought the low productivity and brought the high costs and brought the inflation. So how can we now fight the inflation by encouraging the economic slowdown, and by bringing on still another recession?

That has been true all the way through. So, look at the inconsistency. We get the increase in inflation because the economy is threatening to go to hell again, and we say we will cure the inflation now by encouraging real growth, forgetting about reducing unemployment because unemployment and growth are no longer the real problem.

This tragic farce has not happened just once. At the end of the Truman administration when we had the 2.9 percent unemployment and 0.8 percent inflation, a man came in, and never did anybody have more influence over economic policy, my immediate successor, who influenced the policies of the President and of the Federal Reserve Board too. I won't mention his name, except to say that Joe Fisher as he has just stated was only one who worked for both of us. My successor inherited 2.9 percent unemployment, 0.8 percent inflation, so he thought we have to worry about inflation; that unemployment was too low. So through him and his hand-picked successor, over 8 years, they succeeded in lifting the unemployment rate from 2.9 percent to 7.6 percent. It is all shown on my charts here. Concurrently, they multiplied the inflation rate 2½ times. Thereafter, Walter Heller came along and said let's go for broke, to make the economy run again, let's get it to move, and by 1966 unemployment was reduced to 3.8 percent, and during 1961–1966 the average price-increase rate was only 1.5 percent annually. Then the whole doctrine of the trade-off came back, under Republicans and Democrats, there is nothing partisan about this, the Democrats were just as much for the trade off as the Republicans.

I have never understood the acceptance of the trade off. For it is a simple apple pie American doctrine, that you do better on prices when your economy is working at optimum use. I use the analogy of the automobile.

I am sorry if I say so much about this, but it is so darn important. To get to the question, the best goal you can have in the law is what is in there now. We want to get the economy running again, and we won't have to worry so much about inflation, because there will be so much less of it.

When they started to say "when you slow down the economy, you stop the inflation," I said this: During World War II, the economy was growing 9 percent a year in real terms. That was too fast for normal times. We had inflation. So the economists said, "well, the way to stop inflation is to slow down the economy." But they didn't apply this idea only until it slowed down to a normal rate of growth.

They said "the more you slow it down, the less inflation you have." But they didn't really understand that, just as an automobile burns more gas per mile when it goes 90 miles per hour than when it goes 50, similarly, it burns more gas when it goes 25 miles an hour than 50.

Too fast or too slow is uneconomical. The economy is the same. When the slowdown is too great, productivity declines, scarcities appear, and the inflation rate goes up. You get back to the normal speed, and you reduce most of those inflationary pressures.

Senator BROOKE. Thank you very much. Mr. Chairman, Senator Sarbanes has been most considerate. I have gone way over my time. I just have one more question. I will direct this to you, Mr. Nathan.

Thank you, Dr. Keyserling.

Mr. Nathan, Ken Galbraith testified before this committee 2 years ago that a 4-percent unemployment rate would be inflationary, an unrealistic goal. The American economy just could not sustain low employment and a low rate of inflation. How do you feel about? Are these two goals incompatible?

Mr. NATHAN. It depends, Senator Brooke, upon what policy one pursues. If we make no effort to increase investment, no effort to increase productivity, no effort to try and overcome some of the structural deficiencies in the labor force, and no effort to increase the competitiveness in the economy in the response of prices to changes, and demand and supply, maybe 4 percent is too low.

The real test is whether you sit back and relax at 4 percent and say—or 5 or 6 or 7. I think Herb Stein is probably right. If you just don't do anything, 7 percent becomes something. But I don't know that that is the American way and the American concept.

I think when women want to work, that is a positive factor. Not a negative factor. They are productive, they can add to our total capability of producing in the economy, and a lot of people say, one of the problems is, all the women want to work. So what? That's great. This means we can have a higher standard of living, higher productivity, higher improvement, really higher levels of general growth.

I favor that. I think it depends upon what kind of policies we adopt, but if we sit back and don't do anything in training, don't do anything in competition, don't do anything in stimulating investment, don't do anything toward improving productivity, 4 percent may not be unrealistic, but 5, 6 or 7 may be unrealistic.

Senator BROOKE. Thank you gentlemen, and thank you, Mr. Chairman.

The CHAIRMAN. Mr. Sarbanes.

Senator SARBANES. Gentlemen, I want to ask this rather simple question. That is, why don't we have a zero unemployment rate objective in the bill?

Mr. KEYSERLING. Because we are not morally ready for it. I wish we were.

Senator SARBANES. What do the others say to that?

Mr. NATHAN. Just one word. I think given our organizations, our institutions, our arrangements about freedom of choice and so forth, you are bound to have a lot of mobility in this economy, you are bound to have changing job capabilities, skills, job demands, geographic differentials, and this is one of the elements in that private enterprise system.

You think if one were to decide you are going to have zero unemployment, really provide last resort employment Government jobs, I think you could approach it, but you never get down to zero. You can change the definitions.

And get to zero.

Dr. CARLSON. Because of the definitions we use, even though they are in between jobs you call them unemployed. I think what you are really aiming at in this bill are the people are not increasing their well-being and bettering their conditions. They are unemployables, can't find jobs, and it takes a lot of tools, including just plain literacy and getting a discipline so people can work within our society. It takes time.

Our schools, training system, the transition from school to a career job, and many other things must improve over long periods of time. One thing we can do to reduce unemployment is to make people employable. The increase in minimum wage level has caused some of the youth unemployment, Government policy did that and could undo it. So we are making more of our own problems, and adding to what Bob Nathan is talking about, we are adding to our structural problems, not reducing them, so consequently, the Herb Steins in the world can estimate higher figures in the future, because we are adding to our employment.

Dr. BRIMMER. I would say that even if we could get down to zero unemployment, and I agree with my colleague that you probably cannot for structural and other reasons, definition reasons, I would personally not like to see you try. I will repeat that. I think it would be very bad for public policy, which really means mandated to policy, to decide that everybody has to be working. That is what zero unemployment means. Everybody, in the labor force, he or she, that he's in the labor force, would have to have a job. That is the definition.

I think that would go too far in the abrogation of freedom of choice. Perhaps I want to be in the labor force sometimes and sometimes not. Perhaps I want to be idle. That is trivial——

Senator SARBANES. If you were not in the labor force I guess you wouldn't be counted. As I understand it, Dr. Carlson said the tradeoff for zero unemployment under inflation would just be enormous.

Dr. CARLSON. I have to agree with Charles Schultze and the other people Senator Brooke referred to, historically there is a tradeoff. As you lower the unemployment rate below a point. Not in the beginning of the recovery, but in the latter stages, the stage we are entering now.

Senator SARBANES. The general view is, if I came here and said, we ought to pursue a generalized fiscal and monetary policy with prime reliance on getting the unemployment rate down to 2 percent or 1 percent or a half of 1 percent, you would say, you are just going to trigger a tremendous inflation problem; wouldn't you?

Dr. CARLSON. Yes, sir.

Senator SARBANES. You would testify to that? Doesn't the fact that we have exceeded the 4-percent unemployment figure, indicate that this is a tremendous deference to the inflation consideration——

Dr. CARLSON. The standard we used in 1956, we were supposed to have a tradeoff in that year, roughly 4-percent unemployment, but so much has changed since then, including the composition of the labor force that the equal social pain level of unemployment according to the administration is now 4.9 percent—President's 1978 economic report.

Some people say it is 5¼, up to 5½.

Senator SARBANES. Let's pursue that. I am prepared to enter into a discussion which recognizes that the fact that we are using an unemployment rate of higher than zero percent, whatever that rate may be, is a deference to the inflation consideration.

Then we can have a discussion.

Is the right rate for your goal 4 percent, 4½, 3½, 5?

But you not only want to do that. You also want to add an inflation goal when an inflation goal has already been built into the objective of the bill by level unemployment rate.

Dr. Carlson. I am opposed to a numerical value. I prefer the process, with the additional information and different definitions to be set each year and modified for the out years—third, fourth and beyond—as opposed to putting one in law now. I don't think the 1956 economic conditions are appropriate as a guide at this time in 1978.

And the guide we select for today now will not be appropriate in 1983. It should be set in the process itself.

I did concede with Senator Proxmire, if he told me my choice was, if we had a bill with the numerical bill for unemployment, then I would argue we ought to have an explicit one for price stability.

But I prefer to start with none. Let the process generate.

Mr. Nathan. Well, I agree with the implications, Senator Sarbanes, when we go to 4.9—by the way, it was Alan Greenspan's contribution to our economic advancement, that 4.9 I don't think—although I agree with Charles Schultze's figure, there is a tradeoff even above that, but there is no doubt that you are right, Senator Sarbanes, whatever you are going to pick above—I wouldn't say above zero but above that level of unemployment that is truly transitional, mobility, structural, where you have people changing jobs, skill movings, people moving from one city to the other, but I think anything above that, that is probably 2 or 3 percent, you are making already an implicit tradeoff with inflation.

I think fundamentally what we are doing, we keep raising that 4.9, 5½, as I remember the words of Greenspan's economic report, when they went to 4.9, he talked about, that's probably too low, so he already was prepared to have a higher tradeoff.

I think if we do begin to resign ourselves to setting down both in quantitative goals, my guess is, we will end up with a real tradeoff approach, and I would say 4, 5 years from now we would have 8 or 9 percent unemployment.

Senator Sarbanes. You double the inflation factor because you accept an unemployment rate which recognizes the inflation factor and that rate is established at a level above the very minimum that we are talking about, because you don't want to push beyond that; and then you weight it again by putting a specific inflation goal into the bill, so it ends up being double-weighted.

Dr. Carlson. I don't know of anybody who has an estimate what the inflation rate would be at 12 percent. The model we run is well over 10 percent and running not very quickly, especially as time goes on.

I want to know what the tradeoff is to be able to advise you what inflation rate you are accepting when you accept a 4-percent unemployment rate.

Senator Sarbanes. Rather than arguing for double weighting you ought to argue for different unemployment figures, then we can go back and forth about that as to how much is being built into that figure, and how reasonable that is, rather than play it both ways, to try to get the figure up and you also double weight it by putting in an inflation goal.

Dr. Brimmer. In anticipation of this kind of question, we did try to estimate the interrelations among the unemployment goal, 4 percent, the rate of growth in output, that will be required to reach that goal by 1983 and the rate of inflation that might be associated with that effort.

We summarize those results on pages 19 and 20 of my statement.

Essentially what we concluded, without going into details, is this: In the absence of the Humphrey-Hawkins bill, taking into account, the accounts of the economic advisers, we concluded the rate of unemployment by 1983 might be in the neighborhood of just under 5½ percent. If one sought to reduce that unemployment rate to 4 percent, one would need to generate an additional 1½ million jobs in the private sector.

To do that would require, the policy would require the economy to grow at an annual average compound rate in excess of 5 percent. That would be associated with the rate of inflation close to 6 percent. For this reason, we concluded that it would be wise, not unwise, to have in the bill an explicit quantitative target for inflation, if you were to stick to the 4-percent target for employment.

I wouldn't assert that these figures are definitive and you should live and die by them, but I do think they are suggestive.

Mr. Keyserling. I feel compelled to say, in all honesty, I agree with everything explicit and everything implicit that Senator Sarbanes is saying.

If I put myself in the position, as I do, of defending a great nation which sets a goal of not getting unemployment any lower than 4 percent, by 5 years from now, I am doing so only in the practical vein of what I think is acceptable and not in accord with my economic analysis, not in accord with the lesson of experience, and not in accord with my moral judgments.

I want to make a challenge directly to Dr. Brimmer, or anybody here who takes his position. I have made this challenge for about 20 years. About 20 years ago, I wrote a book called "Inflation: Cause and Cure," and in which I forecast, before anyone was thinking of it, that more unemployment could cause more inflation. Everything since that has proved it. I challenge Dr. Brimmer. It doesn't mean anything to stuff things in models and make projections of how much unemployment 5 or 6 years from now will be consistent with what rate of inflation without regard for the empirical evidence to date.

You feed garbage hypotheses into the model or computer and you get garbage out. Why don't they look backward? Why don't they offer any charts or any tables to show at any time that the rate of inflation has gone up, as Charles Schultze testified 5 years ago, when unemployment gets below 5 percent. It isn't so.

It is not what happened. It is not what the record is.

A second point. The second point is that is not what the tradeoff really involves. The really important tradeoff question is not, whether if you have a little more unemployment you will have a little less inflation. That is not the big issue.

The big issue is whether the 60 million people in the United States directly affected by unemployment last year should be told, "you should suffer that burden or that cross because an economist tells you that Leon Keyserling can go to Delmonico's in New York and buy a steak dinner for a little less, because you are unemployed. That is un-American and I don't think it works. The real tradeoff anyway is not between inflation and unemployment. It is the relative value to the economy of a lower level of unemployment as against a marginal change in rate-of-price inflation.

I again challenge any economist to take the $5.3 trillion we have lost since 1953 through the roller coaster economic performance, and the $1 trillion in public revenues lost thereby, and the consequent budget deficits, and take the social and civil costs, and take the inability to meet priority needs, and try to weigh that against what it would have cost the American economy if, in accord with their hypothesis, which they cannot substantiate, we had had a half a percent higher inflation rate if we had not had those other losses. That is the real tradeoff. That is the first tradeoff any economist should try to measure. But see if you can find those measurements. I can't find them anywhere.

Senator SARBANES. Let me pursue a couple of other questions.

Dr. Carlson, has the Chamber of Commerce done any studies to correlate the level of corporate profits with the unemployment rate?

Dr. CARLSON. No. I would be glad to comment on what it would show. As the unemployment rate goes down, especially in the initial phase of the business recovery, you have your largest percentage increase in corporate profits.

It does go up rather rapidly, and partly because of the productivity increases that Mr. Keyserling is talking about in the initial phase of the business recovery.

As the recovery matures, the rate of increase in real terms tends to decline, becomes negative.

Senator SARBANES. But it increases, does it not?

Dr. CARLSON. During the recovery it does increase.

Senator SARBANES. If one were to just take the view of what would maximize corporate profits, a look backwards of our experience would indicate that one of the best things to maximize corporate profits is a low rate of unemployment. Is that not correct?

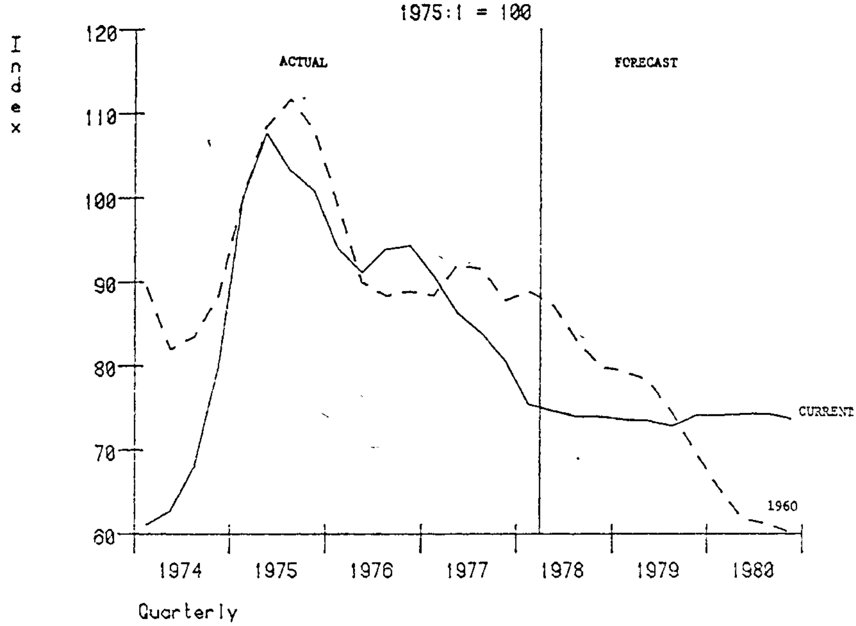
Dr. CARLSON. Sure.

Senator SARBANES. I never have understood the sort of reticence of the business community toward policies that will bring us to low levels of unemployment.

Dr. CARLSON. On the contrary, you will find they do it. They may not choose the way you do it, they may prefer tax relief to increase plant and equipment spending and sustain a balanced expansion. Higher expected corporate profits will lead to investment which creates jobs and reduces unemployment.

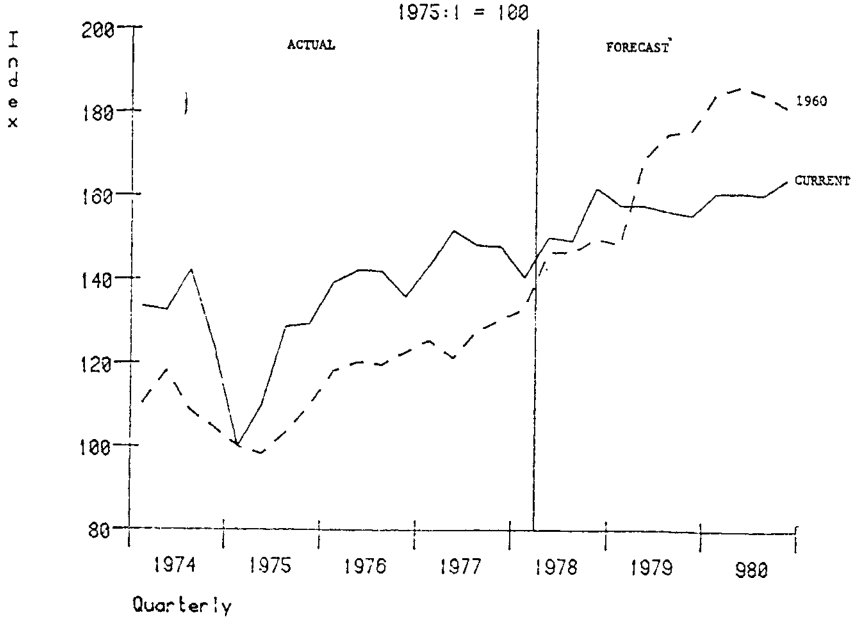
Unemployment
During Current and 1960 Cycle

1975:1 = 100



Real Business Profits
During Current and 1960 Cycle

1975:1 = 100



Senator SARBANES. I was with Walter Heller when he finally managed to get that part of the approach across, and generally now the business council walks in to see the President and comes out and says, we need a business tax cut, even though it produces a deficit, because given the circumstances we are under, we have to stimulate the economy and if we stimulate the economy, and put the people back to work, we will end up not having the large deficit we would have had if we allow the economy to continue to deteriorate, so on the part of some of the business community, at least on that aspect we are getting some response, but that is a relatively new development, is it not?

And the Chamber doesn't always go along with the Business Council, is my recollection, with respect to that approach.

Dr. CARLSON. If you are saying it is important to keep a healthy economy for the business community, you are perfectly correct. For instance, the increase from January to March in spending going from $38 bill to $45, thereby squeezing out tax relief, special tax relief that can encourage the investment that many people talk about here, yes, that is of considerable concern.

Because we haven't had any real growth in investment since 1973, that is, making tools for our workers; therefore productivity is cut in half. It is of great concern to the business community, and should be to any worker interested in real earnings increases in the future.

Senator SARBANES. Let me ask the panel this question: what level of unemployment would you regard as kind of a critical point where you think generalized fiscal and monetary policies are going to really produce not very significant benefits in bringing down the unemployment rate, and create serious inflationary pressures? Assuming a reasonable program to deal with inflationary pressures, in terms of how the markets function and so forth, nothing radical.

What is the rate of unemployment or the range without making a too broad of a range that you see as the warning area?

I know our time is running out. If you all could just sort of give me a number, maybe just a brief explanation of it, I would prefer that rather than a long, detailed answer, short as we are with time.

Dr. BRIMMER. That range in my judgment is somewhere around 4½ to 5 percent, and the explanation is what I suggested earlier, basically.

Mr. NATHAN. I would say the range is around 4 percent given present circumstances, but that does apply what you say are reasonable anti-inflation policies on the productivity, investment front, and working with labor and management to try to slow the rates of change.

Dr. CARLSON. I would think those suggestions Bob had would be rather major changes in the operation of the economy. If you take the way it is operated now, I think the 5-, 5½-percent range, and you will have difficulty getting into that range unless you have a significant increase in investment.

Investment is one of the factors that is making it difficult to get it down, let alone the composition of the labor force changes.

Mr. KEYSERLING. I take the position there is no empirical evidence that would enable us to fix a figure at which a lower rate of unemployment generally generates a higher rate of inflation. The evidence in general is the other way. The main question is, at what point is unemployment so high that inflation increases?

Senator SARBANES. I think I want to direct this to Dr. Carlson, and Dr. Brimmer. Do you accept the view that significant levels of unused manpower and unused resources, in other words, a low utilization of plant capacity, but a high unemployment rate is a contributor to inflation, because of the loss of productivity and the increase in unit cost?

Dr. BRIMMER. Yes. But I don't start there. I know you want to save time, but I feel I must say——

Senator SARBANES. I don't want you to give an answer you don't want to give, so take the time to clarify your answers.

Dr. BRIMMER. One thing that stands out, I refer to it on page 20 of my statement, over the long run, if one looks at the historical evidence, the basic rate of inflation is closely related to the rate of increase in compensation per hour worked in excess of the rate of improvement in productivity. That relationship holds year in and year out, to describe the trend rate of inflation.

On top of that, excess demand, which is a cyclical phenomenom, does add to the rate of inflation.

That catches what you just described. Excess capacity can be measured, as aggregate demand rises, then one gets additional pressure on price. The declining unemployment during such phases of the cycle is simply a manifestation of the underlying relationship I just described.

And as one reverses that, the credence of excess labor can be misread as taking the pressure off prices.

It is the lack of pressure when one underlines the capacity to produce, that is a part of it.

So, rather than responding to the question as I put it, which I agree, I would say that the high level of unemployment can be misread, in reflecting the high unit cost.

It is the effect of high fixed cost, being spread over lower volume of output, which gives the impression that high unemployment is associated with high cost, as Mr. Keyserling described.

What we have to come to grips with is the underlying trend rate of inflation which is present to a more or less degree, even during the down phase of the cycle. That is the basic cause of inflation. It is currently that compensation—that compensation is currently running around 9 percent.

Productivity is running around 2 percent.

So the hard core rate of inflation stays at 7 percent. You can't explain that away. That is the point I would like to stress over and over again.

Dr. CARLSON. When your unemployment is clearly above 5½ percent and declining as the economy grows, productivity is moving up rapidly. It will start running into bottlenecks of skilled labor between 5 and 5½ percent, and in terms of recovery you will run into shortages in plant and equipment and that will outstrip any productivity gains.

Senator SARBANES. To what extent would you say that concern about either existing unemployment or potential unemployment as perceived by workers and by their representatives, specially in those situations in which they are organized, constitutes a psychological, if not a real impediment to support of anti-inflation policy?

I guess a classical example is maybe a featherbedding situation, in which there is strong resistance to an improvement in efficiency, because of a fear that you are going to lose your job.

Now, if you had a situation in which it was generally perceived that you should be able to find work, and you weren't going to be moved into a severe unemployment situation, would that not create significantly better national attitude toward measures to increase the efficiency and productivity and, therefore, make a contribution on inflationary issues?

Mr. KEYSERLING. I have never tried to spread out a theory and then assume that the facts are going to fit the theory. I always try to look at the facts, and then build the theory as merely a helpful way of explaining the facts. Getting to the matter that Dr. Brimmer talked about, he said quite correctly, that when the unemployment rate—Dr. Brimmer said quite correctly, when the rate of money wage rate increases exceed the rate of productivity gains, we have a pronounced pressure in an inflationary direction.

Conversely, if the rate of money wage rate increases do not exceed the productivity gain or fall below it, we have an anti-inflationate pressure. I couldn't agree with that more.

But let's just use commonsense, although I can support it by empirical evidence, to see how this ties in with the rate of unemployment. I have done something that I haven't seen elsewhere. I have correlated the rates of productivity growth with the rates of real and money wage rate increase at every level of unemployment and every rate of real economic growth. What do you find? When the rate of real economic growth is high, and when the unemployment growth rate is low, the real wage rate increases fall behind the productivity gains, and so do the money wage rate gains to the extent that the price level is stable.

In other words, when the real rate of economic growth is high and the unemployment rate is low, the wages are operating under noninflationary pressures and, incidentally, there is a lag in wage gains behind productivity gains which has been one of the causes of the oncoming stagnation and recession.

Contrariwise—the last year is a good example—when the unemployment rate is high, and 6 percent is very high, and 82 percent use of plant capacity is very low, then the productivity is exceeded by the rate of money wage rate increases.

God forbid if it weren't, because if we brought the wage increases down to the low productivity growth rates, we would have what we got in the 1930's.

Even Mr. Hoover argued for the businessmen not to do that.

So the whole thing fits together. It is the lowering of the unemployment rate that raises the productivity rate. The increased real economic growth rate raises the productivity growth rate.

When that happens, the wage rate gains, moneywise, are equal to or lag behind the productivity growth rates, and you have a noninflationary factor. It is unnecessary to argue whether this is true, if you get down to 2-percent unemployment. For you are saying, "Maybe we can get down to 3 or 4 percent by 1983."

Thus, so far as the situation that we have to deal with, within the ambit of the framework of this bill, we will even by 1983 be operating in a situation where the productivity growth rate will not have the incentive of a high enough level of utilization, and the problem will continue to be academic as to what to do when there is too much pressure upon available resources.

Senator SARBANES. Would the others like to speak to that point?

Dr. BRIMMER. I would say, quickly, Senator Sarbanes, I would interpret you to say it is a scarcity complex. I feel not having enough jobs to go along, if technology or other sources, or efficiency would be promoted, that you would be somehow displaced, that jobs would be lost.

I think that at one time was quite restrictive of many craft unions. I think it is less today.

Senator SARBANES. Let me say to you as one who, because he is a politician, has to spend time out on the street, that I am not sure I agree with that. I think on the part of many Americans who work in situations in which they see fluctuating employment, people being laid off, even if they may not reach them, in many instances it may reach them even with a number of years of seniority that the anxiety that prevails makes them regard efforts to improve efficiency and productivity with a very skeptical eye, because they are very fearful that their jobs are at stake.

If they have some sense that we really are going to be moving well on the job front more or less all the time, I think you might well over time develop a different response.

The other point I want to add to that, and it goes to a different point—the chairman has been very generous—but there is a point in your paper, Dr. Carlson, about the cost of public jobs, and if you translated that into what the average family pays in taxes, maybe they wouldn't want to pay that in order to put the people to work. It is an interesting point, but it is only an economic point.

I think the undercutting of the work ethic that takes place when you permit high levels of unemployment is extremely serious. I want people to work and I want to have programs to put them to work. I think we really need to have a work ethic in the sense of the discipline that comes with it and the notion of productivity and the use of those resources in society. And two things happen when you fall short. One is you carry the people, you are not going to let them starve. So among a certain group you develop an attitude of "let's rip off everybody else and get a free ride." And then among those that are continuing the work there is a sense of outrage that they are being ripped off and taken advantage of.

So it becomes debilitating in two respects. One in creating a class that is basically not work oriented but is basically designed to learn how to play off the system. And then, of course, debilitating in that a significant number of those working resent—I mean they have an exaggerated notion of what is happening, but in any event they resent what is taking place.

It seems to me all of those arguments, and I really address them more to you because it seems to me the people you represent in a sense have the greatest interest in these kinds of attitudes I am talking about, but all of those arguments argue very strongly for an approach, and, of course, this legislation is really an approach, it is not the substance of the programs—it leaves open the question, in terms of the substance of the programs, to either take the tax cut approach that you all might favor under the circumstances as opposed to a spending approach that someone else wants to take, it leaves open the question whether the tax cut is to go to consumers or investment and so forth. It is just an approach.

It seems to me the people you represent, in an enlightened view of what their self-interest is in the broader view of the society, ought to be very strongly for implementing or putting into place these things.

Dr. CARLSON. I think my testimony makes it clear this is part of the high unemployment effort. The increase in minimum wage, the increase in social security taxes, we could have folded in the Federal employees, for example, and certainly in terms of looking at those that can't find jobs even in a high employment economy we have supported assistance to the structurally unemployed. We would like to keep the employment possibilities greater in the private sector as opposed to the other sector.

The CHAIRMAN. Thank you.

I want to congratulate Senator Sarbanes on this line of questioning. It has been particularly interesting.

I would like Mr. Nathan to comment on this. Why not have a dual goal, recognizing the wisdom of what you said, Mr. Carlson said and what others have said, the argument that the level of unemployment you have with the given level of inflation depends on the policies you follow on. And what this would be doing really is giving a message loud and clear that we want those policies followed, so that you can reconcile these two goals. Policies like training unskilled people so that they are better able to qualify; policies like providing a greater degree of mobility.

In Wisconsin, for instance, we have a system overnight, every single night on the computer system you can go into every city of 10,000 and find every job that is available. That is one of the reasons our unemployment is less than other places.

Productivity policies, which we have been very reluctant to push and very lax in doing so, policies the President has been urging of achieving a greater degree of price restraint by management and wage restraint by labor—why wouldn't these policies be really encouraged by this bill in a positive, constructive, emphatic way to produce these goals?

Mr. NATHAN. The question, Mr. Chairman, is whether the setting of those goals will be inclined to stimulate the policies of structural changes or stimulate those policies of wage-price restraint or stimulate those policies——

The CHAIRMAN. Well, I say the inflation goals shall be designed so as not to impede the achievement of the unemployment goals. That is the way you do it.

Mr. NATHAN. If you go that route, I would like to put in a few other phrases right there.

The CHAIRMAN. Fine.

Mr. NATHAN. Put in a few other phrases, and certainly it is not to be designed as a substitute for specific positive measures on the policy front, to increase productivity, to lower wage-price increases, to increase investment and modernization and the like, so that it clearly does not become an excuse for these policy measures. This is what I am fearful of.

I just think that the trade-off in wages and prices is a simplistic thing, that too darn many people—unfortunately, at high prices, they buy it even though they say they don't. If we do get enough of the qualifications there to make sure it isn't a trade-off, that at least would be a big help.

The CHAIRMAN. That is very helpful.

Dr. Brimmer, the Federal Reserve is required by the bill to comment on the President's economic proposals contained in the economic report. You were very helpful in this. There was excellent analysis that hadn't occurred to me, comparing the House bill and Senate bill as far as the Federal Reserve is concerned, but the legislation does not require the Federal Reserve to comment on the budget even though the monetary policies must take these things into account.

Should a requirement be added to the bill that would have the Federal Reserve report to Congress after the first concurrent resolution on the budget that has been adopted, in which it would provide its views in a manner similar to the report it would make on the President's proposal?

Dr. BRIMMER. First, Mr. Chairman, I hadn't thought of putting the question that way, so I haven't worked it through. I see the implications though. I think the Federal Reserve ought to stick substantially to monetary policy and I think it would be very difficult for the Board as a whole, for the Federal Open Market Committee to come to any kind of consensus on the content of the budget or appropriate level of spending or fiscal policy in general. That is trying to get an agreed view——

The CHAIRMAN. They sure as dickens let us know. Arthur Burns and Miller come up here and they tell us what they think of things, but they don't speak for the Board, and when they don't do that it is hard to know what emphasis to put on it. They have great effect on the Congress. They should have. They are men of great sense and prestige, and they are in a position of considerable power. But why shouldn't they be frank and tell us the whole thing?

Dr. BRIMMER. I would naturally be reluctant to criticize the personal behavior of my former colleague.

The CHAIRMAN. I didn't mean that. Just describe what they do.

Dr. BRIMMER. That is part of the problem. Much of what was said and still is said before Congress on matters other than monetary policy reflects personal opinion, and trying to get 12 people on the Open Market Committee or 7 people on the Board to agree to what ought to be fiscal policy would be very difficult.

Senator SARBANES. It is worse than getting seven Senators to agree.

The CHAIRMAN. But for us to understand why they have adopted the monetary policy they have and for us to develop any kind of a debate and have any influence on it—after all, we are the committee to whom they are responsible; they should know we have oversight over them—it seems to me they should spell out what they are talking about. They come up and talk about M1, M2. Forget it. Nobody will pay attention to that. If they talk about the level of unemployment, level of prices, talk about interest rates, talk about things people can understand and have strong feelings about, it seems to me we can make some progress.

Dr. BRIMMER. I agree. I didn't neglect the issue altogether. On page 14 and 15 of my statement I developed an approach which I would recommend strongly that the committee might consider. I took advantage of the fact that the Federal Reserve now reports four times a year before Congress. I also took advantage of what seems to be an innovation at the Federal Reserve where the Chairman of the Federal Reserve, as he did on April 25, volunteered some views with respect to the outlook for the real economy.

The CHAIRMAN. That is page 15?

Dr. BRIMMER. Page 14 and 15, Chairman Miller's comment, the summary on page 14 of my statement. And as I said, he went quite far. He went beyond projection of the monetary aggregate; he talked about the outlook for real GNP and prices and unemployment. These are my personal views, but I understand. As a matter of fact, he was summarizing the consensus view in the Open Market Committee. He may have said so before the Congress here.

The CHAIRMAN. When he addressed us the last time, we asked him specifically about that. He said he could only express his own personal views.

Dr. BRIMMER. But it is my understanding that that was in fact a reflection of the consensus in the Open Market Committee. I understand further that the Congress can look forward to receiving that kind of commentary each time the Federal Reserve representative appears.

Taking that as background——

The CHAIRMAN. Why not require that? Why not require that so that they understand it, the Federal Reserve Board Governors understand it, and they instruct the Chairman when he comes up what their position is? That is all we are asking.

Dr. BRIMMER. This is my compromise, and I suggest it as a compromise: One, the legislative record of the Congress' consideration of this matter indicates that the Congress expects this kind of conduct. I say further that the committee, and I have this committee in mind, for example, once the Federal Reserve representative has appeared, has now talked about the monetary aggregates and the outlook for the economy, that this committee ask its own staff to take the Federal Reserve's commentary; make its own assessment. And I say in my statement that its staff may have to be enlarged somewhat to do that. They may have to call on the resources of the Congressional Research Service, but I can visualize a scenario under which this committee would take the staff's reports based on the Federal Reserve's own forecasts and projections of monetary aggregate, draw its own conclusion with respect to the implication for the economy as a whole and, as I said, even the outlook for monetary policy interest rates.

I wouldn't expect the Federal Reserve to be willing to discuss interest rates, but I would like to see the chairman of this committee submit to the Chairman of the Federal Reserve, before the next representative appears, this committee's own interpretation of the implications of the Federal Reserve projected policy for the economy as a whole. That would be an agenda for discussion between the Federal Reserve and this committee.

I know in advance the Federal Reserve would be reluctant to adhere to that, especially the discussion on the outlook for interest rates and credit, but I personally think the Congress needs much more of a focussed debate on these measures. My paper summarizes this approach.

The CHAIRMAN. That is very helpful.

I might point out, it is going to be hard. We could get a useful colloquy between the committee as a whole and the Board of Governors as a whole, because while they may have their differences, we really have ours all over the place. But we might be able to get a majority view, undoubtedly with many minority views attached. That is what we don't have now. We don't have that kind of discussion on the effects of monetary policy. A few Senators may make a speech somewhere, but we don't really develop the kind of discussion we ought to have that would help monetary policy, to be useful in achieving the goals we are all interested in achieving.

Dr. CARLSON. I think one ought to be very cautious about the innovations in this area, because if the Federal Reserve appears to be losing some of its independence to Congress or a committee of Congress, that could have an adverse effect.

The CHAIRMAN. That old myth of independence of the Congress. I don't know where it develops. Every chairman seems to go further in asserting it. There isn't any.

Paul Douglas directed to William McChesney Martin, "You write on your bathroom mirror 'I am a creature of Congress' and look at it every morning."

We are not independent.

Dr. CARLSON. No question as far as the Constitution. But as far as influencing of funds into the committee, the fact that there are wise people, based on the information they have as opposed to a political decision as to the size of M_1, M_2 or M_3, or whatever, is very important in the confidence in the committee.

So I think movements toward what appears to be, what is existing, de facto independence of the Fed, should be handled very carefully.

The CHAIRMAN. We will be careful.

Thank you very much.

The committee will stand in recess until 10 o'clock tomorrow morning.

[Whereupon, at 5:08 p.m., the committee adjourned, to reconvene at 10 a.m., Tuesday, May 9, 1978.]

FULL EMPLOYMENT AND BALANCED GROWTH ACT OF 1978

TUESDAY, MAY 9, 1978

UNITED STATES SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, D.C.

The committee met at 10:05 a.m. in room 5302, Dirksen Senate Office Building, Senator William Proxmire (chairman of the committee) presiding.

Present: Senators Proxmire, Cranston, Brooke, Garn, Heinz, and Schmitt.

The CHAIRMAN. The committee will come to order.

Today we are continuing our hearings on the Humphrey-Hawkins bill, the Full Employment and Balanced Growth Act of 1978. We had an excellent hearing yesterday in which we spent a good deal of time discussing the numerical unemployment goal that's in the bill, the 4-percent overall unemployment in 5 years, and the 3-percent inflation goal that I proposed to be added to the legislation. We did not find unanimity among the witnesses yesterday, but there was a consistent feeling that unemployment and inflation are both serious problems for which we must find solutions and it would be far better to approach them head on rather than be paralyzed by the tradeoff fear.

Our first witness this morning is Senator Mike Gravel from the great State of Alaska, where I understand unemployment has increased dramatically since the completion of the pipeline. He is to be followed by the Secretary of Labor, Ray Marshall; and Charles Schultze, Chairman of the President's Council of Economic Advisers. Then we will hear the views of Gov. Charles Partee.

We are going to ask Senator Gravel to proceed and we will question him and then follow up with the other witnesses.

STATEMENT OF MIKE GRAVEL, UNITED STATES SENATOR FROM THE STATE OF ALASKA

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

In your consideration of the Humphrey-Hawkins bill you will be establishing specific national employment goals. In developing your recommendations I would like to suggest that you consider a minor extension of the bill to deal with the broadening of capital ownership. However, before I talk about my specific proposal, let us pause for a moment to consider the roots of our historic concern for employment.

Why are we concerned about full employment? We are not concerned about employment for its own sake, but as a source of income for the employee. Traditionally, the majority of our citizens have relied for their income solely on their personal labor. For most Americans employment is the only source of income. We are concerned about jobs not because we necessarily want everyone to work, but because we want everyone to have sufficient income.

However, job-related income is not the only source of income in our economy. There is another source of income which is enjoyed by a select few in our economy. Income which does not hinge on employment, income which grows even while the owner sleeps. I am referring, Mr. Chairman, to income from capital. The Rockefellers do not need jobs. We are not concerned about full employment for the DuPonts. No, Mr. Chairman, we are only concerned about full employment for those in our country who do not have sufficient capital income to survive without wages.

Income from capital can provide the same basics of life which come from employment income. And the capital stock of our economy is sufficient to provide significant amounts of income for many Americans. However, 5 percent of Americans own over 50 percent of the capital assets in our economy and this has been the case throughout this century. The same 5 percent own 62 percent of American businesses and 83 percent of the corporate stock. By virtue of this ownership this small group of individuals receive a large portion of our national income from capital.

Now, Mr. Chairman, I would not suggest that we appropriate that capital and spread the wealth around. Although, I would submit that we do much the same thing through the high levels of taxation necessary to fund transfer payments and job support programs for those who have no capital-related income. What I would propose is that we look to the future and ask ourselves whether we may not develop a means for broadening the ownership of the new capital which must be generated in the future to fuel the expansion of jobs and the economy.

Over the next 20 years our normal economic expansion will require a doubling of the capital stock of the American economy. If we can devise a system through which this new capital can be owned by new capitalists, without taking anything away from those who now own most of our capital, we can ease the pressure for the creation of artificial jobs by putting capital related income into the hands of those who have never before benefited from capital ownership.

I have developed a proposal which would begin the spread of capital ownership and capital income throughout our society. I would like to include in the record a copy of a paper outlining in some detail the principles of this proposal. The program would provide federally guaranteed nonrecourse loans to individuals for the purchase of capital investments which would generate income for the individuals involved. The individuals could then use the income generated to repay the debt and be left, after debt retirement, with an asset which would continue to produce income for them.

Mr. Chairman, as you know the formation of capital in our economy is essential to the creation of jobs. The proposal of which I speak would provide for the discount of capital formation loans directly to the Federal Reserve Bank at nominal interest rates. This would accelerate the formation of capital by lowering the cost of new investment and in the process expand the job market. There are those who might argue that such an expansion of credit would cause inflation by increasing the Federal deficit, but I would submit that it is the monetization of transfer payments which is inflationary rather than the monetization of productive capacity.

Mr. Chairman, the proposal which I put forth here may be one of the tools about which the Humphrey-Hawkins bill speaks when it refers to devices which expand employment without at the same time increasing inflation. The diversification of capital ownership in our society must be undertaken as a compliment to the creation of jobs, for without an expansion of capital ownership the creation of jobs will simply be one more tool in the armory of income transfers, welfare disguised as work.

And so, Mr. Chairman, I would like to encourage the committee to include in the bill a statement on the importance of expanding capital ownership in our economy. It would also be appropriate for the bill to require the President, in his annual report to Congress, to state the progress made during the year on widening the participation in our capital stock. It could also instruct the President to develop policies and programs designed to broaden capital ownership.

The assurance of jobs in our economy for those who desire to work is a laudable national objective, but we must not lose sight of the fact that we are concerned about jobs because they provide income. We must, of necessity, focus on other sources of income as well, and encourage the growth and expansion of those sources. Growth of jobs cannot occur without capital investment, and the new capital can form the basis for a significant new income source for the average American.

I would only add, Mr. Chairman, that by the year 2000 when we have doubled the capital stock of our country if we as policymakers can make the same statement that we made today, that 5 percent of the people own more than 50 percent of the wealth, then all I can add is shame on us for not having altered that situation.

The CHAIRMAN. I want to thank you very much, Senator Gravel, for a very interesting and innovative suggestion. You want to see far more Americans become capitalists I take it, far more Americans with a capital at stake, far more Americans with the kind of motivation and drive and initiative and so forth that somebody with an investment has, and I think that's commendable, and we will certainly consider your suggestion very carefully.

Senator GRAVEL. I would hope so. The inclusion of the language and the data provided by the President would not be a great departure from what you presently have and I think it would add information that would help us make a case. I thank you.

The CHAIRMAN. Senator Brooke.

Senator BROOKE. I have no questions. I'd just like to say I'm always pleased to hear the suggestions of our very able and distinguished colleague from Alaska and I think it's a very interesting concept. We'll certainly give it every consideration.

The CHAIRMAN. Senator Schmitt.

Senator SCHMITT. Senator Gravel, does your paper, which I will read with considerable interest, trade off the general reduction of taxes versus the guaranteed investment proposal which you have given us?

Senator GRAVEL. Trade off taxes in what way?

Senator SCHMITT. If you reduce taxes and put more capital in the hands of people, presumably many of them will reinvest that in the same way your program would have the Government finance it. Now I'm wondering if you have done the economic tradeoff. Not everybody will reinvest. One of the apparent reasons that there's a lower amount of investment by individuals nowadays than has been in the past is because of taxes, and that's another way in which we take from the productive, and transfer to those portions of the society that generally spend.

Senator GRAVEL. The only way that I would reduce taxes is through another proposal that I'm proposing in the Finance Committee and that would be through the utilization of the general stock ownership plan or a continuation of an ESOP where we do away with the double taxation at the corporate level. Under the ESOP we don't tax the corporate income; it goes to buy the stock for the employee; and I would hope to do the same thing in a GSOP. I have not done any macroeconomic studies other than a seminar at Brookings that was sponsored by the Ford Foundation. Myself and Larry Klein were the two hosts of that and we discussed the economics at great length, but there's been no specific study. I think the inference is clear that if we can provide an incentive for capital expansion that there would be in a direct sense a reduction in taxation, but in the long-term sense there would be increased revenue because there would be more income going into more hands.

Senator SCHMITT. Thank you.

The CHAIRMAN. Thank you very much, Senator Gravel.

Senator GRAVEL. Thank you.

[Additional material received for the record follows:]

STATEMENT BY SENATOR MIKE GRAVEL

INTRODUCTION: THE FINANCED CAPITALIST PLAN

The capital requirements of our economy will double in the next twenty years providing for growth in capacity of American industry. Under present financing methods most of this new capital will belong to those who own the bulk of our capital today. The internal generation of capital and the use of debt financing for corporate expansion inhibits the broadening of capital ownership.

One of our greatest challenges is to provide more Americans with a stake in our economic system. Wages, received in return for labor, allow many of our citizens to share in the economic bounty of America. Congress has often directed its effort toward the creation of jobs. But, income from labor is limited, and old age, health, or technology may intervene to terminate the laborer's job. When a laborer loses his job or retires, our economic system is put to its severest test: where will this person find the money to survive? The best aid we have been able to develop is the transfer payment. But, like all of us, the unemployed laborer, the social security recipient, the working poor—all resent charity. Government transfer payments, like all forms of charity, result in a loss of economic independence.

The loss of economic independence in American has grown at a frightening rate. Transfer payments funded through federal programs such as Welfare, Supplemental Security Income, Social Security, and military retirement threaten to bury us financially.

The actuarial problems of the Social Security System have become almost insoluble. Our citizens groan under the enormous tax burdens required to fund these programs. Yet, we have no answer for their cries, no remedy but "more of the same". We are moving away from our roots in capitalism, from our belief in the power of free enterprise and the independence of the individual. We are creating a system whereby we take from the rich to maintain the poor. Eventually, the confrontation must come between the last vestiges of capitalism and the new society we are creating. That confrontation will mark the end of the individualist in America.

We may yet be able to save ourselves from our own folly. We may be able to improve the economic independence of all our people by allowing the poor to share in the wealth of our country instead of merely transferring to them income enough to survive. In the past, Congress has focussed on the creation of jobs. But, jobs are only part of the larger issue of insufficient income. Perhaps we can create a system whereby the expansion of our capital plant and equipment can provide capital income in addition to job related income for many who have never had such income before.

The immense capital requirements of our economy in the coming years will provide the opportunity for the great masses of poor and middle income Americans to become owners of capital. This capital can generate a second income for them. We can develop a program which will build capital ownership into those who have never owned capital before. The income from this capital can then supplement and perhaps even eventually replace their income from labor or the transfer payments which they may receive through federal programs.

BROADENED CAPITAL OWNERSHIP: A PLAN

I propose a new approach to capital expansion which would diffuse ownership of new capital to those who have not previously reaped the benefits of capital ownership. In simple outline the plan would guarantee private loans to purchase corporate stock, with the new capital being used by the corporation to pay for the expansion of plant and equipment. The stock would be held as security for the loan, and dividends used for repayment. After the loan is fully or partially retired, the investor would receive dividend income. The plan provides investment capital for industry while developing an alternate source of income for those who historically have depended on their labor income alone The plan would not transfer existing wealth from the rich to the poor, but rather allow the poor to obtain a share of the new wealth generated by our capital expansion.

The plan should be tested on a limited scale to determine its effect on individuals, corporations, government and the economy as a whole. In each of five consecutive years $800 million in private, federally guaranteed loans could be made available to participants in amounts of $20,000 per family unit, $800 million represents approximately 1 percent of the non-residential fixed private net investment of American industry for calendar year 1977, using national income accounting figures for depreciation. In comparison, this sum is about 10 percent of the total loans guaranteed by the Federal Housing Administration during fiscal year 1975 and less than 5 percent of the loans guaranteed by the Small Business Administration during 1976. Under these restrictions, the test program would involve about 40,000 participants per year for five years for a total of 200,000 participants. This would give a sufficiently large and representative sample for analytical purposes.

THE PARTICIPANTS

The participant would be eligible for federal guarantee of a loan, not to exceed $20,000 to be used for the purchase of new corporate stock. The proceeds of the new issue would have to be used by the corporation to finance capital expansion. Participants would be drawn from a cross section of American society. They would be chosen at random from four target groups: the blind and disabled, low income working poor, middle income taxpayers, and Social Security recipients. These groups were chosen because they are faced with a diversity of problems and are likely to have wide educational and sociological differences. Many of the members of these groups may also receive some federal assistance varying from Aid to Dependent Children to FHA guaranteed home loans. The hard core unemployed and welfare recipients would be excluded for purposes of the test because their special problems and needs in relation to a program of this nature might make excessive demands on the system. Geographic diversity of the participants will be emphasized. The experience of these four groups will give valuable insight into how such a program would be received by the general public and would allow for a fair evaluation of the program's successes and failures. Of course, if the program proved successful it could be extended to groups not included in the test program.

The participant would receive notification of his eligibility by mail. The notification letter would suggest that he contact his banker or financial advisor regarding the matters discussed in the letter. Since many of the participants could not be expected to be familiar with financial institutions or transactions, the notice of eligibility would be followed up by telephone and personal contact from the local social services agency. The program would be explained and assistance offered to the participant in contacting the appropriate financial intermediaries.

THE SECURITIES (FULL RETURN STOCK)

The proposal contemplates the creation of a new class of corporate stock. The stock, referred to as Full Return Stock, would be preferred as to dividends and have its share of corporate earnings distributed quarterly. The corporation would be required to distribute all the per share earnings currently to the Full Return stockholders. It would, however, be allowed to retain a reasonable percentage of the earnings of the Full Return Stock as a reserve for contingencies.

The full distribution of earnings on the Full Return Stock could have a dilutive effect on the equity of the common stockholders. Part of the corporation's profits are attributable to the earnings of the common stockholders which have been retained by the corporation. Thus, if earnings are simply divided by the number of shares outstanding to determine the amount distributable to the Full Return stockholders they will receive dividends which are, in part, attributable to the retained earnings of the common stockholders. In order to encourage corporations to participate in this program by issuing Full Return Stock this dilution problem must be resolved. Two possible solutions are presented for discussion:

(1) The earnings of the corporation could be reduced by the earnings attributable to the retained earnings and the balance could then be divided by the number of shares to determine the per share distribution on the Full Return Stock. Corporate tax would then be computed on corporate profits, including profits on the retained earnings less a deduction for the profits on Full Return Stock which had been distributed. The effect of this adjustment would be to have the common stockholders neutral with respect to earnings distributed to Full Return stockholders and would exempt the Full Return dividend from tax at the corporate level.[1]

(2) The dilution problem could also be dealt with through a tax deduction or credit for distributions to the Full Return stockholders. Deductions have the disadvantage of varying in value with respect to the profitability of the corporation. The more profitable the corporation the greater the cost to the organization of money raised through the Full Return Stock if a deduction isused to resolve the dilution problem.[2] Tax credits on the other hand would not vary in effect with

[1] On a tax expenditure basis using a 48 pct corporate tax rate and computing the tax based on average corporate pretax profits of 16 pct this would represent a subsidy of approximately $61,440,000 in the first year of the program and $307,200,000 in year five. This would be a continuing subsidy until all the Full Retrun Stock was converted to common stock. However, this exemption might be more accurately viewed as a form of corporate integration and therefore not a subsidy at all.

[2] Assuming a deduction of 110 pct. for the Full Return Stock distributions and a corporate tax rate of 50 pct with a cash dividend on the stock equal to pre-tax earnings per share the following possibilities present themselves:

	1	2	3
Received for sale of shares	$1,000,000	$1,000,000	$1,000,000
Shares of FRS outstanding	10,000	10,000	10,000
Earnings per share	10.00	20.00	25.00
FRS cash dividends paid	100,000	200,000	250,000
Deductible for tax purposes	110,000	220,000	275,000
Tax credit at 50 pct	55,000	110,000	137,000
Net cash outlay annually	45,000	90,000	112,500
Earnings necessary to cover net outlay before taxes	90,000	180,000	225,000
Effective rate of "interest" (percent)	9	18	22.5

the profitability of the corporation except to the extent that the corporation's effective tax rate varied. To take account of the variations in the effective tax rate the credit amount could be adjusted based on the actual effective tax rate for the year. Thus, if the corporation paid 35% tax on its total income the credit would be equal to 35% of the Full Return distribution for the year. In this way the corporation would be returned the tax which it had paid on the Full Return Stock earnings which were distributed. However, as accumulations of retained earnings developed within the corporation the credit would have to increase in order to assure the common stockholders parity with shareholders in a similar corporation which did not issue Full Return Stock.[3]

While the shareholders of the corporation may be rendered indifferent financially by the distribution adjustment, they may still lose some rights of preemption and suffer some diminishment of their liquidation rights. In order to compensate the existing shareholders for this loss and to give the corporation some incentive for entering into this program by the issuance of Full Return Stock, participating corporations could be allowed an additional investment tax credit of 1 percent on all investments made during years in which Full Return Stock is outstanding.

OWNERSHIP OF FULL RETURN STOCK

The ownership of the Full Return Stock could be handled in either of two ways, or a combination of both. The stock could be owned directly by the participant or the participant could purchase shares in a mutual fund holding full return stock. The Full Return Stock is designed to provide income since the full distribution of earnings by its very nature limits considerably prospects for appreciation. This income emphasis will result in very favorable rates of return to Full Return Stock investors and the stock will be underpriced in relation to other public offerings. As a result it will be necessary to limit the transferrability of the stock or mutual fund shares.

The participant could acquire a federally guaranteed loan only for the purchase of Full Return Stock or shares of a mutual fund investing solely in such stock. Any mutual fund designed to comply with the requirements of this program would be required to pass through the Full Return dividends, retaining only a reasonable amount for administration. If a mutual fund approach were used, transfer limitations could easily be imposed upon the fund shares. The fund shares could be made transferrable only by gift or inheritance (or transfer could be limited to inheritance alone) and sale would only be allowed in the event of a repurchase by the fund. The Full Return mutual funds would be entitled to trade the Full Return Stock held by them, but if the sale were made to other than a qualified mutual fund the stock would convert from Full Return Stock to ordinary common stock. While some suggestions have been made to operate the fund under a government agency, private industry has the capacity to handle such transactions and private operation would be more philosophically consistant with the other aspects of the plan.

It would also be possible for participants to purchase Full Return Stock directly. In such a situation the corporate stock could be restricted as to transferrability by a conversion factor which would decrease the transfer value in relation to the income value. Upon transfer by gift or inheritance the stock would continue to have its full claim on earnings. But, if the stock were sold or transferred for consideration it would loose its preference on earnings and revert to ordinary common stock. This mandatory conversion upon sale would decrease the value of the stock, encouraging its retention in the family group. For estate tax purposes the stock could be valued at its common stock value rather than through an income discount approach. This would minimize the need for a forced sale by the estate.

---

[3] For purposes of illustrating the tax credit approach to achieving stockholder neutrality on the issue of Full Return distributions it may be helpful to set up a simple example comparing two corporations, X and Y. Each corporation has 200 shares outstanding and $200 of paid in capital, one dollar per share. Each corporation earns 100 pct per year on its capital. The corporations retain all earning on common stock and corporate tax is assumed to be 50 pct. Corporation X has only common stock outstanding, corporation Y has outstanding 100 shares of common and 100 shares of Full Return Stock. One Half the pretax earnings are distributed by corporation Y to its Full Return stockholders. The results over three years and the necessary tax credits are set forth in the chart attached as Appendix "A". As can be seen from the chart, it would be necessary to vary the amount of the credit to the corporation in order to maintain equivalence for the common stockholder with similar stockholders in a corporation which had not issued Full Return Stock.

Either the mutual fund or the individual share approach could be used effectively in this program. The mutual fund approach is attractive in that the risk of loss is spread to all participants while the individual share approach brings the participant somewhat closer to the operation of our economic system. The individual share approach may also allow for a greater diversity in investment successes and failures. In a test program, reaction to these more radical results might be informative. It should be noted that these two alternatives are not mutually exclusive and both might well be included in any test program.

THE FINANCING

The foundation of the program is to provide 100 percent financing for the purchase of the Full Return Stock. This will allow those without collateral to borrow for the purchase of stock. The loan would then be repaid from the dividends on the securities purchased. Local banks, savings and loan associations, credit unions, insurance companies and trust companies would be authorized to loan the participant up to $20,000 for the purchase of Full Return Stock or Full Return mutual fund shares. As security for repayment the borrower would execute a promissory note and the lender would retain a security interest in the stock or shares. The securities would be held in escrow until the loan was retired.

The loan would be non-recourse so that upon default the lender could not collect any deficiency from the investor. If default occured, the lender would have the right to foreclose the loan and sell the stock or shares, applying the proceeds to the remaining principal balance of the loan. Any deficiency would be insured by a new independent federal corporation, the Capital Development Insurance Corporation. This corporation would insure the sale of the stock or shares to the extent of 75 percent of the original principal balance. The CDIC would be a self liquidating insurance corporation funded through a nominal charge against the dividends paid on the insured stock or mutual fund shares.

Dividends on the stock or mutual fund share would be paid through the escrow to the lender in amortization of the loan from the bank or other financial institution. Dividends used for repayment of the loan would be tax exempt at the shareholder level, but once the loan were amortized and the shareholder began receiving dividends, those dividends would be treated as ordinary income and subject to federal income tax.[4] Since dividends might vary in timing and amount, no prepayment penalty would be allowed and interest would be computed on the remaining principal balance. Until 25 percent of the balance had been amortized, all dividends would be applied against the loan. Thereafter, the investor could elect to receive 25 percent of the dividends until 50 percent of the balance had been amortized. When 50 percent of the loan balance had been retired, the investor could elect to receive 50 percent of each dividend payment. When the remaining principal balance reached 25 percent of the initial loan, the participant could receive 75 percent of each dividend with the remaining 25 percent going toward retirement of the loan. The participant could elect not to receive any or all of the incremental payment steps, thereby accelerating the retirement of the loan. Based on average pretax corporate earnings of 16 percent and an interest rate of 4 percent to the investor, the loan would be retired as follows:[5]

(1) If the participant received each incremental payment the loan would be retired in 16 years.

(2) If the participant waived the final 25 percent incremental payment the loan would be retired in 12 years.

(3) If the participant waived the final two incremental payments, the loan would be retired in 10 years.

---

[4] Under a tax expenditure theory, this tax exemption would generate a loss to the Treasury equal to the total loan payment amounts under the program times the effective tax rate of the participants. Generally, since the participants would be in the lower income tax brackets their effective rate on all income would probably not exceed 15 percent so that the total subsidy over the life of the program would amount to approximately $900,000,000, assuming a 4 percent interest rate and election by all participants of the most rapid amortization schedule. Of course, it could be argued that no tax expenditure exists because new income would be created which without the program would not have been taxed anyway, so that there is no loss to the Treasury from the tax exemptions.

[5] See Appendix "B", which sets forth the amortization schedules upon which these retirement projections are based.

(4) If the participant waived all the incremental payments and elected to use all dividends for amortization of the loan until retired it would take 8 years to pay off the loan.

If the business cycle experience turned out to be worse (or better) these repayment schedules would have to be changed.

The investor could sell the stock or mutual fund shares in escrow subject to the approval of the lender. Sale of the escrowed securities would be subject to the same restrictions as the sale of stock or shares in other situations. If escrowed shares are sold, the proceeds of the sale would have to be reinvested in Full Return Stock or Full Return mutual fund shares. Once the shares were released from escrow the investor would have the unrestricted right to sell the stock or redeem the shares and retain the proceeds of the sale. One of the aspects of the program which warrants careful study would be the retention rate of the securities—who keeps the stocks or shares to benefit long term from the income and who sells them for immediate cash.

The investor in conjunction with the lender would have discretion as to which stocks or shares to purchase, assuming that the private markets develop more than one Full Return mutual fund. Since the bank or other lender will rely on the stock or shares as security for repayment of the loan, the lender would have authority to veto the investor's selection.

The program is designed to allow the private sector maximum flexibility in dealing with this new type of investor. The operation would require the cooperation of local social service personnel, bankers and other lenders, stock brokers and financial advisors, and trust or escrow companies. The mechanics of the relationships could be worked out by the parties involved, and several viable methods might be developed which would be superior to a single legislated method. Similar problems have been solved by banks and brokerage firms in developing relationships to handle investor-directed Individual Retirement Accounts. To the extent that these private institutions provide services to the participant, it is anticipated that they would receive their normal fees which would be allowed as a deduction from the initial loan proceeds prior to investment of the balance in stock or mutual fund shares. It should be emphasized that the system is designed to operate with only a single federal subsidy, for interest. The balance of the program would function without the support of direct federal funds. The insurance corporation would be self liquidating through premiums charged against dividends on insured securities. The federal guarantee would go only to the ultimate solvency of the CDIC.

INTEREST RATES

Essential to the success of the program would be reasonable rates of interest on the loans to participants. An interest rate of 4 percent was assumed in the figures quoted on page 13, above. It was noted there that at 4 percent interest with no partial early payout it would take approximately 8 years for the loan to be amortized assuming average corporate pretax earnings of 16 percent. If the interest rate were substantially higher, say 8 percent, it would take much longer to amortize the loan. At a interest rate of 8 percent it would take 9 years to retire the loan with no early payout.

There are two possible ways in which the interest rate could be kept to a manageable level. Direct federal subsidies could be used as in the case of federally supported educational loans under the National Defense Education Act, or the loans could be discounted to the Federal Reserve Bank.

Interest Subsidy

If a direct interest subsidy were used it would be funded through the U.S. Treasury and would be paid directly to the lender. Since the loan would be federally guaranteed it would be fair to assume that it would already bear a relatively low interest rate. In order to bring the rate to the investor down to the level of 4 percent it should not be necessary to have an interest subsidy in excess of 4 percent. This assumes a lending rate by the financial institutions of approximately 8 percent. Of course, whether or not such an interest rate would be sufficient to allow financial institutions to service such loans must be explored.

The interest subsidy computed on an $800,000,000 initial loan amount retired over an eight year period would amount to a total subsidy of $119,245,000. This assumes that corporate profits run at an average rate of 16 percent pretax and are fully distributed with the participant electing to have all of the dividends from the mutual fund used in amortization of the loan until it is retired. These are the assumptions which went into the development of the retirement schedule previously discussed at page 13, above. This interest subsidy is computed on the average outstanding balance for each year of the total eight year period and is not adjusted for present values.

The maximum interest subsidy under these assumptions would occur in year five of the program when the final $800,000,000 would be lent. Assuming the full $800,000,000 was loaned out on January 1 of each eligible year, the interest subsidy in year five would be *$108,636,800*. This would be a direct cost to the Treasury and would require an appropriation under the federal budgetary process.

Federal Reserve Discount

Alternatively, the interest rate could be subsidized in a less direct manner through expansion of the money supply. The notes acquired by the lending institutions could be discounted to the Federal Reserve Bank. This direct discount is within the Fed's powers, but is not often exercised on a commerical basis. The discount to the Fed would be kept at a minimum, sufficient only to cover the cost of administration to the Federal Reserve Bank. With a normal profit to the lending institution the interest rate on the loan to the participant should not exceed 4 percent.

The effect of a Federal Reserve discount would be to expand the money supply. The Federal Reserve currently controls the size of the money supply through open market operations and other devices such as member bank reserve requirements. Current Fed projections are for an expansion of the money supply on the order of 5 to 7 percent annually. The effect of discounting notes directly to the Federal Reserve Bank would be to target some of this expansion. It could be assumed that the Federal Reserve Bank would not revise its estimates of reasonable monetary expansion as a result of this program, so that the effect of such a discount would be simply to shift the focus of the monetary expansion somewhat.

CONCLUSION

The plan I have proposed here is revolutionary and needs careful study. Continuing social and economic review of the plan's operation should be undertaken. The studies could be funded through the Capital Development Insurance Corporation, with fees paid out of dividends on the insured stock. An annual report to Congress should be prepared discussing the operation of the plan.

This is a modest proposal to test a program holding great promise for our nation. The program could simultaneously increase the income of many of our citizens while expanding the investment of American industry in plant and equipment. It could provide dividend income to those whose incomes have been limited to wages. It could expand the industrial capital of our economy and improve the job market for the American worker. By raising Americans' incomes through new jobs and dividends we increase the buying power of consumers. Increased buying power could generate a more rapidly expanding economy with new jobs and new demands for capital.

This program holds out the promise of investment related income for many Americans. It does this in a manner consistent with our fundamental concepts of free enterprise. It does not take from the rich and give to the poor as so many of our present programs do. It is not another income transfer scheme. The plan simply provides the structural framework within which a cross-section of lower and middle income Americans can do what the rich have always done—borrow to finance capital investment and repay the loan out of the earnings. The plan does not transfer wealth. It does insure that the ownership of the new wealth created by the expansion of American industry will be diffused through the population instead of belonging only to those who already own the bulk of our national wealth.

It is my hope that this program will prove to be a great boon to America. Through this mechanism we not only can help our economy grow more rapidly, but we also can spread the ownership of that new growth to a whole new class of property owners. If this program proves successful in its modest form, expansion of the concept may be undertaken at a rate limited only by economic prudence and the constraints of the capital demands of our economy.

APPENDIX A

	Corporation X			Corporation Y		
	Shareholder A		Shareholder B	Shareholder A		Shareholder B (FRS)
Capital	100		100	100		100
Earnings of corporation		200			200	
Corporate tax		(100)			(100)	
Profits (after tax)		100			100	
Full return distribution		0			(100)→	→100 →
Tax credit		0			50	
Additional credit		0			0	
Retained earnings	50 ←	100	→50	50 ←	50	
Total	150		150	150		100
YEAR 2						
Capital	150		150	150		100
Earnings of corporation		300			150	
Corporate tax		(150)		(125)	(125)	
Profits (after tax)		150			125	
Full return distribution		0			(125)	→125 →
Tax credit		0		67.50 ←	67.50	
Additional credit		0		12.50 ←	12.50	
Retained earnings	75 ←	150	→75	75.00		
Total	225		225	225		100
YEAR 3						
Capital	225		225	225		100
Earnings of corporation		450			325	
Corporate tax		(225)			(162.50)	
Profits (after tax)		225			162.50	
Full return distribution		0			(162.50)→	→162.50→
Tax credit		0		81.25 ←	81.25	
Additional credit		0		31.25 ←	31.25	
Retained earnings	112.50 ←	225	→112.50	112.50		
Total	337.50		337.50	337.50		100

APPENDIX B

[Assumptions: 16 pct corporate profits, full distributions quarterly, 4 pct loan interest rate]

Year	No distribution	25 pct distribution to shares	25/50 pct distribution	25/50 pct distribution
1	17,656.33	17,566.33	17,566.33	17,566.33
2	14,992.93	14,992.93	14,992.93	14,992.93
3	12,355.29	13,167.41	13,167.41	13,167.41
4	9,610.19	11,267.51	11,267.51	11,267.51
5	6,753.24	9,296.29	9,490.23	9,490.23
6	3,779.91	7,238.67	8,252.64	8,252.64
7	685.42	5,097.23	6,964.63	6,964.63
8		2,868.53	5,624.13	5,624.13
9		549.03	4,229.04	4,631.04
10			2,777.11	4,007.62
11			1,266.03	3,358.78
12				2,683.15
13				1,980.75
14				1,249.32
15				488.10
16				
17				

The CHAIRMAN. I'm going to ask Secretary Marshall and Chairman Schultze to come forward as a panel. Gentlemen, we are honored to have you before us today on this critical legislation and we would be happy to hear you in order. Secretary Marshall, go right ahead, sir.

STATEMENT OF F. RAY MARSHALL, SECRETARY, DEPARTMENT OF LABOR

Secretary MARSHALL. Thank you, Mr. Chairman.

The CHAIRMAN. Incidentally, if you would like in any way to abbreviate your statement we would be happy to have it printed in full in the record.

Secretary MARSHALL. All right. Thank you.

[Complete statement follows:]

STATEMENT OF F. RAY MARSHALL, SECRETARY OF LABOR

Mr. Chairman and Members of the Committee: I am happy to be here today to express the Administration's support of the "Full Employment and Balanced Growth Act of 1977," the Humphrey-Hawkins bill. It is time this country made a commitment to the maintenance of full employment. As the President put it in his State of Union Message, "job opportunity—the chance to earn a decent living—is also a basic human right which we cannot and will not ignore."

The Humphrey-Hawkins bill provides for a specific annual target leading to a full employment goal of 4 percent unemployment in 1983 with reasonable price stability. To meet that target will not be simple, but I believe we can and must achieve it. In citing this goal we follow in Senator Humphrey's footsteps and spirit. He never shirked from the pursuit of social and economic justice simply because the way was difficult.

In my remarks today, I would like to emphasize the 4 percent unemployment goal and how it can be achieved. I believe the key to accomplishing this objective is a coordination of monetary and fiscal measures with so-called structural policies. When I speak of structural policies I mean measures aimed at reducing the unemployment barriers facing specific groups—whether those barriers be lack of education and training or discrimination. Further, I would like to discuss the relationship between the Humphrey-Hawkins goal and the level of inflation.

COORDINATION OF MACROECONOMIC POLICIES

This bill establishes a mechanism for bringing together macroeconomic measures (both monetary and fiscal) and structural measures to reduce unemployment. Two types of coordination are implicit in the mechanism contemplated in the Humphrey-Hawkins bill. First, there is coordination among the various actors in the macroeconomic scene. Second, there is a coordination between macroeconomic policies and structural policies. Both aspects of this coordination are critical to the achievement of the Humphrey-Hawkins goal.

Internal coordination of macroeconomic policy is critical if such aggregate policy is to permit us to reach the maximum possible level of employment consistent with reasonably stable prices. We are all too familiar with the situation in which a concern about inflation has caused monetary policy to tighten while fiscal policy is still in an expansionary stage. Higher interest rates also produce inflationary pressures by raising the cost of money, causing serious problems for industries like residential construction that depend heavily on borrowed funds by home buyers. Such conflicting application of the principal macroeconomic policy tools leads to higher interest rates and therefore to lower rates of real economic growth and higher rates of price increases than would otherwise be the case. I feel the annual review of the economy required by the Humphrey-Hawkins bill can avoid these problems and can bring a significant new level of coordination to government economic policymaking.

The mechanism by which such coordination is achieved is both critical to the success of the effort and, as always when institutions are being changed, difficult to construct. With the divided responsibilities for economic policy that exist within the Congress, the Administration, and the Federal Reserve, both innovation and compromise are going to be required in order to achieve an effective mechanism for policy coordination. It is important that the Federal Reserve, the Congress, and the Administration all be a part of the coordination process. I'm sure you will agree with me that the welfare of millions of unemployed Americans is dependent upon our wise and competent solution of this problem.

But macroeconomic policy is not enough. History has taught us all too well that macroeconomic policy has its limits. The creation of too much additional demand has, in the past, caused inflation to increase. Structural policies will be necessary if we are to reduce significantly the level of unemployment that can be reached without additional inflation. Thus, I see the second form of coordination being that between macroeconomic policy and structural policies. I feel this coordination is critical if we are to achieve the goals of the Humphrey-Hawkins bill.

STRUCTURAL POLICIES FOR DEALING WITH UNEMPLOYMENT

The goal of structural employment policies must be to reduce the disparities in unemployment rates which exist within various groups in the labor force. The challenge facing structural employment policies can be seen from existing unemployment patterns. In April, with an overall unemployment rate of 6.0 percent, the rate for adult white males was 3.6 percent while the rate for adult white females was 42 percent larger than the male rate; the white teenage unemployment rate was more than 300 percent larger than the adult male rate; the adult minority unemployment rate was nearly 180 percent larger than the adult white male rate; and the minority teenage unemployment rate was nearly 10 times the adult white male rate. Table I of the attachment shows the underlying unemployment data for April 1978.

We believe we can influence the structure of unemployment through such measures as training, improved coordination with private firms, public service employment, youth programs, improved labor market information, antidiscrimination enforcement, and limitations on the entry of undocumented workers.

The general policies must be aimed at improving the employability of a variety of specific groups that have high unemployment rates. The Labor Department will continue to propose changes in targeting requirements to enable us to reach those groups with the programs now administered.

We expect unemployment rate differences to persist unless specific policies are adopted whose goal is to reduce the differentials. The differences will create bottlenecks in the attempt to reach four percent unemployment. For example, we estimate that at an aggregate unemployment rate of 4¾ percent in 1983 with an unchanged labor market structure, the black unemployment rate would still be 130 percent larger than the white rate; the adult female unemployment rate would still be 40 percent larger than the adult male rate, and the teenage unemployment rate would still be 200 percent larger than the adult rate.

These wide differences in employment experience are unacceptable, as is the overall unemployment rate of 4¾ percent reported in that table. If the differentials can be reduced, the overall unemployment rate can be reduced further without adding to inflationary pressures.

Programs aimed at reducing black/white, male/female, and youth/adult differentials in unemployment rates can have a significant impact on the overall unemployment rate. A series of programs which halved these differentials would reduce the unemployment rate by more than one point.

In the many discussions which have been held concerning the achievability of the Humphrey-Hawkins goal, concern has been raised that inflation may begin to accelerate before we reach 4 percent unemployment. Clearly, the point at which inflation begins to accelerate is a significant determinant of the mix between macro stimulus and structural programs which we use to achieve the Humphrey-Hawkins goal. My own feeling is that at the present time we need structural programs large enough to reduce unemployment by about three quarters of a million people in order to achieve the Humphrey-Hawkins goal by 1983. Implicit in this number is my judgment that we can get to a 4¾ percent unemployment rate using macroeconomic policy tools without causing inflation to accelerate. Reducing unemployment by three quarters of a million will require large scale, successful skill training and transitional public service employment programs, substantially targeted in the intervening years on low income and minority workers. Administration proposals in the area of welfare reform and the CETA reauthorization are intended to accomplish this with tighter targeting, strong emphasis on training and placement in the private sector, and over one and a quarter million public service jobs by 1983.

However, some concern has been expressed that we may not be able to get as low as 4¾ percent unemployment before inflation begins to accelerate. In the event that inflation should begin to accelerate at higher levels of unemployment, I see two choices. First, we can permit the unemployment rate to remain at a higher level. Second, we can pursue more vigorously those structural programs aimed at reducing unemployment differentials. Given our recent success with the CETA public service employment and training programs, I feel encouraged that we can achieve the Humphrey-Hawkins goal even if macroeconomic policy is able to do no better than an unemployment rate of 5 percent. However, there are circumstances that could arise which would warrant changing the Humphrey-Hawkins goals. The bill now provides this flexibility.

INFLATION

I firmly believe that the appropriate combination of structural and monetary and fiscal policies can achieve a 4 percent unemployment rate in 1983 without causing any increase in the rate of inflation.

However, considerable concern has been raised that the inflation goal of the Humphrey-Hawkins bill is not stated strongly enough. In fact, there have been several suggestions that a numerical goal should be incorporated in the bill. While I believe that inflation is a serious problem, I do not believe that the incorporation of a numerical goal is the appropriate way to deal with this problem. In order to set out specific numerical goals for public policy, I believe we must satisfy two criteria. We must understand the causes of changes in the goal that we set forth. We must also have some control over the principal causes of these changes. I believe that inflation policy satisfies neither of these two criteria.

The mechanism by which inflation is transmitted through the economy is nowhere near as well understood as the mechanisms affecting unemployment. While we can, within fairly narrow limits, determine how much employment will be generated by a specific fiscal or monetary policy, we do not enjoy the same level of success with predicting the impact of policies designed to counteract inflation. Thus, while we can set forth aggregate levels of growth and the appropriate fiscal policy to achieve this level of growth and be pretty sure of coming close to a specified unemployment target, we cannot set forth in anywhere near as precise a fashion the level of or type of policies appropriate to reduce inflation, by say, one percentage point a year.

Secondly, as events in the recent past in both the energy and food sectors have shown, we are particularly subject to developments outside the domestic economy in the area of inflation. Thus, the large elements of uncertainty which must attach to both future energy and food prices would become crucially important determinants of the overall economic policy and hence of the rate of unemployment. Thus, I feel that until such time as the state-of-the-art provides policymakers with appropriate tools to meet an inflation target, it would be premature to include a numerical inflation goal in the Humphrey-Hawkins legislation.

Let me at this point turn to an issue that has interested the chairman in the past. That is the issue of the link between reduced inflation and lower unemployment. I believe that the attainment of full employment would reduce some inflationary pressures. I see the following forces operating to reduce inflation.

First, high rates of unemployment cause a drain on the unemployment and social security trust funds. High unemployment causes outlays to rise and revenues to fall. We then raise payroll taxes and thereby increase unit labor costs. We estimate the drain on the trust funds increases by four tenths of a percent of total wages and salaries for each percentage point increase in the unemployment rate. For example, State funded unemployment fund payouts grew from 4 billion in 1973 to nearly 13 billion in 1975. Many State unemployment systems are still in trouble as a result.

Second, State and local sales tax receipts fall as unemployment rises. A natural response to this decline is to raise tax rates, including sales taxes which are part of the cost of living. While State and local tax rates have not risen since 1975, there has been extensive assistance to localities through the economic stimulus package. We are currently looking at the fiscal impacts of this assistance as part of our evaluation of the economic stimulus package.

Third, as is well known, increasing unemployment is associated with productivity declines and hence higher costs. During the 11 quarters after the peak in the first quarter of 1973, productivity averaged 2.6 percent below its highest level, implying unit labor costs were 2.6% higher over this period. Further, lay offs often result in a demand for productivity lowering work-rule protections.

Finally, overhead costs from idle capital facilities must eventually be recovered. As output declined from normal levels to the trough in 1975, we estimate that overhead costs per unit of output rose more than 20 percent. While firms clearly absorb some of this increase, increased prices will occur wherever firms have sufficient market power. Overhead costs per unit of output are still 2.4 percent above those which we would have at 85 percent of capacity.

Since these factors do not affect prices on an immediate or regular basis, they are not given their proper weight in the simple statistical relations used to establish a link between low rates of unemployment and high rates of inflation.

There are reasons to expect inflation to accelerate as the economy nears full employment. Shortages of particular kinds of labor or productive facilities arise and prices rise to alleviate the shortages. In the labor market, shortages for skilled workers can arise before all of the unskilled workers have found jobs. These shortages, often specific to certain regions, occupations, or industries, cause wage pressure to increase well before full employment is reached.

A long recession can make this problem worse. An extended period of high unemployment—like the one we have been in—can cause fewer workers to accumulate needed skills. Opportunities for younger workers to gain experience are necessarily limited in a recession. Shortages of skilled and experienced workers are, therefore, more likely in the subsequent recovery and these shortages are as much the result of high unemployment rates in the recession as they are of low unemployment rates in the recovery. Continued high levels of employment will expand the supply of skilled labor, thus reducing wage pressure and offering wider opportunities to those not now enjoying access to good jobs. Our structural programs should continue to play a major role in this movement to a skilled labor force.

CONCLUSION

I am optimistic that we can do better than 4 percent in the long run. Our best estimates, however, indicate that the 4 percent goal will provide quite a challenge. We know that our structural programs will have to perform better than before if this goal is to be reached, that we will have to tighten up further on antidiscrimination programs, and that we will have to reduce the illegal flow of easily exploited low wage workers from abroad.

While the goal provides a challenge, it is not beyond our reach. It is a goal we are committed to achieving because it is a goal we truly believe is important.

I would be happy to answer any questions.

TABLE 1.—UNEMPLOYMENT RATES FOR VARIOUS DEMOGRAPHIC GROUPS

	April 1978	
	Rate	Number (000 omitted)
Total, 16 years and over	6.0	5,983
White:		
Total	5.2	4,559
Men, 20 years and over	3.6	1,696
Women, 20 years and other	5.1	1,640
Both sexes, 16–19 years	14.6	1,223
Black and other:		
Total	11.8	1,398
Men, 20 years and over	8.8	501
Women, 20 years and over	10.5	539
Both sexes, 16–19 years	35.3	358

Note.—Table I is taken from the Bureau of Labor Statistics April 1978 release on the unemployment situation.

TABLE 2.—HYPOTHETICAL UNEMPLOYMENT RATES FOR VARIOUS DEMOGRAPHIC GROUPS IN 1983[1]

	Rate	Number (000 omitted)
Total, 16 yr and over	4.75	5,292
White:		
Men, 20 yr and over	3.0	1,509
Women, 20 yr and other	4.1	1,601
Both sexes, 16–19 yr	10.9	901
Black and other:		
Men 20 yr and over	7.0	447
Women, 20 yr and over	9.3	591
Both sexes, 16–19 yr	21.7	243

[1] Assuming an overall unemployment rate of 4¾ pct and no change in the historical structure.

Note: Table 2 gives the simulated distribution of unemployment rates by demographic group if macroeconomic policy succeeds in reducing the overall unemployment rates to 4¾ pct. The simulation procedure uses the average relation over the business cycle from 1954 to 1977 between the unemployment rates for various demographic groups and (1) the unemployment rate for males between 25 and 55 and (2) the fraction of the population 16 and over which is between 16 and 19. This is the same procedure followed by Michael Wachter in "The Changing Cyclical Responsiveness of Wage Inflation," Brookings Papers on Economic Activity, 1976:1, pp. 115–167

The CHAIRMAN. Thank you, Secretary Marshall.
Chairman Schultze.

STATEMENT OF CHARLES L. SCHULTZE, CHAIRMAN, PRESIDENT'S COUNCIL OF ECONOMIC ADVISORS

Mr. SCHULTZE. Thank you, Mr. Chairman. I have a statement which I would request be put in the record and I shall excise freely in order to speed the time.

[Complete statement follows:]

TESTIMONY OF CHARLES L. SCHULTZE, CHAIRMAN, COUNCIL OF ECONOMIC ADVISORS

Mr. Chairman, I am pleased to appear before this Committee in support of S. 50, The Full Employment and Balanced Growth Act. As noted by the President in his State of the Union Message, this Administration supports early passage of the Humphrey-Hawkins bill.

The Full Employment and Balanced Growth bill accomplishes four major goals:

It reaffirms and strengthens our national purpose of providing job opportunities for all those who are able and willing to work;

It sets forth a national policy of achieving reasonable price stability;

It explicitly recognizes the need to combine overall fiscal and monetary measures with structural economic programs and reforms;

It substantially improves the procedures by which national economic policy is formulated and coordinated.

THE FULL EMPLOYMENT AND BALANCED GROWTH ACT AND THE EMPLOYMENT ACT OF 1946

The Humphrey-Hawkins bill modifies and extends the general principles of the Employment Act of 1946. That act, for the first time, charged the Federal Government with responsibility to assure satisfactory performance of our national economy. The broad economic objectives of maximum employment, production, and purchasing power enunciated in that act have served as useful guidelines for designing overall economic policy during the past 30 years. Although the Employment Act, wisely, did not enact particular programs or approaches into law, it did play an important role in ensuring that the economic performance of our nation in the decades after the second world war was vastly superior to that of earlier periods.

In recent years, however, our nation, along with all the other industrial countries of the world, has been afflicted with the simultaneous appearance of high unemployment and persistently high levels of inflation. Structural unemployment among teenagers and minority groups has grown to serious proportions. And a significant decline in the rate of productivity growth has reduced the growth of our living standards.

The table below summarizes the inflation, unemployment, and growth picture during the past 30 years. After the immediate economic adjustments from the second world war, the average performance of our economy—in terms of unemployment, inflation, and rising living standards—while far from perfect was on the whole quite good. The period of our heavy involvement in the Vietnam war saw a significant rise in the rate of inflation, but a maintenance of relatively low unemployment rates. Since 1972, however, both the rate of inflation and the rate of unemployment have averaged far above the earlier postwar years. We are making progress in reducing unemployment, but the rate of inflation has been persistently running in the 6 to 6½ percent range for over two years.

INFLATION AND UNEMPLOYMENT 1948–77

[In percent]

	Average annual inflation rate [1]	Average unemployment rate	Real economic growth per capita [2]
1948–1966	1.7	4.8	2.3
1967–1972	4.3	4.6	2.0
1973–1977	7.7	6.7	1.9

[1] Change in consumer price index.
[2] Real gross national product growth per capita.

Structural unemployment has been a problem for a long time but its seriousness has grown in recent years. In the absence of measures to deal specifically with structural unemployment problems, a return to an overall economic performance similar to that which characterized the earlier postwar years would still leave unemployment at intolerably high rates among some groups, and most particularly among minority youth.

UNEMPLOYMENT RATES BY DEMOGRAPHIC GROUPS

[In percent]

	1956	1965	1973 III	1978 I
Total	4.2	4.6	4.8	6.2
White:				
Males 20 yr and over	2.7	2.6	2.8	3.9
Females 20 yr and over	3.9	4.2	4.4	5.1
Teenagers	9.1	12.3	12.2	14.4
Black and other:				
Males 20 yr and over	6.7	5.4	6.0	9.0
Females 20 yr and over	9.4	9.0	8.1	10.8
Teenagers	16.6	24.6	31.5	38.6

NOTE.—Data for 1956 and 1965 adjusted for change in definitions in 1967. Quarterly data are seasonally adjusted.

While the Employment Act of 1946 has served the nation well, the problems that now confront us are not the same as they were when that act was passed. The time has therefore come both to reaffirm our commitment to stable economic prosperity and to devise a new set of procedures to reach this objective in today's economic circumstances.

The Full Employment and Balanced Growth Act updates the Employment Act of 1946 in ways that respond to these needs. Its focus is not on enacting into law specific programmatic measures. Rather, the bill establishes a long-term framework for economic policy making that should serve us for the decades ahead. It sets forth a process in which policies designed to meet the needs of the immediate future are formulated within the context of a longer-term economic strategy. Furthermore, the bill emphasizes the importance of adopting specific policies to deal with the *structure* of the economy as well as *overall* monetary and fiscal policies to deal with the management of aggregate demand.

In its deliberations on this bill, I urge the Congress to keep in mind that it is establishing a framework for economic policy making, under which we can deal not only with the problems and circumstances of today but with the different problems and changed conditions of tomorrow. The bill now before you does that; it is a broad and flexible instrument for current and future policy making.

The Full Employment and Balanced Growth Act that you are currently considering has evolved over time from earlier versions. Last year, lengthy discussions between the Administration and the Congressional sponsors contributed to that evolution. We believe the time and effort were well spent. Those discussions resulted in a number of substantial improvements in the legislation. The Administration fully supports the bill now before you.

ECONOMIC GOALS AND THE POLICY MAKER

The heart of the Humphrey-Hawkins bill is a new set of procedures for establishing and reviewing economic goals and policies in which the President, the Congress and the Federal Reserve all participate.

The President would be required to enunciate explicit short-term (2-year) economic goals for employment, unemployment, production, real income, and productivity, and to recommend the fiscal policies necessary to achieve them. He would also be required to set forth medium-term (5-year) goals for the same economic variables and present projections of Federal receipts and outlays consistent with them. In the first *Economic Report of the President* submitted under this bill, the President would be required to include the goal of reducing the overall unemployment rate to not more than 4 percent within a 5-year period.

The Congress would review the President's economic goals and policy recommendations, and adopt its own set of goals and policies, which may or may not coincide with those of the President. The Administration has not made recommendations on the specific procedures for Congressional review, because this is a matter for the Congress to decide itself. Nevertheless, we feel strongly that Congressional deliberations and conclusions on economic goals should be closely integrated with the new procedures in the Congressional Budget Act of 1974. Both the Congress and the Administration should be subject to the same discipline—namely, that economic objectives and budgetary policies should be established on a mutually consistent basis. Without that discipline of consistency, there is substantial danger that the establishment of economic goals would become meaningless, and fail to accomplish the purpose intended in the bill.

The Federal Reserve would be required, under this bill, to submit to the Congress a report on its intended monetary policies, and to explain the relationship between those policies and the President's short-term goals. This provision goes somewhat beyond existing reporting procedures, but is consistent with the recent efforts of the Congress to monitor the course of monetary policy and to improve the coordination of monetary and fiscal policies.

Let me emphasize that the bill does not call for review or oversight by the Executive Branch of the Federal Reserve's policies. The monetary authority would continue to be responsible to the Congress and to the Congress alone. The independence of the Federal Reserve System from the Executive Branch of government, an arrangement which has served our nation well, would be preserved.

This process of placing economic goals and proposed policies formally on the record serves several important purposes. The Congress and the public would be regularly informed of the Administration's economic objectives, and the means for pursuing them would be clearly identified. Setting explicit goals also disciplines the formulation and execution of policies, and creates a system of early warning signals for midcourse policy adjustments. Moreover, the requirement to establish economic goals for a 5-year time horizon will focus attention on the longer-term implications of short-run policies. Thus we are more likely to avoid the mistakes that can occur from too short range a view of the implications of a given course of policy.

THE PROBLEM OF INFLATION

In the past, concern has been expressed that the Full Employment and Balanced Growth Act may be dangerously inflationary. I can assure you that the Administration would not endorse this bill if it threatened to aggravate our inflationary problem. The problem of inflation is much too serious to be given second place among our priorities. We must, and will, give it our fullest attention. This legislation recognizes the seriousness of the problem of inflation. It also recognizes that the kind of inflation that troubles our economy today cannot be dealt with effectively by relying solely on monetary and fiscal policies.

Gaining better control over inflation is absolutely critical, not only for its own sake but because it could threaten the achievement of high employment and full prosperity. We and other nations are still suffering from the trauma produced by the marked worsening of inflation during 1973 and 1974 and the deep recession that followed it. Fears that inflation might be aggravated continue to inhibit many countries around the world from taking the steps that are needed to invigorate the growth of world economic activity.

The United States has made significant progress in reducing inflation from the 12 percent rate of 1974. But despite significant slack in the economy during the course of the recovery—with unemployment rates ranging between 6¼ and 9 percent—the underlying momentum of inflation has not abated. Over the past six months, prices of consumer goods and services less food and energy—a measure of the underlying trend of inflationary pressures on the economy—rose at an annual rate of 6.6 percent. That is little different from the 6 to 6½ percent range in which the underlying inflation rate has remained for almost three years.

Although considerable slack exists in our economy today and we are not now facing a situation where excess demand is exerting upward pressure on prices, as we approach higher levels of employment in the period ahead, the risks will increase that the rate of inflation may worsen. A significant increase in the inflation rate would undermine the confidence of consumers and businesses and jeopardize the recovery. Moreover, we would be inhibited from taking the fiscal and monetary steps necessary to keep the economy growing at a pace consistent with a steady reduction in unemployment. Progress against inflation is thus absolutely essential to reduce unemployment.

The inflation problem that we face today has two distinct aspects. We need, on the one hand, to pursue policies that will avoid a worsening of inflation as we regain high employment. And we must take steps now to begin unwinding from the high rate of inflation that we have inherited from the past.

The government can, by following prudent fiscal and monetary policies, ensure that inflationary pressures are not increased due to excess aggregate demand when the economy returns to high employment. The Humphrey-Hawkins bill recognizes that coordinated use of fiscal and monetary policies has a vital role to play in dealing with inflation.

A second important step is to ensure a healthy growth in investment. We must promote an expansion of industrial capacity rapid enough to prevent shortages and bottlenecks in individual industries as we reach the higher levels of output and employment called for by this bill. And we must also seek to reverse the recent slowdown in the growth or productivity. The bill recognizes this fact, and requires the President to recommend, as appropriate, policies and programs to increase the rate of capital formation.

Third, a successful attack on the structural sources of unemployment also is essential to reduce the chances of higher inflation rates in the future. This, too, is fully recognized in the Full Employment and Balanced Growth Act.

In addition to measures that avoid any worsening of inflation, however, we must take steps now to begin unwinding the high rate of inflation that we have inherited from the past. The current inflation has been underway for more than a decade, and is now deeply entrenched in the process of setting wages and prices. It cannot be brought to a halt by governmental actions alone. Nor can it be eliminated through the action of any one group of workers or businesses. There is no easy way out of the dilemma in which we find ourselves, but some effort must clearly be made. I believe the President's program for voluntary deceleration of wage and price increases offers the best chance for success in resolving this very difficult problem. It is a fair and flexible proposal. If it succeeds in accomplishing a gradual reduction in inflation, as I believe it will, our chances of sustaining economic growth will be improved, and the risk of new inflation reduced.

The Humphrey-Hawkins bill contains a far more explicit recognition that inflation is a major national problem than did the Employment Act of 1946. That earlier act required the Federal Government to promote "maximum purchasing power," but left the meaning of the phrase ambiguous. This bill explicitly identifies inflation as a major national problem and establishes the goal of reasonable price stability as a high priority objective of national policy.

The bill explicitly requires the President to recommend macroeconomic policies "to achieve reasonable price stability as rapidly as feasible." Furthermore, the potential conflict between low rates of unemployment and inflation is implicitly recognized; the bill specifies that in choosing policies to achieve these two goals, "those means which are mutually reinforcing shall be used to the extent practicable." Also, the bill provides the President with the flexibility—after three years—to modify his goal for reducing unemployment if he finds it necessary to do so.

At the same time, the bill recognizes that the rate of inflation is increasingly unresponsive to widespread unemployment and idle capacity, and that overall monetary and fiscal policies alone are not able to bring under control the kind of inflation we have today. The bill recommends that programs and policies be developed which directly improve the structure and functioning of individual markets. Included among such measures are an early-warning system to detect emerging capacity problems, stockpiling of agricultural commodities and other critical raw materials, regulatory reform, vigorous enforcement of the antitrust laws, and the promotion of labor-management cooperation in efforts to boost productivity. These steps are consistent with the Administration's views as to the measures needed to cope with the present inflation. Together with policies to deal with structural employment, they can help us make progress simultaneously toward reducing unemployment and controlling inflation.

THE UNEMPLOYMENT PROBLEM

Let me turn next to the goal of reducing unemployment. The Employment Act of 1946 was concerned principally with cyclical unemployment—that is, unemployment stemming from insufficient aggregate demand. The Full Employment and Balanced Growth Act is also concerned with that problem, as it should be. In addition, however, it addresses the more intractable problem of structural unemployment.

The rate of unemployment, in good times and bad, varies substantially among different groups in our society. Some kinds of differentials are understandable and necessary. Even with plentiful job opportunities, young people are more likely than others to be changing jobs, searching for a desirable life-time career. Short spells of unemployment while engaged in a search for better jobs are not a major social problem, and do not constitute structural unemployment. But among some groups in our society unemployment rates, even in good times, remain unconscionably high. They do *not* result from the successful search for better jobs, but represent a major economic and social problem. The problem exists in a variety of forms and for a number of reasons: lack of skills or skills that have become obsolete; a regional mismatching of workers' skills with job requirements; wage rigidities; a job market whose requirements, in terms of working hours and schedules, are changing too slowly to accommodate the growing number of married women seeking work; and discrimination against minorities. There are many groups affected, but as the earlier table showed, none so much as minority workers, and among them, young people. Moreover, the problem of structural unemployment has worsened appreciably in recent years. At the trough of the 1974–75 recession, the unemployment rate for black males over 20 years of age and over was 12.0 percent—1.8 times as high as the rate for white adult males. This ratio would normally decline in the course of a cyclical recovery in economic activity; in fact, however, it has risen. In the first quarter of 1978, the unemployment rate for black male adults—at 9 percent—was 2¼ times as high as that for white adult males. Still worse, the unemployment rate for black teenagers has shown no improvement at all during the first three years of recovery, and still ranges between 35 and 40 percent.

Overall monetary and fiscal policies alone cannot deal with the problem of structural unemployment. Effective measures to reduce structural unemployment are absolutely essential to the goal of controlling inflation as our economy returns to higher levels of employment and output. When the overall unemployment rate declines, at some point the number of job vacancies begins to exceed the number of qualified job seekers. The unemployment rate among experienced adult male workers drops to very low levels, while unemployment rates among other groups remain much higher. Instead of meeting their labor force needs from among the groups with high unemployment rates, firms compete with each other to hire from among the group of older and experienced workers who are in increasingly short supply. The result is strong upward pressure on wages and prices, and the emergence of renewed inflation, even though there are still very high unemployment rates among many groups in the labor force. Effective programs to increase job opportunities for groups with high unemployment would greatly reduce the prospects that wage and price increases would begin to accelerate while the overall unemployment rate was still unacceptably high.

The Humphrey-Hawkins bill recognizes that monetary and fiscal policies to deal with aggregate unemployment must be accompanied by structural employment and training policies that focus directly on groups with chronically high unemployment. There is no requirement in the bill that any specific program be introduced, but a number of programs are recommended to the President for his consideration—including public works projects, public service employment, countercyclical revenue sharing, and youth employment programs.

The bill also provides for establishment of such additional public and private nonprofit employment projects as the President determines are needed to meet the long-term target for the unemployment rate. These additional projects may be created, however, only after an official finding by the President that all other means of reducing unemployment are insufficient. Furthermore, new programs recommended by the President would require specific authorization and funding by the Congress.

THE 4 PERCENT UNEMPLOYMENT GOAL AND STRUCTURAL EMPLOYMENT POLICIES

Achievement of the 4 percent goal for the overall unemployment rate target by 1983—assuming passage of the bill in 1978—would imply that actual GNP would exceed our current estimates of the nation's potential output. Therefore, the actual unemployment rate would lie below the "benchmark" unemployment rate on which estimates of potential output are based.

It is generally believed that during the mid-1950s the overall unemployment rate could be reduced to about 5 percent by overall monetary and fiscal policies before inflationary pressures would begin to appear. A number of forces have been at work during the past 20 years to raise this rate. The principal factor seems to be the shift in the composition of the labor force toward those demographic groups—particularly teenagers—with the highest rates of labor force turnover and unemployment. This means that the overall rate of unemployment corresponding to any degree of labor market tightness is higher now than it was two decades ago.

Given the present structure of labor markets, it is highly unlikely that a 4 percent unemployment rate could be achieved through aggregate demand policies alone without at the same time causing increased inflation. But this does not mean that a 4 percent unemployment rate by 1983 is unachievable. As the Full Employment and Balanced Growth Act clearly recognizes, it merely means that we cannot rely solely on monetary and fiscal measures to get there. Responsible policy requires not that we abandon efforts to reach the 1983 unemployment goal, but that we work steadily to reduce any potential conflict between low unemployment and inflation through the development of structural measures to improve the functioning of markets, especially labor markets.

The task we face is a difficult one. We have already taken some important first steps, but much remains to be done.

In the 1977–78 stimulus package, the level of jobs under the Public Service Employment program was increased from 310,000 to 725,000. The program was also modified to target it more carefully on the longer-term and low-income unemployed, who are the most likely to be among the structurally unemployed. The President is proposing to continue this program at the 725,000 job level in 1979.

The current public service jobs program is principally countercyclical in nature, and will be stepped down gradually after 1979 as the overall unemployment rate declines. A more permanent program, designed to provide work for 1.2 to 1.4 million persons, is part of the President's proposed overhaul of the nation's welfare system. This program is aimed at offering work, rather than cash welfare, to those of the nation's poor who are able to work. The 1979 budget includes a request to fund a 50,000-job program to demonstrate the feasibility of the Program for Better Jobs and Incomes.

Special programs for young people were authorized under the Youth Employment and Demonstration Projects Act enacted by the Congress in 1977. These projects are aimed at testing a number of alternative approaches to combine work experience and training for young people. In the 1979 budget, we are requesting funding for 166,000 slots in the YEDPA programs and to increase the Job Corps.

The private sector also has a major role to play in attacking the structural unemployment problem. Most new jobs will be created there. To bring the structurally unemployed into the mainstream of the American economy—with decent jobs and a chance for advancement—they must have full access to private jobs. The President has sent to the Congress a proposal to provide incentives and to enlist the cooperation of private industry toward increasing the hiring of disadvantaged workers. Some $400 million has been set aside in the 1979 budget for this new initiative. Also, the Administration has proposed, as part of the President's urban initiative, a new targeted employment tax credit, ultimately to cost about $1½ billion, to help provide job opportunities to disadvantaged young people.

Between now and 1983, we expect to make significant progress in reducing structural unemployment. We do not yet have answers to all the problems, however. I cannot, therefore, assure you that we will be able to achieve a 4 percent unemployment rate by 1983 without risking more inflation. That is why the Administration believes it essential that the bill provide the President with the flexibility he needs to modify his goals for the overall unemployment rate if that should be necessary. The bill before you contains that needed flexibility.

We will work strenuously ourselves, and with the Congress—to determine which structural employment programs work well and which do not, to concentrate our efforts where they do the most good, to improve the effectiveness of existing measures, and to design new ones if needed—in order to attack successfully the problem of structural unemployment, and thereby help meet the overall unemployment goals of the bill without setting off inflationary pressures. The bill establishes a difficult set of goals. But it is precisely in striving to meet difficult goals in a responsible way that we make progress.

CONCLUDING COMMENTS

The Full Employment and Balanced Growth Act challenges us to make our economy function better, and proposes a new set of procedures to help meet our short- and long-run economic objectives. There is a strong commitment to full employment; at the same time, the bill places the achievement of reasonable price stability on an equal footing with the achievement of high employment, and it provides adequate safeguards against policies that ultimately could prove destructive. Moreover, it relies on existing governmental institutions to achieve its objectives and does not authorize massive new Federal programs or impose controls on the economy. And it reaffirms the critical role that a healthy and dynamic private sector must play in achieving our long-term economic goals. It is in the spirit of the Administration's economic goals as stated in the Economic Report of the President.

This new framework cannot guarantee that our nation's resources will always be fully employed or that the economy will always be healthy. But, it should help identify where the most serious obstacles are and point the way toward rational solutions. The Administration believes this legislation represents an important and necessary step beyond the Employment Act of 1946, and we urge its prompt passage.

The CHAIRMAN. I want to thank both you gentlemen for excellent and very powerful, persuasive statements in support of your position.

Chairman Schultze, didn't you previously indicate at least some reluctance about the Humphrey-Hawkins bill? In fact, did you at one point oppose it? I'm not talking about this particular measure. I realize it's been modified, but I'd like to know just what changes or improvements have been made that has persuaded you to give you its enthusiastic support now whereas you expressed reluctance in the past.

Mr. SCHULTZE. As a matter of fact, earlier, as a private citizen, I did oppose what I think is the third modification prior to the bill now before you.

There have been a number of very substantial improvements in this bill:

First, the bill as it now stands puts inflation control as a major objective of national policy. The earlier bill did not.

Second, the bill as it now stands does not authorize a number of large additional programs. The earlier bill did in some cases and in other cases required the President within 60 to 90 days to come up with such proposed authorization.

Third, this bill provides the necessary flexibility to deal with unforeseen circumstances in the economy. Among other things, it gives the President, should it prove necessary, the flexibility to modify his goals if circumstances should require it. The earlier bill did not.

These I think are the major changes in the bill which make it, I think, substantially improved and gained my support.

The CHAIRMAN. Well, the very first point you make is that this bill, unlike the previous bills, does provide for a priority for inflation and for controlling inflation and limiting inflation. I just wonder if that priority is as effective as you imply. There's rhetoric in here and there's some very substantial suggestions here, but there's nothing really that puts inflation on the same basis as unemployment.

Let me point out that we now have a situation in which some of the balest economists in the country are arguing that we are already right now today at a point where the reduction of unemployment has put us close to what some people call full employment and other people say is beginning to exert pressure in pushing up wages and pushing up prices.

Dr. Burns, whom we all highly respect, has indicated that the 2.8 percent unemployment level of married men suggests that we may now be close to full employment. He said that yesterday. George Parris, whom I'm sure you admire and respect, said we are already at a level where employment pressures may be driving up wages and prices. The polls indicate that four times as many people argue that inflation is our No. 1 problem as argue that unemployment is our No. 1 problem today, and yet in this bill we have a specific target for unemployment—and I think the overwhelming majority of members of the Congress and the public would regard that as what the Humphrey-Hawkins bill really does—and we don't have that for inflation.

I wonder in the light of that and in view of the way that has been expressed, to wit, I have suggested as you know a 3 percent inflation goal to go in tandem with the 4 percent unemployment goal, and I say "policies to achieve the inflation goal which will be designed so as not to impede the achievement of the unemployment goal." That is, the inflation goal can't be used as an excuse for not meeting the unemployment goal.

Now what's wrong with that kind of approach?

Mr. SCHULTZE. Well, let me start first by referring you to Secretary Marshall's very cogent arguments that the very nature of our tools to deal with inflation make it much more difficult to set a numerical goal and achieve it than in the case of unemployment. Both are difficult, but it is substantially more difficult to achieve a specific numerical goal for inflation.

Let me go on. What is very important is that we continue to push the rate of inflation down; that we make progress in decelerating inflation.

The CHAIRMAN. That's what a goal is for. That's what a specific numerical goal is for, so you have benchmarks so you know whether you're moving or not.

Mr. SCHULTZE. The bill as now drafted explicitly states reasonable price stability as a goal and requires the President to set forth his programs and policies to achieve it.

Let me also note that this is an act which, like the Employment Act of 1946, is not an act just from now until the year 1983. It is setting a long term framework for economic policy. Putting a numerical goal for inflation in the legislation, as opposed to requiring the President each year to say something about what his goals are, as the bill does, runs into an incurable dilemma.

No. 1, if you put a number in which is reasonably achievable over the long term, that number in the short term is going to be looked on as unrealistic. If, on the other hand, you put a number in which in the short term may be reachable, then the Congress has placed its stamp of approval over the long term on too high a level.

I don't believe any number ought to be put down as a desirable number on inflation. I think it is important that we keep trying to reduce whatever rate of inflation we have but I think there is a real dilemma in putting a number into this bill.

That does not mean the Congress shouldn't require the President each year in his 5-year goals, as the bill does, to say what he is going to do with regard to reasonable price stability and what his objectives are so that the Congress can evaluate this each year. But putting a number in a long term piece of legislation, a single number on inflation, seems to me, in addition to the problems Secretary Marshall has pointed out, to suffer from that dilemma.

The CHAIRMAN. Let's see what that language means. The bill as it passed the House provides a requirement that the President state short term goals for employment and unemployment, production, real income, productivity, and prices for each of the next 5 years.

Now the burden will fall upon you, as chairman of the Council of Economic Advisors, to tell the President the appropriate and consistent goals for these variables for 1979, for 1980, 1981, 1982, and 1983. What goals will you select for unemployment and inflation for 1983 if they are not numerical?

Mr. SCHULTZE. Well, there is a difference, Mr. Chairman. The bill requires the President to lay out a rolling 5-year plan—each year you set forth 5-year goals and the next year you come back and add a year and modify in between, depending on circumstances. That is doable. That is acceptable. That is desirable. That's a different thing from stating in the legislation that the President for year "*x*" must put in a certain number for inflation.

The CHAIRMAN. You see, as I envison my amendment, it would enable the President to change the long term inflation goal at the same time that he might modify his long term unemployment goal.

Mr. SCHULTZE. I understand that, Mr. Chairman. What I'm saying is that if you tell the President he must put down 3 percent for 1983 and have this in a long term piece of legislation, it may be unrealistic and what we really need to do is make progress. It might turn out we could make it, but the key thing is to make progress now.

On the other hand, if you put in 3 percent and bless it, this is saying the Congress thinks 3 percent now is the right number. I'm saying what you want is to force the President to set forth his goals, to state the national policy of achieving reasonable price stability as rapidly as possible, but not to pin that on a single number because it is different from unemployment.

The CHAIRMAN. Well, the fact that you require the President to make that and offer him the opportunity to modify as time goes on seems to me does give him flexibility. Also, I think it's clear that we are sophisticated enough, the people in this country are, to recognize if you have an embargo on oil, if you have any number of other developments—a crop failure worldwide for 2 or 3 years—that you're going to have inflation, and there's nothing you can do about it and prices are just going to go up very high—either that or you're going to have a monetary policy that's going to put you in an incredible depression.

Let me ask you, Mr. Marshall, you told me that we have the ability to design programs to achieve the 4 percent unemployment goal in the Humphrey-Hawkins bill. You said we know where the problems are and how to deal with them. At the same time, you said that we do not know how to solve the inflation problem and that we do not have a program to reduce inflation.

Now it seems to me that inflation may be more difficult to deal with because stopping it may require sacrifices from everybody, but it can be done if we have the will to do it under most circumstances except under the kind of unusual circumstances I just described—a war situation or an international situation that could be devastating or something of that kind.

Do you believe that appropriate policies to reduce inflation can be found and implemented?

Secretary MARSHALL. Yes, I do. I don't think we can state them with the same precision, and I think some of them are more uncertain in their outcome than is the case with unemployment, but I believe very strongly that we can and must find ways to reduce inflation as well as unemployment.

The CHAIRMAN. My time is just about up, Mr. Marshall, but before I yield to Senator Brooke, let me just say that I think that by putting a numerical inflation goal there what you really do is to mandate—put in the way I have said so you don't impede progress toward reducing unemployment—you mandate the kind of policies which you have been calling for. The only way you can achieve this is by training policies and by productivity improvements and by increased mobility and by restraint on the part of management and labor. Policies of that kind could give much more force and explicitness and direction if you have that goal spelled out as clearly as a matter of national policy as you have the unemployment goal.

Senator Brooke.

Senator BROOKE. Thank you, Mr. Chairman, and thank both of you for your very excellent statements.

Secretary Marshall, do you see any danger that we might be unduly raising the level of expectations for the unemployed and the consumer in this country that we are really going to be able to hold down inflation without any mechanism in this bill at all, any machinery for achieving these goals?

Secretary MARSHALL. Well, I think there is that danger, but I think that it's important to establish goals that we can reach and that it will take a lot of hard work to achieve both of these objectives.

Senator BROOKE. Is the administration prepared to come forth with some machinery, some mechanisms for achieving these goals if the Humphrey-Hawkins bill is passed?

Secretary MARSHALL. I think so. In fact, I think much of the machinery to achieve these goals is already either proposed or in existence and that's one of the major differences between the situation that we face now and the situation we faced earlier with respect to the Humphrey-Hawkins bill. Much of what the earlier versions of this bill contemplated have already been passed or proposed.

Senator BROOKE. Now the revised version of S. 50 places a good deal of emphasis on the CETA program to prepare people for useful, productive employment in the private sector. Do you think that the present CETA superstructure is adequate to cope with the demands which are likely to be placed upon it by the Humphrey-Hawkins generated increase in volume?

Secretary MARSHALL. No; I do not believe that it's currently adequate, but I think that by the time we get more to the 1983 target we must make it more adequate.

One of our major objectives this year in the Labor Department is to start that process of first perfecting the system itself, improving the system itself, and improving the linkages between the public service employment and training programs and the private sector. Unless we perfect those linkages it will be very difficult for us to achieve our objectives and that's the reason we have assigned it such high priority.

Another thing that's important to the achievement of that objective is welfare reform. In our thinking about how to get to the 4-percent unemployment target without inflationary pressures, we have placed great emphasis on those jobs that we hope will be created as a part of welfare reform.

Senator BROOKE. In the main, you're really talking about the hardcore unemployed, aren't you?

Secretary MARSHALL. Yes; we are, and of course in the CETA reauthorization—the other thing I should mention besides targeting on the private sector—we have got to target most on those people with the highest rate of unemployment, and on those places with the highest rate of unemployment. This is exactly what we proposed in the CETA reauthorization currently before the Congress.

Senator BROOKE. But in your very startling statistics and the data that you gave us in your text this morning it just appears to me, no matter what programs come out of the Government, that we still are not making any marked decrease in unemployment in the hard-core. So these programs are really not reaching the people that we really have to reach in order to get the reduction we are talking about. Isn't that true?

Secretary MARSHALL. They need to be targeted more in order to achieve those results, but it is not true that they have not had an impact. If you look at——

Senator BROOKE. Well, some impact, but not the impact—I think you have to——.

Secretary MARSHALL. I think the public service employment program—take, for example, the experience we had with the President's stimulus program in 1977. During the first half of 1977 black unemployment was rising while white unemployment was going down. During the first half of 1977, Vietnam veterans' unemployment was rising, while the overall rate was going down. When these programs went into operation those trends changed dramatically during the year, black unemployment peaked during the last half of the year and started declining. Black youth unemployment, for example, was about 40 percent. Now it's about 35 percent.

Now if you compare points in time it looks like there's no change, but if you compare the fact that it was rising and now it's coming back down, I think that you get dramatic results.

Senator BROOKE. But 35 percent is still an unconscionable rate.

Secretary MARSHALL. That's right, but if we can reduce it 5 percent at points every 6 months between now and 1983 we will do a lot of reducing.

Senator BROOKE. Do you anticipate that?

Secretary MARSHALL. I think that we will not be able to do it that dramatically, but I think we can do it, and I think there are a number of things that we can do to accomplish it. There are only about 252,000 unemployed black teenagers in the country. We created more jobs than that just in the last half of the year in our stimulus program.

Senator BROOKE. And they all have to go into the public service jobs. Is there no possibility of getting them into private sector jobs?

Secretary MARSHALL. No; I think it's absolutely essential that they get into private sector jobs, and we are paying every attention to that, as I mentioned. If you just get them into public service jobs you won't solve the problems, because most of the better jobs are in the regular economy, and we have to work very hard in establishing the linkages between the regular economy and our public sector jobs.

The way we do that is to first get the private sector to help us and that's the reason we are proposing to do that.

Senator BROOKE. Well, I voted for public service jobs because of our consistently high unemployment, but I don't think that's the road we want to travel.

Secretary MARSHALL. I don't think it is either. I think we need to get people into training programs so that their skills are improved, and we need to look at the characteristics of the people you have and try to permit the flexibility in the system to meet the unique problems that they have. Some young people need programs that make it possible for them to return to school, for example. Some need programs to make it possible for them to stay in school. Our Youth Employment Demonstration Act does that. Some people need remedial educational work as well as training. The Job Corps does that. We are moving to double the size of the Job Corps. We need to establish better linkages between the educational system and the workplace, and we are trying to do things to accomplish that, but we also need to strengthen these linkages between the public programs and the private sector.

Senator BROOKE. And the permanency of that you can achieve in private sector jobs as opposed to public service jobs.

Secretary MARSHALL. Yes.

Senator BROOKE. Now Humphrey-Hawkins at least implicitly contemplates a return to the good old days we experienced during the period of 1952 to 1957 when we had a low rate of unemployment and a low rate of inflation, but do you really feel this is a realistic goal, or are we really stuck between this tradeoff between inflation and unemployment?

Secretary MARSHALL. I believe it's a realistic goal and I don't believe the tradeoff is necessarily a real tradeoff. If, for example, the structural changes in the economy make it more difficult for us to reduce unemployment, then it's clear that we need to take structural measures to deal with that problem.

So I think the combination of general or macroeconomic policy and structural policy can deal with the problems that we now face which are substantially different than the problems we faced in the 1950's and 1960's.

Senator BROOKE. Chairman Schultze, your predecessor was here yesterday, Leon Keyserling, and he argues very persuasively that his experience under President Truman showed that deficits follow unemployment as does inflation and if you get rid of high unemployment rates, large Federal deficits and high rates of inflation will then take care of themselves.

How would you react to the Keyserling analysis? It seems to buttress the theory behind the Humphrey-Hawkins bill.

Mr. SCHULTZE. Well, I would say first that if you look at the periods in which we have had very large deficits and very high unemployment that the major factor causing large deficits is high unemployment. At the same time, I think it's also true that you cannot thereby also state in some sense that you can magically, by pushing a button, get low unemployment and wipe out the deficit and everything will be OK. That is, we also have to work in the measures we take to promote economic growth, to promote employment so that we also don't wind up having overdone it with large deficits and low unemployment leading us therefore into a potential of inflation. So I take a mixed view.

It's clear that the big deficits do come in periods of high unemployment. I think at the same time we do have to pursue monetary and fiscal policies so that as we get back to these lower levels of unemployment and higher levels of prosperity, we don't maintain the same kind of deficits driving us into inflation.

Let me add one point with respect to the realism of achieving the goals. I think it's absolutely unquestionable it's going to be much harder to get there than it was in the middle 1950's and the middle 1960's. It's going to be much harder to get there. The nature of our labor force is different. The composition has shifted. There are larger problems of structural unemployment. So first, yes, it is more difficult. Second, I think the major point of the Humphrey-Hawkins bill is precisely that it realizes it is more difficult and puts very heavy stress on structural employment policies to provide incentives to the private sector to hire not just, quite frankly from the highly experienced work force, but to dip more into that pool of high unemployment during periods in which production is expanding. That's the name of the game in effect, to redirect those patterns so that we don't put so much pressure on bottleneck areas but spread the employment increase around so everybody does better. And that is going to be difficult but it is not unachievable and I think it's a good goal.

Senator BROOKE. Thank you. My time has expired.

The CHAIRMAN. Senator Garn.

Senator GARN. Thank you, Mr. Chairman. I'm sorry that I was unable to be here at the beginning of these sessions, so not to take the time of the witnesses I would ask unanimous consent that a statement explaining my opposition to Humphrey-Hawkins be included in the record.

The CHAIRMAN. Without objection, so ordered.

[Statement of Senator Garn follows as though read:]

STATEMENT OF SENATOR GARN

Senator GARN. I am in full agreement with the goals of the Humphrey-Hawkins Bill. I think that everyone would agree that it ought to be a top priority of our government to work towards the reduction of the unemployment rate, the furtherance of balanced growth, and the control of inflation.

Where I, and many of my colleagues disagree, is whether the approach embodied in Humphrey-Hawkins is the way to achieve those worthwhile ends.

As we all know, a basic proposition of economics is that "there is no such thing as a free lunch." And I fear that the cost of the "free lunch" contemplated in Humphrey-Hawkins far exceeds the value of the goods delivered.

Humphrey-Hawkins assumes that a major cause of our nation's economic ills—particularly unemployment—is the lack of coordinated planning by agencies of the Federal Government charged with economic policy. To remedy this assumed defect, the bill directs planning and coordination on an unprecedented scale.

If you begin with the wrong assumption, as I would argue Humphrey-Hawkins does, then the remedies are likely to be irrelevant to the problem, or worse, may even compound the problem you seek to deal with.

Unemployment is not caused by poor planning and coordination in the Federal Government. It is the result of wrong-headed—and, perhaps, too well-coordinated—Federal programs, which create disincentives to invest in the private sector, drain off vital capital from the private sector, and generally impede the free market forces essential to good economic health.

More planning and coordination, particularly if it involves compromising the independence of the Federal Reserve, as Humphrey-Hawkins contemplates, is likely to compound the problems which have already been created by deficit spending and interventionist Federal policies.

Most ironically of all, Humphrey-Hawkins contemplates the formulation of "5-year plans." One might have hoped that the disastrous Soviet experience with "5-year plans" would have warned even our most liberal economists away from such experiments with centralization of the economy, particularly when even the Soviets have begun to move away from rigid planning.

I fear that the goals contemplated in S. 50 are unattainable and indeed a cruel hoax on our Nation's poor and unemployed. It is wrong to raise their hopes only to dash them once more when Congress balks—as it is likely to do—at huge deficits to finance deadend, makework projects a few years down the road when the economic planning and coordination contemplated in Humphrey-Hawkins shows its bankruptcy.

Secretary Marshall, I'm concerned particularly along the line that my distinguished colleague from Massachusetts was pursuing, about public service employment versus private.

Do you have any facts or figures that you have accumulated to show that public service jobs have led to private employment?

Secretary MARSHALL. Yes. About 41 percent of those who were in public service employment between January and June 1975 and who are now employed are employed in the private sector. We think that—and I am confident that the experience we have had in the past is not necessarily predictive of what we can do. I think at least during this past year when I was involved in it, we were so busy building up the programs that we didn't give complete attention, nor the kind of attention that we are now giving, to perfecting the linkages and improving the movement of people into the private sector.

Now, some of our programs were mainly private sector programs and those have worked reasonably well during the year. I think we need to do much more with that. Our main defect, I think, has not been our inability to get the help of the business community at the national level. The real problem has been improving the linkages between public service employment and training programs and the private sector at the local level. That's the place I think we need to give the greatest attention.

Senator GARN. Is it possible, not only for the last year, for you and the Department to go back and supply us with specific figures on this transfer over a period of several years? I would appreciate it if you could do that for the record.

Secretary MARSHALL. We are preparing a report in this area and will make it available to you as soon as it is completed.

Senator GARN. Of course, implied in your statement when you say one-third have, that means that two-thirds have not.

Secretary MARSHALL. That's right.

Senator GARN. That becomes a very expensive proposition. The reason I'm interested in more overall statistics, I look back at my own situation when I was mayor of Salt Lake City and saw very little transfer to private employment, and as long as the programs were continued to be enacted we hired people and most of them were carried as long as the Federal funds were there and when they were not, depending on the whims of Congress, the jobs were gone and the people were back on the unemployment rolls; plus a lot of other problems that were created for cities in trying to create these kinds of jobs because of the rules that went with them. Somebody had to be on unemployment for 30 days to qualify. So we had people coming in on our work force requesting to be taken off the payroll for 30 days so they could get one of these public service type jobs and there was pressure on local mayors and city councils to do that very thing because of having difficult financial conditions of keeping the present work force on, and so it didn't make much sense to hire public service people at the same time out of your general fund budget you were having to lay people off and that happened in a lot of cities around this country. I was an officer of the National League of Cities, so we would talk about this problem of public service jobs.

So not only if your statistics are correct two-thirds did not go, there were just a lot of other problems that still have not been solved and it made no sense to lay people off so you could rehire them and pay them from a different fund, but that was done. It was done in a lot of cities. So you were getting no decrease in unemployment whatsoever by the public service jobs. You were merely transferring them from a local property tax funded payroll to a federally funded program.

This is one of the reasons I have such difficulty with these Federal programs. For 7 years I worked with them. I finally reached a point where I turned down a half a million dollars of public service jobs the last year I was mayor because I didn't want to get caught up in that any more. I was continually trapped. The new budget year came and the funds ended and what did you do? Did you fund it from local funds or did you terminate them? That was the choice and I didn't want to get in that bind. So I said give that $500,000 to somebody else; we don't want it.

Unless we start to address some of those problems—I don't disagree with the goals, with what Humphrey-Hawkins is trying to accomplish at all. I don't know how anybody could. I really have a very difficult time seeing how coming up with the idea to plan and coordinate and set goals is going to solve the massive problems we have had just in this public service area.

Can you respond to what has been done in the last year to try and solve that public service job problem—not just the lack of transfer, but the lack of cutting down unemployment even with the very expensive public service jobs?

Secretary MARSHALL. Yes. We have had the same concerns that you expressed about substitution and we tried initially—and the evidence indicates that we had some success—with the stimulus program in reducing substitution—that is, reducing the use of these programs for regular local government employment. We have done a number of things in the CETA reauthorization to reduce that further.

There was a study by Richard Nathan at the Brookings Institution looking at that particular question. His estimate was that in the programs before the stimulus program, substitution was about 20 percent. In the stimulus program it was 8 percent. So if his study is correct, that indicates that we were able to do some immediate things in the stimulus program, like trying to emphasize more projects rather than letting the local communities do whatever they wanted to with the resources, that reduced substitution. We have in the CETA reauthorization tried to tighten that up even more through a number of measures: one key thing is to try to emphasize the private sector—either the private profitmaking sector or the private non-profitmaking sector—because the more we can encourage the system to use the private nonprofits, the more you minimize substitution.

One of the reasons that prime sponsors didn't try to get people out of the public service employment position and into the private sector is that there was no requirement to do that. We have proposed in the reauthorization a definite time limit on how long anybody can spend in the public service employment. Also fairly stringent limitations have been proposed on the extent of supplementation by local units of government of the wages of people who are in the CETA program. If you permit completely open-ended supplementation, then you're likely to encourage substitution. We are doing other things also to offer an incentive for moving people into the private sector. Such a private sector move is an integral part of the President's welfare reform proposals, thus, there are lower earnings in the public service jobs than in the private sector jobs. We are trying also to give employers incentive to hire people through targeted job tax credits. Now we have tried to do all those things and I'd be glad to give you our thinking about it and give you some statistics and information on what we have tried to do to tighten the program up as well as just enforce the law. Much of what you're talking about was illegal substitution, and I have created in my office an Office of Special Investigations to enforce the law. We have required restitution of funds by local units of government that did not carry out the laws as Congress intended.

Now I think all these things will be hard for us to do, but I think we can do it and I think that we can see how to do it and we will be glad to share at least on paper the thinking that we have tried to do.

[The following was received from the Department of Labor for the record:]

FISCAL SUBSTITUTION IN PSE PROGRAMS

Concern over the extent of fiscal substitution in the Department's PSE programs has been widespread. It first arose shortly after the implementation of the Emergency Employment Act in 1971 and has been directed at the CETA-based programs as well. In recent months, questions about substitution have come up in hearings on CETA reauthorization, Welfare Reform, and Humphrey-Hawkins.

The worry over substitution makes a great deal of sense given that the combined enrollment in CETA Titles II and VI has recently surpassed the 725,000 level where it will remain through the end of FY 1979 under the President's budget request. If substitution is large and pervasive in the program, then much of the $6.3 Billion requested for FY 1979 might be used inefficiently since State and local governments will simply be using these funds to perform activities and to hire workers which they would have done anyway.

At the same time, recent evidence suggests that the extent of true fiscal substitution has been overstated and that in any event it is a problem which can be controlled and limited effectively through relatively simple design features.

THE NATURE OF SUBSTITUTION

The main objective of a PSE program is to provide employment which would not have otherwise existed in both the locality and the nation as a whole. There are two basic ways in which this direct job creation through PSE takes place. They are:

Program Expansion or Addition: Personnel are hired, in projects or otherwise, to expand existing programs and services or to add new ones which would not have been possible in the absence of the PSE funds.

Program Maintenance: Personnel are hired to maintain existing programs and services in the locality which would have been either curtailed or eliminated entirely in the absence of the PSE funds.

The first is easier to visualize as actual job creation than the second; however, in the case of program maintenance despite the fact that measured employment fails to rise, direct job creation has occurred. The point of reference is the decline in employment which would have taken place in the program's absence.

Budget leakage, or substitution, does occur, of course, so that not all of the monies are spent on direct job creation in this first expenditure round. The leakage which takes place is partly analogous to households' saving a portion of a personal income tax cut: Only the part of the increase in their disposable income which they in turn consume leads to further economic stimulus. However, it can be shown that the analogy can only be carried to a point, since in most cases even the funds which represent substitution or leakage can lead to job creation at the next or later rounds.

In practice, four types of substitution can be identified, all of which are contrary to DOL policy. They are the following:

Transfers: Personnel are transferred from positions supported by State or local funds to those supported directly by Federal PSE monies.

Rehires: State or local personnel are laid off so that they can be and are subsequently rehired in PSE supported positions.

Contract Reduction: Personnel hired with PSE funds are used to internalize work which had been, or normally would have been, contracted to an outside organization.

Potential Hires: Personnel hired with PSE funds are those whom the State or local government would have hired in any event.

These are situations which must be added to the calculations estimating the net employment impact the various uses to which the funds released through substitution are put. There are five possible uses for these funds, each of which has a different employment effect: They are:

Increased Non-employment Purchases: Funds could be used to purchase non-employment goods or services, such as capital equipment, outside services, etc.

Tax Reduction: Funds could be used for reducing taxes, maintaining taxes at a level lower than they otherwise would have been, or preventing an increase in taxes.

Debt Reduction: Funds could be used for reducing the amount of debt outstanding, either by borrowing less or by increasing debt repayment.

Increased Transfer Payments: Funds could be used to increase transfer payments either by enhancing existing public assistance or by matching a greater amount on AFDC or other programs.

Increased Non-Encumbered Fund Balances: Released funds could be used to increase balances on hand which are not committed to any particular use in order to provide a financial cushion for the locality.

These alternative uses are listed approximately in declining order of job creation impact. Increasing non-employment purchases may even have a greater employment impact per dollar than direct job creation via the PSE program depending on the sectors to which the purchases flow. Only the last alternative of increasing fund balances has no employment generating effect and is thus completely analogous to the household savings case. The other three alternatives have roughly the job creation impact of a Federal income tax cut of the same size.

ESTIMATES OF SUBSTITUTION

There are essentially only two basic methods of estimating job creation or substitution occurring with a PSE program, and with each the difficult part is not calculating how many jobs exist with the program, but how many jobs would have existed *without* it. Each of these methods—econometrics and field observation—has its strengths and weaknesses, and the estimates which have been generated encompass a very broad range as indicated in Table I.

Econometric Methods. Most of the studies of substitution have relied heavily on econometrics which attempts to estimate the level of employment that would have existed without PSE by first building economic models which lay out all of those factors thought to influence the level of employment, and then controlling for the effects of these factors statistically so that the true influence of PSE can be guaged. These studies have taken the form of cross-sectional analysis, measuring program effects over many different units of government at a point in time, and of time-series analysis, measuring program effects on units over time.

Unfortunately, the limitations to the econometric analyses to date have been many. The studies have only estimated program effects on State and local governmental units, omitting non-profit organizations which have received funds. They have not estimated rates of job creation or substitution for the nation as a whole. There has been little effort given to calculating the employment effect of the substituted funds. More importantly, certain of the limitations are inherent in the approach. Even the studies which are of the highest quality have difficulty specifying the proper relationships between all of the factors thought to influence employment within the model, deciding which of the factors are, in fact, the key ones to include, and obtaining data for measuring those variables. The result of these limitations is that the findings are generally imprecise, allowing a very wide range of estimates to fall within normally accepted bounds of confidence: As can be seen from Table I, the estimates of substitution after one year, range from a low of about —10% to a high of 120%. And these estimates fail to provide any information concerning the uses of these released funds.

Field Observation. The alternative to econometric estimation is to make use of some type of field observation, either in the form of mailing out survey questionnaires to State and local officials or detailing professional observers familiar with the local situation as well as with the national program provisions. The survey technique entails many problems which the observer technique corrects for, though certain problems do remain. In particular, maintaining the field network is very costly, data comparability across sites may be poor, and the subjective judgment of the observers may vary in ways which cannot be guessed. As with the econometric studies, at best only inferences can be drawn about the net employment effects for nation as a whole. However, despite the difficulties involved, the estimates derived from the field observation avoid many of the problems of the econometric work, and offer a more reliable look at the extent of substitution when properly carried out.

The Brookings Institution study of PSE, commissioned by The National Commission as Manpower Policy, relied on the field observation method and issued a preliminary report in February 1978. Their sample of 42 units nationwide is heavily weighted in favor of large urban locations. The most serious problem with the study is its timeliness: their observations were made in July 1977, at a time when total enrollment in the program was well under 400,000, and for many localities the buildup of slots and project-type PSE under the Economic Stimulus Package appropriation had scarcely begun, if at all. Of course, it is in the buildup portion of the PSE effort that many of the features designed to constrain substitution were contained.

The Brookings' findings, while tentative, indicate far lower rates of substitution than the econometric estimates: the overall rate for all units of observation ranging from local government to community based organizations and including both projects and sustainment PSE was only 20 percent. As expected, substitution in project PSE was less than in sustainment PSE, 8% and 21% respectively. And in addition, governmental units under extreme fiscal pressure experienced far less substitution than those under no such pressure for sustainment PSE.

Much of the difference between the Brookings' estimates—particularly the much lower overall rate of substitution—and those from econometric studies can be attributed to the fact that (1) nonprofit organizations are included, and (2) the sample is biased towards the large urban governments which exhibited a high proportion of "program maintenance" job creation which would likely have shown up as substitution in econometric analysis. Fully one-third of the retained positions in the sample government units were classified as "program maintenance", and a large share of this was accounted for by the distressed large cities. However, economic improvement in these areas can transform program maintenance to substitution.

Unlike the earlier studies the Brookings study also provided a brief look at how the sample units utilized the released funds. At the time of observation more than two-thirds of the funds classified as substitution were being used for tax reduction or stabilization, while less than three percent were being used to build up fund balances. Thus, it appears that, not only was the rate of substitution relatively low generally, but also those funds released through substitution were having approximately as much stimulative effect on the economy as a Federal income tax cut.

LIMITING SUBSTITUTION

Regulations and Compliance Efforts. The "maintenance of effort" regulations for CETA Titles II and VI prohibit the use of PSE funds to (1) reduce existing local governmental contracts for service (2) employ a PSE participant in a position equivalent to one which is vacant due to a hiring freeze, unless the freeze resulted from a lack of funds to sustain staff levels, (3) replace currently employed workers, (4) reduce the wages, hours, or benefits of existing workers, or (5) substitute PSE jobs for existing Federally-assisted employment. The Department actively reviews prime sponsor plans each year to preclude substitution, and in addition makes use of field staff monitoring and periodic audits as well.

When substitution appears, two types of sanctions are applied. First, prior disapproval is exercised to deny funding of such slots, as in the case of some 500 positions in FY 1977. Second, funds are disallowed after the fact and monies recovered. In FY 1977 an estimated $1.4 million has been questioned for disallowance.

As a practical matter, it is only feasible to curtail substitution through these administrative measures to a limited extent, in that only the more flagrant violations are detected. The more subtle infractions are very difficult to detect without meticulous and extended investigation of local budgets, an activity precluded with existing staff levels.

Program Design Measures. A clear alternative to the administrative control of substitution is the utilization of design features which can effectively limit it with a minimum of administrative effort and red tape. Several recently enacted program features as well as some measures proposed in the Administration's CETA Reauthorization Bill (HR 11086) illustrate this approach and suggest its potential effectiveness.

The 1976 CETA Title VI extension incorporated two provisions in part designed to minimize substitution. The first split PSE into a project and a sustainment portion mandating that program expansion take place in projects which had a specific objective and a limited duration of no more than one year. The Brookings study, while using a narrower definition of "projects" and also dealing with the very early stages of the buildup, found a significant lowering of the substitution rate in going from sustainment to project PSE. The second provision targetted eligibility more narrowly on the disadvantaged. Thus far no evidence of an effect from this change has been forthcoming.

In Title VI of HR 11086, the provisions designed to counter substitution pressures include the following: All PSE must be in projects; all participants must be economically disadvantaged; and the supplementation of wages with State and local funds is limited to (i) those already being supplemented at the beginning of FY 1979, and (ii) a maximum of 10% of the prime sponsor's wage bill beyond that amount. These measures should help to constain the possibilities considerably.

CONCLUSIONS

While some of the early studies of fiscal substitution may have led to the general belief that PSE funds could result in little net job creation, in fact more recent analyses put the situation in a better light. It is now recognized that, first the estimates of the extent of substitution were biased upwards for numerous reasons, and, second that in most cases even the funds released through substitution have the effect of creating jobs on balance. In any event, early findings suggest that it can be limited or controlled in a relatively inexpensive way by designing the program to make use of special projects or by curbing wage supplementation.

However, it is equally clear that if not kept in check, substitution can grow to unmanageable proportions diluting the impact of the limited funds the nation has to spend on employment creation. As the economic situation improves in the country and in the many localities, the problem must be watched that much more carefully.

TABLE I.—ESTIMATES OF FISCAL SUBSTITUTION IN PSE PROGRAMS

Type of study author	Date of study	PSE program	Time reference	Rate of substitution (percent) Estimate	Range
Econometric Studies Cross-Sectional Analysis:					
National Planning Association	1974	PEP	1 yr	46	−11 to 120.
Isseman	1976	Recalculated NPA	do	31	
Time series analysis:					
Johnson-Tomola	1974	PEP	do	49	
Do	1975	PEP	do	49	
Do	1977	PEP/CETA	do	58	
Brrus-Hamermesh	1978	Recalculated Johnson-Tomola 1977	do		−9 to 56.
Proher	1974	Non-PSE data	"Long-run"		60 to 90.
Wield Observation Studies:					
Brookings Institution	[1] 1978	CETA	[2]	20	[3] 8 to 21 [3]

[1] Preliminary findings.
[2] As of July 1977. Some sustainment slots extant from 1974–77; other project slots less than two mo.
[3] The 8 pct is for title VI projects, 21 pct for sustainment in titles II and VI.

EFFORTS OF THE DEPARTMENT OF LABOR TO CONTROL PSE SUBSTITUTION

In recognition of the potential problem of Federal expenditures replacing local expenditures when substantial amounts of funds are devoted to public service employment, Congress included several provisions in the CETA legislation which were meant to prohibit such substitution. These provisions are:

Section 208(a): "The Secretary shall not provide financial assistance for any program or activity under this title unless he determines, in accordance with such regulations as he shall prescribe, that the program (A) will result in an increase in employment opportunities over those opportunities which would otherwise be available, (B) will not result in the displacement of currently employed workers (including partial displacement such as a reduction in the hours of nonovertime work or wages or employment benefits), (C) will not impair existing contracts for services or result in the substitution of Federal for other funds in connection with work that would otherwise be performed, and (D) will not substitute public service jobs for existing federally assisted jobs."

Section 703(7): "The program will not result in the displacement of employed workers or impair existing contracts for services or result in the substitution of Federal for other funds in connection with work that would otherwise be performed."

Section 205(c)(7): The Act does "not authorize the hiring of any person when any other person is on lay-off from the same or any substantially equivalent job."

Section 205(c)(8): The CETA prime sponsor shall provide "assurance that no funds received under this title will be used to hire any persons to fill a job opening created by the action of an employer in laying off or terminating the employment of any regular employees not supported under this title in anticipation of filling the vacancy so created by hiring an employee to be supported under this title."

Section 205(c)(25): "* * * jobs funded under this title are in addition to those that would be funded by the sponsor in the absence of assistance under this Act * * *."

When title VI was added to CETA, substantially expanding the level of public service employment under the Act, these provisions were incorporated into the new title. However, because increasing Federal expenditures for PSE also increased the potential for substitution, the "project" concept was introduced in title VI. The majority of title VI funds were provided to establish public service employment projects which were to be of limited duration (on longer than one year) and which were to involve special activities that were not merely an expansion of ongoing services provided by local governments. Also Congress intended, as described in the Explanatory Statement of the Conference Report, that a substantial portion of project funds be allocated to private nonprofit organizations. Both of these provisions were an attempt to reduce the likelihood that local governments would curtail their own expenditures for jobs as the Federal jobs money become available, and both have undoubtedly helped in this area.

While there are legislative prohibitions against substitution and Congress has made the specific efforts mentioned above to reduce the substitution potential, there are also some statutory factors which tend to contribute to the problem. One is the prohibition, included in the 1976 title VI amendments, against setting any limit on the number of laid-off State or local government employees who can be rehired using CETA funds. State and local governments facing financial deficiencies can therefore lay-off employees and rehire them as public service employees under CETA with, in effect, no limitation other than the amount of PSE funds available to the jurisdiction. Another factor that tends to contribute to substitution is the requirement that PSE employees must do work that is normally done by the jurisdiction. That is, local governments are generally constrained by State law, city charter, etc. to providing certain services. PSE jobs must, then, be established within the bounds of what services and functions already exist in the jurisdiction. Thus, it is often difficult for local jurisdictions to create PSE jobs in job categories different from the locally funded positions, and the substitution potential is raised.

Conversely, there are elements of Federally-funded public service employment which tend to hold substitution in check. The majority of public service jobs are in categories such as laborer, park maintenance, other maintenance, and various types of "aide" positions, which involve peripheral rather than essential services. The percentage of CETA participants in ongoing municipal functions such as police, fire and other similar activities is relatively small. One of the reasons for this circumstance is the CETA limitation on wages ($10,000 per year out of CETA funds) but another is that peripheral positions can be terminated without critically disrupting local government functions. This is particularly true with PSE "projects," since they can last no longer than a year. Thus, it is unlikely that the bulk of these noncritical jobs are substituting for jobs that the jurisdiction would otherwise fund out of local resources. Another check against substitution is the monitoring of PSE programs by local public employee unions. Many instances of potential substitution are avoided as a result of unions identifying problems and working out a resolution at the local level or bringing the problem to the attention of the Department of Labor. Lastly, local elected officials are conscious of the adverse political effects of improperly using CETA funds, both in terms of infringing on the employment of their regular work force and of adverse publicity in the event of fiscal penalties for illegal use of PSE monies, and are therefore disinclined to construct a program that would lead to such effects.

PROCEDURES THE DEPARTMENT HAS IMPLEMENTED TO ENFORCE MAINTENANCE OF EFFORT PROVISIONS IN CURRENT LAW.

Review and Monitoring Procedures

The ongoing management by the Department of Labor of PSE programs incudes a number of activities which involve the monitoring of programs for potential substitution. The initial step in monitoring is the review of the grant application prior to implementation and enrollment of participants. On the basis of the review prime sponsors will often reqeust determinations by the Regional Administrator as to whether certain arrangements represent potential maintenance of effort violations. This provides a frequent opportunity to avoid subsequent problems or disallowances. The regulatory complaint system, by which allegations of violations of the act or regulations at the local level are processed and resolved, brings to our attention cases of potential violation. The regular monitoring of all CETA programs includes examination of maintenance of effort, and CETA programs are regularly audited in accordance with the Act and the regulations. In addition, all prime sponsor programs are formally reviewed and assessed prior to granting funding each fiscal year and each annual plan is reviewed for compliance with the act and regulations prior to the funding of the applicant.

However, it must be recognized that monitoring the legislative prohibitions against substitution of Federal for local funds is a difficult task and the determination of substitution a most elusive one. In order to police "maintenance of effort" it is necessary to analyze virtually all local public expenditures over a period of years. This, of course, is an enormous task, and the Department of Labor does not have adequate staff resources to monitor the expenditures of all local governments receiving CETA funds. Potential violations of maintenance of effort most readily come to our attention, and are most easily examined, when layoffs occur. The Department has issued regulations and established procedures for responding to situations when layoffs occur where there are CETA workers in jobs substantially the same as those from which the regular employees are laid off. We have also issued regulations and procedures dealing with local governments' use of CETA funds to rehire laid off employees who were formerly on the local payroll. Our regulations on maintenance of effort place the burden of proof on the local jurisdiction to document that CETA funds are not being used to substitute for other expenditures. This policy, which is in accordance with the CETA legislation and with recommendations of the General Accounting Office, provides the Department with the tools for identifying and correcting problems of substitution and allows us to devote primary attention to the management of all CETA programs.

Actions Taken by the Department Including Disallowance of Costs, as a Result of Maintenance of Effort Violations by Prime Sponsors.

The Department has put substantial effort into reviewing cases where maintenance of effort questions have been identified and in a number of cases punitive action has been taken. Preliminary information from a survey of our regional offices indicates that during the past year, over 100 such cases have been identified and an extensive amount of staff time has been devoted to reviewing and resolving these cases.

There have been a number of cases where penalties have been imposed through the disallowance of costs. Preliminary information indicates that about $1,400,000 has been disallowed as a result of maintenance of effort violations.

The following are examples of several major maintenance of effort cases which regional offices have dealt with over the past two years.

Minneapolis, Minnesota

The City of Minneapolis in 1975–76 constructed a municipal parking ramp using nearly $900,000 in CETA funds to supplement local bond revenues for the project. Subsequent to a complaint by local contractor associations that the City had previously planned, and had requested bids, to build the parking facilities entirely from local revenues, ETA investigated and found the complaint substantiated. Pursuant to this finding of a violation of maintenance of effort, the ETA regional office ordered that the city make restitution of the improperly expended CETA funds. The case is now on appeal.

Las Vegas, Nevada

The City of North Las Vegas laid off seven locally funded employees in its fire department but retained two CETA funded firemen, contrary to the CETA prohibition against employing CETA personnel when regular workers are laid off. Las Vegas was required to pay back approximately $21,000 in disallowed CETA costs.

Buffalo, New York

Several maintenance of effort violations were discovered in the Buffalo New York program through ETA regional office monitoring. Approximately $109,000 was restored to the CETA program by Buffalo following a regional office investigation and substantiation of charges. Eight ETA

New Bedford, Mass

Through its regular monitoring activity the Regional Office discovered evidence of CETA workers employment substituting for that of regular city jobs. After a thorough investigation the city was notified of a finding of violations of maintenance of effort and has agreed to restore $26,000 to the CETA program.

STRENGTHENED CONTRACT REVIEW AND COMPLIANCE ACTIVITIES

In order to further control substitution of Federal for State and local funds, the Department of Labor is continually reviewing and strengthening, where necessary, its contract review and compliance activities.

The Department has recently established an Office of Special Investigations and Review, which is responsible for investigations of maintenance of effort abuses and other program deficiencies and for recommending corrective action and monitoring its implementation. This office is responsible directly to the Secretary and reports directly to him on a regular basis. The Department is now building a permanent staff for this office. The Department could, if given additional resources, expand this office in order to more closely monitor and control substitution in CETA programs.

In the FY 1979 budget the Department has requested additional personnel for all its contract compliance activities. In the expectation of Congressional approval for this increase, we are developing a program where we would randomly select 25 to 50 prime sponsors a year for intensive on-site investigation into all program aspects. With sufficient Federal staff to review all aspects of these prime sponsors' programs we could obtain valuable data about the problems common to all prime sponsor programs, including the substitution problem, and be in an excellent position to design a more effective monitoring system for all our prime sponsor programs. More importantly, knowledge by all prime sponsors that a sizeable fraction of them would be randomly selected and rigorously audited each year would encourage much more attention to conscientious compliance by all.

Recently, in order to further strengthen prime sponsor contractor compliance, including maintenance of effort provisions, the Employment and Training Administration has instituted the following actions:

(1) Strengthened an "Early Warning System" by use of what we call Questionable Activities Reports from regional offices to alert the national office to actual or alleged irregular activities.

(2) Installed regional office Compliance Staff Units answering directly to the regional administrators. These units will handle all complaints and perform reviews concerning fraud, political patronage, and maintenance of effort.

(3) Began increasing the staff of the national Office of Investigations and Compliance. Given additional resources, we could further expand this office to more closely monitor maintenance of effort provisions.

Senator GARN. I would appreciate that. Listening to you talk about all the problems, I think you make my point of why I don't like the public service job approach, and I think you would have to agree, without arguing the philosophy of public service jobs at all, that it's a very, very expensive way to create jobs.

Secretary MARSHALL. I think it's the least expensive way to reduce unemployment, and it's the next best thing you can do.

Senator GARN. How can you say it's the least expensive way?

Secretary MARSHALL. To reduce unemployment.

Senator GARN. With two-thirds not going to private employment? What we had didn't even show up. The unemployment rate in our city didn't show any reduction at all as far as the overall rate.

Secretary MARSHALL. Our statistics show during the year, as I mentioned before you came, that we were able to turn some unemployment trends around with these programs, and we have got evidence that the programs had an impact. A third of all the increase in black employment in this country last year during this expansion of the stimulus program was in titles 2 and 6 of CETA. You've got a problem, of course, because as you create more jobs, you draw more people into the work force. We had to create 4 million jobs in order to reduce unemployment by just over 1 percentage point. But you have to look at the effect of these jobs on employment as well as the effect on unemployment. The evidence, from CBO and other people who made independent studies of it, indicates that the net cost of reducing unemployment through public service employment is lower than any other way that you would reduce unemployment.

I also believe that it's better to put unemployed people to work doing useful things that the society needs to have done, than to have them either unemployed or on unemployment insurance or welfare, and I think those are your options.

Senator GARN. Let me just follow up.

Secretary MARSHALL. The reason I say it's the next best thing, I think the best thing to do is to get people a regular job.

Senator GARN. My time is up, however that is the point I wanted to make. I disagree on the cost. Maybe I have seen too much of it on the other end of the tunnel to think that it is the least costly way to create jobs. I don't agree with that, especially if we are not putting more people permanenly to work, rather than just a temporary shot in the arm, reducing unemployment rates while they are employed in that particular Government program.

But I do appreciate your willingness to supply additional information and I do agree with you that it is a far better way to put people to work in the private sector on permanent jobs than in temporary public service jobs.

Thank you, Mr. Chairman.

The CHAIRMAN. I just have one more question. We do have a Governor of the Federal Reserve Board that will follow, as you know.

This question is for Chairman Shultze. Chairman Shultze, are you aware that in the first 4 months of this year we had about a 12-percent annual rate of inflation? The newspaper this morning, in the financial pages, says, "Lack of support imperiling anti-inflation plan."

Consumers, business people, and I should say labor and business people alike are blamed for not being willing to slow wage and price increases. I think that much of this is because there is a feeling that the Government itself really isn't taking inflation as seriously as they should, except for the Federal Reserve Board. We have, No. 1, the $500-billion budget that many people perceive as being too big, we have an enormous deficit at the present time, and I think some people feel the kind of signal that would mean something like a big cut in the budget, rejection of Humphrey-Hawkins, which I oppose—as you know, I favor Humphrey-Hawkins—and at the very lease giving inflation an equal status with unemployment as a goal we would like to achieve.

That is what my amendment would do. If you pass Humphrey-Hawkins at a time when you have rapidly diminishing, or rather, rapidly increasing employment, and some diminution in unemployment, when you had rapidly rising inflation, at a time when you have prominent economists saying you are already having inflationary effects from this, which I disagree with that, it seems to me you are not giving the kind of signal you ought to give at all.

I think if we put inflation on the same basis in this bill, it could have that desirable effect, and not in any way compromise what you gentlemen are anxious to achieve, we are all anxious to achieve, a reduction in unemployment.

Mr. SCHULTZE. Mr. Chairman, there is no disagreement about giving inflation equal billing in the bill. The only question is the wisdom or lack of wisdom in putting a specific numerical target in the bill. It has nothing to do with the priority you give inflation. That is point No. 1. No. 2——

The CHAIRMAN. The only other way to do it is take the 4-percent unemployment goal out of the bill. Then you have nothing.

Mr. SCHULTZE. No, sir, I think the fact is that the achievement of a specific numerical number goal is easier with respect to unemployment than with respect to inflation. That fact itself, which does mean you don't put a numerical goal in for inflation, that fact does not mean you don't give them both equal billing. It is important to reduce the rate of inflation. What is really significant is to try to edge it down each year.

The CHAIRMAN. The trouble is on one hand you have a specific numerical objective commitment, on the other hand you have rhetoric. For unemployment you have a specific numerical goal. In inflation you say we are against it and that is about it.

Mr. SCHULTZE. No, sir; there is a lot more than saying that.

The CHAIRMAN. You don't require anything.

Mr. SCHULTZE. You do, it does require the President each year to lay before the Congress, for a 5-year period, his specific targets. Those will change over time as you roll that 5 years forward, depending on circumstances. It is not simply saying we are against inflation. The bill in section after section lays out the control of inflation as a high priority objective, sections 102, 103, 104, 106, and 109, all of them.

The CHAIRMAN. Senator Brooke.

Senator BROOKE. Secretary Marshall pointed out that in his statement. You know, we can control unemployment, at least. It might not be acceptable to all of us as to how to control it, but we can control unemployment. But we can't control inflation. Obviously, you know, there are too many factors that come into it over which we have no control.

So it is going to be very difficult, if not impossible, is it not, to control the inflationary goals.

The CHAIRMAN. I think the Senator is correct. But I think we can make progress toward an inflation goal and recognize that there will be various elements that will interfere with it.

Senator BROOKE. What machinery can we put into place?

The CHAIRMAN. These gentlemen have indicated many things, we can improve productivity, training, mobility, we can do all of these things that will make it possible for the people who are unemployed to work and that will tend to achieve both a low level of unemployment and a lower level of inflation.

This is the kind of thing, it seems to me, that is mandated by putting those goals in there. Congress is saying we want to move in the direction of holding both down, we want to follow those kinds of policies. And we are going to make a commitment to do it and this is the way we are going to try to achieve it.

Mr. SCHULTZE. Mr. Chairman, again I would stress that there is no disagreement in terms of the priority you give control and reduction of inflation. No. 2, we want to do that not just for its own sake, but because unless we also do something on inflation, we are not going to do something on unemployment. It cuts the other way, too. Continued economic growth and reductions in unemployment depend upon dealing with the inflation problem. But there is still a difference in terms of your ability to hit a particular numerical number. And for Congress to bless in a piece of long-term legislation any single number seems to me to be dangerous on both grounds. It is either too much or too little.

The CHAIRMAN. It is not nearly as easy as we would like to think. We don't know what is going to happen to the work force, I wish we did. Everybody has been wrong in the last few years on that. Given the increase in employment we have had in the last couple of years, we should have unemployment down close to 4 percent now, if it hadn't been for the unexpected, unpredicted enormous increase in the work force. The number of women coming in was completely unforeseen, the number of teenagers who are in the work force now was unforeseen.

Senator BROOKE. That is probably going to increase.

The CHAIRMAN. I don't think so. The demographic figures suggest that will not be the case.

Mr. MARSHALL. And that indicates it is more unpredictable. The big unknown——

The CHAIRMAN. Maybe. But it is all maybe, we just don't know. About 50 percent of the women now, as I understand it, the married women, 50 percent of the married women with a child between the ages of 6 and 16 now are in the work force, twice as high a proportion as 25 years ago. That could go to 75 percent, we don't know.

Mr. MARSHALL. But you know what the limit is.

The CHAIRMAN. It is finite.

Mr. MARSHALL. The thing that keeps it from being more finite that you really have to work on, I think, and creates the biggest uncertainty in my mind about the unemployment, is illegal immigration. We don't know how many are coming in.

Senator BROOKE. A lot of women are working because they have to work, Mr. Secretary; you know that. There is no question about that. I mean the income of the husband is just not sufficient to hack it, as they say. So a lot of them are going to work because they are forced to go to work.

The CHAIRMAN. I agree with that. That is why it is unpredictable.

Senator BROOKE. Germany has been able to achieve a low rate of unemployment and a low rate of inflation.

You are shaking your head. What have they done we didn't do?

Mr. MARSHALL. There are fewer jobs in Germany now than there were in 1970, and unemployment has been rising.

Mr. SCHULTZE. German unemployment is higher than it was at the peak of the recession. No. 2, it also is true that wages and prices in Germany, for reasons I don't fully understand, are somewhat more flexible.

The CHAIRMAN. Do they also export their unemployment?

Mr. SCHULTZE. Some of it.

The CHAIRMAN. A lot of people working there were from surrounding countries, and they have gone back.

Mr. SCHULTZE. It is not quite so much that they have gone back, but the big flood of incoming ones has stopped.

Senator BROOKE. They don't send them back.

Mr. SCHULTZE. There have been some that have gone back. The big thing is it is like cutting the labor force growth in half, or even more.

Senator BROOKE. The sum and substance is both of you believe we can achieve a low unemployment rate and a low inflation rate at the same time?

Mr. SCHULTZE. We both—I think that is fair to summarize by saying we both believe it. We both recognize it will be difficult. We can't guarantee it, but we think it is a worthy objective to try for.

Senator BROOKE. Do you think the time frame is a reasonable one?

Mr. SCHULTZE. Yes. Five years, yes; I think so.

Senator BROOKE. What about balancing the budget?

Mr. SCHULTZE. The more we are able to achieve the goal of high employment, through appropriate structural measures in particular, the more we are going to be able to achieve that balanced budget.

The CHAIRMAN. Gentlemen, we want to thank you very very much for excellent testimony and a fine record.

Senator BROOKE. Thank you for your optimism.

The CHAIRMAN. Our final witness is the Honorable J. Charles Partee, member of the Board of Governors of the Federal Reserve System.

We are delighted to have you, Mr. Partee, not only a distinguished Governor of the Federal Reserve Board, but you have been with the Board longer than any other Governor who is serving at the present time. Isn't that correct, Governor Partee, counting your service as a staff member?

STATEMENT OF J. CHARLES PARTEE, MEMBER, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM

Mr. PARTEE. Counting the service as a staff member, about 16 years. Not that long as a Governor.

The CHAIRMAN. Well, you are a real expert.

Mr. PARTEE. Thank you, Mr. Chairman.

The CHAIRMAN. We are delighted to have you. We apologize for it being so late.

Mr. PARTEE. That is quite all right. It is an important subject.

[The statement read by Governor Partee follows:]

STATEMENT BY J. CHARLES PARTEE, MEMBER, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

I appreciate this opportunity to present the views of the Federal Reserve Board on the Full Employment and Balanced Growth Act—known popularly as the Humphrey-Hawkins bill. This proposed legislation would amend the Employment Act of 1946 by setting forth specific economic goals and by providing explicit roles in the economic policy planning process for the President, the Congress and the Federal Reserve.

The several, somewhat different versions of the Act now under discussion in Congress contain substantial improvements over the earlier bill on which I testified before this Committee in the Spring of 1976. Particularly welcome is the increased emphasis of the current bills on the need to reduce inflation as well as unemployment. The Federal Reserve strongly supports this change, as the more specific recognition of the goal of price stability addresses a major inadequacy of both the 1946 Act and the amendments to it proposed in earlier versions of the Humphrey-Hawkins bill.

We are encouraged also by deletion of some of the major inflationary features of the previous bill. The Board had been especially concerned by the provisions that would have required the Federal government to become the employer of last resort, and by the very high wage standards mandated for such Federally funded jobs. The new versions of the bill require that all special programs which provide job opportunities to the hard-core unemployed be designed to avoid drawing workers from private employment, and the wage rate provisions appear to be more reasonable than those of the earlier bill.

The bills under discussion today also no longer contain those provisions that would have unduly restricted economic policy by requiring a comprehensive policy planning process directed toward the achievement of a 3 per cent unemployment rate goal, with no regard for any inflationary consequences until that goal was reached. That earlier structure would have stripped monetary policy of its ability to respond flexibly to changing economic conditions.

These improvements in the current bills are clearly all to the good. However, the Federal Reserve continues to have reservations about some of the provisions that still remain. I would emphasize in particular that the unemployment goals to be attained within five years are extremely ambitious. The goals established by the bill—3 per cent for workers aged 20 years and over, and 4 per cent for workers aged 16 years and over—were last achieved only during the 1966–69 period, when the U.S. economy was suffering from demand-pull inflation stemming from the military manpower requirements and heavy spending pressures of the Vietnam War.

The historically low unemployment goals, moreover, tend to ignore the significant changes that have occurred in the composition of our labor force over the past decade or so. Due to changes in the age distribution of our population and to increases in the participation rate for certain groups, the numbers of teenagers and adult women in the labor force have grown dramatically. For example, in the last 10 years, total population has increased by about 9 per cent, while the numbers of adult women and teenagers in the labor force have risen by 42 and 40 per cent, respectively. If the unemployment rate for the first quarter of this year were to be adjusted to take account of this change in labor force composition, it would have been nearly one-half percentage point lower than the 6.2 per cent rate that was reported.

Efforts to keep our rapidly expanding labor force fully employed have been further complicated because those seeking work have often lacked the skills required to handle the jobs available. Also, the job markets in which opportunities occur have often been at locations far distant from the persons in search of work. These structural problems, I believe, can be attributed partly to the higher skills required by a technologically advancing society, and partly to geographical shifts in population and job opportunities—broadly from north to south, and also from central cities to the suburbs. Moreover, in the case of unproved workers, such as unskilled teenagers, the unemployment problem has aggravated by increases in the minimum wage. Such increases have tended to mean that marginally productive job applicants become unemployable on an economic basis at the going wage.

In our present circumstances, therefore, it is unlikely that macroeconomic policies alone can achieve the low unemployment goals of the Humphrey-Hawkins bill without running the grave risk of substantially exacerbating the inflation problem. If sole reliance were to be placed on general economic policies to reach these very ambitious unemployment rate objectives, certain critical labor skills could be expected to come into short supply and some industries would be pressed above practicable capacity limits, well before aggregate demands had risen sufficiently to absorb the more marginal types of workers.

It seems to me abundantly clear, therefore, that any hope of attaining the Humphrey-Hawkins unemployment targets without escalating price pressures will depend on a major effort to develop special employment programs. These are needed to make our unemployed more employable, to put the jobless in touch with available jobs, and to generate employer interest in taking on marginal workers—perhaps at an initially subsidized wage cost that makes their employment economically attractive. Moreover, although our structural employment problems are aggravated by business cycle downturns, they appear also to be growing over time, so that their correction is likely to require more than the countercyclical programs contained in Title II of the proposed bill.

Apart from training and other programs for the hard-core unemployed, careful consideration also needs to be given to the recent shortfall in business investment spending and to the effects this is likely to have on the creation of new job opportunities. Unfortunately, during the past five years, growth in the nation's stock of capital has been slowing relative to growth in our labor force. If this trend persists, it may mean a slower creation of new jobs relative to our employment needs as well as a slower increase in the general productivity of our economy. Thus, there is an important stake for all of us in finding effective means of encouraging more investment in productive plant and equipment, through stronger incentives for business and perhaps some structural revision in the tax laws.

In addition, the Board is deeply concerned that the emphasis and organization of the current bills still appear to place the objective of controlling inflation in a role distinctly subordinate to that of reducing unemployment. Although the reduction of inflation is mentioned in one way or aother 5 or 6 separate times in the bills, the prescription for moderating inflation is quite vague. Moreover, in the House-passed version, the President is not even required to report on progress or plans for controlling inflation until the third year of the program.

The amendment introduced by Senator Proxmire seeks to redress this relative imbalance in objectives by adding an explicit goal for reducing inflation to 3 per cent or less, on the same time-table set forth for achieving the unemployment rate goals. The Federal Reserve supports the inclusion of a specific interim inflation rate objective, though we believe that greater flexibility for revision should be provided than the amendment contemplates. A possible approach would be to permit the President to recommend modification in the inflation rate goal and/or the timetable for attainment, starting with the third Economic Report after the law becomes effective. This alternative would provide parallel treatment for both the inflation and the unemployment goals.

The Board would urge also that every effort be made to reduce or eliminate the many inflationary biases that are at work in the economy, some of which are a result of long-standing Federal programs. We are encouraged by recognition in the Humphrey-Hawkins bill of the need for structural measures to combat inflation—including the removal or modification of governmental restrictions that have anti-competitive effects or add needlessly to costs, and the effective enforcement of the anti-trust laws. But there is a need to reexamine the relative costs and benefits of other Federally mandated programs as well, such as the Davis-Bacon Act, the minimum wage for teenagers, extended unemployment insurance, and the full indexing of public retirement benefits. Also, we would recommend that the inflationary costs as well as the potential benefits explicitly be taken into account in setting our environmental quality goals, particularly at the outer margins of the improvements specified. Meaningful progress in reducing the overall inflation rate will require a comprehensive attack on the problem, program by program, in the public as well as the private sector.

Let me turn now to the specifics of the Humphrey-Hawkins bill that apply to monetary policy. The procedures currently contemplated for evaluating and monitoring the role of the Federal Reserve in economic policy planning and coordination have substantially improved upon the rigidity of the earlier bills. The Federal Reserve would now be required to provide an independent statement setting forth its intended policies for the year ahead, along with an explanation of their relationship to the economic goals presented in the *Economic Report* of the President.

In the House-passed version of the bill the role of reviewing the intended policies of the Federal Reserve remains appropriately with the Banking Committees of the Congress. The Board believes that this assignment is consistent with the quarterly oversight procedures now in place, and would benefit from the accumulated experience and familiarity of these Committees with the Federal Reserve and the major issues encountered in the formulating of monetary policy. And to the extent that the Congress determines that action may be called for in order to ensure the consistency of monetary policy with the purposes of the bill, the Board would favor a provision that assigns principal responsibility to the Banking Committees.

In order to provide further consistency with the current procedures for Congressional review of monetary policy, the Board supports the inclusion of the last sentence of Section 2A of the Federal Reserve Act, as appears in H. R. 50. Section 2A provides that the Federal Reserve not be required to adhere strictly to its intended policies for the year ahead if the Board and the Federal Open Market Committee should determine that these policies, as reported to the Congress, cannot or should not be achieved because of changing conditions. That language was wisely included in the Federal Reserve Reform Act in order to preserve the flexibility essential to the proper conduct of monetary policy. Its inclusion in the Humphrey-Hawkins bill would avoid the statutory inconsistency that might otherwise occur.

One potential problem inherent in the planning for general economic policies designed to control both unemployment and inflation is that trends in employment end to respond more quickly to changes in policy, including monetary policy, than do trends in prices. Actions that stimulate a general expansion in spending for goods and services tend to generate needs for additional workers fairly early in the process. While this step-up in demands for workers and the materials they use may exert some immediate upward pressure on wages and prices, the full impact of the stimulus is likely to be stretched out over a fairly extended period. Some wage and price adjustments are delayed until the expiration of existing contracts, or until the strengthening trend develops sufficient upward momentum. But when these contracts are eventually adjusted, they often generate additional catch-up demands for further adjustments in other sectors of the economy. Because of this long trail on inflation, public policies are in danger of giving insufficient weight to potential inflationary pressures unless they focus on a planning horizon that looks beyond the next year or two.

Thus, the inclusion of inflation as well as unemployment rate targets to be attained on the same timetable 3 to 5 years out would be a desirable addition to the Humphry-Hawkins bill. Policymakers would then be guided by both these longer-range economic goals, and the undue focus on short-term objectives which can occur would tend to be moderated. It must be recognized, of course, that the linkages between current policy actions and the performance of the economy over a longer horizon are quite tenuous. Moreover, since current economic conditions can often change in abrupt and unexpected ways, appropriate adjustments in short-term policy goals may require revisions in longer-range policy plans as well. But so long as the longer-range unemployment and inflation rate goals are not considered rigid absolutes, it would be preferable to make adjustments in short-term policy with an eye to their implications for the timing and attainability of longer-run objectives, especially with respect to price developments.

In conclusion, I want to assure you that the Federal Reserve fully shares the desires of Congress and the Administration to achieve conditions that will foster the creation of jobs for all of our people who are able and willing to work. Since the passage of the Employment Act in 1946, this has been an explicit objective of national economic policy to which the Federal Reserve has subscribed. The economic history of this and other countries in the postwar period, however, has amply demonstrated that our performance with respect to inflation has a critical bearing on the chances for actually achieving meaningful and sustainable full employment. High and rising rates of inflation, quite aside from the inequitable consequences they bring to our people, tend to distort economic decisions, sap consumer purchasing power, and lead to conditions that are likely in time to reduce rather than enhance employment prospects. We must be on guard also to avoid the higher Federal expenditures and therefore larger budget deficits that might follow from mechanical efforts to achieve the employment objectives of this bill.

While the current versions of the Humphrey-Hawkins bill take more account than earlier versions of the threat that inflation poses to our economic health, they still do not ackowledge adequately the crucial need to reduce inflation, both as an integrated element in the process of achieving full employment and as a necessary condition for effective public and private planning. There is a real risk that the Humphrey-Hawkins bill, if enacted with the present lopsided emphasis, will accord by law a back seat to the need for more effective control over inflation. It seems paradoxical that this might take place at precisely the time when inflationary pressures are coming to represent the major threat to the stability of our economic process.

The CHAIRMAN. Thank you very very much, Governor Partee. Do you speak for the Board?

Mr. PARTEE. Yes.

The CHAIRMAN. You do. Not simply for yourself, but for the Board?

Mr. PARTEE. That is right. This statement was approved by the Board yesterday.

The CHAIRMAN. On page 5 you suggest a change. You support my amendment, but then you suggest that we should permit the President to recommend modification of the inflation rate goal and/or the timetable for attainment, starting with the third Economic Report after the law becomes effective.

I agree with that. We intended to make that change. That has been suggested, and we will be happy to accommodate that.

Mr. PARTEE. I think, Mr. Chairman, it might reduce the criticism of the kind that Chairman Shultze was making, because a specific target out in the future might prove to be not attainable. You recognize that, and that the goal may have to be adjusted.

The CHAIRMAN. Some of the arguments have been made that it is so hard to attain that it should be modified to some extent.

Then in your statement on page 7 you say that you favor a provision that assigns principal responsibility to the banking committees. I think this committee would tend to support that. I think your reasoning makes sense, too, that is, we do have that experience here, and that is our responsibility. So I think we will be happy to support that.

Then further down on page 7 you say section 2A of the Federal Reserve Act provides that the Federal Reserve not be requird to adhere strictly to its intended policies for the year ahead if the Board and the Federal Open Market Committee should determine that these policies, as reported to the Congress, cannot or should not be achieved beceause of changing conditions.

On that I think we can agree, but we ought to have the Federal Reserve come in and tell us, explain.

Mr. PARTEE. That is precisely what we are proposing, precisely the same language as occurs in the Federal Reserve Act. And, as we do now, we would come and tell you in the quarterly oversight hearings. I think that would make the two bills consistent.

The CHAIRMAN. You are the first witness to challenge the goals as being extremely ambitious over a 5-year period. If you had to make the decision as to the appropriate rate of unemployment, fix a goal for 1983, what rate would establish, if not 4 percent?

Mr. PARTEE. Well, Mr. Chairman, it is very difficult to talk about this subject, because the appropriate rate depends so much on what goes on during the interim period, between now and 1983. I would say that on the basis of what we have now in the economy, and without any greater impact on unemployment from special programs than we are now receiving, it is extremely unlikely that the unemployment rate could be reduced below 5 percent without substantial inflationary pressure.

If we could come up with microprograms that were truly effective in training and putting people to work, and finding jobs for them, then I think perhaps we could move on down towards 4 percent. But I have some doubt that we could reach it.

The CHAIRMAN. And the adoption of the amendment that would give inflation equal status, numerical status specifically, would pretty much mandate policies of that kind, wouldn't it?

In other words, if we are going to achieve it, we have to achieve it through structural programs.

Mr. PARTEE. I think it would put emphasis on structural programs. There are a lot of structural programs mentioned in the bill and the Secretary of Labor has an important role. But I think giving inflation equal status would put added emphasis on structural programs both to increase employment and to reduce inflation. I particularly would like to see equal emphasis given to structural programs to reduce inflation, in which I think your amendment helps quite a bit.

The CHAIRMAN. Your testimony points out in the House-passed version of the bill, the President is required to report on the programs and policies being used to reduce inflation and the progress made beginning with the third economic report after enactment. Now the legislation that was recently approved by the Human Resources Committee doesn't contain that.

Do you think we should add a requirement about progress on inflation back into the bill, and at the same time change it to require the Preseident to do this each year?

Mr. PARTEE. Yes, I think it should be required from the beginning, and I think there should be as a part of this, as Charlie Schultze said, planning machinery—a distinct plan to work with inflation—that is announced by the President. I would certainly do that.

I might say I am at a little disadvantage here. We have, apparently, three bills, H.R. 50, S. 50, and the amended version of S. 50. And I may be somewhat vague at times about exactly what is in one bill as against another.

The CHAIRMAN. The various versions of the bill require the Fed to provide an independent statement setting forth its intended policies for the year ahead, along with an explanation of their relationship to the economic goals presented in the Economic Report of the President.

Do you interpret that to mean that the Federal Reserve would comment on the appropriateness, consistency, the attainability of the goals specified by the President?

Mr. PARTEE. Well, I think that it could. I don't know that one often would want to have a situation in which there was a public challenge to the President's program by the Federal Reserve. But the bill would certainly give it the authority to do so.

The CHAIRMAN. Well, we get that from individual chairmen. In fact, we always had that from individual chairmen. I think it is a welcome response by the chairmen. I think it is their responsibility to do this. Some debate from one of the best qualified economic institutions in our Government is most desirable.

So I would hope it would be interpreted that way.

The bill would require the Federal Reserve to announce its intended policies for the year ahead, and thir relationship to the short term goals specified by the President. Those goals cover a period of 2 years, the remainder of the current year, and the next year.

That seems to be a little inconsistency that we might want to correct.

Do you see any problem for the Federal Reserve in stating its intended policies for the same period as is covered by the short term goals specified by the President, as long as we provide you with the flexibility to adjust your policies if need be because of changing economic conditions or changes in the President's goals?

Mr. PARTEE. Another year is a good deal longer to go out into the unknown future in specific terms. This would mean almost 2 years rather than 1 year. I think if it were well understood that that second year is much more provisional than the first, that what you propose would be acceptable.

Again, the important thing is maintaining the ability to change in response to changes in the economy. Why? Because we just don't see the future very well; we have missed time and time again. And when I say "we," I think I mean all of the Government, in fact, all of the professional economist community. We have to be prepared to adjust to those changes that we have not anticipated.

The CHAIRMAN. The Federal Reserve Act, section 2A, requires the Federal Reserve provide the monetary aggregate growth rate changes at each quarterly oversight hearing, as you know. I have a few questions about that procedure.

First, do you think there is undue stress on the monetary aggregate growth rate changes?

Mr. PARTEE. No, I don't think so. I think it may be that we should have a broader range of the aggregates that we discuss than has been the case typically in the last year or two of oversight hearings.

But I believe it is awfully important to keep in mind the fact that, in the end, if you create a great deal of money and credit, regardless of what interest rates are doing, you are going to have inflationary consequences.

The CHAIRMAN. That is right. I just wonder if the monetary aggregates are enough, if we shouldn't have a broader analysis that would cover other statistics also, so we have a better understanding, which would convey to us more clearly the strategy being pursued by the Federal Reserve.

Mr. PARTEE. What kind of other statistics do you mean? Do you mean credit statistics, or interest rate statistics, or others?

The CHAIRMAN. I mean interest rate statistics and I mean credit statistics, too.

The CHAIRMAN. You see my problem is I think the monetary aggregates are among the least understood, least discussed by people in general, let alone economists. A lot of economists don't pay much attention to it for various reasons. Members of Congress, when you talk about what happened to M_1, M_2, or M_3, it doesn't mean much, but when you talk about interest rates they begin to get interested and to understand.

The CHAIRMAN. I am not saying forget about M_1. I am saying bring in other elements, too.

Mr. PARTEE. As far as credit statistics are concerned I agree with you. As a matter of fact, we have provided in the recent oversight hearings a good deal more discussion on credit flows, particularly in the first report that Chairman Miller gave before the House Committee.

But as far as interest rates are concerned, I don't like to be in the position of having the central bank predict interest rates. I think that is a poor policy procedure, because financial market participants may act on the basis of those predictions, and may themselves fulfill the prophecy.

Also, I might say that having coped with this area for many years, we are no better at predicting interest rates than anybody else, so we shouldn't be given that kind of emphasis.

The CHAIRMAN. My time is up, but let me say I will never forget the chart you put up here that showed you hit the Federal funds rate right on the nose every single month and the monetary aggregates were way off.

Mr. PARTEE. I think there might be some misunderstanding, Mr. Chairman, of the role that the shorter term aggregate ranges have for us. They are triggers indicating the need to adjust money market conditions. Money market conditions are the instrument of change. Therefore money market conditions are naturally what we intend them to be, and the changes that occur are based on whether we are running over or under those shorter term monetary aggregate ranges. These ranges indicate where we think the proper number should be under a given set of conditions, but we can seldom hope to achieve them in so short a period of time.

The CHAIRMAN. Thank you. Senator Brooke.

Senator BROOKE. Thank you, Mr. Chairman.

Mr. Partee, does your statement represent the unanimous opinion of the Board or are there minority views?

Mr. PARTEE. With respect to the content of this statement, there were no points on which there was a dissent by any Board member.

Senator BROOKE. Then I take it that the Board feels that without inflationary goals, that we should not have unemployment goals?

Mr. PARTEE. The Board didn't discuss that point specifically. But speaking personally, I would take the view that if we did not have a specific inflation target, we should not have a specific unemployment target. Rather, simply state that our objective is to achieve high levels of employment and low levels of unemployment, just as the bill now states our objective with regard to inflation.

I think parallel treatment is very important in terms of the kind of actions that this bill precipitates.

Senator BROOKE. You seem to be pleased with the arrangements for coordinating the Federal Reserve policy with the economic planning, in the latest version of S. 50.

Mr. PARTEE. Yes.

Senator BROOKE. Do you foresee any danger at all of the loss of the Federal Reserve's independence in the new role contemplated for it in S. 50, or any of the other current versions of Humphry-Hawkins?

Mr. PARTEE. I know that there has been something made of that, but I can't find it myself in the bill. I must say that I have paid more attention to H.R. 50, because it has already been passed by the House, and I am not absolutely certain of all the points of difference in S. 50, some of which I mention in my testimony.

But it seems to me that unlike the earlier version of a couple of years ago, the current versions call for us to report to the Congress, which is appropriate, rather than to the administration. And the President is not called upon to specify monetary policy as he was in the bill 2 years ago. Now, if we can establish the role of the oversight committees in this legislation, it seems to me that what is involved would be consistent with what is now done in the oversight hearings for the Federal Reserve.

There is the question of accepting the national goals for the coming 2 years as stated by the President, and presumably accepted by the Congress—specific quantitative goals called for by the bill. As the chairman stated, we could differ with those goals, if we wished. The chances are we wouldn't except when there was a rather fundamental difference. All in all as a matter of proper political process, I must say I think that the organizational framework for policy planning in which the Federal Reserve would fit is a better one than exists at present. I think it is an improvement.

Senator BROOKE. What is the unemployment floor past which major inflationary pressures would be generated?

Mr. PARTEE. Well, it is a continuum, Senator Brooke. I would say I would disagree with the previous witness today to a degree. I believe there is some sign of demand pull or excess demand pressure right now in the economy. I think the increase in some construction material costs in the last year is evidence of demand pull. I think in the last 3 or 4 months we have had similar evidence in the commercial building sector. I think there are materials coming into short supply, aluminum being a prime example. And I think that there are some special labor skills now in sufficiently short supply that they are being bid up in the marketplace.

There will be differences of opinion among individual economists and individual Board members as to achievable unemployment targets. As I stated, I believe if we were to work carefully and gradually, we could probably reduce the unemployment rate to the 5-percent vicinity over time, without strong inflationary pressures developing. To go below 5, I think, would require better structural programs than anything that we have seen in the last few years.

Senator BROOKE. Now you call attention to the need to stimulate more investment in productive plant and equipment. But you don't seem to be very specific about just what the Federal Government ought to do to do that. Would you care to elaborate on your call for stimulation, giving just a little more programmatic content to it?

Mr. PARTEE. This is a very big subject and I hate to answer the question quite so casually. I do believe that we should consider tax revisions that would particularly reward new investment and not just general corporate profitability.

Senator BROOKE. You mean investment tax incentives?

Mr. PARTEE. Yes, and there might be other possibilities, incremental programs, to encourage investment. I think also that we ought to give considerable attention to the effect that environmental quality requirements have on investment in this country. There are many major primary industries where there has been little new expansion in recent years, and industry leaders will tell you it is because they can't meet that very last bit of the environmental requirements at reasonable cost. I think we ought to look into this as a matter of policy.

I might say that the Board staff is giving considerable attention to the question of the shortfall in investment and what might be done about it in the long run. With the research program that is now underway, we would hope to have material dealing with this subject and suggestions developed by the end of this year.

Senator BROOKE. I appreciate that. I would further appreciate it if you would submit for the record any additional views you may have as to the specifics for such a program.

Mr. PARTEE. I can certainly do that.

[Governor Partee submitted the following letter for inclusion in the record at this point:]

FEDERAL RESERVE SYSTEM,
Washington, D.C., May 19, 1978.

Hon. EDWARD W. BROOKE,
United States Senate,
Washington, D.C.

Dear Senator BROOKE: Last week, when I appeared before the Banking Committee to present the views of the Federal Reserve Board on the Humphrey-Hawkins bill, you requested that I submit for the record my suggestions for possible means to stimulate investment in productive plant and equipment. This letter is submitted in response to that request.

Over the past three years of economic recovery there has been a noticeable shortfall in investment spending compared with past periods of recovery. This shortfall appears to have been especially acute with respect to major additions to our capital stock, such as the construction of plants and factories and the purchase of long-lived types of heavy equipment. A principal difficulty in stimulating such investment, in my view, has been the problem of heightened uncertainty in the prospective pay-off from investment as perceived by business firms. After the experience of the early 1970's, businesses are wary of the effects that rising materials and labor costs and unexpected shifts in the demands for their output can have on the profitability of investment.

Thus, my recommendations for stimulating investment are premised on the need to reduce the expected duration of the pay-off period. This can be done in several ways which are not necessarily mutually exclusive. One way would be to reduce the effective cost of capital goods by increasing for a time the size of the investment tax credit. In this connection, I would think it desirable to consider larger percentage allowances for the kinds of long-lived plant and equipment needed in our basic materials industries. Similarly, faster depreciation schedules often have been suggested as an incentive to investment spending, since they serve to delay the stream of profits from a project on which taxes must be paid. Here, too, I would urge that special emphasis be placed on long-lived additions to our stock of productive capital.

A second means of encouragement, as I noted in my statement, could flow from some reduction of the regulatory barriers to investment. It appears that the largest shortfalls in plant and equipment spending have occurred in those industries most subject to our new, tighter safety and environmental quality standards. These tend to be the major materials industries which are often sources of potential bottlenecks at critical points in the business cycle. I do not mean to suggest that such standards ought to be relaxed altogether, but that the precise setting of the goals specified, and the speed with which they are to be reached, may warrant reconsideration in terms of their impact on investment initiatives in strategic sectors. A modest relaxation of standards, or extension of the timetable for achievement, might well prove extremely effective in reducing the costliness of new investment.

A third area of action which could materially improve the environment for investment would be to achieve more stable economic conditions generally. If inflation can be moderated, the severity of the business cycle dampened from that experienced in the early 1970's, and a dependable basis established for business planning with respect to energy prices and supplies, I believe that the effect would be to stretch out acceptable pay-off periods once again. This would be especially true if interest rate levels (and hence, rates of capitalization) could also be reduced over time, which I would expect to be the case in a less inflationary and more stable economy.

One final point. Excessive demands for plant and equipment, like excessive demands for goods and services generally, can be a source of inflationary pressure in an overheated economy. It is thus important to have in hand devices that can be used to modulate the investment resurgence that we seek to bring about, so that it will not run up so far or so fast as to exceed our productive capabilities. This suggests to me that segmented, potentially reversible programs for stimulating investment are better than all-out, once-and-for-all efforts.

Sincerely,

J. CHARLES PARTEE.

Senator BROOKE. Now you place a great deal of emphasis on the need to control inflation, as well you should, as a member of the Board. But the supporters of Humphrey-Hawkins, particularly the labor unions, argue to add the numerical inflation goal such as you suggest would be to significantly weaken the thrust of Humphrey-Hawkins, which is directed at unemployment.

How would you respond to that?

Mr. PARTEE. Senator, I think I would say first that this series of Humphrey-Hawkins bills was initiated during a somewhat different period than the one we are now in. I can see that there would be great concern about undercutting the efforts to get down unemployment when we were in the midst of a recession, when the unemployment rate was very high—up around 8 or 9 percent—where it was when these bills all got started. It seems to me, though, that the degree of concern and the degree of pain ought to have been reduced as time has gone by, and the unemployment rate has dropped by 3 full percentage points.

Second, I do seriously accept Chairman Schultze's view that this is a planning document. It seems to me that a planning document that looks only at one objective of public economic policy is a flawed one. In the long run the public—labor and the public generally—is not going to be better off with double digit inflation and temporarily high levels of employment.

There need to be ways found that will get unemployed people into productive useful jobs without creating conditions of very large governmental expenditure, inflationary Federal Reserve monetary policy, and wage-price cycle developments that create double digit inflation.

I must say, as one who has always felt employment is a very important goal and a very serious priority for the economy, that the thrust of this bill scares me to death—especially the possibility that over time it will guarantee double digit inflation. I don't think labor would be well off in that environment. Perhaps what is required is a little trust and confidence that if an inflation objective is included in the bill, this won't mean that we are just going to disregard the need and the desire to get unemployment down through constructive and useful programs.

Senator BROOKE. Thank you. My time is up. I just wanted to ask, you don't have any problems with the role or the requirements for the Federal Reserve?

Mr. PARTEE. No.

Senator BROOKE. You can meet those without any problem?

Mr. PARTEE. So long as we have the suggestions I made for that section of the bill.

Senator BROOKE. Thank you.

The CHAIRMAN. Senator Heinz.

Senator HEINZ. Thank you, Mr. Chairman. Mr. Partee, you have raised the issue of equal treatment for, on the one hand employment, and on the other, inflation.

Now the employment goal in Humphrey-Hawkins is 4 percent for those 20 and over.

Mr. PARTEE. Three percent, sir, for those 20 and over.

Senator HEINZ. Excuse me, 3 for those over 20, and 4 percent for the work force as a whole.

Senator Proxmire's amendment states an inflation goal of 3 percent. Now several questions occur to me in that regard.

The first is really a question of reasonableness. We have attempted here today to try and decide whether the 4 percnt goal is reasonable and the administration testified, I believe Mr. Schultze testified that they felt that through macroeconomic policies they could get down a little bit lower than that. You felt 5 percent was about the best you could do with macroeconomic policies.

Mr. PARTEE. In the current situation, yes, with the current labor force and skills, and existing structural programs.

Senator HEINZ. Yes, right. Mr. Schultze said he felt that 4¾ percent was about what would be realized and felt that public service job programs could take us down from 4¾ to 4 percent.

So that is his statement of feasibility. You have said that about the only way we could go from 5 percent down to 4 percent would be with better structural unemployment programs. So there is not a magnitude of difference between yourself and Mr. Schultze, although you might disagree with the public service jobs.

Mr. PARTEE. I think I would probably err on the high side of the 5, and he would probably tend to err on the low side of 5.

Senator HEINZ. Right. But it is not a magnitude of difference, it is literally fractions. I think that is a fair statement, is it not?

Mr. PARTEE. Although every point represents a million unemployed people.

Senator HEINZ. That is correct. And a quarter of a point is 250,000 people.

Now inflation, in Senator Proxmire's amendment, at 3 percent, I would also like to find out how we can get to 3 percent. I can see that there are ways where we can get to somewhere between 4 and at the outside 4¾ or 5 percent unemployment. I have a little more difficulty seeing how we are going to get down to 3 or 4 percent inflation, given the present outlook.

Could you speak to that a little bit?

Mr. PARTEE. It is a very ambitious target. There is no question about it.

I am inclined, by the way, to feel that targets ought to be ambitious; that you ought to make that little extra effort that would be required in order to get the rest of the way. Thus, I don't greatly disagree with the 4 percent target for the unemployment rate, so long as it is adjustable—as long as the President can say, "We can't make this by 1983," or "This rate, given our conditions, is just impossible."

Senator HEINZ. Which you feel he can do under this bill?

Mr. PARTEE. Yes, he would be able to, as I understand the bill. The same could be said of Senator Proxmire's 3 percent inflation goal under my suggestion; the President might have to admit we just couldn't make it, or couldn't make it by 1983 under the kind of conditions that we face. I must admit that it is hard to see how we would get down to 3 percent by 1983.

Senator HEINZ. Under those circumstances, maybe Senator Proxmire's amendment is not enough, maybe we should insist on zero.

Mr. PARTEE. I agree with Chairman Schultze that zero is just too heroic a number to put into law at this time. I believe that the Chairman's proposal is that 3 percent is an interim target, and once having reached the interim, we should move on down to zero. That seems to me a good way of putting it.

Now I believe that quite a bit can be done to reduce the rate of inflation with structural programs, through avoidance of areas of excess demand and through supply-creating activities, such as more investment and a better program for increasing agricultural products and other raw materials in the economy.

I also think that it is just conceivable that we might again find ourselves in the circumstances where the wage-price spiral will slow. To my knowledge, nobody forecast the period of very low rates of inflation that occurred in the early 1960's. In the late 1950's, the view was that we were going to have an accelerating rate of inflation in the country, that 3 percent was a minimum, and it was going to build up from there. Yet, in the early 1960's somehow we landed on the kind of conditions that made it possible to have an average annual CPI increase of 1.25 percent, for example, and for wage increases to be within sight of the productivity gains in the economy.

I don't see that it is an impossibility that we could have that kind of situation again, perhaps with Government aid, perhaps as a result of natural forces. And if we do, the 3 percent inflation rate that the chairman has proposed is not unreasonably low. Indeed, if we could eliminate the circularity that leads to 8.5-percent wage rate increases, 2.5-percent productivity gains, and a 6-percent unit labor cost increase each year—a circularity that doesn't benefit anybody at all—3 percent would be a rather high rate of inflation for the economy to be generated on the basis of, say, spot droughts, the energy crisis, and shocks like that.

So I don't consider moving down to 3 percent or below an impossibility, by any means.

The CHAIRMAN. Would the Senator yield on this Senator's time for just a minute?

Senator HEINZ. I would be happy to yield on the Senator's time.

The CHAIRMAN. I think we ought to recognize the fact throughout our economic history, except for war periods, price stability has been pretty much a characteristic. It is very hard to compare, but the evidence is that the prices in 1940 were about the same as they were in 1840; in 100 years they didn't go up very much.

There were periods of deflation, inflation, they skyrocketed one time and then dropped down sharply. It is only in recent years that we have had this high inflation, and we have really only had it in the last 10 years or so.

On the other hand, unemployment has been something that has been around 3, 4, 5, 6, 7, or 8 percent. We have had some serious depressions.

So looked at from a historic standpoint, that 3-percent goal would seem to be more in keeping with our economic history by far than the unemployment goal.

Senator HEINZ. I am delighted to have the Senator's views.

The CHAIRMAN. On my time.

Senator HEINZ. Mr. Partee, I would still like to ask you to come back to this question, and that is is the inflation limitation or goal of 3 percent going to be more difficult for us to achieve than the employment goal of 4 percent?

I mean I agree with you that we ought to have goals that challenge us. But on the other hand, if we are asking one group of people to jump 7 feet and the other to jump 9 feet, knowing full well that the world's record is 7½ feet, we are a little tough on one group of people.

We want to make sure that we haven't set the hurdle at an unacceptably high level here for us to have any reasonable chance of clearing it.

Now that carries with it the very real implication that if you set a goal which you know you can't possibly achieve, pretty soon everybody says well, let's not pay any attention to that part of the law, they didn't know what they were doing, or if they did know what they were doing, they were being cynical, and pretty soon you invite breaking the law, and the law enforcement branch turns its head, as they do with so many of the laws that legislators have written on the books, both Federal and State. We have lots of laws that are not enforced because nobody believes they are reasonable laws.

So my question is are you sure that 3 percent is indeed of equal reasonableness with 4 percent? We have had a rationale as to how we get the 4 percent unemployment. Can you give us any kind of similar rationale for an inflation goal of 3 percent, and if not 3 percent, give us a rationale for 3½ or 4 percent or 4½ percent, whatever you feel you can give us a rationale for?

We look to the Fed as one of our principal bastions of fighting inflation. I would want to be sure the Fed has a good rationale for fighting inflation here, and I would like to hear it.

Mr. PARTEE. As I said, my rationale for 3 percent is simply that I believe that would allow plenty of room for the kind of rates of inflation which might result from occasional shocks to the economy, the need for energy prices to rise significantly over time, that kind of thing. What it doesn't allow room for is a situation in which unit labor costs go up 5 or 6 or 7 percent a year as they have been doing recently.

What is necessary in order to get the current inflation rate down is a reduction in the increase in unit labor costs. That is very difficult to do through monetary policy alone, because the kind of restraint that monetary policy can introduce falls on both prices and real activity. In fact, initially it falls more on real activity than prices, in my view. So it is very difficult for monetary policy to dampen unit labor cost increases.

What we need to find, and I would not rule it out, is a way of entering into this wage-price spiral problem. If we can do that, a 3-percent target is OK.

I wouldn't quarrel greatly with 4 percent as a target. The difficulty with it is that prices would double in 18 years at a 4-percent rate of inflation. That seems pretty fast. At a 3-percent rate of inflation, it takes a quarter of a century for prices to double and that seems to be a more reasonable kind of an objective to have in terms of an interim target.

If inflation continues at a rapid rate I think it will have a tendency to accelerate, because of precautionary behavior on the part of the public attempting to protect themselves against the inflation. Therefore, I think we have to take care that we don't have an interim target that is so high that it might lead people to engage in precautionary inflationary behavior. Thus, I have some preference for 3 percent, though 4 perhaps is a more realistic target.

Senator HEINZ. One last question. The chairman has been very patient.

You mentioned on page 7 of your statement that you seek to add the language from section 2A of the Federal Reserve Act.

Does that mean if that language were added, and the Fed saw this cycle of inflation building up and let's say it saw a combination of macro and ineffective structural economic policies being put into effect, so that while some additional people were being employed, the overall benefit to the economy was extremely marginal, and larger deficits were being created and were fueling an inflationary fire, that the Fed would construe this language to mean they would be obligated and certainly at the minimum authorized to take steps to mitigate such an inflationary situation by whatever means they might have at their disposal?

Mr. PARTEE. Yes, but I would read that language as having more effect on the interim between yearly reports. I think if there were over time developing inflationary processes that were getting to an uncontrollable point, that we would differ with the President's program in the annual report. But it also could well happen that during the course of the year there might be a change in circumstances that could call for a change in emphasis. For example, we are only into early May 1978, and yet I don't know anyone who would have predicted at the end of last year, 4 months ago, that the unemployment rate would already be down to 6 percent. Generally the expectation was that it would drift down gradually as the year went on to something above 6 percent at the end of the year. We are way ahead of expectations in that area.

Senator HEINZ. Do you consider the Federal deficit ahead or behind expectations?

Mr. PARTEE. I am not as well informed on that.

I was going to say, on the other hand, that I don't know of anyone who would have predicted that the rate of price increase thus this year would have been as large as it has been; it is close to a double digit rate in the first 4 months.

So it might well be that interim developments, unexpected at the time the President writes his report, and at the time we comment and write our independent report, would call for a change in posture. I think we ought to have the right to change and to report to this committee, as we do under the Federal Reserve Reform Act.

Senator HEINZ. Thank you very much, Mr. Partee.

The CHAIRMAN. Thank you, Governor Partee. It was excellent testimony. It is most heartening to see we have the seven distinguished

Governors of the Federal Reserve Board supporting the Proxmire amendment.

Mr. PARTEE. We only have six currently, Mr. Chairman.

The CHAIRMAN. Well, you speak with a voice of 600. At any rate, thank you very much.

The committee will stand in recess until 10 o'clock tomorrow morning.

[Thereupon, at 12:30 p.m. the hearing was recessed, to reconvene at 10 a.m. the following day.]

FULL EMPLOYMENT AND BALANCED GROWTH ACT OF 1978

WEDNESDAY, MAY 10, 1978

UNITED STATES SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, D.C.

The committee met at 10:10 a.m. in room 5302, Dirksen Senate Office Building, Senator William Proxmire (chairman of the committee) presiding.

Present: Senators Proxmire and Riegle.

The CHAIRMAN. The committee will come to order.

Today is the third and final day of the committee's hearings on the Humphrey-Hawkins bill.

As you are all aware this legislation would amend the Employment Act of 1946 with the major idea of establishing a 4-percent unemployment objective for 1983 and the creation of a framework within which policies designed to foster full employment and balanced growth would be formulated and coordinated among the various parties in the Government with responsibility for economic policy.

Our economy is confronted both with an unemployment problem and an inflation problem. The committee has been told repeatedly during the past 2 days that these problems should be approached together rather than separately and we have had several suggestions on how this might be done. As you may know, I favor a 3-percent inflation goal for 1983 to go along with the unemployment goal so they are approached on an equal basis and so that the inflation is not confined to rhetoric but has the same status as the numerical specific unemployment goal.

Our witnesses today are all from the business community which has long ago embraced the concepts of corporate goals and corporate planning to achieve them. I am interested in hearing the views of today's witnesses on how goals and planning can be used to help the Congress and the administration fulfill its responsibilities for economic policy.

Our witnesses today will be heard as a panel. They are: Mr. Lewis Foy, chairman of Bethlehem Steel and representing the Business Roundtable; Mr. Hugh P. Donaghue, vice president and assistant to the chief executive officer, Control Data Corp.; Mr. George Hagedorn, chief economist and vice president, National Association of Manufacturers; and Mr. Arnold Saltzman, chairman and chief executive officer, Seagrave Corp.

I'm going to ask Mr. Foy to go first. Mr. Foy, unfortunately, is going to have to leave after his statement. He's told me that he has very able people who can respond to questions relating to the Roundtable position on the bill and we regret very much that Mr. Foy has to leave but we certainly understand. Mr. Foy, why don't you go ahead and give your statement and then you will be excused. We would appreciate it if you could limit your statements to 10 minutes because of the fact that we have four distinguished witnesses and we would like to get into questioning if we could, and to assist you in that regard we are going to run the green light for 9 minutes, the yellow light for 1 minute, and then the red light will tell you that your time is up. These are all for your assistance.

STATEMENT OF LEWIS W. FOY, CHAIRMAN, NATIONAL PLANNING AND EMPLOYMENT TASK FORCE, THE BUSINESS ROUNDTABLE; ACCOMPANIED BY RICHARD SCHUBERT, VICE PRESIDENT, PUBLIC AFFAIRS, BETHLEHEM STEEL CORPORATION; AND MALCOLM LOVELL, PRESIDENT, RUBBER MANUFACTURERS ASSOCIATION

Mr. Foy. Mr. Chairman, I will watch the light.

[Complete statement and additional material received from Mr. Foy follows:]

Testimony Presented by Lewis W. Foy,* Chairman of The Business Roundtable Task Force on National Planning and Employment

Mr. Chairman and members of the committee, I appreciate the opportunity to appear before you this morning to present the views of The Business Roundtable on Senate Bill 50—"The Full Employment and Balanced Growth Act of 1978"—better known as the Humphrey-Hawkins Bill.

Accompanying me this morning are Richard Schubert, vice president, public affairs of Bethlehem Steel Corporation, and Malcolm Lovell, president of the Rubber Manufacturers Association.

The Business Roundtable believes that our society must mount a major attack on structural unemployment. Toward this end, we support specific measures to deal with such real and serious problems as the high level of joblessness among minorities and youth.

Representatives of The Business Roundtable have offered testimony in support of reauthorizing the Comprehensive Employment and Training Act, and we have been working with the administration and the National Alliance of Businessmen to perfect the new private sector training initiatives proposed in that act.

Such programs must be specifically designed and targeted to meet specific problems.

Unfortunately, in our judgment the Humphrey-Hawkins Bill is not a specific and practical response to the structural unemployment problem.

Generalized national planning solutions, like this proposed act, only serve to deflect the energies and obscure the purposes that must be pursued if we hope to alleviate the human and economic suffering that result from structural unemployment among certain groups.

Before proceeding to give you our detailed reasons for opposing this legislation, I believe it would be useful and instructive to remind ourselves of the origins of the widely diverse purposes and interests that are embodied in the current version of the Humphrey-Hawkins Bill.

The original House bill sought a goal of "full employment" by setting forth a legally enforceable right to a job at prevailing wages for every citizen willing and able to work and it made the federal government the guarantor of that right.

The federal government was responsible for ensuring that within two years, the unemployment rate would be three percent, and was made the "employer of last resort." The government was required to create the requisite number of public jobs necessary to meet the deficit in private jobs.

The original Senate bill provided for a new "national planning" system with an elaborate set of "indicative" planning requirements. It essentially set up dual planning systems, with the President required to propose numerical five-year planning goals which the Congress was then obliged to act on and either adopt or revise in legislation.

*Mr. Foy is Chairman and Chief Executive Officer of Bethlehem Steel Corporation.

These two disparate proposals with widely differing purposes were subsequently joined together apparently in an attempt to both broaden the base of support for "national planning" and to benefit from the public's concern over the continuing high levels of unemployment.

This original, joint Senate-House bill thus welded "national planning" and "full employment" together by making the achievement of "full employment" the over-riding purpose of "national planning."

It called for the development of numerical five-year plans through a "national planning" process, but it dictated an explicit five-year "full employment" goal in legislation.

The original version of the Humphrey-Hawkins Bill has been gradually revised over the past several years—first by its sponsors, and then by the President—so that many of the most far-reaching and controversial of the initial provisions have been deleted.

The legally enforceable job guarantee was deleted early in the process, and the authorization of major public job-creation programs was trimmed later at the President's insistence.

But in spite of these wise modifications, the basic structure of the bill remains. It still overpromises that both "full employment" and "balanced growth" can be achieved by "national planning," and it still legislates a specific unemployment goal of four percent by 1983, while leaving the setting of other goals to the operation of the planning process.

Apparently reflecting the presumed strength of the "full employment" symbolism in the bill, no attempt was made in the House to remove the explicit four percent unemployment goal. In fact, the overwhelming vote by the House mandating the achievement of 100 percent of parity for farm prices might be interpreted as establishing a goal equal to that of the unemployment goal.

The House also greatly strengthened the provisions of the bill directed at reaching "reasonable price stability" and a "balanced budget."

On the other hand, attempts were narrowly defeated to set a three percent inflation goal for 1983, to balance the budget by 1983, and to legislate specific tax rate reductions.

The most significant action taken by the House was the deletion of the procedures in Title III by which the Congress was to act on and set specific numerical economic goals, thus properly leaving with the President the responsibility for planning and implementing economic policy.

The Business Roundtable believes that both Senate Bill 50 and the House-passed bill are unwise and unrealistic. While all Americans desire "full employment," it is unrealistic and less than honest to promise such a result simply through installation of a complex new national planning system, or through the symbolism of legislating an unachievable unemployment goal.

We support the House amendments to Title III, but still believe the "national planning" purposes of the bill are flawed, particularly because the bill prejudges the result of the planning system by legislating specific economic goals.

Mr. Chairman, now I'd like to give you some of the reasons why we believe it's unwise to legislate an unemployment goal, and particularly the four percent goal specified in the bill.

First, because of changes in the make-up of the labor force, the lowest level of unemployment we could achieve solely through noninflationary macroeconomic policies is no longer four percent, but probably closer to 5½ percent. The old four percent goal is outmoded and has no valid meaning under today's circumstances.

The National Commission on Manpower Policy has just published a study by Professor R. A. Gordon of the University of California entitled "The Need to Disaggregate the Full Employment Goal."

Professor Gordon writes as follows: "It is common today to consider a national rate of about 5½ percent as corresponding to 'full employment'—not only because of the changing age-sex pattern of the labor force, but also because of the worsened tradeoff between inflation and unemployment that seems to have taken place."

Professor Gordon is eminently well-qualified to make that judgment. In 1962, he chaired the President's Committee to Appraise Employment and Unemployment Statistics, which led to the last major restructuring of unemployment data. He is recognized to be a leading authority in this field.

Our point here is not only that four percent is no longer a realistic criterion for "full employment," but that the "full employment" concept itself is dynamic and ever-changing. This year's "full employment" rate may be inappropriate next year, and will most probably be inappropriate several years hence. Thus, it would not only be a mistake to write into law the obsolete rate of four percent, but it would be a mistake to write any arbitrary numerical rate into permanent law.

Second, the methodology and procedures for collecting unemployment statistics are not sensitive enough to the realities of our economic system so that the data can be reliably used to evaluate progress toward an absolute economic goal.

Likewise, the very definitions of "employment" and "unemployment" reflect judgments that must change with the times and indeed were changed significantly in 1967 as a result of the recommendations of the committee chaired by Professor Gordon.

The Congress has recently recognized the dynamic nature of these statistics by establishing a National Commission on Employment and Unemployment Statistics. The commission is chaired by a distinguished economist, Dr. Sar Levitan of George Washington University, and is to issue a final report in the fall of 1979.

The report will undoubtedly call for some basic changes in the concept and methodology for computing unemployment. Consequently, it would seem wise to refrain from casting the current unemployment concepts and methodologies in the concrete of legislation.

Third, the Carter administration's economic report of this past January calculated that the "full employment without inflation" rate was now 4.7 percent. Nevertheless, the administration has continued to support the Humphrey-Hawkins goal of four percent, by maintaining that the rate would be brought down from 4.7 percent by the creation of public jobs.

Assistant Secretary of Labor Arnold Packer in recent testimony before the House Budget Committee, estimated that total unemployment in 1983 will have to be reduced by something in the range of 800,000 to 840,000 through structural programs if the four percent goal is to be achieved.

Because creating public sector jobs draws workers into the labor force, he estimated it would require two public jobs to reduce unemployment by one. On that basis he concluded that it would require 1.6 to 1.7 million public jobs to meet the four percent goal.

A public job program of that size would cost an estimated $14 billion annually. By comparison, the current public jobs program employs about 725,000 workers and costs about $6.2 billion annually.

The implications are serious. By adopting the four percent goal in the face of the administration's own estimates, Congress would be implicitly committing itself to more than doubling the existing public job creation program which is already large and costly.

Finally, the supporters of an explicit four percent "full employment" goal maintain that the goal is flexible since an escape clause is written into the legislation. This provision allows the President to recommend a revision in the goal if he finds that it cannot be met.

As a practical reality, this provision won't give the President "flexibility," but rather confront him with a "no-win" situation. He will have to either modify the goals and suffer the political consequences, or, by law, present a budget and economic plan that will meet the goal.

Once national goals are fixed in legislation they become absolute political imperatives that can only be revised at great political peril. It's risky to rely on political embarrassment as the tool to ensure that the President wisely and vigorously pursues effective economic goals.

The President's so-called "flexibility" to revise economic goals under the provisions of Senate Bill 50 would be substantially diluted by the amendment recently voted by the Senate Human Resources Committee.

This amendment provides that any modification of a goal or timetable recommended by the President would not take effect if either House adopted a resolution disapproving the modification.

This additional intrusion of the Congress into detailed economic policy-setting could have very serious consequences.

If only one House disapproved the President's economic policies, he would be forced to adjust his revenue and expenditure programs to meet economic goals which, in his judgment, were unwise and perhaps unattainable.

Mr. Chairman, I'll now move along to the reasons why we oppose the "national planning" provisions of the bill under consideration.

I want to emphasize that short- and long-range planning by the executive branch is absolutely essential and should be constantly encouragegd and improved. No modern enterprise can prosper without strategic plans, and this is particularly true of our national government.

Presently, the executive branch carries out detailed economic and fiscal planning, and constantly reports the results of these various planning processes to the Congress.

The President's budget and economic report now contain five-year economic, expenditure, and revenue estimates, and would seem to provide sufficient information to allow the Congress to make informed decisions.

Consequently, it's clearly not necessary for the Congress to require by law that the executive branch continue to carry out and develop an effective and integrated planning system.

Indeed, specific legislative requirements might interfere with the continual process of change and adaptation to new circumstances that are the very essence of a dynamic and effective planning system.

Secondly, we are concerned that the bill prescribes five-year numerical planning and goals for economic variables that aren't defined in the bill and which may have a variety of interpretations and a number of optional data sources.

For example, the terms "production," "capital formation," "real income," "productivity," and "reasonable price stability" have no common and accepted definitions and no authoritative data base for measurement.

Mr. Chairman, rather than going into detail on this point I'd like to offer for the record a paper The Business Roundtable commissioned by Dr. John Kendrick of George Washington University.

We believe the paper shows the difficulty and confusion that may result from the facile belief that these broad economic concepts can be reduced to simple numerical goals that can be readily understood and effectively measured.

Finally, on this point, we're concerned that the original bill, Senate Bill 50, makes numerical national planning paramount by requiring that both the executive branch and the congressional budget and taxing policies shall be "geared to" the goals.

This would subordinate both the new congressional budget process and the long-standing tax-writing procedures of the Congress to this new economic goal-setting process.

Certainly the country should not condemn its well-tested fiscal processes to the vagaries of economic forecasting.

The joint economic committee has been an important and useful vehicle for studying economic problems and trends and then focusing national attention on them. But it would be a mistake to elevate it to the pre-eminent position of setting the economic parameters within which the budget, finance, and other fiscal committees are required to operate.

As I stated earlier, Mr. Chairman, we support the House amendments to Title III. The Senate Human Resources Committee has recently recommended amendments to Title III, which, in our judgment, are a step backward from the House action.

These amendments would restore a strong role to the joint economic committee and would provide for the setting of economic goals by the Congress in conjunction with its action on the first concurrent budget resolution.

I repeat that we are opposed to a national planning process wherein the Congress sets explicit numerical economic goals.

We are concerned, Mr. Chairman, by the provisions of the bill that would alter the relationship between the Federal Reserve Board and the Congress.

The desirable independence of the Federal Reserve Board could be damaged by requiring it to report to the Congress on the relationship of its "intended policies for the year ahead" to those of the President. And further, by directing the Congress to take such action as it finds necessary to "insure closer confomity" to the purpose of the bill.

In summary, Mr. Chairman, we oppose the bill for two primary reasons: First, the Congress should not infringe on the responsibility of the President to plan and implement the economic policies of the nation. Second, the Congress should not set explicit numerical economic goals for unemployment or any other economic variables thereby mandating in exquisite detail the results of the planning processes, and possibly forcing the President into unwise economic choices.

This concludes my statement, Mr. Chairman. My colleagues and I will be glad to answer any questions the committee may have.

Definition and Methodological Problems With Key Concepts Incorporated in the "Full Employment and Balance Growth Act of 1978" (H.R. 50) (Humphrey-Hawkins Bill) by Dr. John W. Kendrick

The Full Employment and Balanced Growth Act of 1978 (H.R. 50) as passed by the House asserts the responsibility of the Federal Government "to use all practicable programs and policies to promote full employment, production, and real income, balanced growth, adequate productivity growth, proper attention to national priority needs, and reasonably stable prices." (p. 7) Elsewhere, reference is made to high rates of capital formation as being necessary to ensure adequate rates of capacity expansion and productivity growth (p. 37). Further, the President is required to set forth "annual numerical goals for 5 years for employment and unemployment, private sector employment, production, real income, farm income, productivity, and reasonable price stability." (p. 10).

Despite the importance placed on these various economic objectives, nowhere in the Act are the concepts refined even in general terms, with the exception of the unemployment and employment goals, nor are they related to specific statistical series. This lack of specificity with respect to most of the economic variables would cause serious ambiguities and difficulties in administration of the Act. The purpose of this paper is to set forth some of the alternative interpretations that can be given to the major economic variables cited in the Act, and some of the alternative statistical series that could be used to implement the concepts for purposes of goal-setting and the monitoring of economic developments relative to those goals. This review points up the serious conceptual and methodological problems with reducing to single numbers the series of general economic goals included in the Act.

PRODUCTION

The broadest currently available official measure of production is the gross national product (GNP). But since movements in the GNP reflect changes in prices as well as changes in the "real" physical volume of production of final goods and services, it may be assumed that the authors of the Act are interested in the levels and growth of real product (i.e., current dollar product deflated by appropriate price indexes to constant dollars). But there are two versions of aggregate real product: real GNP, and real NNP (net national product) which excludes real capital consumption allowances. Given the interest expressed by the Act in "economic well-being," presumably the authors would prefer the real NNP measures, although it is less well-known, and subject to greater margins of error owing to difficulties of estimating depreciation and other capital consumption in constant prices. But the Act does not indicate whether it is referring to gross or net product measures.

Nor does it specify whether "production" relates to the total economy, or the business sector. The official GNP and NNP estimates comprise product originating in general governments, households, and nonprofit institutions, and the rest-of-the world, as well as in business, although the latter represents about 85 percent of the total. Because of the unavailability of adequate output measures for the non-business sectors, the Bureau of Economic Analysis measures income and product originating in the government and personal sectors in terms of compensation of employees. Compensation is deflated by average earnings, so that the real product reflects changes in labor input, not output. Income originating in the rest-of-the-world is almost entirely property income, and this is deflated by the "implicit price deflator" for the GNP, so that real net income from abroad is measured in terms of its purchasing power for domestic products, not in terms of output. Some portions of gross business product, primarily in the finance and service sectors, are also deflated by input prices instead of output prices, so that even real gross business product is not a pure production measure.[1]

Because of problems in measuring output in parts of the service sector, some analysts prefer to follow the Federal Reserve Board's index of industrial production, which covers manufacturing, mining, and utilities. This index is more cyclically sensitive than real product, even that of the business sector, and is available monthly rather than quarterly. But the current FRB index is based to a significant degree on productivity-adjusted input data as well as on direct output data. When more adequate annual production data become available, the FRB index is revised. And every five years it is further revised to reflect the more comprehensive data available from the economic censuses.

It should also be noted that the overall FRB index is duplicative, in that it includes materials and other intermediate products as well as final products. Indexes are also available for final production alone. Even these indexes do not show the same movements as the BEA estimates of real product originating in the same industries because of both conceptual and statistical differences between the two sets of measures. The BEA estimates are basically value-added measures, in that the real cost of intermediate goods and services are deducted from the real value of total production in order to obtain real product originating in industry. This differs from the FRB measure of final production. Further, BEA uses price-deflation techniques, whereas FRB uses primarily direct production measures or proxies for production. Movements for the same industries differ even between years in which both sets of measures have been adjusted to benchmark Census data.

Consequently, there are three general measures of "production" which are now in use by economic analysts for various estimation purposes. Each has its particular strengths and weaknesses, and each would produce a different numerical goal for purposes of the Act.

REAL INCOME AND ECONOMIC WELL-BEING

The term "income" is often used synonmously with "product," as in the national income and product accounts. In the accounts, income, or factor costs and other charges against product, is the debit side of the national production account and final expenditures are the credit side. Although real income could therefore be considered identical to real national product, gross or net of capital consumption allowances, it is more likely to be interpreted as relating to real national income (factor cost), in which real indirect business taxes less subsidies, and real business transfers, are deducted from real NNP. This represents NNP at constant factor costs per unit of final product, not real factor costs measured as factor inputs at constant factor prices, which is an alternative measure.

Real income might also be interpreted as real disposable personal income (DPI), which would come closer to the notion of economic well-being. But there is some question as to how disposable personal income should be deflated—by the BLS consumer price index or by the BEA implicit price deflator for personal consumption expenditures, to represent the potential command of disposable personal income over consumer goods and services; or be a combination of consumer prices and investment goods prices, since part of disposable personal income is saved and invested.

The material basis for increased individual well-being does not increase unless real income rises faster than population. For this reason, there is special interest in estimates of real income per capita. Population is a crude denominator, however, since various groups differ considerably in consumption patterns and requirements. But there are many problems involved in estimates of real income—whether NNP, national income, or disposable personal income—as a basis for comparisons of economic well-being. For one thing, there is much

---

[1] Concepts and measures of production are treated in John W. Kendrick, "Economic Accounts and Their Uses" New York: McGraw-Hill Book Co., 1972).

non-market economic activity whose value is not included in national incomes and product; for example, the value of unpaid services of housewives and other family members. Nor is the value of voluntary leisure time estimated. In its proposed budget for Fiscal Year 1979, BEA has a project which would experimet with estimates of the "imputed" values of such activities, which clearly contribute to economic well-being. Unofficial estimates indicate such imputations would add more than 50 percent to the official GNP estimates. Further, there are no deductions of "bads" from the income and product estimates, such as the negative value of the disamenities of urban living. Nor do the estimates reflect changes in the quality of the physical environment.

Professors Nordhaus and Tobin have attempted to produce a "measure of economic welfare" by adjusting the official NNP estimates for the variables mentioned above, and others.[2] It has been cited by Paul Samuelson in his latest Principles textbook, under the acronym NEW, for net economic welfare. But its authors admit there are severe conceptual and statistical problems involved in estimating economic well-being. It is unlikely that a panel of economists could agree on the conceptual framework for such estimates, and if they could many of the basic data required to produce reasonably good estimates would be lacking. It must be concluded, therefore, that the term "economic well-being" as used in H.R. 50, is non-operational unless those who would be administering the Act were willing to settle for such admittedly imperfect measures as real NNP or DPI per capita.

PRODUCTIVITY

The most common measure of productivity is made in terms of the "output per labor-hour" concept. The BLS produces quarterly estimates of real product per hour of all persons engaged in production in several major sectors of the U.S. economy. But the broadest of these is confined to the business sector (adjusted to remove rental income from residential real estate), since as noted above there are not adequate independent measures of real product and labor input for the non-business sectors. Even real business product and productivity estimates have some downward bias as explained above. But presumably the authors of H.R. 50 would settle for measures of productivity in the business economy, since reasonably adequate measures do not exist for the entire U.S. economy.

It is important to observe, however, that labor is only one of the factors of production, so that outpct per hour is a "partial productivity ratio," and there are as many partial producivity ratios as there are classes of inputs associated with output. Associated with real product are inputs of capital and land as well as of labor. Associated with gross production measures (such as the FRB indexes) there are also inputs of energy and other intermediate products as well as of the basic factors of production (land, labor, and capital).

The most comprehensive productivity measures are "multifactor" or "total factor" productivity measures, which relate real product to all the associated tangible factor inputs, or relate gross production to the sum of factor and intermediate inputs. These ratios reflect the net savings achieved over time in real costs (inputs) per unit of output, and thus the increase in productive efficiency generally. Estimates of total factor productivity for the U.S. private domestic business economy by major sector and industry have been presented in studies by the National Bureau of Economic Research[3] and by other research institutions and individuals. But they are not prepared on a regular, continuing basis as are the BLS output per hour measures which reflect changes in input mix (factor substitutions) as well as changes in productive efficiency generally.

It would seem reasonable to assume that the authors of H.R. 50 would prefer to have their productivity concept implemented in terms of multi-factor productivity. This would involve expanding the productivity measurement program of the Federal statistical agencies. If they are willing to settle for the partial output-per-hour ratios, this should be specified in the Act.

Of course, policies to promote "adequate productivity growth" require adequate analysis of the sources of productivity growth. More or less rough

---

[2] William D. Nordhaus and James Tobin, "Is Growth Obsolete?", "The Measurement of Economic and Social Performance," Vol. 38 of "Studies in Income and Wealth" (New York: National Bureau of Economic Research, 1973).

[3] See John W. Kendrick, *Postwar Productivity Trends in the United States, 1948–1969* (New York: National Bureau of Economic Research, 1974). In this volume reference is made to earlier studies of total factor productivity.

estimates of the major sources of growth of real product and productivity in the U.S. economy have been made by a number of analysts, notably Edward F. Denison of The Brookings Institution.[4] But much more work remains to be done to quantify the major factors affecting productivity change as a basis for formulation of policies to promote productivity.

INFLATION AND REASONABLE PRICE STABILITY

Whereas H.R. 50 names "reasonable price stability" among its objectives, nowhere in the Act are the appropriate measures of the general price level specified in terms of which the President should set forth explicit short-term and medium-term goals. With regard to the BL indexes, the consumer price index would be more directly relevant to individual well-being than the industrial price index. But the broadest general price index is the implicit price deflator for the GNP, published quarterly by BEA in several versions (fixed 1972 weights, as well as changing weights, and a "chain price index"). The deflator for government product is, however, the average compensation of government employees, by type, which is not an output price index. Therefore, if the implicit price deflator were to be used by administrators of the Act as an indicator of the degree of price inflation, it should be confined to the implicit price deflator for gross private product, or business product. Even then the preferable version of the implicit price deflator should be specified, since short-run movements of the several versions can differ significantly.

None of the price indexes adequately adjust for changes in the quality of goods and services, of course. Even if the most appropriate one of the available price indexes were chosen, there would be considerable latitude of judgment regarding what constitutes "reasonable price stability."

CAPITAL FORMATION (INVESTMENT)

Finally, the Act would seek to encourage "high rates of capital formation" as necessary for adequate growth of productivity and productive capacity.

In the official BEA estimates the saving-investment account is confined to gross private domestic investment, consisting of new construction, producers' durable equipment outlays, and the net change in business inventories, plus net foreign investment. Under government purchases, new construction is identified, but not equipment purchases, and no allowance is made for inventory change. With respect to the personal sector, new residential construction for owner-occupancy is included under business investment; but while expenditures for consumer durable goods are identified, they are not classed as investment although many economists so view them, since they provide flows of services over a number of years. Estimates are not available on changes in household inventories, which are conceptually also a form of investment.

If capital formation is defined as outlays providing services over a number of years, the concept includes more than investments in structures, equipment and inventory accumulation by all sectors. It can also be interpreted as including intangible investments which enhance future income-and/or output-producing capacity. In particular, outlays for research and development (R&D), education and training, health, safety, and labor mobility may be classed as investments. These outlays, in addition to non-business tangible investments, more than double the official estimates of investment.[5] The Act does refer to research and development and training, and touches on other forms of investment tangentially, but not as comprising part of capital formation. Clarification is needed regarding the scope of capital formation if the administrators of the Act, should it become law, are to promote its goals unambiguously with reference to specific statistical series.

The CHAIRMAN. Mr. Foy, we appreciate it very much and we excuse you. We regret very much that you have to go, but we certainly understand it and we will follow up with questions for your colleagues who I understand will remain.

---

[4] Edward F. Denison, *Accounting for United States Economic Growth, 1948–1969* (Washington: The Brookings Institution, 1974).

[5] See John W. Kendrick, *The Formation and Stocks of Total Capital* (New York: National Bureau of Economic Research, 1976).

Our next witness is Mr. Hugh Donaghue, vice president and assistant to the chief executive office, Control Data Corp.

STATEMENT OF HUGH P. DONAGHUE, VICE PRESIDENT AND ASSISTANT TO THE CHIEF EXECUTIVE OFFICER, CONTROL DATA CORPORATION; ACCOMPANIED BY SHERMAN R. ABRAHAMSON, SPECIAL ASSISTANT TO THE CHIEF EXECUTIVE OFFICER

Mr. DONAGHUE. Mr. Chairman and members of the committee: My name is Hugh P. Donaghue. I am vice president and assistant to the chief executive officer of Control Data Corp., which is headquartered in Minneapolis, Minn. Accompanying me today is Sherman R. Abrahamson, special assistant to the chief executive officer.

Our company and its chief executive officer, William C. Norris, are greatly concerned about jobs in the United States. Therefore, I deeply appreciate the opportunity afforded me to speak about the Humphrey-Hawkins Full Employment and Balanced Growth Act of 1977.

We believe that enactment of the Humphrey-Hawkins bill must be considered as a top priority objective of the second session of the 95th Congress. Its passage will announce to all our citizens that the United States is firmly and fully committed to reducing unemployment in our country. It also provides a framework for follow-on legislation that will be needed to establish specific action programs to reduce unemployment, underemployment, and to create jobs for our expanding work force.

There are a number of provisions in the bill that are exemplary, and in my written statement I have addressed these. However, in my oral testimony I would like to emphasize just a few.

First, the bill makes clear that while its main purpose is to maximize the number of jobs, it places primary emphasis on the expansion of employment in the private sector, and all related policies and programs are to be geared to that purpose.

There are those who sincerely wish to reduce unemployment but are equally sincere in their fear of massive diffusion of public funds or vast increases in the powers of the Federal Government. Those who have these concerns are provided opportunity for constructive initiative and support of Humphrey-Hawkins by the unequivocal thrust of the bill towards the private sector.

This bill provides the basis for a coming together of all elements of our society who have a common aim: meaningful, productive jobs for Americans. In this regard, we believe that for too long the American business community, along with labor unions, the churches, universities, and other sectors of society, have been too occupied with narrowly focused goals and objectives of doing what each wants to do as opposed to each utilizing its resources to the most reasonable extent in addressing the problem of unemployment. With passage of this bill, however, we believe the likelihood of all parts of the private sector joining with Government in a coordinated effort to obtain national employment goals will be greatly increased.

Another significant provision that we should like to emphasize is that of youth employment policies. Minority youth unemployment, at a 40-percent rate and even higher in some of our large cities, is a shameful blight on our society. We can do better—we must do better.

We are convinced that dedicated and coordinated large-scale cooperation of the private sector—that is, business, academia, labor unions, and the church, with the government—all levels of government—can make a vast improvement. This has been demonstrated by our company's success in placing plants in poverty areas, thereby creating local job opportunities within those communities.

Let me give you a specific example from our experience. More than a decade ago Control Data adopted an explicit social responsibility program. Its objective was to identify areas in which our know-how could be used to solve social problems.

At the urging of some of our younger managers who wanted us to innovate in hiring part-time employees, we set up a bindery plant in 1970 in a rehabilitated bowling alley that had been gutted during the riots of the 1960's in downtown St. Paul. The plant's operations were designed especially to employ people who could work only part time, such as students and mothers.

By 1974 the plant proved to be sufficiently successful to justify our putting up a new building. It was the first new building to be constructed on the mile-long strip in inner St. Paul in 70 years.

Today the plant employs 160 permanent part-time and 10 full-time employees in three shifts: 8:30–2 to accommodate mothers who want to be home when their children arrive from school; and 2–5:30 and 5–9:30 to accommodate family and school schedules. Ninety percent of all workers are from minority groups.

The plant binds all the company's documentation, ranging from annual reports to software manuals, as well as similar work from 80 outside steady customers. Last year the plant's volume exceeded $700,000. To tell the truth, the work could be automated with far less employees. Nevertheless, the operation pays all its corporate overheads and makes a profit, with wages that are competitive with other bindery plants in Minnesota.

For many of our employees at the plant, this was their first work experience. Some had criminal convictions and others severe marital problems and drug addiction. We had to invest considerable time and effort in training and counseling. This effort has paid off in another respect, too. Over 150 of our part-time employees have gone on to full-time jobs in CDC and other companies in the Twin Cities. Just one example to show what can be done if you have the desire to do it.

Finally, let me address another feature of the bill that we wholeheartedly endorse and that's its concern with inflation, but some comment should be made on the question of whether a specific, numerical, anti-inflation control should be added to the bill, as insisted upon by the National Chamber of Commerce and that I understand you are in favor of. We believe such addition to the bill is not in the best interests of the country, and goes against the grain of past experience. It would inevitably lead to the establishment of an inequitable wage/price guideline, and ultimately to the demoralizing imposition of wage/price controls.

There is another reason why a numerical anti-inflation goal should not be included in the bill. It is generally conceded that inflation in this country has not risen totally from domestic pressures on wages and other traditional factors. In fact, one doesn't have to be an economics expert, which I certainly am not, to perceive international causal factors of U.S. inflation, notably the oil price-setting actions of the OPEC cartel. If you establish numerical goals to attack both unemployment and inflation in this bill, you will be creating a situation that will inevitably force tradeoffs that can defeat both efforts, and we should not be diverted from our goal of providing jobs for Americans.

And there is a noninflationary solution to unemployment. We must recognize the interrelationship of solutions to our energy problems, our employment problems, our urban problems, our industrial materials problems, the high cost of food, our water problems, and other major societal problems. Millions of new, private sector productive jobs would be derived from their solutions. Therefore, aggressive efforts are called for to implement solutions under provisions of the bill which call for programs and policies with particular emphasis on food, energy, and critical materials.

There are within the United States vast but latent resources that could be employed in providing more timely and effective creation of new jobs if all sectors of society were to participate in a dedicated and cooperative effort. The Humphrey-Hawkins bill provides the framework within which we can move more rapidly toward meeting national employment goals.

The CHAIRMAN. Thank you very much, Mr. Donaghue.

[Complete statement follows:]

STATEMENT OF HUGH P. DONAGHUE, VICE PRESIDENT AND ASSISTANT TO THE CHIEF EXECUTIVE OFFICER, CONTROL DATA CORPORATION

Mr. Chairman and members of the committee, My name is Hugh P. Donaghue. I am Vice President and Assistant to the Chief Executive Officer of Control Data Corporation, which is headquartered in Minneapolis, Minnesota. Accompanying me today is Shermn R. Abrahamson, Special Assistant to the Chief Executive Officer.

Our company and its Chief Executive Officer, William C. Norris, are greatly concerned about jobs in the United States. Therefore, I deeply appreciate the opportunity afforded me to speak about the Humphrey-Hawkins Full Employment and Balanced Growth Act of 1977.

We believe that enactment of the Humphrey-Hawkins Bill must be considered as a top priority objective of the Second Session of the 95th Congress. Its passage will announce to all our citizens that the United States is firmly and fully committed to reducing unemployment in our country. It also provides a framework for follow-on legislation that will be needed to establish specific action programs to reduce unemployment, underemployment, and to create jobs for our expanding work force.

There are a number of provisions in the bill that are exemplary:

EMPHASIS ON PRIVATE SECTOR JOBS

First, the bill makes clear that while its main purpose is to maximize the number of jobs, it places primary emphasis on the expansion of employment in the private sector, and all related policies and programs are to be geared to that purpose.

There are those who sincerely wish to reduce unemployment but are equally sincere in their fear of massive diffusion of public funds or vast increases in the powers of the federal government. Those who have these concerns are provided opportunity for constructive initiative and support of Humphrey-Hawkins by the unequivocal thrust of the bill towards the private sector.

This bill provides the basis for a coming together of all elements of our society who have a common aim: meaningful, productive jobs for Americans. In this regard, we believe that for too long the American business community, along with labor unions, the churches, universities, and other sectors of society, have been too occupied with narrowly focused goals and objectives of doing what each wants to do as opposed to each utilizing its resources to the most reasonable extent in addressing the problem of unemployment. With passage of this bill, however, we believe the likelihood of all parts of the private sector joining with government in a coordinated effort to obtain national employment goals will be greatly increased.

PRIORITY FOR DEPRESSED AREAS

The second significant provision of the bill requires the President, as appropriate, to initiate and recommend legislation for encouraging new private sector production and employment within depressed regions and localities where unemployment is high.

By avoiding the allocation of funds for economic development broadly, on a simple per capita basis, thousands of jobs can be created where they are needed most without adding to inflation. In other words, instead of allocating funds or providing tax incentives in areas with low unemployment, provide these types of economic stimulants where they are urgently needed, such as in the geographical areas of high unemployment.

YOUTH EMPLOYMENT

The third significant provision that we should like to emphasize is that of youth employment policies. Minority youth unemployment, at a forty percent rate and even higher in some of our large cities, is a shameful blight on our society. We can do better—we must do better.

We are convinced that dedicated and coordinated large scale cooperation of the private sector, that is, business, academia, labor unions, and the church, with the government—all levels of government—can make a vast improvement. This has been demonstrated by your company's success in placing plants in poverty areas, thereby creating local job opportunities within those communities.

JOB TRAINING AND COUNSELING

Our experience relates closely to another important section of the Humphrey-Hawkins Bill, which provides for job training, counseling, and other support activities necessary to better prepare disadvantaged persons to enter the work force. Here again, much has been accomplished with existing programs, but much more needs to be done and can be done by closer, more dedicated efforts between the private sector and government.

CAPITAL FORMATION

As a businssman who has started several small business firms, and who has personally experienced the challenge of raising enough risk capital to get started, I am pleased that the bill includes a section on capital formation. This issue has not been given sufficient consideration in national tax legislation, especially the availability of funds to the small business community. In our country small business firms have been the principal vehicle for introducing innovation into our economic system, and they have suffered severely during the recent period of recession and inflation. Interest rates have been high, the stock market has been depressed, and the availability of funds has been so constrained that funds for the start-up of new businesses have been virtually choked-off.

During the five-year period 1972–1976, first-time stock offerings fell as a proportion of all SEC-registered stock offerings from 62 percent to 16 percent. Registered stock offerings by firms with less than $5 million in assets dropped from a high of 698 in 1969 to a low of 3 in 1975, and only 41 for the three years 1974 through 1976. A section on capital formation in the Humphrey-Hawkins Bill gives this important issue the attention and consideration it deserves.

DEVELOPMENT AND DIFFUSION OF NEW TECHNOLOGIES

Fully as important as capital formation is the provision that the Economic Report should review and assess federal support for the development and diffusion of new technologies. Technological innovation is the wellspring of both new and improved products and services and hence, new jobs. In recent years, in the U.S., this process has been slowing, and it is crucial to bring about a reversal, and once this is achieved, to maintain it at the required levels.

Here again, the requirement in the Humphrey-Hawkins Bill for reports on technology development and diffusion will help to stimulate the required action.

ECONOMIC REPORT

Unfortunately, the relationships of technology and capital to the creation of new jobs are not widely understood. However, the Economic Report can be used by the Executive Branch and the Congress not only to take appropriate action to correct deficiencies, but also to assist in gaining a broader public understanding of the processes by which jobs are created.

Of course, the Economic Report will serve many other important uses, and is a highly essential tool for developing policies and programs needed for achieving employment goals.

INFLATION ISSUE

Another feature of the bill that we wholeheartedly endorse is its concern with inflation, but some comment should be made on the question of whether a specific, numerical, anti-inflation control should be added to the bill, as insisted upon by the National Chamber of Commerce. We believe such addition to the bill is not in the best interests of the country, and goes against the grain of past experience. It would inevitably lead to the establishment of an inequitable wage/price guideline, and ultimately to the demoralizing imposition of wage/price controls.

There is another reason why a numerical anti-inflation goal should not be included in the bill. It is generally conceded that inflation in this country has not risen totally from domestic pressures on wage and other traditional factors. In fact, one doesn't have to be an economics expert to perceive international causal factors of U.S. inflation, notably the oil price-setting actions of the OPEC cartel. If you establish numerical goals to attack both unemployment and inflation in this bill, you will be creating a situation that will inevitably force trade-offs that can defeat both efforts, and we should not be diverted from our goal of providing jobs for Americans.

And there *is* a non-inflationary solution to unemployment. We must recognize the inter-relationship of solutions to our energy problems, our employment problems, our urban problems, our industrial materials problems, the high cost of food, our water problems, and other major societal problems. Millions of new, private sector productive jobs would be derived from their solutions. Therefore, aggressive efforts are called for to implement solutions under provisions of the bill which call for programs and policies with particular emphasis on food, energy, and critical materials.

There are within the U.S. vast but latent resources that could be employed in providing more timely and effective creation of new jobs if all sectors of society were to participate in a dedicated and cooperative effort. The Humphrey-Hawkins Bill provides the framework within which we can move rapidly toward meeting national employment goals.

The CHAIRMAN. Mr. Hagedorn. Mr. Hagedorn is vice president and chief economist of the National Association of Manufacturers. We are happy to have you, sir.

STATEMENT OF GEORGE HAGEDORN, VICE PRESIDENT AND CHIEF ECONOMIST, NATIONAL ASSOCIATION OF MANUFACTURERS

Mr. HAGEDORN. Thank you, Mr. Chairman.

Your committee has been chewing over this whole subject for several days now, and it's hard to know what you can add to the thoughts that have been expressed here. I have given you a tome on the subject for the record.

The CHAIRMAN. We will be happy to have it printed in full in the record. It's an excellent statement.

Mr. HAGEDORN. Well, thank you.

[Complete statement follows:]

STATEMENT OF GEORGE G. HAGEDORN, CHIEF ECONOMIST AND VICE PRESIDENT, NATIONAL ASSOCIATION OF MANUFACTURERS

If ever there was a time that cried out for a thoroughgoing reconsideration of the theory and practice of national economic policymaking, it is the present. Judged by their result, the style and philosophy which have prevailed in that field since the mid-1960's have been a national disaster. We have achieved what was previously thought to be unachievable—simultaneous high rates of inflation and of unemployment. These are accompanied by such other signs of economic deterioration as: a productivity slowdown, sub-par gains in real wages, and a sharp drop in the international-exchange value of the dollar.

If the Humphrey-Hawkins bill, in its various versions, truly represented a disillusionment with the practices of the recent past, and a recognition of the need for drastic change, we would welcome it as opening the way for a return to sounder principles. To the extent that it is based on the belief that we have now accumulated the wisdom to create a wholly new framework for economic policy making which, we may confidently expect, will lead to better results in the future, it merely substitutes a new illusion for the old.

Actually, S. 50 is not quite either of these two alternatives. It has relatively litte to say about the substance of economic policy, and that little is not very new. The suggestions for policies to be considered in improving the state of the economy are mainly reworked versions of policies that have been tried, without much success, during the past decade.

This point is not raised with the intention of urging that a large new substantive economic content should be added to the proposed legislation. We clearly are not ready for that. Events have given all of us an extensive and valuable economic education during the past decade. But it has been mainly education of a negative kind. We have learned a lot about economic programs and policies that do *not* work and that is hardly a firm basis for establishing in law a bold new program for the conduct of economic affairs.

The bill is devoted mainly to establishing new intra-governmental procedures for the development of economic policy. These new procedures are elaborate and, one has to say, cumbersome. Some doubt is justified that this is the way to get to the heart of the economic problems that plague us.

Intellectual modesty is appropriate for all of us, in and out of government, who are concerned with the formulation of economic policy. The events of recent years have given us so much to be modest about. One wishes that evidence of such modesty were more visible but, in any case, modesty is not a satisfactory base for radical revision of our fundamental legislative guide to the development of economic policy.

(The objection may be raised that, like it or not, since existing procedures for policy development have not achieved the desired result, we have no choice but to develop a brand new approach to the problem. But present law—the Employment Act of 1946—allows plenty of leeway for shifts in the approach to policy formulation as conditions change and experience accumulates. It is the proposed new legislation, S. 50, that threatens to lock us into a new rigidity.)

Perhaps the most serious danger involved in S. 50 is not that it offers so much in the way of fundamental change in how government carries out its economic responsibilities but that on its face at least, it does so little to change the unsuccessful practices of the past. Somehow the public has obtained the opposite impression—high hopes have been built up that this legislation will usher in a new economic era in which all problems will be solved. It is widely described in the press as "landmark legislation." Since these expectations are bound to be disappointed, the end result could be severe damage to the national morale, constant pressure for more extremist policies, and further deterioration of the economy.

For these, and other reasons which will be explained in what follows, we must urge that Congress not enact legislation of this character. I hope it will be clear that our opposition is not based on a generalized aversion to innovations in governmental policy. To the contrary, new departures from the practices which have prevailed in recent years are desperately needed. But it is not the limitations of the Employment Act of 1946 which has impeded us in finding and adopting new approaches. It is S. 50 and related bills which would create a new orthodoxy and solidify an elaborate set of policy-making procedures that will further impede the search for new directions.

MULTIPLE ECONOMIC GOAL IN S. 50

In its general statement of national economic goals S. 50 takes a somewhat broader view than the original Employment Act of 1946. This is neither objectionable nor surprising, since the 1946 Act was rather narrowly focused on fears of a return to the special conditions prevailing in the decade of sub-par economic performance preceding World-War-II. Our problems in the 1970's have turned out to be less severe, but more diverse and just as intractable.

Where the original Act simply directed government to "promote maximum employment, production and purchasing power," S. 50 would change "maximum employment" to "full employment" and add as additional goals "real income, balanced growth, adequate productivity growth, proper attention to national priority needs and reasonably stable prices." At other points, S. 50 calls for: "better management, increased efficiency, and attention to long-range as well as short-range problems" in the policies and programs of government; and "high rates of capital formation." A number of other goals are scattered through the text of S. 50.

There is little in this list of general goals that can be regarded as exceptionable, in the sense that anyone would find attainment of any of these as undesirable. A minor quibble can be raised regarding inclusion of "balanced growth," which seems to have become a popular cliché with no clearly-defined meaning.

Some question has been raised to statement of the anti-inflationary objective in terms of "reasonably stable prices." It is sometimes suggested that this should be reinforced by adding a specific numerical target to which the rate of price climb should be reduced. However, I am not especially troubled by the existing language. While opinions may vary as to what precise degree of price stability is "reasonable," it is perfectly clear what kind of price-level behavior is *not* reasonable. No sane persons would affirm that an accelerating price rise—one that becomes worse each year than the year before—can be accepted indefinitely as reasonable price stability. (As will be pointed out later, this is the real danger that we face in repeated efforts to lower the unemployment rate by fiscal and monetary stimulation.) There seems no inclination to regard the 6% to 7% underlying inflation rate of the past three years as reasonably acceptable.

Leaving peripheral objections aside, the major question posed by the goals set forth in S. 50 is why anyone should think it necessary or helpful to set them down in legislative language. These have been the *de facto* if not the *de jure* aims of national economic policy for many years. Any of our recent President's would surely have been happy to go down in history as the man who finally reconciled low levels of unemployment with low levels of inflation, with or without a legislative directive for doing so.

Enactment into law of these general goals might make sense if at least one of the following two conditions prevailed:

1. The economic means for attaining these goals were well understood and generally agreed upon, and all that had been lacking was a will on the part of government for undertaking the job.

2. A breakthrough in economic wisdom had suddenly occurred which made attainable what was previously unattainable.

Neither of these conditions holds.

PROCEDURAL REQUIREMENTS

Having described general economic goals, S. 50 turns over to the President the problem of how to achieve them. At least, it is left up to him to take the first step in converting the general goals into numerical targets and program proposals.

One wonders what is gained by such a legislative directive to the President. Any President who was confident that he knew how to attain all the good things mentioned in the Act would hardly keep his knowledge concealed. The only real effect of the requirement is to compel a President who does *not* know how to reach the Act's goals nevertheless to propose a program for doing so.

As things stand, the annual Economic Reports of the President, and of his Council of Economic Advisers, do almost invariably discuss the subjects listed in S. 50 as goals and, to the extent feasible, suggest ways of dealing with them. Numerical projections for future years are made of the major indicators of economic performance and, since these are in accord with what the President hopes to achieve by the programs he has recommended, they are, in a realistic sense, targets. These procedures are well established by custom and the fact that they are less formal than those required in S. 50 is an advantage rather than the reverse.

The procedures within Congress, as established in S. 50 are complex and multi-layered. The President's report is to be forwarded to all the standing Committees of both houses, which are to report on their reactions to it to the Joint Economic Committee. The members of the Joint Committee from the Senate, and those from the House, are then, separately, each to recommend a concurrent resolution on the subject to their own branch of Congress. The House and the Senate, separately, is each to consider and act on its own version of the concurrent resolution. The whole process is to culminate in a conference report reconciling the two versions of the concurrent resolution, and both houses will have to act on it. All this is to be done every year.

In this legislation Congress would be imposing an enormous body of additional work upon itself. Perhaps Congress is willing to assume that burden, but the real question is what kind of economic policy would emerge. If a camel is a horse designed by a Committee, what kind of monstrosity would this multi-layered operation produce?

THE 3%–4% UNEMPLOYMENT TARGET

For the most part, S. 50 leaves to the President the conversion of its general goals into specific numerical targets and programs. The notable exception is the setting forth in the Act itself of numerical targets for reduction of the unemployment rate: The President is required to set this unemployment objective at 3 percent (for adults) and 4 percent (for the civilian labor force as a whole), in (or before) the fifth calendar year after the first Presidential report under the Act.

True, the President may recommend modifications in these numerical goals, beginning with his third economic report after enactment, and Congress may then "take such action as it sees fit." But any such modification would surely be a traumatic political event, especially since the 3%–4% goal would have been allowed to stand for a period of more than three and possibly almost four years. After that length of time the public would surely regard modification of the employment goal as betrayal of a promise.

One can, of course, take the attitude that all the Act commands is the setting of targets; it does not command that the targets be attained, or impose any penalties for failure to do so. I trust, however, that members of Congress will not take any such cynical attitude toward their legislative responsibilities. There is little point, and grave danger, in enacting into the law of the land an unemployment target if it is virtually impossible of attainment, or possible of attainment only under unacceptable conditions of inflation.

It is not clear what, if any, analytical basis exists for the choice of 3%–4% as the unemployment goal—instead of, say, 2%–3% or 4%–5%. Have the authors of this bill simply seized upon figures which look good in print, have a tradition of acceptability, and seem to have become popular in public discussion?

A further complication arises from the fact that a National Commission, established by Congress, is now at work considering the need for a revision of the concepts and methodology used in computing the unemployment and manpower statistics. Their assignment is a wide one and it will be surprising if they do not recommend important changes. We are quite likely to find, sometime in the future, the 3% or 4% measures of unemployment have an entirely different significance than they have at present.

Leaving that complication aside, it does not appear that 4% unemployment in the civilian labor force is a realistic goal for non-inflationary unemployment, or that it ever was during the past quarter century. In the 1955–57 period unemployment did get down to the neighborhood of 4 percent, but only to the accompaniment of an accelerating inflation (which, however, now appears as a minor inflationary incident in the light of subsequent experience). In the late 1960s unemployment held below 4% for a period of four years—during which the inflation rate accelerated alarmingly. Since then, unemployment has never got even close to 4 percent. It did get, briefly and barely, below 5 percent in 1973—the onset of double-digit inflation.

Progressively, over the entire period since the Korean War, demographic trends (and other developments) have been against us in efforts to reconcile 4 percent unemployment (total-labor force) with reasonable price stability. Our prospects for attaining the numerical objectives of S. 50 have reached the vanishing point.

THE RELATION BETWEEN UNEMPLOYMENT AND INFLATION

Crude conceptions of a calculable trade-off between unemployment and inflation, prevalent a decade or so ago, are now in disfavor but they did much damage while they lasted. Toleration for inflation, as a means of holding unemployment down, has been a losing game and we have wound up losing ground in both respects. It is not that government officials, consciously and explicitly, advocated accepting inflation as the price to pay for high employment, but there was a tendency to take all the risks on one side.

Hopefully, that era is now over, but it would be a mistake to assume there is no connection whatever between unemployment rates and inflation rates. A deeper penetration of the subject now indicates that there is such a relationship, but that it functions rather as a limitation on what can be achieved by economic policy, than as an option which gives us scope for policy choices.

The connection between the unemployment rate and the inflation rate is more subtle than had previously been supposed. We cannot simply read off a chart, with reasonable accuracy, what particular rate of inflation we must tolerate in order to achieve a specified unemployment rate. The relationship is between the *acceleration* in the rate of inflation, and the level of the unemployment rate. In other words, once unemployment is pushed and maintained below some trigger rate, the inflation begins to become more rapid each year than the year before.

This is, of course, precisely in accord with our experience of recent years. It also puts an entirely different face on the matter. Toleration of inflation as a means of lowering unemployment can no longer be regarded as a practical option for policy makers. Although opinions may differ as to what rate of inflation is tolerable as the price to pay for lower unemployment, an inflation which is allowed to grow continuously more rapid must eventually exceed anyone's limit of toleration.

What is the trigger rate of unemployment that sets off an accelerating inflation? Since that is the crucial question, I have attached a paper on the subject, prepared in our NAM offices, as an appendix to this testimony. It summarizes the methods and conclusions of a number of experts in estimating NIRU (the non-inflationary unemployment rate).

Although the experts have approached the question in widely differing ways, there is a surprising degree of consensus in their findings. *The "safe" rate of unemployment—the lowest rate which does not set off an accelerating inflation—lies in the range of 5.5 percent to 6.0 percent.* There are some dissidents whose results lie outside that range, but most of them are above rather than below it.

In this light, the 4% unemployment goal (total civilian labor force) set forth in the Act is entirely unrealistic. In fact, with unemployment at 6.0 percent last month, we are already at the upper edge of the zone of inflationary tightness in the labor market.

I do not mean to imply that the 5.5 percent to 6.0 percent "safe" range of unemployment is an unalterable limitation imposed on us for all time. In fact, it is clear that the non-inflationary rate of unemployment *has* changed by about 2 percentage points over the past quarter century—unfortunately in the wrong direction. It is reasonable to hope that in the future we will be able, both through more favorable demographic trends and through deliberate action, to reconcile a substantially lower rate of unemployment with reasonable price stability than is now possible. But the changes in underlying conditions necessary for that to happen occur slowly and the time required must be measured in decades rather than years.

In principle, an effort to create and maintain unemployment rates as low as those set in S. 50 would set off an accelerating inflation that would finally become astronomical. I do not, however, think that things will work out precisely that way. My expectation is that, in the foreseeable future, we are not likely to get either the 3%-4% unemployment stated in the Act or the astronomical inflation a persistent effort to achieve them would bring. Rather we are likely, if this Act is passed, to see a repetition of the stop-go economic policies of the past dozen years—with both inflation and unemployment getting progressively worse with each turn of the cycle. Surely, our painfully-acquired economic experience since the mid-1950's should have taught us to do better than that.

STRUCTURAL ECONOMIC POLICIES

In S. 50 there is a heavy emphasis on "structural" economic policies. This is to be welcomed as a healthy shift from the previous emphasis on aggregate-demand management as the key to creating and maintaining prosperity. If ever we are to create conditions in which unemployment levels substantially below the present limitation of 5.5 to 6.0 percent are feasible, sustainable, and compatible with price stability, it will be through changes in the structure of society and the labor market.

(In the Act, and in common parlance, the term "structural" has taken on a broad meaning, referring to all aspects of economic policy except the management of aggregate demand. Perhaps our academic brethren can refine the semantics for us but, for present purposes, I accept this broad interpretation.)

There is, however, danger that we may be encouraged to expect too much too soon from this new attention to structural factors. There are limitations on what government, in a free society, can do to influence the underlying social structure we have to deal with. Demographic trends must largely be taken as given. Basic attitudes, which affect employability, change in ways that are only dimly understood and which usually surprise us when they occur.

Government can, presumably, make a contribution to the improvement of basic education and practical skills, although there is little on the record which encourages us to believe that we know how to do this on any large scale. In any case, the results of even successful efforts of this nature are likely to be achieved on a time scale to be measured in generations rather than years.

S. 50 outlines a number of employment programs, governmental, and/or governmentally supervised, and/or governmentally financed. There is not much that is basically new in these programs although new vocabulary and new administrative procedures are introduced.

Clearly these programs are meant to be a means for improving the employability of individuals, rather than to be a major ongoing form of job creation. There is substantial danger that they might become the latter, but leaving that aside there is a more basic problem with such governmental efforts. Too much government assistance to an individual is likely to detract from, rather than add to, his employability. It is an entirely different thing to hold a job because of a general government policy which asserts that it is desirable that we should have one, than to hold a job because a specific employer needs us and finds we are worth what we cost. The individual himself knows that and prospective future employers know it.

The Act directs that the reservoir jobs created under it shall be "useful and productive." This forthright declaration is welcome but—is there any adequate test of usefulness and productivity outside the free market place?

The conclusion has to be that, while employment programs of the type described in Title II of S. 50 should continue to be experimented with, great caution should be exercised if they are not to be counterproductive in our effort to achieve a better reconciliation between high employment and price stability. Whatever they may eventually contribute to the goals of S. 50, they cannot have much impact over the timescale contemplated therein.

A PERSPECTIVE ON ECONOMIC ACTIVISM

Since S. 50 is a major reopening of the fundamental legal guide to economic policymaking, a broad-gage comment may be appropriate. The whole spirit of this legislative proposal is that government should "take charge" of the economy and so direct it that it will achieve the goals government chooses to set for it. In other words, it is a call for continued and intensified government activism in the economic field.

History has provided those of us who are empirically-minded with, in effect, a controlled experiment on the effects of economic activism. The quarter-century since the Korean War divides itself rather neatly into two periods: the "limited—role-for-government-period," extending from 1953 to 1964; and the "intense-economic-activism" period of 1964 to the present.

The year 1964 is a natural breaking point between the two eras. It was the year of the war against poverty, and the Gulf of Tonkin Resolution which started us on our guns-and-butter approach to Vietnam War financing. Above all, it was the year of the New Economics—the belief that management of aggregate demand through fiscal and monetary policy was the means of steering the economy along a steady course between recession and inflation. You will remember the chorus of self-congratulation in 1964 to the effect that "We now know how to manage a modern economy." As events cast doubt on this confident assertion, the aggregate-demand approach was supplemented by an abortive "guidepost" policy in the 1960's, and a near disastrous experiment with wage-price controls in the early 1970's. The fundamentals of demand management were nevertheless preserved throughout this interval. Hardly a year goes by without a new call for economic stimulation. The proposal of new forms of "incomes policy" has become a year-round pass-time. It has been an era of constant new initiatives in economic policy.

By contrast, the period from the Korean War to 1964 was one in which relatively little happened in new governmental initiatives. The philosophy and practice of that time envisioned a much more limited economic role for government.

This makes it natural to compare economic performance in the two eras. That is done in the following table.

The results are striking. By practically every significant economic criterion, performance in the limited-role-for-government period was markedly superior to performance in the intense-economic-activist period.

Thus it is hard facts rather than ideological prejudice which leads us to question the desirability of a high degree of government involvement in economic affairs. We have more to fear from excessive government attention than from government neglect. The Humphrey-Hawkins approach is based on the assumption that more (government) is better, while experience keeps proving the opposite.

SUMMARY OF ECONOMIC PERFORMANCE IN TWO ERAS

[In percent]

	Limited-role-for-government period (1953–64)	Intense-economic activist period (1964–77)
Average unemployment rate	5.2	5.8
Range of interest rates:		
Prime rates	3–5	4.5–12
Corporate bonds (AAA)	2.8–5.4	4.4–10.4
Annual rate of increase:		
Consumer prices	1.4	5.0
Wholesale price	.7	5.2
Total economic output	3.2	2.8
Real wages	2.3	1.5
Productivity	3.1	1.6

CONCLUDING RECOMMENDATIONS

For all the reasons described in the testimony we must urge that Congress *not* enact S. 50 or any variant forms of the same legislation. Changes should be made in the basis for ongoing formulation of national economic policy, but S. 50 does both too much and too little in that respect. It offers the public false hopes which will surely lead to disappointment, confusion, contention and governmental hyperactivism. It is far better to leave changes in our methods for economic policy to a natural development, and the prospects are now excellent that this will lead to better results in the future.

APPENDIX TO THE NATIONAL ASSOCIATION OF MANUFACTURERS TESTIMONY, THE CONFLICT BETWEEN THE HUMPHREY-HAWKINS FULL EMPLOYMENT GOAL AND THE NONINFLATIONARY RATE OF UNEMPLOYMENT, BY KURT MOHAY, NAM RESEARCH ANALYST

We are all aware that the Full Employment and Balanced Growth Act of 1978 would establish a full employment goal of 4 percent unemployment by 1983 for the civilian labor force aged 16 and over. But many are unaware of the fact that there is a basic economic inconsistency between the Humphrey-Hawkins full employment goal and the goal, also stated in the Humphrey-Hawkins bill, of reasonable price stability.

This is not to say that we should ignore the unemployment problem or relegate it to a lower rank in the hierarchy of economic concerns. Quite the contrary, we should all be genuinely concerned about unemployment because of the hardship, suffering, waste of productive human resources and stresses and strains in personal relationships it causes. In the same vein, our other economic ambitions should not take a back seat to achieving the Humphrey-Hawkins full employment goal.

Careful economic analysis by some of the nation's leading labor economists and by the Council of Economic Advisers indicates that the bill's unemployment goal is achievable only at the cost of severe inflationary consequences. The following is a brief review of their analysis and conclusions. The studies examined here are listed on the last page of this appendix.

All the studies outlined here are attempts to determine the noninflationary rate of unemployment (NIRU). NIRU is defined as a critical rate of unemployment such that, as long as unemployment does not fall below it, inflation can be expected to decelerate; if unemployment does fall below this level, inflation can be expected to accelerate; and if the unemployment rate equals this level there will be no change in the inflation *rate*. In other words, NIRU is the "lowest rate of unemployment attainable, under the existing institutional structure, that will not result in accelerated inflation." [1]

Another employment concept that should be mentioned is the full employment unemployment rate. This is simply the target rate of unemployment that is established by the government. If the Humphrey-Hawkins bill becomes law, it will set a full-employment unemployment rate of 4 percent, which is far below the NIRU. This, as indicated in the NIRU definition above, means that attempts to achieve the full employment goal will lead to accelerating inflation.

It should be made clear at this point that this does not mean that the pursuit of an unemployment goal below the noninflationary rate should be given up as an aim of policy. Specific programs directed toward the structure of the labor market may indeed prove useful in reducing the unemployment rate consistent with non-accelerating inflation. These programs may improve the mobility of the labor force or possibly increase the educational level or productivity of workers. These programs, however, may take many years to perfect and it may be perhaps, decades before their employment impact is realized. Thus, the utility of these programs for reducing unemployment in the short period provided in the Humphrey-Hawkins legislation is severely limited. Recourse to aggregate demand policies or inefficient make-work programs, however, will only reduce unemployment below the critical NIRU level at the cost of accelerating inflation.

Conscientious research reveals that NIRU changes over time and that 1957 was the last year in which the 4 percent full-employment unemployment rate established by Humphrey-Hawkins was compatible with NIRU.[2] More precisely, NIRU has increased every year since 1957. Research indicates that this constant increase is attributable to such demographic factors as changes in the composition of the labor force and to such legal provisions as changes in the minimum wage level and changes in welfare and unemployment benefits. Practically all attempts to measure NIRU place it in the 5.5% to 6.0% range. (Table #1 and the studies listed at the end of this paper.)

As mentioned above many factors have been cited as contributors to the constantly increasing NIRU and several methodologies have been employed in an attempt to measure NIRU. It is noteworthy that all these endeavors have

---

[1] The Annual Report of the Council of Economic Advisers, January, 1977, pg. 48.

[2] Wachter, Michael L., "The Demographic Impact on Unemployment: Past Experience and the Outlook for the Future," Demographic Trends and Full Employment, the National Commission for Manpower Policy, Special Report #12, December, 1976, pg. 48.

come up with parallel estimates of NIRU. Mention should be made here of the factors that have increased NIRU and the various methodologies used by researchers to estimate it.

The dominant cause of an ever rising noninflationary unemployment rate is the changing composition of the labor force due to an influx of women and young workers. The proportion of women in the labor force has increased from 31 percent in 1956 to 42 percent in March, 1978. This is reflected in a rise in their participation rate from 37 to 49 percent. The proportion of young workers (16 to 24 years old) has increased from 17 percent in 1956 to 23 percent in March, 1978. Women and young workers tend to have higher unemployment rates and unemployment rates of these groups makes for a higher overall unemployment rate. Estimates of the impact of women and young workers on NIRU have ranged from .5 to 1.0 percent.

Changes in the cost of being unemployed have also impacted on the NIRU. The cost of being unemployed is the difference between the market wage rate and transfer payments, i.e., food stamps, in-kind transfers, unemployment compensation, and welfare payments received by the unemployed. Evidence indicates transfer payments have been increasing relative to market wages in the last ten years. As the cost of being unemployed declines the incentive or urgency to find work declines. The unemployed stay jobless longer and the unemployment rate rises. Estimates are that this factor has increased NIRU by .3 to .5 percentage points.

In 1972, Congress required mothers receiving welfare who were able to work to register for employment. This swelled the unemployment rolls and added an estimated .2 percentage points in NIRU.

Finally, the ever higher minimum wages have also increased NIRU. Employers are less inclined to hire young and marginally skilled workers whose productivity is not sufficient to make them attractive as employees at the higher minimum wage. The increased minimum wage, in addition to the greater coverage of the minimum wage laws, has added an estimated .7 percentage points to NIRU since 1956.

The above are the major demographic and legal factors that are cited as reasons for the rising noninflationary rate of unemployment. All told these factors have added approximately 2 percentage points to NIRU. Other factors, such as, increased manpower programs have reduced NIRU by .2 percentage points. The net change then, is an addition of about 1.8 percentage points to NIRU.

Most researchers agree that the 1956 unemployment rate of 4.1 percent was the NIRU of the time. If the 1.8 percentage point increase in the full employment rate is added to the 1956 NIRU we find that the present NIRU is almost 6 percent.

Three distinctive methodologies have been utilized in an attempt to estimate a current NIRU. These methodologies are outlined below.

One scheme that has been used is basically the same as that which was outlined above. This procedure attempts to determine the NIRU at some point in time, usually 1956, and then calculate how much this "base" figure has increased over time in order to arrive at a current NIRU. The 1956 unemployment rate is usually chosen as the "base" figure because the period 1955 through 1959 seems to illustrate a classical example of NIRU. In this period the national experienced accelerating inflation as the unemployment rate fell towards 4.1 percent; as the unemployment rate leveled off at about 4.1 percent the nation experienced no change in the inflation *rate*; and in subsequent years as the unemployment rate rose above the critical 4.1 percent rate, inflation decelerated. Hence, most researchers adopt an unemployment rate of 4.1 to 4.3 percent as the 1956 NIRU.

The demographic and legal factors listed above that have increased the unemployment rate since 1956 are then added to the base figure of 4.1 percent to get an updated NIRU of almost 6.0 percent.[3]

The Council of Economic Advisers has made a similar calculation and arrived at a comparable estimate of NIRU. "Using available data on labor force composition and unemployment rates, and adjusting for the increased proportion of young persons in the labor force and for the increase in their unemployment rate relative to adults, the CEA has estimated that the NIRU equivalent to 4 percent in 1955 is now 4.9 percent." Furthermore the CEA stated that "the

[3] See the last page, papers written by Alfred Tella and Phillip Cagan.

effects of many of the other factors which are believed to influence NIRU are much more difficult to guantify, but it is likely that they have raised NIRU even higher than the current estimate, perhaps closer to 5.5 percent." Finally, the CEA said that the "current benchmark estimates incorporate only the effects for which evidence is substantial. As further evidence becomes available the current estimate of NIRU might be even further refined." [4]

A second methodology that has been employed is the graphical approach. In this approach the horizontal axis measures the change (acceleration or deceleration) in the rate coordinates are then plotted for each year from 1956 through 1974. When this is done one notices that years in which the unemployment rate was 5.8 percent or more enjoyed decelerating inflation. Also, one notices that years in which the unemployment rate was less than 5.1 percent suffered accelerating inflation. Researchers who used this approach concluded that the "noninflationary rate of unemployment is in the 5.1 to 5.8 percent range—probably toward the upper end." [5] Thus, through the graphical approach one arrives at the conclusion that NIRU is about 5.6 percent.

A third method determines a noninflationary rate of unemployment for each of 14 different age-sex groups. An aggregate noninflationary rate of unemployment is then determined by taking a weighted summation of the separate NIRU's for each age-sex group. The weights for each group are the relative importance of each age-sex group in the labor force.[6]

When this method is employed one finds that the aggregate noninflationary unemployment rate in 1975 was 5.5 percent. Furthermore, one finds that NIRU has increased every year since 1957, when it last equaled the 4 percent Humphrey-Hawkins full employment goal.[7] Thus, this methodology results in a NIRU that is very similar to that which was derived by the previous procedures, and when this methodology is applied to historical data it indicates that the Humphrey-Hawkins goal is 21 years out of date.

To summarize then, several economic researchers using distinct methodologies have come to very similar conclusions concerning a noninflationary rate of unemployment. All have found this value to lie in the 5.5 to 6.0 percent range. The conclusion that should be drawn from this is obvious. Attempts to achieve a full employment goal which is almost 2 percentage points below NIRU will touch off an accelerating inflation that will have a devastating impact on the entire economy. Given our present economic wisdom, the goals of 4 percent unemployment and reasonable price stability are clearly incompatible.

TABLE NO. 1

Researcher	NIRU estimates (percent)	Year NIRU estimated to
Phillip Cagan	5.9–6.3	1977
Modigliani & Papademos	5.6	1974
Alfred Tella	5.5–5.8	1975
Michael Wachter	5.5	1975
Council of Economic Advisers	+5.5	1976

PAPERS

Cagan, Philip, "The Reduction of Inflation and the Magnitude of Unemployment," Contemporary Economic Problems, American Enterprise Institute, 1977.

The Annual Report of the Council of Economic Advisers, January, 1977, "The Full-Employment Unemployment Rate."

Modigliani, Franco and Papademos, Lucas, "Monetary Policy for the Coming Quarters: The Conflicting Views," The New England Economic Review, March/April, 1976.

Tella, Alfred J., "Analyzing Joblessness," Op-Ed page of *The New York Times*, October 27, 1976.

Wachter, Michael L., "The Demographic Impact on Unemployment: Past Experience and the Outlook for the Future," Demographic Trends and Full

[4] The Annual Report of the Council of Economic Advisers, Jan, 1977, pg. 51.
[5] See the last page, paper by Modigiliani and Papademos, page 9.
[6] See the last page, paper by Michael L. Wachter.
[7] Ibid.

Employment, the National Commission for Manpower Policy, Special Report #12, December, 1976.

Mr. HAGEDORN. In my oral remarks I will just make a few comments on the highlights extemporaneously.

The bill describes in very general terms certain goals. As far as these general goals and directions are concerned, nobody can have any quarrel with them. But beyond that, it seems to me the bill approaches the whole problem backward or at least in an unbalanced way.

There's no thorough examination of our resources for attaining the goals in the bill. I don't mean just financial resources, although that has some importance, but I mean our intellectual resources. Do we know how to do it? We have been trying to attain the goals described in the bill for a long time and tried a lot of different things, and here we are without much hope of doing it in the immediate future.

It seems to me, instead of setting targets and then trying to arrange a program, trying to figure out a program for attaining those targets, you have to examine closely what's practical, what resources you have, and what you can do; and then you have to work out the program first and then decide in that light what target is practical. At least the two things have to be done more or less simultaneously rather than one after the other.

Let me talk about the 4-percent unemployment goal. Now you've got a lot of testimony that as things stand, given the structure of the economy, 4 percent unemployment is not compatible with price stability, and I certainly endorse that, and there's a great deal of material in my written statement supporting that argument.

The point that's always brought up—and it's certainly a valid point—that with a structural approach you can reduce the level of unemployment that's compatible with price stability, and that's certainly true. Things along that line have been done with some success. Mr. Donaghue was just describing his company's efforts in St. Paul, and there's a great deal of that type of activity going on in the country. I hope it will continue and I assume that it will. But it hasn't made any big dent in the unemployment problem. We hope that it will have further beneficial effects in the future. I assume that it will, but they are going to come slowly.

When you try to change the structure of society, and the other basic things that determine employability, that's something that you accomplish over a time scale that's more like generations than years.

With that 4-percent unemployment goal standing in the bill, I'm afraid it will be an invitation to extremism. As the years go by and it becomes clearer and clearer that you are not going to achieve the 4-percent unemployment goal, then the political pressures will be for more and more extreme measures. I'm afraid, particularly, of overstimulation of the economy and continuation of the stop-go situation we have been in in recent years. More about that later.

Well, now, let me talk about the 3 percent inflation goal that's been brought up in these hearings. I have heard it elsewhere and I hope you and I are still friends after I get finished with what I have to say about this.

30-454—78——17

I am totally opposed to putting that sort of thing in the bill. In the first place, on general principles, I'm opposed to it for the same reason I think it's unwise to put the 4 percent unemployment goal in the bill. You are tying yourselves to a number when the process should be a search and find type of process in looking for solutions. Whatever solution we find ultimately, if we do find one, probably will surprise us by its nature and we shouldn't tie ourselves down in advance to any rigid framework for doing that.

A second reason that I oppose it is that I'm not really troubled by those words, "reasonable price stability" that now appear in the bill. Sure, they are imprecise, but I think we know well enough what they don't mean. They don't mean an accelerating inflation, an inflation that gets worse each year than the year before, the kind of situation we had in 1966 through 1969 where each year the inflation got worse than the year before because we were overstimulating the economy.

I think everybody would agree—whether your feeling is that reasonable price stability might be 3 percent, I might think 5 percent is right, somebody else might think 10 percent—but everybody has to agree that an inflation that gets continually worse is going to exceed whatever standard any of us has set. I think clearly that's outside the range of reasonable price stability. I don't feel the pressing need for making the goal more precise.

Another reason for my urging you not to put that sort of thing in the legislation is that it would lead to another form of extremism—wage and price controls. We have seen a constant search for something that would have all the good effects of wage and price controls and none of the bad effects but still isn't wage and price controls. That's something called incomes policy. A new version of incomes policy comes out every few months and gets attention but you know it's really just wage and price controls under another name.

The objection to wage and price controls, putting it very briefly, is that Government doesn't have the wisdom to know better than the marketplace what any given wage or price ought to be, and that applies to every form of incomes policy that I have ever seen. So, I'm afraid that perhaps your 3 percent inflation goal would create much more pressure for some kind of incomes policy and through that kind of a route we will wind up with wage and price controls. Indeed, we already have a kind of incomes policy—the deceleration program—though people don't like to refer to it as an incomes policy.

To wind up, I'm afraid this bill raises false hopes. If you read the bill carefully nowhere does it say, "We, in Congress, promise the American people that these goals will be achieved," but they imply a promise. I thing generally that the people of the country will take it as a promise that you're going to achieve those goals. The fact that we aren't, which I think is pretty clear, is going to do grave damage to the national morale. It's going to be an invitation to Government overactivism.

As for its economic results—well, I'm not going to tell you if you pass this bill immediate disaster is going to overtake us. We have survived a lot of other things. But what I am afraid of is that this bill would lead to a continuation of the stop-go type of distressing economic events that we have had in the recent past. They have been coupled with a progressive deterioration in productivity. The slowdown in productivity is a very ominous sign. I'm afraid that with this bill that sort of thing would continue.

Anyway, these are my reasons for urging you not to pass this bill.

The CHAIRMAN. Thank you very much, Mr. Hagedorn.

Our final witness is Mr. Arnold Saltzman, chairman of the board, Seagrave Corp., and old friend. Go right ahead, Mr. Saltzman.

[Complete statement follows:]

STATEMENT OF ARNOLD A. SALTZMAN, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, THE SEAGRAVE CORPORATION, AND RECENTLY CHAIRMAN, FEDERAL ADVISORY COMMITTEE ON NATIONAL GROWTH POLICY PROCESSES

Senator Proxmire: The last time I testified before a Congressional committee of which you were Chairman was September of 1971, when you were Chairman of the Joint Economic Committee. At that time we were discussing unemployment, inflation, and the ability of our government to avoid problems by looking ahead in their policy making.

Despite the passage of almost seven years, what we are really talking about in reference to the proposed S.50 is unemployment, inflation, and how to get our government out of the "crisis intervention" business.

In regard to unemployment we will hear arguments that 6% unemployment doesn't mean that we can put all of those people back to work—or perhaps not even 3,000,000 of them—and that is true. One can hear arguments about those who won't or can't work, about students or women going in or out of the labor force, about people moving and creating temporary unemployment—thus skewing the numbers—about the increasing number of people joining the work force and all of these events distorting the statistics and thus our clear understanding of the choices. All of this has sufficient merit to suggest that we need a better grasp of what kinds of unemployment we suffer, what are the causes, and which remedies can be most effective considering both social and economic costs. This should be accomplished by the S.50.

I believe we have already entered a third great phase in our economic society—equal in importance to the Agricultural Revolution and then the Industrial Revolution. Major changes in patterns of employment and unemployment that flow from this upheaval must be recognized and managed. For example, the shift from industrial production to services is evidenced by the fact that in 1947 over 50 percent of all American workers were employed in the production of goods, whereas by 1980, two-thirds of the nation's manpower will be concentrated in service industries such as transportation, trade, finance, and government. This post-industrial revolution has profound implications for the nation's economy—including patterns of employment. Thus, I do sympathize with those critics who argue that we must avoid simplistic formulas in regard to unemployment. One of the advantages of the Humphrey-Hawkins legislation is that it will tend to foster that kind of introspection on the part of the Executive office of the President, as well as the Congress.

However, I do not believe our nation can accept the present and past several years' rate of high unemployment since it is first of all immoral, also economically unsound and financially intolerable. Unemployment destroys families, promotes crime and erodes individual self-respect, and if these immoralities were not enough, it also tears at the fabric of our democratic society. It is particularly pernicious in youth who have not had a foundation of faith in our system with good years behind them to look back upon.

I could never understand the argument that unemployment helps keep inflation in check. The best hedge against inflation is large-scale production and employment by the private sector with an abundance of goods that people and companies buy. We have just seen that 8 percent and 9 percent unemployment has not prevented double digit inflation. In fact, inflation increased as unemployment went up. But it is essential that urgent and innovative plans be formulated in compliance with this legislation to make the private sector the employer to the highest degree possible.

It is four years since Project Independence was announced to move us towards self-sufficiency in Energy. Instead, today we import fifty percent more oil than we did five years ago, in large measure because we have not adequately converted to coal. To do that, we need a massive commitment to improve the roadbeds of our railroads, to produce large numbers of additional freight cars, to create coal-fired ovens, scrubbers for those ovens to avoid excessive air pollution, and an assortment of additional machinery to bring forth the coal which exists in huge abundance. This is what the private sector can and should do with the proper incentives, creating a large number of jobs as opposed to public employment. It is a matter of ferrying the money to the right place coupled with a commitment to move.

Inflation is a virus that has not been appropriately understood or tackled by this or previous Administrations. We do not have a scenario, or alternative possibilities for dealing with it on a coordinated basis. It is time we had the courage to say these are the causes, here are the alternative possible cures and here are the costs in economic and social terms to keep it in check. At least then clear purposeful decisions can be made—even if we choose to have inflation. Right now, Government decisions are made on the basis of, "Oh, that won't work", or "The American people wouldn't accept that", or "Let the Fed raise interest rates".

The single greatest cause of inflation in our country today results from our huge imbalance of trade payments. Our reaction so far has been waiting for an energy bill, and for Ambassador Bob Strauss to scurry about trying to put his fingers in the various holes in the dykes. It is high time we took a look at the whole series of problems that flow from the way we (the Government) conduct our foreign trade policies—and all the complications that flow from those policies. America no longer has a "lock" on much of the world's technologies, with the most productive manufacturing capabilities, when so-called Free Trade concepts were more or less taken for granted. We need to explore—without preconceived bias—the various avenues for tackling our unfavorable balance of payments. Certainly selling cheap and buying dear because of our debased currency does not help.

I am convinced that "jawboning" is not a solution. It can only have temporary shock value. Voluntary restraint suggests that business leaders and labor leaders must forego their own immediate economic well-being for some less well perceived general benefit. I fear that type of moral persuasion is a very weak reed on which to hang our anti-inflation program.

So we cannot now tie a specific inflation rate to a specific employment objective. These two factors do not directly relate to each other, and Government is not now prepared to propose an integrated anti-inflation plan.

This word "plan" takes me to the less obvious but more vital part of the Humphrey-Hawkins bill—the need for a more farsighted and integrated approach to solving our nation's problems, not merely unemployment.

From July of 1973 until March of 1974, I conferred with the leaders of both parties in both Houses of Congress on the proposition that we lacked the machinery in our Government to induce proper economic policy-making. By April of 1974 all four leaders agreed that our national policy-making for some time had been too often a matter of reacting to crises instead of anticipating events. It was replete with ad hoc uncoordinated actions on a piece-meal basis—frequently counterproductive to the larger objective. The leaders agreed that a Committee be formed of which I was named Chairman, to report on why that was happening and ways to improve the result. The need was so obvious that the legislation passed with only a couple of dissenting votes. I am hopeful that our same legislators will remember that history and find in this bill the continuity of those objectives. It is now four years later and Congress continues to be plagued with the same problems that cause the same questions to be asked.

1. Since we knew in 1970 that we had begun to use more oil than we produced, why did we wait until 1974—and now 1978—without a coordinated energy policy?

2. Since we knew in 1974 that our unfavorable balance of payments threatened the world's monetary standard—the American Dollar—why are we in even worse trouble in 1978—with no plan or no solution in sight?

3. And wasn't it clear in 1974 that using high interest rates as the way to fight inflation was driving us into Recession and hurting the weakest the most? And do we have any other plan on the table in 1978 as we again face that possibility?

4. And isn't it clear in 1978—as it was in 1974—that the proportion of Americans over 65 was increasing dramatically, with enormous consequences to industry, to the pension systems, to the family, to social structures, to our economy—and is there any concerted approach to the issue?

One could go on and on to demonstrate that we lack the mechanisms to cause the Government to look at major problems in an integrated fashion even when they have surfaced.

It is all the more difficult for Congress and the President to focus on the less clearly perceived problems of the future—which need to be identified, quantified, and solutions proposed—to anticipate the coming crisis. It is this functional disability of our Government which has kept us in the "crisis-intervention" business in Washington. And the failure of Washington to anticipate and avoid trouble has brought major hardship to most states and cities.

The question facing the Congress and the President is, why doesn't "the system" work as well as it used to? What has changed over the last dozen years that gives people the feeling that their Government is not performing as well as it should?

The answer is short and simple. The world has changed enormously since 1960, but Governmental institutions and mechanisms have not responded adequately to the changes in the environment that they are supposed to understand and manage. We are backing into the future stumbling as we go.

There are two major developments that have materially altered the condition of the U.S.; our nation has not fully recognized them, nor has the Government adequately reacted to them. The first is the accelerating interdependence of the nations of the world (despite increased nationalism and often poor cooperation) and the effects of this on a United States economy committed—in theory, if not in practice—to free-market principles. The second is the almost unmarked but rapid shift of our already mature industrial civilization into a new phase of industrial and societal development. Together these have produced a host of new problems that tax our government's capacity to understand, let alone deal with. The difficulties are exacerbated by an increasingly widespread belief that improving the economic well-being of individual citizens is a legitimate responsibility of Government.

The world is indeed smaller, but the ensuing benefits have been obscured by the willingness of nations—particularly emerging or relatively underdeveloped nations—to use their sovereignty as an economic sledgehammer. Growing world trade spurred the prosperity of recent decades and cemented global interdependence. Between 1960 and 1974, the United States' Gross National Product tripled, but the value of its imports and exports multiplied sixfold. It is symptomatic of the changing world that trans-national corporations have recently grown at an annual rate of 10 percent, twice that of the world's economies taken as a whole. By 1980, it is expected that sales by trans-national corporations will constitute 16 percent of the Gross World Product.

During this period, our vulnerability to foreign economic pressures has increased with American dependence on imported raw materials. The world does not face an imminent shortage of natural resources, but American dependence on imports and the willingness of producers to form cartels or to use materials to promote immediate national objectives may combine in the future, as they have in the past, to create domestic shortages of necessary raw materials or sudden artificially high prices.

During this same period we have seen the great surge forward of the West European nations and Japan—our allies, trading partners and trading competitors. We no longer have most of the world's supply of gold, we no longer have the world's strongest currency, the overwhelming superiority in technology—we no longer dominate the world economy which permitted us to "call the shots".

All of the above means that substantial and rapidly increasing influences on our total economy are more difficult to control. Yet, America must have a coordinated set of economic policy objectives, with respect to both foreign and domestic considerations. In the absence of such objectives we will perform inadequately both at home and abroad. And the growth of the Federal Government's role in economic policymaking mirrors the concentration of power in America's giant corporations. The two hundred largest manufacturing corporations controlled 48 percent of all manufacturing assets in 1950, 56 percent of such assets in 1960, and 60 percent of these same assets in 1970. The issue then is not whether the Government should be involved in economic policymaking but whether it performs poorly or well.

S. 50 intends to improve our national planning process by causing both the President and the Congress to look ahead two, three, five years and more and ask what are our nation's capabilities and what are our needs? The President is required to set goals leading to lower unemployment, controlled inflation and a balanced national growth and development. Congress is required to respond both philosophically and through its budgetary process.

I purposely used the word planning because it has been studiously avoided in the legislation. Congress has been pressured to fear the use of the word—although every businessman gives high priority to planning in his corporation and every family plans ahead for its vacations, its children's education, the home it will buy, through its insurance policies.

In planning "American style" we are not advocating a small group of technocrats, isolated from criticism achieving centralized power, i.e., the Soviet Union or China. I do not contemplate a group in an ivory tower deciding that America will produce four million red dresses in 1981. Obviously no one who cares about American liberties could support such a process. Furthermore, no planning process can or ought to try to achieve that degree of precision. Ideological critics who think of planning as "totalitarian" seem to forget that no program will go forward until the duly elected and democratically accountable representatives of the people want it to go forward. Any planning will be conducted within the Constitutional framework.

I urge that America become a planning society, not a planned society. In the long run, I believe that intelligent planning will actually reduce burdensome governmental intervention in matters affecting the private sector. Much governmental interference in the economy now consists of ad hoc reactions to situations which have become acute because they had been ignored until they became intolerable. With the benefit of foresight, I expect that any necessary Government intervention will be more considered, more timely, and less heavy-handed.

In addition, the provision in the bill calling for an Advisory Board is of major importance. It is particularly desirable that those who are chosen be selected based on their knowledge and experience of both the Government and the private sector and not only for balance or political convenience. We need a small body of "wise men (women)" for serious consultation—not window dressing—who can think of the welfare of the country as a whole. They can also guarantee wide citizen participation in the process by the judicious use of sub-committees.

Let me turn briefly to my caveats in regard to the bill.

1. In regard to the Federal Reserve Board, I question the wisdom of including the Fed in the process. It is unrealistic for the Fed to marry itself to a policy for a year in advance even if only in reaction to the Economic Report. A major source of its strength lies in its ability to shift gears quickly and often purposely without advance notice.

Its inclusion in this legislation is a product of the major role the Fed has previously been assigned in reacting to inflation. I believe it has been unwise to rely almost entirely on fiscal and monetary policies to curb inflation or reduce unemployment and they have proved unsuccessful. We must rely on sectorial and regional solutions—using a rifle and not the shotgun of the Fed.

2. In my view, both the Executive Office of the President and the Congress presently lack the capability to do the job assigned to them by S. 50. In the case of the Executive Office of the President, there is presently no place where the long-range planning function is handled (except for individual isolated causes that may arise). There are, indeed, in particular Departments (such as Agriculture and Defense) competent efforts of this type. But these are directed to the purpose of those individual Departments and not aimed at an overall national purpose.

What is even more serious is that there exists no clear mechanism to insure an integrated policy approach on a broad front on an ongoing basis. This is especially true when we are talking about the avoidance of future problems that have not yet even been fully identified. Of course, on any given major problem the President can sit with Department Heads and try to thrash out a consolidation of views. But on a regular basis, and looking at the wide range of issues to be integrated and solved, a better way must exist. The President should develop that capability now in a group or person with sufficient authority to range across Departmental and Agency lines. Such a job needs to be done, Humphrey-Hawkins or no.

Likewise, the Congress presently lacks the capability to appropriately reply to the President's Economic Report—and incidentally to monitor the appropriate performance of the Executive Branch in that regard. Here the mechanisms do exist. To carry out the intent of the legislation, the Joint Economic Committee will have to be beefed up—and to some extent the Congressional Budget Office. All of these can be achieved, however, without a huge expenditure of money.

3. There may be a piece missing from the logical structure that the Humphrey-Hawkins bill is endeavoring to create. S. 50 aims at improving the economic decision-making capability of the Executive Office of the President and the Congress on a combined basis by causing them to focus on the same matters with similar yardsticks. It does not quite achieve that, although the objective is valid.

One of the reasons we still do not have the energy legislation the President has been speaking is that on important and controversial issues, it is very hard to shorten the time span. If goals and objectives had been set out several years ago with the necessary factual data (which could have been the case), and had alternative solutions been proposed, there would have been time not only for orderly debate in the Congress but for national public awareness and participation. It is exceedingly difficult in our kind of democratic form of government to make legislative haste. Moreover, I have found from talking both to the White House and my friends in the Senate, that each tends to be sensitive about encroaching on the other's prerogatives and responsibilities.

Somewhere in this process it is desirable to have a small neutral body—with no legislative or executive responsibility—to assist the White House and the Congress in focusing on anticipated major economic problems before they arise—and at the same time, we need an early warning system to sound alarms to the E.O.P., the Congress, and the public. It could not only identify the incipient problem but also lay out alternative possible solutions and attach to each of the possible solutions the economic and social costs. This arrangement could ensure that the Economic Report is not missing potentially important problems (or opportunities). It could also provide for much more orderly debate, since it would set forth the pros and cons and alternatives of matters to be debated, so that Congresss, the President, and the Public will all look at the same possibiilties.

One might call this a National Growth and Development Commission, and their contribution could be: (a) an improved and more farsighted President's Economic Report; (b) an improved and more comprehensive response by the Congress to the President's Economic Report; (c) earlier and more knowledgeable public participation in the national debate on major issues; (d) the greater likelihood of taking care of a problem through legislation before it gets to be a mess.

In conclusion, let me add that I regret that so far business has not rallied in support of this legislation. When I look at the achievements of Japanese and West German business enterprise, in large measure a product of joint economic planning by Government and Business, I think why not us? When I realize that Government cannot and will not withdraw from influencing economic policy, I think far better that the private sector should know in advance what Government intends to do than be faced with unanticipated actions that may require major and costly readjustments on my part. And I would hope that the private sector—business and the general public—will bring all its ability, experience and wisdom to the planning process this legislation envisages.

If Government performance is to improve, it must reflect a corresponding change in the attitude of its citizens. The public must understand the whole potential problem early enough to contribute to the national debate and then be ready to share the burden. Focusing on the future instead of the present and sacrificing some of the present to insure the future has not been a popular pursuit either by the people or its Congress. But the turbulence we see all around us today is a product of "yesterday's futures" not tended to—opportunities lost to improve ourselves or to stay out of trouble.

American conditioning is influenced by our history. We dream of a land of infinite size and riches—of water to waste, oil to spill, forests to raze and free land to stake out. This dream is philosophically inconsistent with today's reality, which demands that we conserve, husband our resources, define more sharply our objectives at home, use our strength more selectively abroad with heightened reliance on economic solutions. That means we must plan more carefully the use of our more limited resources and more fragile environment while we improve our mechanisms to avoid trouble instead of merely reacting to it.

Crossing the psychological divide between the dream and the reality is our nation's most difficult obstacle. Foresight and integrated policymaking in Government will emerge only if an informed public understands the need for it and demands it. The Humphrey-Hawkins bill can be an important first step in that process.

The CHAIRMAN. Thank you very much, Mr. Saltzman.

I want to thank you gentlemen for a clear and emphatic statement of your position.

Let me start off with the Roundtable, Mr. Lovell and Mr. Schubert. On page 7, you go right to the heart of the statistical problem here. If we're going to have a Humphrey-Hawkins bill with a 4-percent rate of unemployment, the rate of unemployment ought to stand up. That is, the statistics ought to have some integrity and some reliabiilty. And you say at the top of the page,

The methodology and procedures for collecting unemployment statistics are not sensitive enough to the realities of our economic system so that the data can be reliably used to evaluate progress toward an absolute economic goal.

Now for the last 7 years we have been holding hearings in the Joint Economic Committee, which I have chaired about 90 percent of those hearings, on unemployment. Every month when the unemployment figures come up we have the head of the Bureau of Labor Statistics come up and testify on it. We have gone into great detail on those statistics. We have had Professor Gordon before us several times and Sar Levitan and there's no question, on the basis of their testimony, that they feel that our statistics are the best in the world. That, of course, doesn't make them perfect, because they are not perfect anywhere, but we have an enormous sample. We have, as you know, a cross section so we not only have household data—that is, some 55,000 households that are queried every month—we also have establishment data coming in from corporations all over the country giving their reports too. So we have a cross-check there.

It seems to me if any of our statistics can be considered to be reasonably reliable, these are. So what do you base this charge that the statistics are not senstitive enough to the realities of our economic system?

Mr. LOVELL. Well, I think, as you know, Sar Levitan is commissioned to reexamine the unemployment statistics because there has been concern as to what the basic conceptions are.

The CHAIRMAN. There are a number of things Mr. Levitan suggests that makes sense. For instance, he doesn't see any reason why people in the military should be considered as out of the work force. I couldn't agree with him more. After all, the 2 million people in the military are working and working hard in their very essential function of preparing to defend this country, but they are excluded completely. But that wouldn't have—and he would agree on the basis of our questioning him—he would agree that the statistics—that the elements that he would suggest changing would not significantly alter the statistics.

Mr. LOVELL. Senator, it's not a lack of accuracy of the statistics because I think they accurately portray what they say they portray, given the assumptions that they have. I think our concern is that to base all our economic actions on a figure of that character that represents a wide variety of kinds of unemployment, some of which is much worse than others, is a totally unrealistic base.

The unemployment of poorer youth represents a tremendously serious problem, far greater, for example, than the unemployment of inschool youth who are looking for part-time work, and yet the same figures are part of the computation.

I think our concern is in setting our priorities we should look at the kinds of unemployment that give us the greatest concern and take swift and useful action to correct that kind of unemployment rather than bringing in the gross figures that we are.

The CHAIRMAN. I think that's an excellent answer, but I think the only way we can get the overall unemployment figure down clearly is to make some real progress in the area of black unemployment, youth unemployment, and so forth.

Mr. LOVELL. That's right, and the Business Roundtable clearly feels that's the highest priority.

The CHAIRMAN. Well, if we have a 4-percent unemployment target—and we now have today 2.8-percent unemployment for married men, for instance. We have for black teenage females an unemployment rate of around 40 percent. Obviously, if we are going to achieve these goals they are the people we have to provide training for, and so forth.

Mr. LOVELL. That's right.

The CHAIRMAN. And you agree with that?

Mr. LOVELL. Yes.

The CHAIRMAN. Why wouldn't that goal work in the direction you desire?

Mr. LOVELL. Well, if we said that our goal is to reduce black youth unemployment, the steps taken are vastly different than if you're trying to reduce all unemployment from 6 to 5. In other words, you don't generally reduce this kind of unemployment by your macroeconomic actions. The cost of doing it that way are very high indeed.

The CHAIRMAN. This is exactly why I think we need that inflation goal in there precisely.

Mr. LOVELL. I think our basic philosophy is we would like to be here today talking about specific programs that are necessary to achieve that we all agree are more desirable inflation and unemployment goals, and we are concerned about the debate over a statement of philosophy that we want to do this with the thought that this is really going to achieve anything. I think that Congress and the executive branch of this country, under a variety of administrations, have been working a long time to achieve both of these purposes. I don't think there's any lack of purpose. It's that we sometimes lack the courage to do the things that we have to do and occasionally the wisdom. But to pass a law saying that we should have low inflation and low unemployment is like passing a law saying we should abolish cancer. Obviously, the goal is worthwhile, but it doesn't give us any clues as to how we proceed.

The CHAIRMAN. Well, I realize that and I think I'd like to get Dr. Hagedorn in on this too because he seemed to feel that by passing a law providing for a goal of 4-percent unemployment we are giving that an absolute sanctity that we are going to achieve that goal regardless. A lot of people feel we should do that, but we all know that's not the case.

I got an amendment adopted in 1968 providing for a goal of 26 million housing starts in the 10 years beginning in 1968, 2.6 million a year, 600,000 publicly assisted housing starts a year. We achieved only 80 percent of that goal in the 10 years overall. We achieved only 45 percent of the publicly assisted. It wasn't because we set the goal we didn't accomplish it. In spite of that failure—and it was a failure—I don't think the goal was a mistake. I think it measures the degree of our failure and put pressures on Congress to consider it each year. I think it was wholesome, desirable, and supported by builders in the business as well as by the labor people and the academic people—just overwhelmingly supported.

I just don't see why it's wrong to set a goal. What's wrong with a goal? Why isn't a goal desirable? You set your goals in business. You set your goals in life if you're going to have a degree of success. It doesn't mean that you commit suicide if you don't reach the goal, but if you're going to be a successful person or a successful business or a successful family or a successful community, you have some clear notion of where you're trying to go. What's wrong with that, Dr. Hagedorn?

Mr. HAGEDORN. Well, Senator, I think if the American public generally understood this bill in the terms you have just described I would have no strong objections against your enacting the bill, but I also think that if the general public in this country understood the bill as setting goals which we may or may not attain and there should be no pressure for us hitting these targets, if they understood that way, there wouldn't be much enthusiasm for this bill around the country and you wouldn't have parades in the streets here down Pennsylvania Avenue in support of this bill if they had heard what you just said.

The CHAIRMAN. Well, I don't mean that we don't want to achieve the goal. What I'm trying to say is we are not going to just throw everything aside if we have 15 or 20 percent inflation as long as we get unemployment down to 4 percent. We have to consider the consequences of this kind of thing, but we want to have some kind of a clear numerical goal. We have had a rhetorical goal since 1946 since we passed the 1946 bill.

Mr. DONAGHUE. I just wanted to add, that there's one thing about setting a goal, and that is that you're going to be measured against that goal; and the feeling of our company in a lot of these areas is that business doesn't really want to be measured. There are efforts by individual companies to try to do what they can for the unemployed and particularly the minority youth, but the programs have been scattered. They have been individual company actions. But I don't think the business community as a whole has really tried to help solve this problem. By setting a goal we will also realize that there will be pressures upon us, since we will be measured against the goal and we will probably move a lot faster.

The CHAIRMAN. As long as you're speaking, I'd like you to tell us why it is that your corporation—and I'd like also Mr. Saltzman to speak on this—are you so unique? Let's not kid ourselves. The business community supports the Hagedorn and Roundtable position overwhelmingly. I know that and you know that and we all know that. We wanted to get all viewpoints expressed, but the business community does not like this bill.

Now how do you explain the fact that Control Data, a very, very successful corporation, a national corporation, a profitable corporation, has been able to move in as you have described in some cases to provide employment for those who are considered unemployable? How can you bring yourselves to support this and how do you explain the fact that your fellow businessmen don't?

Mr. DONAGHUE. Well, the first thing I'd like to say is we have a very unique chairman in Mr. Norris who differs a lot with the rest of the business community, and I must submit that I believe——

The CHAIRMAN. How big is your corporation, incidentally?

Mr. DONAGHUE. It's a $2 billion corporation, employing over 40,000 people.

The CHAIRMAN. And roughly what was your net income last year?

Mr. DONAGHUE. Net income last year was about $65 million.

Now it seems to us that business reacts to situations. You had the riots in Watts and you had the business community step in to try to assist that area. But as Mr. Norris has stated many times, business considers doing something in a ghetto area or an inner city as being a part of corporate philanthropy, that is, we ought to give because it's good.

In Control Data's case our position has been that where others have sent in their money, we send in our brains and our guts. In other words, when we built a plant, as we have here in Washington, D.C. and Minneapolis-St. Paul and even down in Appalachia, that plant is an integral part of our corporation and our corporate profits depend upon the success of those plants.

We also have a saying in Control Data that somebody's problem may be a business opportunity. We have established in the computer-based education area a project called "Fair Break." "Fair Break" is the use of computers and computer-based education for unemployed minority youth.

One of the things we have discovered in trying to train and counsel young people, especially minority youth, has been their concern about being in a classroom where they want to learn more but being with their peers, if they are not quite as smart, they may feel out of place.

The CHAIRMAN. How do you answer the arguments of Mr. Hagedorn and the Business Roundtable and others that if you follow this Humphrey-Hawkins to its conclusion that you're going to have overwhelming Federal planning, Federal control, Federal direction, Federal domination?

Mr. HAGEDORN. I didn't say that.

The CHAIRMAN. All right. I beg your pardon. I won't include you there. But we have had witnesses who said that and many people who feel that, that this will lead in the direction—I don't say that it provides that here—will lead in the direction of controls of various kinds. Mr. Hagedorn specified it would lead—if we provided that inflation goal, it would lead to wage and price controls, for instance.

Now how do you answer the argument that this would lead in the direction of greater Federal involvement and greater Federal control?

Mr. DONAGHUE. We look at it a little differently. I don't see anything in the current bill that spells out that there's going to be Government control. We certainly have to be very careful in the follow-on legislation that will determine what the action programs are, so it doesn't include Federal control, but includes the cooperation of the Government with all other elements of the private sector. That's what we think is needed—cooperation.

Control Data doesn't want Federal controls any more than any other company does. We feel that through cooperation we can accomplish more than we are doing individually and we cannot afford the 40-percent minority unemployment rate (that we have today) in many of our cities. One of these days this situation is going to explode and then what are we going to do? We are going to pour massive funds into reconstructing our inner cities over something that needn't have happened in the first place.

The CHAIRMAN. Mr. Schubert wanted to comment and then we will go to Mr. Saltzman.

Mr. SCHUBERT. Mr. Chairman, let me say that Control Data and Seagrave are not the only corporations that are not only concerned about the problems that have been alluded to this morning but are doing something about it.

My company, Bethlehem Steel, has been deeply involved in training minorities in centers around the country and one very close at hand is at Baltimore, Md. We are proud of the record we have.

Second, we have been intensively involved with discussions with the administration and legislative leaders here in the Congress in trying to devise a better way to go at the problem.

Third, we oppose Humphrey-Hawkins for three basic reasons. One, we believe it's fraudulent in that it overpromises. It promises something that cannot be, in our perception, achieved. Either it's an unemployment bill or it's a planning bill. If it's an unemployment bill it cannot deal with the structural problems of unemployment that are so telling in our society. If it is planning, we are opposed philosophically to the kind of control that was suggested by the witness from Seagrave Corp.

Mr. Chairman, I would just note one additional comment on a matter that has been touched on earlier. With regard to the matter of an inflation goal, I think we probably don't view this matter in precisely the same way as Mr. Hagedorn does. We oppose the bill. We do not think that even with the inflation target that the bill is an acceptable, credible piece of legislation. But, on the other hand, if the Congress is going to insist on enacting it, we believe that it is better with an inflation target than without because it does provide some balance and stability.

We don't accept the notion that having an inflation goal will necessarily lead to wage and price guidelines or wage and price controls. They will come for political reasons whether there's a 3-percent target in Humphrey-Hawkins or whether there's not any target if they're going to come.

The CHAIRMAN. I appreciate that very much. Mr. Saltzman, will you comment on the general question I asked initially as to why it is that your firm, and you as the principal owners of your firm, I take it, suport the bill?

Mr. SALTZMAN. I believe that the bill is in many ways essential to the welfare of our country, and its citizens, and that includes all of the citizens and businesses as well.

We can look back over the last 10 tor 12 years and it is replete with examples of opportunities that are lost and trouble that we have got into, not only because there are philosophical differences on issues, but more importantly, because we lack the mechanisms in our Government to make our economy function properly in light of the world events today.

We no longer live in a land that is part of an illusion in our minds of free trade and the marketplace. How can you talk about the marketplace in regard to petroleum, for example? Does that mean if we are short, that oil could go to $2 a gallon, and the people who can't afford it won't be able to heat their homes, while if I buy petrochemicals for paint, I can pay any price I want.

The world has changed so enormously in the relationship, in the way the raw materials are divided up with the changes in underdeveloped countries. There used to be a time when we could send in the marines and do something about it. That is no longer the case.

I have spent sometime delving into the way our Government works, as chairman of a committee composed of labor—we had several labor leaders, Woodcock, Pillard, Clayman, and others. We had several industrialists, we had government people like Governor Lucey and Mayor Hatcher, we had people that represented consumers, like John Gardner and Carol Foreman. We had economists, such as Herb Stein, as well as the Nobel Prize winning economist, Leontief. And we started out with very diverse viewpoints and some very very strong opinions that this country should not engage in any kind of goal making or even get near the question of planning. In fact, the word "planning" itself is a dirty word, not to be used.

This legislation carefully avoids the use of the word, because Congress has been pressured to not even think in those terms.

After a year of looking into the way our Government does in fact work, the mechanisms which are missing in order to permit this country to achieve the objectives that it needs to achieve, the pressures that are placed upon us by all of the other peoples in the world, we looked at the way Japan operates, where business and Government work together, and West Germany, where business and Government work together in setting goals and objectives, it became very clear how far we have lagged behind.

At the end of a year and a half of consultation and debate, we reached the unanimous conclusion that there needed to be some kind of planning mechanism which exists in our Government.

We are convinced, and I am convinced, that were there such a thing, the activities of Government would be less heavy-handed, and would be better coordinated.

The CHAIRMAN. Did Herb Stein go along with that?

Mr. SALTZMAN. Yes, he went along with that.

The CHAIRMAN. He didn't go along with the bill though?

Mr. SALTZMAN. He didn't go along with the bill. He went along with the concept that some form of looking ahead, setting forth alternative possibilities of what might occur, measuring those costs both in social and economic terms, and then laying that on the President and the Congress. Because that is fundamentally what this bill does.

The CHAIRMAN. I think what you have described so far nobody would object to, including any of the witnesses here. The objection is in the first place to the 4 percent goal, and then to the Federal Reserve involvement, and other things, but not the general picture that you paint so glowingly.

Mr. SALTZMAN. Mr. Chairman, I have heard different words. I heard there were two objections. One is the objection to setting the 4 percent unemployment rate. The second is we don't need any kind of national planning of any kind whatsoever, because in so doing, we might open up the door for eventual regulation.

The CHAIRMAN. Let me get into that in just a minute. Unfortunately, gentlemen, the chairman of an agency is waiting for me outside, he just has to see me now, so I will have to recess the hearings for about 10 minutes. I will be back as quickly as I can. I apologize for this, it is very rude, but there is nothing else I can do.

[Short recess.]

The CHAIRMAN. Further on in your statement, the statement by the Round Table, on page 8 you say in the second paragraph: "Because creating public sector jobs draws workers into the labor force, we estimate it would require two public jobs to reduce unemployment by one."

As you know, we have had an enormous explosion in the work force in the last couple of years. In fact, last year we had a marvelous year in employment, we increased employment by 4 million, the best year ever. And we have a higher percentage of people working than we have ever had, which is very very encouraging.

What you are saying is that if you follow this public service job program, then you are going to expand it even more.

I don't think that is so bad necessarily. Who are these people who come in and join the work force. They are people who, to a considerable extent, particularly in view of the wages that are paid in public service jobs, who are on welfare. And to some extent the net cost to the Federal Government might not be so much.

Mr. LOVELL. No, Senator if it were people on welfare, we really wouldn't voice that much concern. But public service jobs, particularly when wages are the prevailing wage level, do attract people into the labor force, some of which take the jobs and some of whom indicate willingness to take jobs, and so that increases your unemployment rate, even if they don't take them.

As you know, during World War II, when there were a lot of high paying jobs, and a lot of social pressure to work, people came into the labor force in tremendous numbers.

Now when we say we are interested in a 4 percent unemployment rate, at what base? How many people in the labor market are we talking about at 4 percent? What are we at now in terms—we have roughly 200 million people, and we have 86 million people in the labor force.

The CHAIRMAN. We have 99.735. We have almost exactly 100 million. We are just a shade away from 100 million. It will probably be 100 million next year.

Mr. LOVELL. So we are talking about a little less than 50 percent of the people in the labor force.

The CHAIRMAN. Most of those not in the labor force are babies and retired people, and very young children under 16.

Mr. LOVELL. Well, many. But you could certainly expand the work force by 10 percent if you developed enough encouragement for people to come into jobs that were attractive to them. That is what that comment relates to.

The CHAIRMAN. Well, I think that is something to be aware of, and I think it is another reason why we do provide this flexibility. And you move to that on page 9, when you say the practical reality is that this provision won't give the President flexibility, but rather confront him with a no-win situation.

I don't think there is any political damage there. I wouldn't view that as damaging to a President, if he has to make a statement like that. In fact, I think it could be a popular statement, particularly because so many people are concerned with inflation.

The last polls indicated that four times as many people feel inflation is the No. 1 problem as feel that unemployment is the No. 1 problem.

When you get to a point where the President is convinced of that, and this President is not yet, perhaps other Presidents wouldn't be quite at this point, I think it is going to be relatively easy to say, from the political standpoint, to say now we want to keep working on unemployment, but we have to recognize the target will have to be raised.

Mr. LOVELL. I am glad you mentioned that, because as you may know, the Senate Human Resources Committee, in its amendments to title III, dealt specifically with the ability of the President to change the 4 percent goal. What they said, in essence, as I understand it, is if the President recommends a change in the goal, either House may in essence veto that. So that his recommendation does not take effect and he is therefore compelled to submit to Congress plans and programs to carry out the original goal.

Mr. CHAIRMAN. Well, I think again it may well be that one House might veto it. Maybe we should change that.

Mr. LOVELL. We would certainly hope you would change that provision.

The CHAIRMAN. Does it require both Houses to take action? At any rate, we are moving to a situation now where the most popular position you can take in this country is not on unemployment, but on inflation.

Mr. LOVELL. That is true, inflation affects everybody, and unemployment does not.

The CHAIRMAN. As we know, we have 12 percent inflation annual rate in the first 4 months of this year and we still have an unfortunate unemployment that we are concerned about, but it is much less than is was.

Mr. SCHUBERT. With regard to the matter of the goal, again, I must respectfully decline to view the 4 percent unemployment goal in the bill to be quite the same as the housing goal, which you established and set for our economy as you indicated a few years ago.

This goal has a great deal of meaning to the constituent groups, as you well know, who are so strongly supporting the passage of Humphrey-Hawkins.

Indeed it is the only thing which has held the constituent groups together. And when there have been discussions—in fact, we were involved in the discussions in the House with regard to making the bill more palatable, so larger segments of the business community could support it.

The CHAIRMAN. I would agree with that, it should have that. We would be hyprocrites if we just passed it and said this is just a balm to be given out to those who favor——

Mr. SCHUBERT. But the concern, Mr. Chairman, is a President faced with that continuing reality, despite the increased importance of inflation, who would find great difficulty in not skewing macroeconomic policy to meet structural needs that can't be met by macroeconomic policy anyway.

We perceive this minority unemployment problem in our inner cities to be one that can not realistically be addressed by this.

The CHAIRMAN. I think you are right. I am glad you are indicating your support, if you do have the 4 percent unemployment goal, for a 3 percent inflation goal. Because that would mean you move in the direction of providing additional employment by structural means, rather than by monetary and fiscal policy, a big deficit and a greatly increased supply of money, which would obviously have an inflationary effect.

Mr. SCHUBERT. That still doesn't make the total package acceptable, Mr. Chairman. It is a rational position, certainly.

The CHAIRMAN. I understand that, you have made that very clear. Mr. Saltzman.

Mr. SALTZMAN. Mr. Chairman, I am concerned that the attack on the 4 percent number—and I have expressed my concerns about what that number means—is perhaps designed to defend the desire to avoid the whole implications of the bill. I would like to separate the two things and discuss them with you for a moment.

It seems to me that the thing which is important in this bill far transcends the question of whether we have 4 percent unemployment, or 5, or 3. And that is how do we get our Government to perform both with some farsighted objectives and also how we get some integrated policymaking in our governmental actions.

It was not so long ago, 1970, when we passed the Clean Air Act, which said that we had to put scrubbers on the coal-fired ovens and it was then cheaper to convert them to oil, which was just the very year that oil was coming into a position where we were beginning to produce less than we were using.

Now had we had the kind of mechanisms which implicitly are suggested by the overall philosophy of this bill, setting aside for the moment unemployment, we would have been forced to look at all of the implications, as they affect our economy. And had we done so, perhaps we wouldn't be in the position where, now several years later, we are going back to those same people and trying to make them convert back to coal because previously we had in our mind one aspect of the problem, and that was the environmental aspect.

We are all more comfortable today, we have 6 percent unemployment, the stock market is up somewhat, but it is only 2 years ago that many of the business leaders, and many other leaders in the country, were saying they do not understand how we got into that kind of mess and they really didn't know how to get out of it.

We no longer live in a world which is the one that Adam Smith envisaged. And an atomic bomb explosion in China equals contaminated milk in your State of Wisconsin. It is essential that the governmental mechanisms update themselves to the point where all of the people will know what are our reasonable objectives, what are the country's capabilities, what are the needs, and what kind of a program might be envisaged to try to meet them.

The unemployment portion of this bill is one that was started back in 1946, that everybody ought to be able to have a job in this country. Putting it in more concrete numerical terms does not in my view cast it in concrete. Solutions will relate to the individual situations at the time and one of the advantages of this bill is that we will avoid the very kind of objections that were stated a moment ago, and that is we cannot rely only on macro-economic considerations. That is why as far as I am concerned, I would just as soon take the Fed out of this bill, because that has been the only place that we have relied upon to solve our inflationary problems. High interest rates and monetary solutions will probably create as much inflation as they might cure.

The CHAIRMAN. Well, I think if we took the Fed out of the bill, we would lose a great deal. I think there is a recognition that you have to have a greater degree of coordination and cooperation than we have had in the past in monetary and fiscal policy.

Incidentally, we had the Fed testify yesterday, Dr. Partee, representing the entire Board, he didn't speak for himself, he spoke for himself, for Chairman Miller, for Governor Coldwell, Governor Gardner. Governor Wallich, Governor Jackson who unanimously said there was nothing in this bill that in their judgment would adversely affect the independence of the Federal Reserve Board.

As you know, they were appointed, most of them were appointed by a Republican President, and they represent a broad variety of views and they are experts on it, who think about it all of the time.

So it seems to me both Mr. Hagedorn and the Round Table position that the Federal Reserve Board independence might be affected was answered by the people who can probably supply us with the greatest authority on it.

Mr. SALTZMAN. My objection was somewhat different. I am afraid if we leave it to the Fed we will never have an anti-inflationary program in this country because no other meaningful solutions are being proposed.

Mr. HAGEDORN. I don't think I said anything about the Fed in my oral remarks, and I guess I forgot to get around to it in the prepared testimony.

The CHAIRMAN. I thought you did.

Mr. HAGEDORN. Let me say it would be rather hard for me to answer a question as to whether I think the requirement for the Fed to make a special report should or should not be in the bill, because I don't think there should be a bill at all.

The CHAIRMAN. The Round Table on the bottom of page 12 and the top of page 13 is very explicit in saying the independence of the Fed would be damaged.

Mr. SCHUBERT. There is no question that the language with regard to the Fed has been improved over time and that certainly is not one of our key objections.

But I would like to take an opportunity to approach one other matter, if I might, Mr. Chairman.

Apart from the question that was just raised about the coal conversion fiasco, and there is a logical argument that could be made that the coal conversion fiasco occurred because the Government attempted to intrude too far into the market mechanism, but, Mr. Chairman, more significant than that, intellectually how can this procedure be extolled as the epitome of good hard rational interest-balancing and even planning, and at the same time prejudge what the results will be 5 years from now?

How can we say there ought to be coordinated planning, pulling all of the units of government together, balancing out the various interests, and at the same time say we are going to prejudge what the results are going to b 5 years from now by setting a 4 percent unemployment goal?

Intellecturally there is no way that can be rational.

The CHAIRMAN. Mr. Shubert, you do that every day in business. You say 5 years from now we are going to sell $2 or $3 billion, whatever it is, we are going to have a certain net on this, we are going to have a certain kind of investment during that period. You set your goals and you change them as time goes on, you find that circumstances change, so you have to modify and change them.

If you didn't do that planning, decide you were going to work toward that goal and pull your resources in to do it, and gear up your people to move in that direction, you probably wouldn't make anything like the progress you do having set your goal.

Mr. SCHUBERT. We don't prejudge what our price is going to be, what our employment requirements are going to be, what our costs are going to be.

The CHAIRMAN. What do you mean by prejudge? If you are going to set a sales goal, you have to set a production goal, and you have to determine what in all likelihood you are likely to require in investment, likely to require in workers. That is why you have a hiring and personnel program. You certainly wouldn't tell me that your personnel needs are not related to what you expect your sales to be.

And then, if you are an efficient company, you do that as meticulously and as carefully and precisely as you can. You don't leave it to a guess.

Mr. LOVELL. Senator, I think the critical question is the flexibility of the goal. I think our whole concern is that. If you were to say the President sets the goals, we agree. We don't have any problem with that. And in regard to this planning process, I want to assure my business asociates here as well as you, Senator, the business community is not against planning. We would like to think that responsible Government planning is very useful.

We think the planning mechanism here which sets up a separate congressional planning process that really indeed is not integrated with the President's, in our judgment, but we see two planning processes, and they say a camel is a horse put together by a committee. I just——

The CHAIRMAN. Regardless of whether you like it or not, I think we have to recognize that the Congress, with all of its disparate views and so forth, doesn't make the decisions. The President proposes, and we dispose. We have the spending power, the power of the purse, the Founding Fathers decided it ought to be given to the Congress and that is the way it is.

So therefore we should be in a position of assuming the responsibilities and of working with the President to decide how these goals should be modified.

Mr. LOVELL. Well, certainly I would be the last one to suggest that Congress have less authority in that regard.

I am talking about the original planning process. It would seem to us that the executive would make the plans and submit them to Congress, and Congress would perhaps alter or change them. But as I read this bill, the Congress would have almost an equal planning, initial planning responsibility in all of these broad areas, which could conceivably and almost in many instances be contrary to that which the executive comes up with.

I would be afraid that this would result over time in less effective planning rather than more effective planning.

The CHAIRMAN. Mr. Donaghue, did you want to comment?

Mr. DONAGHUE. First of all, with regard to setting the goals, I am positive every company does. We certainly do in our company and we do it not just on a year-to-year basis, but try to project our goals for 5 years. It is a natural planning process.

We were able to get away with year-to-year planning 10 or 15 years ago, but in todays environment it has to be more long range and it has to be worldwide.

With regard to the Congress and its planning, I personally am not concerned about that. I am sure that in their wisdom they are going to consult the various sectors that are going to be involved in cooperation with them. Just as we have our say right here today, and you are hearing different viewpoints, you are probably going to hear them on every aspect of the planning mechanisms. But this bill provides us with, again, goals, long-range goals, and medium range goals, and also as I read it it is going to involve the private sector in the development of the plan, but it gives us an impetus to move ahead. That is what we are for.

The CHAIRMAN. Let me ask you something else, and we can come back to this later, but I would like to move on if I could to another issue.

Mr. Donaghue, you and Mr. Hagedorn, and I believe the other members of the panel have not taken the same position, you both are clearly and emphatically against the 3-percent inflation goal.

Now the President has announced a program to hold down inflation, that will require cooperation from both business and labor to be successful. Yesterday the Washington Post indicated that the President had concluded that the anti-inflation program is in doubt, because few business and labor leaders seem willing to make the sacrifice needed to slow down wage and price increases.

Why wouldn't—in the first place, do you think that is correct? And in the second place, why wouldn't the goal be helpful in that respect in making it a national aim, something that all citizens would try to achieve if they could, making it more specific.

We have general language in the Employment Act, but we have had that for years, and the general language is just not as forceful as a specific numerical target.

So why wouldn't this be a useful kind of an action under these circumstances? Or do you think it was a misjudgment on the part of the White House that they are not getting cooperation from business and labor?

Mr. DONAGHUE. That is very difficult to say. I understand the President is meeting this morning with some of the leaders of the AFL-CIO on his program.

But our concern about setting a numerical figure is that it may become the overriding issue in the future, and when it comes to the point of tradeoffs, that the unemployment aspect of the thrust of the Humphrey-Hawkins bill might be lost.

Now, unlike many of my colleagues here, we look at unemployment as being the No. 1 issue in the United States. We look at it from a societal viewpoint rather than strictly the monetary aspects of our business. We are very concerned that if the trend toward minority unemployment in youth continues to grow, we are building a tinder box here in the United States. Therefore it is in our national interest to stem that movement or that potential danger of the future.

The CHAIRMAN. Well, the way that we have designed, the way we have drafted this 3-percent inflation goal, we aid "policies to achieve the inflation goal shall be designed so as not to impede the achievement of the unemployment goal."

What we had in mind was we would try to achieve the inflation goal by structural remedies, by providing a greater degree of training, by all of these efforts that everybody seems to enthusiastically support, but we just don't seem to get that kind of concentration of resources that we should.

So this would not be an inhibition in trying to achieve the goal; on the contrary, it would be trying to channel these efforts in a constructive direction, working on both goals at once.

The control over inflation is complicated by a complex set of factors, many of which are not under our direct control. Unemployment is something that we can look towards and develop plans that can help solve the problem.

The CHAIRMAN. We can certainly do that to a very great extent with respect to inflation. None of these things can we determine, I think everybody here would agree. Maybe not. Secretary of Labor Marshall didn't agree yesterday. He indicated we can achieve an unemployment goal, no question about it, all we have to do is say we have the will and that is it.

I don't agree with that at all. I think there are all kinds of reasons why it will be hard to achieve that kind of goal, not the least of which is the work force itself is not a given factor, you just can't spend a certain amount of money, even price controls wouldn't achieve it.

But at any rate, let me ask Mr. Hagedorn about this issue of why labor and management haven't cooperated, if they have not.

Mr. HAGADORN. Well, I am not sure to what degree individual groups have cooperated. Generally the NAM, in the preliminary steps of framing up this program, was working closely with the administration, and still is, in trying to make it a realistic program.

I have to tell you that personally I am a monetarist, and I think all this is an irrelevant sideshow. I can't represent to you that this is the NAM point of view.

The CHAIRMAN. For which I am grateful.

Mr. HAGADORN. This program keeps being presented to us as a voluntary program. The word "voluntary" is emphasized, it appears, in every sentence.

Last week Barry Bosworth made a speech in Atlanta, and in his speech he described this voluntary program. He said if we don't get the voluntary cooperation that we need from business and labor, we are going to pry it out. Those are his words, they are going to pry it out.

Now prying out voluntary cooperation is a combination of ideas I find hard to deal with. Personally, I think with this kind of philosophy pressures will mount on the administration to get tough. With those pressures, I am afraid we are on a headlong race toward wage and price controls. It won't be called that name, it will still be called a voluntary program.

The CHAIRMAN. You see that everywhere. I think they are a danger, they are a threat. We had them in 1973, but I think the experience was so bad, you had such an overwhelming almost unanimous disapproval, from management, from labor, from Members of Congress, I don't think there is any prospect, unless you get 15- or 20-percent inflation, in which case——

Mr. HAGADORN. I know, nobody has a good word to say for wage and price controls in this town, whatever his political persuasion or whatever interest group he is from. But people keep talking about various kinds of income policy. For example the tax-based income policy, as though it was something different from controls.

If you want to argue that point, I would be delighted to have an opportunity to talk at length on it.

The CHAIRMAN. We are going to have hearings on that later on. Maybe we can have you here.

Mr. HAGADORN. I think it is just another word for control.

The CHAIRMAN. Yes, sir, Mr. Schubert.

Mr. SHUBERT. My boss, Mr. Chairman, who appeared before you briefly this morning, was at the business leader meeting at the White House, and his report to me was that there certainly was not any evidence of lack of cooperation, everyone had their own reservations as to the degree to which cooperation could be effectuated, with the guidelines or the targets that were ennunciated by the President.

Obviously in an industry like steel, where the price increases realized over the last 3 years have not in any fashion approached the cost increases that we have all absorbed and experienced, a commitment to a flat number is very difficult.

But everyone at the meeting as described by Mr. Foy, indicated recognition that this was a No. 1 problem, and they would cooperate with the President in every way they could.

The CHAIRMAN. Maybe I should put it in a different way. I don't mean there is not good will, and we are all patriotic and want to do our best, and I mean that sincerely. The difficulty is the conditions may make it virtually impossible. The statistics we have in the first 4 months of this year indicated the materials index, for example, is up very sharply. The price of finished goods is up 11.8 percent in the first 4 months of this year. We have a drop in productivity and a big increase in wage settlements.

Now does that mean that there is no way you can avoid substantially higher prices, or is there a way, with restraint on the part of business, that you can reduce the inflationary pressure.

Mr. SCHUBERT. Mr. Foy suggested to the President in the steel industry we have been very restrained and indeed our profitability last year being 42d out of 42 industries in Citibank's survey kind of demonstrates that.

But the energy increases, for example, that are going to come out of the coal settlements are very significant.

The CHAIRMAN. Profitability is not necessarily keyed to your price level. It depends on your volume, too. And your volume, if it is hit hard and drops, your profitability drops, even though your price picture may be all right.

Steel is an industry that is very, very puzzling. You have had excellent productivity, I don't know about recently, but you have had excellent productivity improvements. You have been an industry that has provided substantial improvements in technology.

Mr. SCHUBERT. There are two problems. The productivity has been relatively good as compared to the rest of manufacturing. But there have been two problems. One is your profitability has been down, and it has been down primarily because of price restrictions. Every time we sneeze, the President reacts against the steel industry, because of alleged impact on the economy. We don't think we have that much of an impact.

Second, foreign imports, which have been traumatic, we are now running at 20 percent, Mr. Chairman, and it makes it very difficult for us to retain the earnings sufficient to meet some of the capital improvements made by some of our foreign competitors.

The CHAIRMAN. Let me ask both Mr. Hagedorn and either of you gentlemen from the round table this question. The Humphrey-Hawkins bill, we know, has a 4-percent unemployment goal for 1983. Yesterday both Secretary Marshall and Chairman of the Council of Economic Advisers Schultze said they thought this could be accomplished by using structural programs in addition to monetary and fiscal policy, but primarily structural programs.

Do you think that is realistic or not? I am not sure that I was able to ascertain that from your statements.

Mr. HAGEDORN. I think it is entirely unrealistic.

The CHAIRMAN. How can you be so sure?

Mr. HAGEDORN. I can't be sure.

The CHAIRMAN. We have had a drop in unemployment, down to 6 percent in the past 2 or 3 years. Why can't we get that down to 4 percent?

Mr HAGEDORN. I can't be sure. Economics is not an exact science, and I am not 100 percent sure of anything.

But the progress we make through structural efforts, laudable though they be, and I certainly want to encourage them, the progress we have made in putting a real dent in inner-city unemployment, for example, has been so slow that we shouldn't count on it; you shouldn't put it in concrete in legislation.

The CHAIRMAN. You criticized Mr. Donaghue's—you didn't criticize, but you indicated Mr. Donaghue's appraisal was limited to a relatively small section of the economy. Let me give you a bigger example, still a segment of the economy, but give you my State of Wisconsin.

We did two things in Wisconsin. No. 1, we have put an enormous emphasis on vocational and technical education, perhaps more than any other State. Reader's Digest had a comparison some years ago that said we spent 19 times as much per capita in Milwaukee compared to Philadelphia on that.

We have a harsh climate, we have a high wage rate, and we are a State that has disadvantages of that part of the Middle West, yet we have been gaining jobs and we are well below the national average on unemployment.

One reason is that strong emphasis on a trained work force. Another is we have a mobility that is based on a computer system, where everybody who lives in a town of 10,000 or more can find immediately every job that is available in Wisconsin simply by going to the Employment Service. They can tell you every job that is available in Milwaukee, what it pays, what the qualifications are, or in Superior, Green Bay, all over the State.

Why couldn't that kind of program nationally, with strong emphasis on vocational and technical education, making a real outreach effort to get the minority groups and the young people, the dropouts into it, and a big emphasis on making the knowledge of where jobs are available, why wouldn't that be a way of moving down that direction?

Mr. HAGEDORN. Accepting all that you have said, Senator, and I know Wisconsin's record is impressive, it is going to take a lot more than 5 years to reform the vocational educational system in all of the 49 other States, so it becomes as successful as the one in Wisconsin.

The CHAIRMAN. But we are asking to get it down to a level of unemployment that we have often had in the past, we have had that level of unemployment below 4 percent in most of the 1950's.

Mr. HAGEDORN. That was before the youth explosion.

The CHAIRMAN. Well, that youth explosion is just about over.

Mr. HAGEDORN. It is tapering off, yes; the signs are much better.

The CHAIRMAN. That should help us get to the 4 percent.

Mr. HAGEDORN. Yes; it will improve the prospects for doing something in the future. But again, demographic changes occur slowly.

You are talking about a period of a quarter of a century ago. Four percent might very well have been realistic then; as a matter of fact, I think it was.

THE CHAIRMAN. Mr. Lovell, would you comment on the realism of the 4-percent figure, given a vigorous program of structural activities?

Mr. LOVELL. I think that there is certainly a lot we can do in terms of some of the specific problems; there are some things that can be done through structural efforts. I would be very surprised and would be delighted but very surprised that we can get down to 4 percent. I have more confidence in structural methods than George does, I think, partly because of my prejudice, having worked on them for so many years.

The CHAIRMAN. Let me put this this way: We are just about to wind up, but let me ask each of you gentlemen to give me an estimate of what level you think we can get to in 5 years.

I think Mr. Hagedorn indicated about 5½ percent. But I am not sure that he had embodied a vigorous structural program in that. I think that was given the present policies. But if each of you could say at what level you think would be realistic, if not 4 percent, 4½, 5, whatever.

Mr. HAGEDORN. I would answer in terms of a safe zone. A safe zone for the unemployment rate, I think, for the next 5 years will be 5½ to 6 percent.

The CHAIRMAN. You say 5½ to 6 percent.

Mr. HAGEDORN. Yes.

Mr. LOVELL. Senator, I think that as long as we recognize it as a goal, rather than as a commitment, and an obligation, it should be set lower than we think will happen by itself. So I might say 5 percent. But my main concern is having the language of this bill, if it is passed, to be able to reflect changing times and changing conditions, and not have people coming before this Congress in 2 years and saying, look, this bill is passed, you have to do A, B, and C that you and others would know are not wise in terms of the total health of the economy.

I think that is our major concern, not to lock ourselves in so we don't have manueverability.

I certainly don't have any objection to a goal that is hard to reach, but we shouldn't be locked into it.

The CHAIRMAN. Mr. Donaghue?

Mr. DONAGHUE. Well, it is very difficult to say whether we will actually meet the 4-percent goal or not. The main thrust ought to be that we certainly have to work for that. There are structural changes that are needed, and there is a great deal of follow-on legislation to start to implement some action programs in this area.

Is it achieveable? I just don't have any crystal ball to really be able to predict that. But we certainly should be aiming for it.

The CHAIRMAN. You don't quarrel with the 4-percent goal?

Mr. DONAGHUE. No; I do not.

The CHAIRMAN. Mr. Saltzman.

Mr. SALTZMAN. Senator, I would say we can reach it. I am not saying we will. I say we can.

One of the things that worries me is in my city of New York, which has had 30 percent unemployment of kids getting out of school, largely blacks and Puerto Ricans, but not limited to them by any means. When the Federal Government advertised there were about 1,200 jobs available for the summer, you saw 4,000 kids line up at 6 o'clock in the evening before, and stay in line all night in the cold and even rainy weather, and fighting for a place in the line. It is clear to me there is a tremendous need to be able to see this——

The CHAIRMAN. Where was this?

Mr. SALTZMAN. New York City, waiting in line.

The CHAIRMAN. What were they paying?

Mr. SALTZMAN. They were paying the minimum wage.

Mr. LOVELL. It was higher than the minimum.

Mr. SALTZMAN. No; it was the minimum wage. But the point is that unless we can bring a submerged portion of the people of this country back into our country, and into the economy, we are in serious trouble, not only socially, but also economically.

I think we can do it. I think it will be difficult and expensive, and one of the problems is that you must spend the money before you get the benefit. We save an awful lot of money by making it possible for these people to go to work, but you have to spend it first.

The second problem is that you do have at least temporarily, an accretion in the inflation rate, while you are doing that, and there is almost no way to avoid that.

But it seems to me, that especially if we set a maximum inflation rate, which may indeed be necessary, that there is a hard line we are going to have to face. Nobody is going to say that they were against a voluntary program. But I cannot understand when we talk about a free marketplace, but at the same time we suggest to labor unions and businesses that they take positions which are contrary to the very nature of the free marketplace—which is to get whatever the free marketplace puts you in a position to try to extract—because the two are incompatible, both economically and philosophically. Whether we like it or not, we are going to get to the point where some strictures have to be applied in order to get to the place we have to get to.

That is true both with our efforts in unemployment and with our efforts in inflation.

The CHAIRMAN. Gentlemen, I want to thank you very much, this has been an excellent panel, well balanced and very thoughtful.

I realize you differ in your views, but I think that is one of the reasons it has been such a good and helpful and enlightening panel.

Thank you very much.

The committee will stand adjourned.

[Thereupon, at 12:10 p.m. the hearing was adjourned.]

[Additional material received for the record follows in the appendix.]

APPENDIX

Purpose: **Amdt. No. 1703**

95TH CONGRESS
2D SESSION

S. 50

IN THE SENATE OF THE UNITED STATES

Referred to the Committee on Human Resources and ordered to be printed
FEBRUARY 23 (legislative day, FEBRUARY 6), 1978

AMENDMENT

Intended to be proposed by Mrs. HUMPHREY (for herself, Mr. NELSON, Mr. ROBERT C. BYRD, Mr. WILLIAMS, Mr. JAVITS, Mr. CRANSTON, Mr. BROOKE, Mr. JACKSON, Mr. MAGNUSON, Mr. ABOUREZK, Mr. ANDERSON, Mr. BAYH, Mr. CASE, Mr. CLARK, Mr. EAGLETON, Mr. HATHAWAY, Mr. INOUYE, Mr. KENNEDY, Mr. MATSUNAGA, Mr. McGOVERN, Mr. METZENBAUM, Mr. MOYNIHAN, Mr. PELL, Mr. RIEGLE, Mr. SARBANES, Mr. LEAHY, and Mr. RIBICOFF) to S. 50, a bill to translate into practical reality the right of all Americans who are able, willing, and seeking to work to full opportunity for useful paid employment at fair rates of compensation; to assert the responsibility of the Federal Government to use all practicable programs and policies to promote full employment, production, and real income, balanced growth, adequate productivity growth, proper attention to national priorities, and reasonable price stability; to require the President each year to set forth explicit short-term and medium-term economic goals; to achieve a better integration of general and structural economic policies; and to improve the coordination of economic policymaking within the Federal Government, viz: Strike all after enacting clause and insert in lieu thereof:

That this Act and the following table of contents be cited as the "Full Employment and Balanced Growth Act of 1977".

TABLE OF CONTENTS

TITLE III—POLICIES AND PROCEDURES FOR CONGRESSIONAL REVIEW

TITLE IV—GENERAL PROVISIONS

GENERAL FINDINGS

SEC. 2. (a) The Congress finds that the Nation has suffered substantial unemployment and underemployment, idleness of other productive resources, high rates of inflation, and inadequate productivity growth, over prolonged periods of time, imposing numerous economic and social costs on the Nation. Such costs include the following:

(1) The Nation is deprived of the full supply of goods and services, the full utilization of labor and capital resources, and the related increases in economic well-being that would occur under conditions of genuine full employment, production, and real income, balanced growth, and reasonable price stability.

(2) Insufficient output of goods and services is available to meet pressing national priorities.

(3) Workers are deprived of the job security, income, skill development, and productivity necessary to maintain and advance their standards of living.

(4) Business and industry are deprived of the production, sales, capital flow, and productivity necessary to

maintain adequate profits, undertake new investment, create jobs, and contribute to meeting society's economic needs.

(5) Unemployment exposes many families to social, psychological, and physiological costs, including disruption of family life, loss of individual dignity and self-respect, and the aggravation of physical and psychological illnesses, drug addiction, crime and social conflicts.

(6) Federal, State and local government budgets are undermined by deficits due to shortfalls in tax revenues and in increases in expenditures for unemployment compensation, public assistance, and other recession-related services in the areas of criminal justice, drug addiction, and physical and mental health.

(b) The Congress further finds that:

(1) High unemployment often contributes to inflation by diminishing labor training and skills, underutilizing capital resources, reducing the rate of productivity advance, increasing unit labor costs, and reducing the general supply of goods and services and thereby generating cost-push inflation.

(2) Aggregate monetary and fiscal policies alone have been unable to achieve full employment, production, and real income, balanced growth, adequate productivity growth, proper attention to national priorities, and reasonable price stability, and therefore must be

supplemented by other measures designed to serve these ends.

(3) Attainment of these objectives should be facilitated by setting explicit short-term and medium-term economic goals, and by improved coordination among the President, the Congress, and the Federal Reserve.

(4) Increasing job opportunities and full employment would greatly contribute to the elimination of discrimination based upon sex, age, race, color, religion, national origin, and other improper factors.

(c) The Congress further finds that an effective policy to promote full employment, production, and real income, balanced growth, adequate productivity growth, proper attention to national priorities, and price stability should (1) be based on the development of explicit economic goals and policies involving the President, the Congress, and the Federal Reserve, with full use of the resources and ingenuity of the private sector of the economy, and (2) include programs specifically designed to reduce high unemployment due to recessions, and to reduce structural unemployment within regional areas and among particular labor force groups.

(d) The Congress further finds that full employment, production and real income, balanced growth, adequate productivity growth, proper attention to national priorities, and reasonable price stability are important national requirements that will promote the economic security and well-being of all our citizens.

TITLE I—ESTABLISHMENT OF GOALS AND GENERAL ECONOMIC POLICIES

STATEMENT OF PURPOSE

SEC. 101. It is the purpose of this title to declare the general policies of this Act; to provide an open process under which economic goals and policies are proposed, reviewed, and established; to provide for yearly review of national economic policies to ensure their consistency with these goals to the maximum extent possible; and generally to strengthen and supplement the purposes and policies of the Employment Act of 1946.

DECLARATION OF POLICY

SEC. 102. Section 2 of the Employment Act of 1946 is amended to read as follows:

"SEC. 2. (a) The Congress hereby declares that it is the continuing policy and responsibility of the Federal Government to use all practicable means, consistent with its needs and obligations and other essential national policies, and with the assistance and cooperation of industry, agriculture, labor, and State and local governments, to coordinate and utilize all its plans, functions, and resources for the purpose of creating and maintaining, in a manner calculated to foster and promote free competitive enterprise and the general welfare, conditions which promote useful employment opportunities, including self-employment, for those able, willing, and seeking to work, and promote full employment, production, and real income, balanced growth, adequate productivity growth, proper attention to national priority needs, and reasonably stable prices as provided for in section 5 (b) of this Act.

"(b) The Congress further declares and establishes as a national goal the fulfillment of the right of all Americans able, willing, and seeking to work to full opportunities for useful paid employment at fair rates of compensation.

"(c) The Congress further declares that inflation is a major national problem requiring improved government policies relating to food, energy, improved fiscal and monetary management, the reform of outmoded Government rules and regulations, the correction of structural defects in the economy that prevent or seriously impede competition in private markets, and other measures.

"(d) The Congress further declares that it is the purpose of the Full Employment and Balanced Growth Act of 1977 to improve the coordination and integration of the policies and programs of the Federal Government toward achievement of the objectives of such Act through better management, increased efficiency, and attention to long-range as well as short-range problems.

"(e) The Congress further declares that, although it is the purpose under the Full Employment and Balanced Growth Act of 1977 to seek diligently and to encourage the voluntary cooperation of the private sector in helping to achieve the objectives of the Act, no provisions of the Act shall be used, with respect to any portion of the private sector of the economy, to provide for Government control of production, employment, allocation of resources, or wages and prices, except to the extent authorized under other legislation.

"(f) The Congress further declares that it is the purpose of the Full Employment and Balanced Growth Act of 1977 to maximize and place primary emphasis upon the expansion of private employment, and all programs and policies under that Act shall be in accord with that purpose. Toward this end, the effort to expand jobs to the full employment level shall be in this order of priority to the extent consistent with balanced growth: (1) expansion of conventional private jobs through improved use of general economic and structural policies; (2) expansion of private employment through Federal assistance in connection with the priority programs in such Act; (3) expansion of public employment other than through the provisions of section 206 of such Act; and (4) only when recommended by the President under section 206 of such Act and subject to the limitations therein, the creation of employment through the methods set forth in such section.".

ECONOMIC REPORT OF THE PRESIDENT AND SHORT-TERM ECONOMIC GOALS AND POLICIES

SEC. 103. The headings preceding section 3 and section 3 (a) of the Employment Act of 1946 are amended to read as follows:

"ECONOMIC REPORT OF THE PRESIDENT AND SHORT-TERM ECONOMIC GOALS AND POLICIES

"SEC. 3. (a) The President shall transmit to the Congress during the first twenty days of each regular session an economic report (hereinafter called the Economic Report), together with the annual report of the Council of Economic Advisers submitted in accord with section 4 (c) (2) of this Act, setting forth—

"(1) the current and foreseeable trends in the levels of employment, unemployment, production, real income, productivity, and prices, and a review and analysis of recent developments affecting economic trends in the United States;

"(2) annual numerical goals for five years for employment and unemployment, production, real income, and productivity. The goals for the calendar year in which the Economic Report is transmitted and for the following calendar year, designated as short-term goals, shall be consistent with achieving as rapidly as feasible the goals of full employment, production, and real income, balanced growth, adequate productivity growth, and proper attention to national priorities.

"(3) the program and policies which the President deems necessary to achieve the goals of paragraph (2) of this subsection, and to achieve reasonable price stability as rapidly as feasible as provided for in section 5(b) of this Act.

"(4) for all of the purposes of the Full Employment and Balanced Growth Act of 1977, the percentage rate of unemployment at any given time shall be the rate of unemployment as a percentage of the civilian labor force as set forth currently by the Bureau of Labor Statistics in the United States Department of Labor.".

FULL EMPLOYMENT AND BALANCED GROWTH: MEDIUM-TERM ECONOMIC GOALS AND POLICIES

SEC. 104. The Employment Act of 1946 is amended by adding a new section 4 as follows:

"FULL EMPLOYMENT AND BALANCED GROWTH: MEDIUM-TERM ECONOMIC GOALS AND POLICIES

"SEC. 4. (a) In each Economic Report after enactment of the Full Employment and Balanced Growth Act of 1977, the President shall incorporate (as part of the five-year numerical goals in each Economic Report) medium-term annual numerical goals covering the same items and for the same purposes as the goals specified in paragraph (2) of subsection 3 (a), but for the three calendar years subsequent to the two years referred to in such paragraph, and the programs and policies the President deems necessary to achieve such medium-term goals, and to achieve reasonable price stability as rapidly as feasible as provided for in section 5 (b) of this Act.

"(b) The medium-term goals in the first three Economic Reports after enactment of the Full Employment and Balanced Growth Act of 1977 shall include (as part of the five-year goals in each Economic Report) the interim numerical goal of reducing unemployment among Americans aged twenty and over in the civilian labor force to not more than 3 per centum and to reduce unemployment among the entire civilian labor force aged sixteen and over to not more than 4 per centum within a period not extending beyond the fifth calendar year after the first such Economic Report, counting as the first calendar year the year in which such Economic Report is issued. Upon achievement of the 3 and 4 per centum goals as specified above, each succeeding Economic Report shall have the goal of achieving full employment as soon as practicable and maintaining full employment after it has been reached. In the third Economic Report after enactment of the Full Employment and Balanced Growth Act of 1977, the President shall review the numerical goals and timetables for the reduction of unemployment, report to the Congress on any obstacles to their achievement, and if necessary propose corrective economic measures toward achievement of such goals and timetables: *Provided,* That beginning with such third report and in any subsequent reports, if the President finds it necessary, the President may in his or her judgment recommend modifications in the numerical goals and/or timetables for the reduction of unemployment, and the Congress may take such action as it sees fit by the method set forth in title III of the Full Employment and Balanced Growth Act of 1977.

"(c) In moving to reduce unemployment in accord with the numerical goals and timetable as called for in subsection (b), every effort shall be made to reduce those differences between the rates of unemployment among teenagers, women, minorities, and other labor force groups and the overall rate of unemployment which stem from any improper factors, with the ultimate objective of removing such differentials to the extent possible. Insofar as these differences are due to lack of training and skills, occupational practices, and other relevant factors, the Secretary of Labor shall take such action as he or she can to achieve the objectives of this subsection; shall make studies, develop information, and make recommendations toward remedying these differences in rates of unemployment, and include these in the annual Employment and Training Report of the President; and, if deemed necessary, make recommendations to the Congress related to the objectives of this paragraph.".

PROVISIONS APPLICABLE TO SHORT-TERM AND MEDIUM-TERM GOALS

SEC. 105. The Employment Act of 1946 is amended by adding a new section 5 as follows:

"PROVISIONS APPLICABLE TO SHORT-TERM AND MEDIUM-TERM GOALS

"SEC. 5. (a) To aid in determining the short-term and medium-term goals for employment, production, and real income, analysis shall be presented in the Economic Report with respect to major aspects of the appropriate composition or structure of each goal, and as to the appropriate apportionment of total national production among its major components (private investment, consumer expenditures, and public outlays) as affected by relative income flows and other factors, in order to promote balanced growth, reduce cyclical disturbances, and achieve the other purposes of the Full Employment and Balanced Growth Act of 1977.

"(b) The objective of achieving reasonable price stability as soon as feasible, as set forth in section 3 (a) (3) and section 4 (a), shall be sought by vigorous efforts through the methods set forth in section 109 and elsewhere in the Full Employment and Balanced Growth Act of 1977, and by such other means as the President may find necessary, including recommendations to the Congress. In choosing means to achieve the goal for the reduction of unemployment and choosing means to achieve the goal of reasonable price stability, those means which are mutually reinforcing shall be used to the extent practicable.".

NATIONAL PRIORITY POLICIES AND PROGRAMS REQUIRED FOR FULL EMPLOYMENT AND BALANCED GROWTH

SEC. 106. The Employment Act of 1946 is amended by adding a new section 6 as follows:

"NATIONAL PRIORITY POLICIES AND PROGRAMS REQUIRED FOR FULL EMPLOYMENT AND BALANCED GROWTH

"SEC. 6. To contribute to the achievement of the goals under the Full Employment and Balanced Growth Act of 1977, the Economic Report shall include priority policies and programs to encourage productive nonwasteful jobs and help to reorder national priorities and employ the jobless in the production of goods and services which add to the strength of the economy, the wealth of the Nation, the well-being of the people, and the restraint of inflation. Such policies and programs shall not be set forth in the programmatic detail developed by specialized Federal agencies, and by others in the public and private sectors, but only sufficiently to furnish an integrated perspective of our needs and capabilities and as a long-run guide to relevant national economic policies and programs. The national priority policies and programs dealt with in the First Economic Report under the Full Employment and Balanced Growth Act of 1977 shall include those listed below, but in subsequent Economic Reports the President may deal with them more selectively as he or she finds desirable:

"(1) development of energy, transportation, small business, and environmental improvement;

"(2) proper attention to the needs of rural America, related to (a) nationwide food and fiber requirements and the labor force and capital needed to meet these requirements, (c) the income needs of farmers to encourage production in accord with the above requirements and moving farm families toward parity of income, (d) encouragement of supplementary nonfarm work and income for farm families, and (e) other policies and programs for rural people outside of agriculture;

"(3) the quality and quantity of health care, education and training programs, child care and other human services, and housing, essential to a full economy and moving gradually toward adequacy for all at costs within their means;

"(4) Federal aid to State and local governments, especially for public investment and unemployment related costs;

"(5) national defense and other needed international programs; and

"(6) such other priority policies and programs as the President deems appropriate.".

THE PRESIDENT'S BUDGET

SEC. 107. The Employment Act of 1946 is amended by inserting a new section 7 as follows:

"THE PRESIDENT'S BUDGET

"SEC. 7. (a) The President's Budget shall recommend levels of outlays and receipts which shall be consistent with the short-term economic goals of subsection (a) (2) of section 3.

"(b) The President's Budget shall provide five-year projections of outlays and receipts consistent with the medium-term goals of subsection (b) of section 4.

"(c) The basic elements in the President's Budget shall be set forth briefly in each Economic Report, toward the end of making clear the relationship between the President's Budget and the goals and policies set forth in such Economic Report. Both the expenditure and the tax sides of the President's Budget, as set forth briefly in the Economic Report, shall be geared to the purposes of the Full Employment and Balanced Growth Act of 1977. The size of the President's expenditure and tax proposals, and the relationships between the two, shall be determined in a manner which pays due attention to the needs of the economy and the people in the priority areas set forth in section 6, and the relationship between the President's expenditure and tax proposals shall be guided accordingly.".

MONETARY POLICY

SEC. 108. The Employment Act of 1946 is amended by inserting a new section 8 as follows:

"MONETARY POLICY

"SEC. 8. The Board of Governors of the Federal Reserve shall transmit to the Congress, within one month after the transmission of the Economic Report, an independent statement setting forth its intended policies for the year ahead, and their relationship to the short-term goals set forth in the Economic Report pursuant to subsection (a) (2) of section 3. The Congress shall then take such action as it finds necessary to insure closer conformity to the purposes of the Full Employment and Balanced Growth Act of 1977.".

OVERCOMING INFLATION

SEC. 109. The Employment Act of 1946 is amended by inserting a new section 9 as follows:

"OVERCOMING INFLATION

"SEC. 9. (a) The Congress hereby determines that the objective of achieving reasonable price stability as soon as feasible, as set forth in section 3 (a) (3) and section 4 (a), shall be pursued by the methods and subject to the requirements of section 5 (b).

"(b) The Congress finds that, in addition to the coordinated use of fiscal and monetary policies to combat inflation, structural measures are also needed. The President shall initiate as appropriate, including recommendations to the Congress where necessary, and included within the Economic Report to the extent practicable without excessive delay, structural policies to reduce the rate of inflation, embracing but not necessarily limited to—

"(1) an effective information system to monitor and analyze inflationary trends in individual economic sectors, so that the President and Congress can be alerted to developing inflation problems and bottlenecks;

"(2) programs and policies for increasing the supply of goods, services, labor, and capital in tight markets, with particular emphasis on food, energy, and critical industrial materials;

"(3) the establishment of stockpiles of agricultural commodities and other critical materials to help stabilize prices, meet emergency needs, and promote adequate income to producers;

"(4) encouragement to labor and management to increase productivity within the national framework of full employment through voluntary arrangements in industries and economic sectors;

"(5) recommendations to strengthen and enforce the antitrust laws and such other recommendations as are necessary to increase competition in the private sector;

"(6) removal or proper modification of such Government restrictions and regulations as add unnecessarily to inflationary costs;

"(7) such other administrative actions and recommendations for legislation as the President deems desirable, to promote reasonable price stability."

COUNCIL OF ECONOMIC ADVISERS

SEC. 110. (a) The second sentence of section 4(a) of the Employment Act of 1946 is amended by inserting "full" immediately after "promote".

(b) Section 4(c)(4) of such Act is amended by inserting "full" immediately after "maintain".

(c)(1) Section 4(e)(1) of such Act is amended by inserting immediately before the semicolon a comma and the following: "and shall consult with the Board or Boards established under section 11.".

(2) Section 4(e) of such Act is amended by striking

out the period at the end of paragraph (2) and inserting in lieu thereof a semicolon, and by adding after such paragraph (2) the following:

"(3) In its work under this Act and the Full Employment and Balanced Growth Act of 1977, the Council is authorized and directed to seek and obtain the cooperation of the various executive and independent agencies in the development of specialized studies essential to its responsibilities."

ADVISORY BOARD OR BOARDS

SEC. 111. (a) Sections 4 and 5 of the Employment Act of 1946 are renumbered sections 12 and 13.

(b) The Employment Act of 1946 is amended by adding a new section 11 as follows:

"ADVISORY BOARD OR BOARDS

"SEC. 11. (a) The President shall establish, in not less than three months prior to the first Economic Report under the Full Employment and Balanced Growth Act of 1977, an advisory board or boards to advise and consult with one or all of the following periodically at reasonable periods of time as he or she shall determine: The President, the Council of Economic Advisers, and such other departments and agencies of the executive branch of the Government as the President shall determine. Such advisory board or boards shall include appropriate representation of labor, industry, agriculture, consumers, State and local officials, and the public at large, and shall advise and consult with respect to matters related to the Full Employment and Balanced Growth Act of 1977 and other appropriate matters related to national economic programs and policies. The President shall take the steps necessary to provide appropriate compensation to the members of such advisory board or boards.

TITLE II—STRUCTURAL ECONOMIC POLICIES AND PROGRAMS, INCLUDING TREATMENT OF RESOURCE RESTRAINTS

STATEMENT OF PURPOSE

SEC. 201. The Congress recognizes that general economic policies alone have been unable to achieve the goals set forth in this Act related to full employment, production, and real income, balanced growth, adequate growth in productivity, proper attention to national priorities, and achievement of reasonable price stability as provided for in section 5(b) of the Employment Act of 1946. It is therefore the purpose of this title to require the President to initiate as he or she deems appropriate, with recommendations to the Congress where necessary, supplementary programs and policies to the extent that he or she finds such action necessary to help achieve these goals, including the goals and timetables for the reduction of unemployment. Insofar as feasible without undue delay, any policies and programs so recommended shall be included in the Economic Report.

COUNTERCYCLICAL EMPLOYMENT POLICIES

SEC. 202. (a) Any countercyclical efforts undertaken to aid in achieving the purposes of section 201 shall consider for inclusion the following programmatic entities: accelerated public works, including the development of standby public works projects; countercyclical public service employment; State and local countercyclical grant programs as specified in section 203; the levels and duration of unemployment insurance; skill training in both the private and public sectors, both as a general remedy and as a supplement to unemployment insurance; youth employment programs as specified in section 205; community development programs to provide employment in activities of value to the States, local communities (including rural areas), and the Nation; and augmentation of other employment and manpower programs which would help to reduce high levels of unemployment arising from cyclical causes.

(b) In any countercyclical efforts undertaken, the President shall consider a triggering mechanism which will implement the program during a period of rising unemployment and phase out the program when unemployment is appropriately reduced, and incorporate effective means to facilitate individuals assisted under programs developed pursuant to this section to return promptly to regular private and public employment as the economy recovers.

COORDINATION WITH STATE AND LOCAL GOVERNMENT AND PRIVATE SECTOR ECONOMIC ACTIVITY

SEC. 203. (a) As an integral part of any countercyclical employment policies undertaken in accord with section 202, the President shall to the extent he or she deems necessary set forth programs and policies, including recommended legislation where needed, to facilitate harmonious economic action among the Federal Government, regions, States and localities, and the private sector to promote achievement of the goals of this Act and an economic environment in which State and local governments and private sector economic activity and employment will prosper and essential services will be maintained.

(b) In any efforts under this section, the President shall endeavor to meet criteria that establish programs which are funded to take account of the fiscal needs and budget conditions of the respective States and localities and their own efforts, with special attention to the rates of unemployment in these States and localities.

REGIONAL AND STRUCTURAL EMPLOYMENT POLICIES

SEC. 204. To the extent deemed appropriate by the President in fulfillment of the purposes of section 201, the

President shall initiate, and recommend legislation to the Congress if necessary, regional and structural policies and programs. In formulating the regional components of any such programs, the President, to the extent he or she deems it desirable, shall encourage new private sector production and employment to locate within depressed localities and regions with substantial unemployment. Any regional employment proposal of the President shall also include an analysis of the extent to which Federal Government tax, expenditure, and employment policies have influenced the movement of people, jobs, industry from chronic high unemployment regions and areas, and proposals designed to correct Federal policies that have an adverse economic impact upon such regions and areas.

YOUTH EMPLOYMENT POLICIES

SEC. 205. (a) The Congress finds and declares that serious unemployment and economic disadvantage of a unique nature exist among youths even under generally favorable economic conditions; that this group constitutes a substantial portion of the Nation's unemployment, and that this significantly contributes to crime, drug addiction, and other social and economic problems; and that many youths have special employment needs and problems which, if not promptly addressed, will substantially contribute to more severe unemployment problems in the long run.

(b) To the extent deemed necessary in fulfillment of the purposes of this Act, the President shall improve and expand existing youth employment programs, recommending legislation where required. In formulating any such program, the President shall include provisions designed to fully coordinate youth employment activities with other employment and manpower programs; develop a smoother transition from school to work; prepare disadvantaged and other youths with employability handicaps for regular self-sustaining employment; and develop realistic methods for combining training with work.

JOB TRAINING, COUNSELING AND RESERVOIRS OF EMPLOYMENT PROJECTS

SEC. 206. (a) Further to promote achievement of full employment under this Act, the President through the Secretary of Labor shall develop policies, procedures, and programs to provide employment opportunities to Americans aged 16 and over in the civilian labor force able, willing, and seeking to work but who, despite serious efforts to obtain employment, remain unemployed.

(b) In meeting the responsibilities to provide job opportunities under subsection (a) and after full utilization of the Comprehensive Employment and Training Act of 1973 and other relevant provisions of law, the Secretary of Labor shall, as appropriate—

(1) assure that counseling, training, and other support activities necessary to prepare persons willing and seeking work for employment under relevant provisions of law including the Comprehensive Employment and Training Act of 1973 (including use of section 110 of such Act when necessary); and

(2) refer persons able, willing, and seeking to work to job opportunities in the private and public sectors through the existing public employment placement facilities and through the United States Employment Service, including job opportunities in any positions created pursuant to sections 202, 204, and 205 of this Act.

(c) Only to the extent that Americans aged sixteen and over and able, willing, and seeking work are not and in the judgment of the President cannot be provided with private job opportunities nor provided with job opportunities under other programs and actions in being, in accord with the goals and timetables set forth in the Employment Act of 1946, the President shall establish reservoirs of public employment and private nonprofit employment projects, to be approved by the Secretary of Labor, in the form of expansion of CETA and other existing employment and training projects and/or through such new programs as are determined by the President to be needed and which the Congress authorizes and provides funds for.

Such new programs as require authorizations under this Act shall not be put into operation less than two years after the enactment of this Act, nor without a finding by the President, transmitted to the Congress, that other means of employment are not yielding enough jobs to be consistent with attainment of the goals and timetables for the reduction of unemployment set forth in the Employment Act of 1946. The Congress hereby establishes the policy that such new programs for reservoir projects shall be so designed as not to draw any workers from private employment to the reservoir projects thereunder. The jobs under such new program reservoir projects shall be useful and productive jobs. Nonetheless, such jobs shall be mainly in the lower ranges of skills and pay, and toward this end the number of reservoir jobs under such new programs shall, to the extent practicable, be maximized in relationship to the appropriations provided for such jobs. The projects under this subsection relating to such new programs shall be phased in by the President as necessary, in conjunction with the employment goals under sections 3 (a) (2) and 4 (b) of the Employment Act of 1946.

(d) The Secretary, in carrying out the provisions of this section, shall establish such regulations as he or she deems necessary. Such regulations shall include provisions for—

(1) an initial determination of the job seekers' ability to be employed at certain types and duration of work, so that he or she may be appropriately referred to jobs, training, counseling, and other supportive services;

(2) compliance with the nondiscrimination provisions of this Act in accordance with section 401;

(3) appropriate eligibility criteria to determine the order of priority of access of any person to any new program under subsection (c) requiring authorization by the Congress, including but not necessarily limited to such criteria as household income, duration of unemployment (not less than five weeks), and the number of people economically dependent upon such person; and denial of access to any person refusing to accept or hold a job other than a job under subsection (c) except for good cause as determined by the Secretary of Labor, including refusal to accept or hold a job subject to reference under subsection (b) paragraph (2), in order to seek a reservoir project job under subsection (c); and

(4) such administrative appeal procedures as may be appropriate to review the initial determination of the abilities of persons willing, able, and seeking to work under clause (1) of this subsection and the employment need and eligibility under clause (3) of this subsection.

CAPITAL FORMATION—PRIVATE AND PUBLIC

SEC. 207. (a) The Congress finds that—

(1) promotion of full employment and balanced growth is in itself a principal avenue to high and sustained rates of capital formation;

(2) high rates of capital formation are necessary to ensure adequate rates of capacity expansion and productivity growth;

(3) an important goal of national policy shall be to remove obstacles to the free flow of resources into new investment; and

(4) while private business firms are, and should continue to be, the major source of investment, the investment activities of the Federal, State, and local governments play an important role in affecting the level of output, employment, and productivity and in achieving other national purposes.

(b) The Economic Report shall, as appropriate, review and assess existing Federal Government programs and policies which affect business investment decisions, including, but not necessarily limited to, the relevant aspects of the tax code, federal regulatory policy, international trade policy, and federal support for research, development, and diffusion of new technologies. In addition, the Economic

Report shall assess the effect of the overall economic policy environment and the rate of inflation on business investment. The President shall recommend, as appropriate, new programs or modifications to improve existing programs concerned with private capital formation.

(c) The Economic Report shall review and assess, to the degree appropriate, federal policies and programs which directly, or through grants-in-aid to State and local governments, or indirectly through other means, affect the adequacy, composition and effectiveness of public investments, as a means of achieving the goals of this Act. The President shall recommend, as appropriate, new programs and policies or modifications to improve existing Federal programs affecting public investment.

TITLE III—POLICIES AND PROCEDURES FOR CONGRESSIONAL REVIEW

STATEMENT OF PURPOSE

SEC. 301. (a) The purposes of this title are to establish procedures for congressional review and action with respect to the Economic Report, the report of the Board of Governors of the Federal Reserve System, and the other policies and provisions of this Act and the Employment Act of 1946.

(b) To provide for comprehensive national policies to meet the objectives of this Act and the Employment Act of 1946, and to provide the Congress with guidance on these matters, the appropriate committees of the Congress shall review and revise, to the extent deemed desirable, the economic goals, priorities, policies, and programs proposed under such Acts by the President and the Board of Governors of the Federal Reserve System. Furthermore, the Congress shall consider the implications of the short-term goals and related policies for the Concurrent Resolutions required under the Congressional Budget Act of 1974. The Congress shall initiate or develop such legislation as it deems necessary to implement these proposals and objectives, after such modification in such proposals as it deems desirable. Nothing in this Act shall be construed to prevent the Congress or any of its committees from considering or initiating at any time action to implement this Act.

REVIEW OF ECONOMIC REPORT BY JOINT ECONOMIC COMMITTEE

SEC. 302. (a) In conjunction with its review of the Economic Report, and the holding of hearings on the Economic Report as required under the Employment Act of 1946, the Joint Economic Committee shall review and analyze the policies and programs recommended by the President and the short-term and medium-term goals for employment, production and purchasing power under sections 3 (a) (2) and section 4 (b) of the Employment Act of 1946.

(b) The Joint Economic Committee shall hold hearings on the Economic Report for the purpose of receiving testimony from Members of the Congress, appropriate representatives of Federal departments and agencies, such representatives of the general public and interested groups, and such others as the joint committee deems advisable. The joint committee shall also consider the comments and views on the Economic Report which are received from State and local officials.

(c) Within thirty days after receipt by the Congress of the Economic Report, each standing committee of the Senate and the House of Representatives and each joint committee of the Congress shall submit to the Joint Economic Committee a report containing its views and recommendations with respect to aspects of the Economic Report which relate to their respective jurisdictions.

(d) Not later than ninety days after the submission of the Economic Report to the Congress, the members of the Joint Economic Committee who are Members of the House of Representatives shall report to the House, and the members of the joint committee who are Members of the Senate shall report to the Senate, a concurrent resolution which shall state in substance that the Congress approves or disapproves in whole or in part the programs, policies, and goals in the Economic Report, and which may contain such alternatives to, modifications of, or additions to the Economic Report as the joint committee deems appropriate and in accord with the purposes of this Act and the Employment Act of 1946. The report accompanying such concurrent resolution shall include findings and recommendations of the joint committee with respect to each of the main recommendations contained in the Economic Report.

(e) (1) When a concurrent resolution referred to in subsection (d) has been reported to the House of Representatives it shall at any time thereafter be in order (even though a previous motion to the same effect has been disagreed to) to move to proceed to the consideration of the concurrent resolution. The motion shall be highly privileged and not debatable. An amendment to the motion shall not be in order, nor shall it be in order to move to reconsider the vote by which the motion is agreed to or disagreed to.

(2) General debate on any such concurrent resolution in the House of Representatives shall be in the Committee of the Whole House on the State of the Union, and shall be limited to not more than ten hours, which shall be divided equally between those favoring and those opposing the concurrent resolution. A motion further to limit debate shall not be debatable.

(3) Except to the extent specifically provided in the preceding provisions of this subsection, consideration in the

House of Representatives of any such concurrent resolution and amendments thereto (or any conference report thereon) shall be governed by the Rules of the House of Representatives applicable to other bills and resolutions, amendments, and conference reports in similar circumstance.

(f) (1) Debate in the Senate on a concurrent resolution referred to in subsection (d), and all amendments thereto and debatable motions and appeals in connection therewith, shall be limited to not more than ten hours. The time shall be equally divided between, and controlled by, the majority leader and the minority leader or their designees.

(2) Debate in the Senate on any amendment to any such concurrent resolution shall be limited to two hours, to be equally divided between, and controlled by, the mover and the manager of the concurrent resolution. Debate on any amendment to an amendment, and debate on any debatable motion or appeal shall be limited to one hour, to be equally divided between, and controlled by, the mover and the manager of the concurrent resolution, except that in the event the manager of the concurrent resolution is in favor of any such amendment, motion, or appeal, the time in opposition thereto shall be controlled by the minority leader or his designee. No amendment that is not germane to the provisions of the concurrent resolution shall be received. Such leaders, or either of them, may, from the time under their

control on the passage of the concurrent resolution, allot additional time to any Senator during the consideration of any amendment, debatable motion, or appeal.

(3) A motion in the Senate to further limit debate is not debatable. A motion to recommit (except a motion to recommit with instructions to report back within a specified number of days, not to exceed three, not counting any day on which the Senate is not in session) is not in order. Debate on any such motion to recommit shall be limited to one hour, to be equally divided between, and controlled by, the mover and the manager of the concurrent resolution.

(4) The conference report on any such concurrent resolution shall be in order in the Senate at any time after the third day (excluding Saturdays, Sundays, and legal holidays) following the day on which such a conference report is reported and is available to Members of the Senate. A motion to proceed to the consideration of the conference report may be made even though a previous motion to the same effect has been disagreed to.

(5) During the consideration in the Senate of the conference report on any such concurrent resolution, debate shall be limited to two hours, to be equally divided between, and controlled by, the majority leader and minority leader or their designees. Debate on any debatable motion or appeal related to the conference report shall be limited to thirty

minutes, to be equally divided between, and controlled by, the mover and the manager of the conference report.

(6) Should the conference report be defeated in the Senate, debate on any request for a new conference and the appointment of conferees shall be limited to one hour to be equally divided between, and controlled by, the manager of the conference report and the minority leader or his designee, and should any motion be made to instruct the conferees before the conferees are named, debate on such motion shall be limited to thirty minutes, to be equally divided between, and controlled by, the mover and the manager of the conference report. Debate on any amendment to any such instructions shall be limited to twenty minutes, to be equally divided between, and controlled by, the mover and the manager of the conference report. In all cases when the manager of the conference report is in favor of any motion, appeal, or amendment, the time in opposition shall be under the control of the minority leader or his designee.

(7) In any case in which there are amendments in disagreement, time on each amendment in the Senate shall be limited to thirty minutes, to be equally divided between, and controlled by, the manager of the conference report and the minority leader or his designee. No amendment that is not germane to the provisions of such amendments shall be received.

(g) Upon adoption of a concurrent resolution under this section with respect to any Economic Report, the concurrent resolution shall serve as a long-term guide to the Congress with respect to legislation relevant to the goals, priorities,. policies, and programs recommended in such report, as modified by the concurrent resolution. A copy of the concurrent resolution shall be transmitted to the President by the Clerk of the House of Representatives or the Secretary of the Senate, as appropriate, for such actions as the President deems appropriate.

EXERCISE OF RULEMAKING POWERS

SEC. 303. (a) The provisions of this title are enacted by the Congress—

(1) as an exercise of the rulemaking power of the House of Representatives and the Senate, respectively, and as such they shall be considered as part of the rules of each House, respectively, or of that House to which they specifically apply, and such rules shall supersede other rules only to the extent that they are inconsistent therewith; and

(2) with full recognition of the constitutional right of either House to change such rules (so far as relating to such House), at any time, in the same manner and to the same extent as in the case of any other rule of such House.

REVIEW OF ECONOMIC REPORT BY COMMITTEES ON THE BUDGET OF BOTH HOUSES

SEC. 304. (a) Section 301 (a) of the Congressional Budget Act of 1974 is amended—

(1) by striking out "and" at the end of clause (5);

(2) by redesignating clause 6 and clause 7, and

(3) by inserting after clause (5) the following new clause:

"(6) the policies, programs, and goals set forth in the Economic Report of the President, and".

(b) The second sentence of section 301 (c) of the Congressional Budget Act of 1974 is amended to read as follows: "The Joint Economic Committee shall submit to the Committees on the Budget of both Houses its recommendations as to the policies and programs and the short-term and medium-term goals set forth in the Economic Report. These recommendations shall be incorporated by the Committee on the Budget of each House in the first concurrent resolution on the budget referred to in subsection (a) reported by that committee, with modifications if necessary to fulfill the objectives of the Full Employment and Balanced Growth Act of 1977. In the event that the Committee on the Budget of either House modifies the recommendations of the Joint Economic Committee, that Budget Committee shall provide its reasons for such modification in the report accompanying the first concurrent resolution.

TITLE IV—GENERAL PROVISIONS

NONDISCRIMINATION

SEC. 401. (a) No person in the United States shall on the ground of sex, age, race, color, religion, or national origin be excluded from participation in, be denied the benefits of, or be subjected to discrimination under any program or activity funded in whole or in part with funds made available under this Act, including membership in any structure created by this Act.

(b) Whenever the Secretary of Labor determines that a recipient of funds under this Act has failed to comply with subsection (a), or an applicable regulation, he or she shall notify the recipient of the noncompliance and shall request such recipient to secure compliance. If within a reasonable period of time, not to exceed sixty days, the recipient fails or refuses to secure compliance, the Secretary of Labor is authorized (1) to refer the matter to the Attorney General with a recommendation that an appropriate civil action be instituted, (2) to exercise the powers and functions provided by title VI of the Civil Rights Act of 1964 (42 U.S.C. 2000d), or (3) to take such other action as may be provided by law.

(c) When a matter is referred to the Attorney General pursuant to subsection (b), or whenever he or she has reason to believe that a recipient is engaged in a pattern or practice in violation of the provisions of this section, the Attorney General may bring a civil action in the appropriate United States district court for any and all appropriate relief.

(d) To assist and evaluate the enforcement of this section, and the broader equal employment opportunity policies of this Act, the Secretary of Labor shall include, in the annual Employment and Training Report of the President, a detailed analysis of the extent to which the enforcement of this section achieves affirmative action in both the quantity and quality of jobs, and for employment opportunities generally.

LABOR STANDARDS

SEC. 402. Any new programs provided for and implemented by this Act, and funded in whole or in part through this Act, shall provide that persons employed pursuant to such policies and programs are paid equal wages for equal work, and that such policies and programs create a net increase in employment through work that would not otherwise be done or are essential to fulfill national priority purposes. The President shall insure that any person employed in any such reservoir project undertaken under section 206 (c) as require new authorization by the Congress, or in any other job utilizing funds provided in whole or in part under this Act, shall be paid not less than the pay received by others performing the same type of work for the same employer, and in no case less than the minimum wage under the Fair Labor Standards Act of 1938 as amended. No person employed under section 206(c) shall perform work of the type to which the Bacon-Davis Act, as amended (40 U.S.C. 276a–276a–5) applies. Any recommendation by the President for legislation to implement any program under this Act, requiring the use of funds under this Act, and submitted pursuant to the requirements of this Act, shall contain appropriate wage provisions based upon existing wage standard legislation.

AUTHORIZATIONS

SEC. 403. There is authorized to be appropriated such sums as may be needed to carry out the provisions of this Act. Notwithstanding any other provisions of this Act, no provision shall be construed to require expenditures in excess of amounts appropriated pursuant to this Act.

American Paper Institute, Inc.
260 Madison Avenue, New York, N Y 10016/(212) 340 0600
cable address AMPAPINST New York

1978 MAR 14 AM 8 53

March 8, 1978

The Honorable William Proxmire
Chairman
Committee on Banking, Housing and
Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Chairman Proxmire:

On behalf of the American Paper Institute, the national trade association representing the pulp, paper and paperboard industry, I am pleased to have this opportunity to submit our statement on S.50, the Full Employment and Balanced Growth Act of 1978. Our 200 member firms provide over 90% of all the pulp and paper manufactured in this country. Our industry employs nearly 700,000 people in virtually every state in the union. In 1976 we paid about $9.5 billion in salaries and wages and $1.4 billion in income taxes.

Our detailed statement for the record is attached. The following is a summary of that statement.

Summary

An economic system ought to provide job opportunities for all who wish to work. That is why the Humphrey-Hawkins bill has such a nice sounding ring to it. It promises full employment in precise statistical measures; it is concerned with price stability and worries about urban problems as well as those of the chronically unemployed. So why should anyone even question such a worthy piece of legislation?

Looking at the practical aspects of this legislation, however, one finds it simply cannot deliver what it promises.

1. It sets an unrealistic target of 3% unemployed for adults (individuals over 20) and 4% for the total population to be achieved within a five year period. The problem with the target is that the low figures ignore the realities of the composition of the present labor force. The current large inflow of work seekers is in part the echo of the early Post World War II baby boom, and in part results from the larger participation of women and minorities in the labor force. Despite the bulge in the size of the labor force last year, the economic recovery reduced unemployment by 1.1 million people. About 4.1 million more people were employed at the end of 1977 than at the beginning of that year.

   With the larger participation of women and minorities in the labor force expected to continue, it is more difficult to project changes in the labor force than before. So how can one plan for a specific number when that number cannot be predicted with a reasonable accuracy? More significantly, the discretionary aspects of the present mix of unemployed people makes an evaluation of appropriate policies difficult. Do women want to work full-time or part-time? What jobs would they like to have and at what pay?

   While a system should provide opportunities for all who wish to work, it cannot guarantee a job for all who wish to work under his or her own conditions.

   A numerical target must take account of these nuances in the quality of unemployment if it is to be realistic. Such minute adjustments are not possible.

2. The existence of an unrealistic target will be frustrating. The target creates an expectation of fulfillment, an expectation that cannot be met with the economic tools now available. It will focus attention on a statistic rather than performance. Furthermore, as it becomes apparent that the numerical goal is not being reached, more government action will be called for. Harmful trade-offs can result as the Administration and Congress seek quick ways to meet the targets.

3. It creates distortions in wage rates, with the government determining the wage rates as well as the job opportunities for millions of people who cannot find the jobs they want in the private sector.

4. It will prove to be inflationary. The government will be forced to make decisions that involve a trade-off of inflation for what it considers equity.

The solution to the problems raised in the Humphrey-Hawkins bill is basically a two-fold one:

1. More investment in job creation is needed and this requires a better investment climate. Taxes are burdensome and should be reduced to encourage private spending and investment. If companies were convinced that their businesses would expand in the year ahead - and reduced taxes will help assure them of such growth - aggressive manpower recruitment and training programs would be undertaken.

   Regulations should be made compatible with growth. Many of our important government regulations are tuned in to the philosophy of sharing scarcity and taxing output. Why should industry plan for growth or more jobs in this climate?

2. A better focus on some of the structural problems in unemployment is urgently needed. Overall teenage unemployment, now a major part of total unemployment, will probably ease after 1981 when the number of teenagers grows more slowly. In the meantime, the steady increase in the labor cost of teenagers built-in by the rising minimum wage and advancing payroll taxes, acts as a deterrent to aggressive hiring of youths. The proposed programs of job credits and wage subsidies are expensive and can lead to abuse. Waiving the minimum wage for teenagers and substituting more liberalized tax treatment for their earnings may be a way to encourage more employment of teenagers.

In short, the passage of this bill will clearly reveal that the tools for meeting the full employment target do not exist; that forcing the economy to overperform will result in actions that would retard the higher confidence so badly needed in the private sector to achieve growth, job opportunities and a better standard of living in the U.S. Why fool the American public?

We thank you for this opportunity to submit our views.

Sincerely,

Norma Pace dke

Norma Pace
Senior Vice President
and Chief Economist

cda

Attachment

cc: The Honorable Gaylord Nelson
Chairman, Subcommittee on Employment, Poverty and Migratory Labor
United States Senate

The Honorable Harrison A. Williams
Chairman, Committee on Human Resources
United States Senate

Members of the Committee on Human Resources
United States Senate

Members of the Committee on Banking, Housing, and Urban Affairs
United States Senate

American Paper Institute, Inc.
1619 Massachusetts Avenue, N.W., Washington, D.C. 20036
(202)332-1050

STATEMENT OF THE AMERICAN PAPER INSTITUTE ON S. 50, MARCH 8, 1978

Senator Humphrey's public service was dedicated to helping the poor, the unemployed and the disadvantaged. This bill which bears his name will not only accomplish little; it may move the country further away from its objective of full employment.

Our concern with this bill reflects several real deficiencies in it:

1. IT IS UNREALISTIC.

It is a statement of full employment goals but its recommendations are diffused and in many ways conflicting. It is a mixture of concern with cyclical and structural unemployment and is imprecise in both areas. It assumes that conflicts can be resolved by the government in a manner that will result in noninflationary full employment growth. But the realities of the political processes are such that the economic decisions made by government are not always based upon efficiency. Trade-offs are often needed in the pursuit of what is considered equity. For example, the bill calls for a monitoring system on inflation. But what can be done about the one-half percent a year inflation resulting from higher payroll taxes? What about the impact on inflation of an increase in energy costs resulting from legislation? Income taxes could be cut but what about government spending and deficits? The trade-offs go on and on.

The bill requires that the budget be supportive of the goals and purposes of the act but what about other considerations such as the impact of deficits on the value of the dollar? The budget process itself leaves much to be desired. Federal spending has fallen short of estimates for two years running. Congressional budget procedures have been tightened considerably since the Budget Control Act but budget busting by the Congress persits. There is no such thing as fiscal policy under these conditions.

2. IT ENDANGERS THE INDEPENDENCE OF THE FEDERAL RESERVE SYSTEM.

Under this bill the Federal Reserve is to report to the Congress on its goals and monetary targets for the year ahead, a process that has been going on for years. But implicit in this bill is the conviction that the Federal Reserve can control the money supply and in that way contribute to full employment. The recent volatility in money supply figures shows how difficult achieving stated monetary goals can be in a large complex monetary system such as ours which is becoming more interrelated with foreign economies.

Furthermore as Chairman Burns has repeatedly testified in Congressional hearings, the rate of use of money is as important as the quantity of money. Synchronizing monetary policy with fiscal policy, a major aim of this bill, may not bring the economy one step closer to full employment. If the confidence of individuals and business is not good, then money supply increases can be offset by a reduced rate of use of money and the economy will surely not grow.

Recent developments in the U.S. economy have clearly shown that the theories on growth which seemed to work in the 1950's and 1960's are not working today. With this experience at hand why should we jeopardize the independence of the Federal Reserve system and risk a worldwide loss of confidence in the U.S. and its currency?

3. IT GENERATES THE DANGER OF UNFULFILLED EXPECTATIONS.

To set a numerical target is to create an expectation of fulfillment, an expectation that cannot be met with the economic tools at hand. No model predicted the 1974-75 recession within a reasonable degree of accuracy, or for that matter the 1973 boom which brought unemployment down to 4.9% that year. The net result of these statistical objectives will be a diversion of policymakers' attention to the nation's statistical performance rather than to the solution of our real and basic problem and that is structural unemployment. Furthermore, as it becomes apparent that these numerical goals are not being reached, more government action will be called for to satisfy the level of expectations on the unemployment rate. Harmful trade-offs can result as the Administration and Congress seek quick ways to meet the targets.

There is nothing wrong with the nation establishing a goal of providing employment for all who wish to work but there can be a lot wrong with a statistical goal that can be based upon imprecise measurements of the source of unemployment and its contribution to economic distress and poverty.

4. IT CREATES DISTORTIONS IN WAGE RATES.

This bill can result in a debilitating rigidity in wage rates, a process that will surely increase unemployment rather than reduce it. Labor costs account for close to 70% of the cost of producing final goods and services in the U.S. If these costs get out of line with productivity, then inflation will result. Job creation must be matched by productivity; this is the reason economists favor private investment incentives for creating jobs. Such investments always provide the promise of more productivity.

5. <u>IT IS INFLATIONARY.</u>

This bill which aims at promoting price stability will in fact lead to more inflation. It is a sad truism that an advantage for one sector can generally only be accomplished at the cost to another. Farm price increases improve the income of farmers but have a significant impact on the cost of living and inflation. Fortunately the market mechanism is an objective, although at times painful, way to correct severe imbalances when they occur. In 1977 the steep advances in coffee prices curtailed consumption; the reduced demand coupled with higher supply turned prices downward again. How can the government perform this function efficiently? It can ameliorate in times of distress; it can help with any adjustment required by the market but it cannot and should not make the market decisions. Given the pressures on public policymakers, their market decisions result in an inevitable trade-off of inflation for what they consider equity.

If government attention to all the details of the economy were necessary to attain a climate where the individual gets the advantage of a rising standard of living and job opportunities, an elaborate government involvement might be warranted and acceptable. But such involvement is not only unnecessary, it is counterproductive.

UNEMPLOYMENT RATES REMAIN HIGH AMONG NON-WHITES

In 1977 the U.S. economy found job opportunities for 4.1 million more people according to data of the Bureau of Labor Statistics, a new record. Although the growth in the labor force was unusually large; namely 3 million last year, the number unemployed dropped by 1.1 million.

This is good performance by any standard but it still leaves the problem of 5.9 million unemployed as we entered 1978. Furthermore, the labor force will grow by another 2.5 maybe even 3 million this year so that the pace of advance in employment must be brisk if the country is to make progress toward reducing unemployment even more in 1978.

Measures of unemployment are never quite adequate in the story they tell on the economic and sociological impact of unemployment. We can, however, obtain some measure of the pressures and the solutions to the problem by noting the following figures of unemployment.

UNEMPLOYMENT AT YEAR-END
(millions of people)

	1976	1977
White Males, 20 years and over	2.6	2.0
White Females, 20 years and over	2.1	1.9
White Teenagers	1.4	1.0
Total White	6.0	4.9
Black Males, 20 and over	.6	.5
Black Females, 20 and over	.5	.5
Black Teenagers	.3	.4
Total Black & Other Minorities	1.5	1.5

Source: Bureau of Labor Statistics, Seasonally adjusted data.

While there has been significant improvement in the unemployment status of white participants in the labor force, the same is not true for minorities. The country cannot remain indifferent to the persistence of unemployment among minorities. But this is not the time for a restatement of goals; it is a time for action on five fronts.

1. ENCOURAGE MORE AGGRESSIVE GROWTH.

   Taxes must be cut to permit more spending and investment in job creating ventures. Growth is the answer to more employment and growth has been stalled by burdensome taxes on both individuals and business. Urgent and immediate attention must be given to tax cuts that will stimulate production and jobs. The President's program is a start in the direction but more can be done. Private industry will respond quickly with training programs when its order books increase and pressure the available manpower. Unemployment among blue collar workers was reduced by 700,000 during 1977: the reserve of skilled workers is shrinking. If companies were convinced that their businesses would expand in 1978 and beyond - and reduced taxes will help assure them of such growth - then aggressive manpower recruitment and training programs would follow. Business does not need government to underwrite the risks, but it does need assurance that government will not continue to penalize growth through excessive taxation and other restrictions to growth, such as burdensome and costly regulations.

2. IMPROVE THE REGULATORY CLIMATE.

   The regulatory climate in this country often works against the goals of full employment. This is in contrast with many other industrial countries where regulations are made compatible with growth and full employment. Excessive regulations reduce confidence and slow down investment. The paper industry is a good example of the restraining effect of excessive environmental, energy and safety regulations on the industry's expansion. Our annual capacity survey shows average growth in paper and paperboard capacity of 2.4% a year between now and 1980, a rate that is almost 1% lower than a reasonable long range growth target. The reasons for the lag in investment are many but a burdensome regulatory climate contributes significantly. The industry is a heavy user of energy and the President's energy program adds dollars to our costs and uncertainty over new supply. An industry such as ours that is threatened with a tax on its output in the mistaken belief that such a tax would solve the solid waste problem of cities is in no mood to expand aggressively. With important government programs tuned in to the philosophy of scarcity and taxing output, why should this industry - or any other - plan for growth and more jobs?

A balanced approach to regulations when needed is a way to achieve growth without any cost to the taxpayer and the consumer.

3. REDUCE PAYROLL COSTS FOR TEENAGERS.

Teenage unemployment will best be helped if labor costs, including payroll taxes do not become burdensome. Increases in the minimum wage and social security taxes act as a disincentive for employment in these age groups. A teenager working a 40 hour week costs his employer $113 a week this year, including social security but excluding other fringes; by 1980 that cost will rise to $132. The President has requested some tax cuts to offset higher payroll taxes but the amounts suggested are simply not enough. Job tax credits and wage subsidies have also been proposed but these can be expensive to administer and can lead to abuse. One solution is to waive the minimum wage requirement for teenagers and substitute more liberalized tax treatment for their earnings. This would focus tax relief on a major trouble spot in unemployment.

4. ENCOURAGE TRAINING PROGRAMS WITH A GOVERNMENT-BUSINESS PARTNERSHIP.

Lack of skills and initiative among the uneducated and poor often contribute to prolonged unemployment and eventually permanent discouragement. Programs are needed to help this segment of the population and a partnership of government and business involvement and commitment can accomplish a great deal. Recent experience with job programs for black teenagers in ghetto areas is encouraging. We can build on this desire to work but we must do it with meaningful programs that create permanent jobs.

The Committee for Economic Development in a recent report indicates limited but encouraging success with combined efforts of business and government, both federal and local, to reduce unemployment by creating permanent jobs. This should be the focus of government action. Business recognizes that persistent unemployment and "turned-off" individuals, particularly the teenagers and minorities who cannot find employment, create major social and political problems for the nation. If businessmen could spend less time on regulations (which now range from 35-50%) they would have more time for constructive solutions to these basic problems.

5. BETTER MANAGEMENT OF THE CHRONIC POVERTY IN THE U.S.

There are segments of the working age population which simply cannot be helped within a specified time frame. We do not know what proportion of the unemployed individuals are in this category. As a matter of fact many of these people are probably not even counted in the unemployment figures. Yet they need help. Sociologists believe that the time span for getting many of these people into meaningful and desirable jobs may be very long. Enlightened and efficient welfare programs are needed to help this group until a combination of better iducation, better attitudes, mobility and all the other influcences can come together to move them into the working force. HEW is the agency that must deal with this problem in a responsible way.

In summary this bill has three functional aspects:

1. To determine when the system is not up to its potential;
2. To determine why;
3. To set out on a correction course.

The first challenge of determining when the system is not up to its potential is well met by our present network of economic intelligence and statistics. There are perils in quantification and data always have limitations but this country has plenty of good statistics on its performance. So lack of knowledge on performance has not been a limitation.

The real short-fall is in the second objective; namely why the economy is off course. While answering this question provides the opportunity for a wide diversity of opinion and conflicting evidence, the solutions generally accepted by government have tended to involve more government in the process than was needed. No one really believes that the free market system is perfect; it is efficient but it is also imperfect: yet these imperfections have not been corrected by government policies, instead they have been magnified. Fiscal policy has given us $300 billion of deficits over the period 1970-1977 and we have had unemployment in excess of 4.0% all during that period. Traditional monetary policy has given us recessions alternating with sprees of monetary creation that financed inflation which averaged 6.6% during that same period.

The third objective; namely mapping out a correction course, will not be met with this bill. The tendency will be to continue to use fiscal and monetary policies in the standard way with the same disappointing results.

Consumers can generally be counted on to spend a fairly steady proportion of their income. They are rarely a problem.

It is in the area of business spending and investment that unstable conditions develop with the economy experiencing bouts of heavy investment alternating with underspending for inventories, plant and equipment. The net result is that the long-term potentials are never met. Business confidence fluctuates in a wide band with significant highs and lows; this affects the pattern of business spending which in turn affects jobs, income and consumer spending. Business spending must be stabilized, yet the thrust of government actions since the mid-1960's has had the opposite effect as described earlier. Although this bill tries to provide assurances by placing a high priority on private capital formation as the best means to create jobs, it also lists a series of government programs that will prove not only expensive but as ineffective as they have historically been in dealing with the problem. It continues to put government in competition with the private sector on how incomes of individuals and business will be spent. Who will decide on which sector should take the lead? To put that solution in the hands of government is akin to letting a dope fiend loose in a doctor's office.

Until the role of government policy in creating jobs is properly made secondary to the more powerful role of the private sector in generating growth through the millions of spending decisions it makes, then a Humphrey-Hawkins bill remains a threat to long-term investment. But having said that the private spending can do the most efficient job in generating a full employment economy, we must still recognize two fundamental weakenesses in that position.

1. Individuals and businesses with money do not feel and pressure to spend it at a constant rate. If for any reason they feel threatened, they will reduce their spending rates and this will contribute to unemployment. Some way must be found to entice money into investment when such spending lags. The government should not conveniently accommodate this non-spending mood of the private sector by running big deficits so that individuals can "invest in governments" rather than in productive facilities. Adequate returns on investment will go a long way toward meeting the need.

2. The availability and efficient allocation of the nation's resources is becoming a more vital concern for the nation's future growth. Some one has to orchestrate the relative supply of different raw materials and there is merit in having one agency reporting to the Congress that combines the monitoring activities now performed by many disparate groups already existing in federal government. Thus an efficient organization of existing monitoring groups would go a long way toward meeting many goals of this bill.

In short, passage of this bill will show that in time its goals will have to be implemented with actions and there is little to indicate that such actions would be conducive to the higher confidence so badly needed in the private sector to achieve the employment goals of this bill.

STATEMENT OF

THE ASSOCIATED BUILDERS AND CONTRACTORS, INC.

The Associated Builders and Contractors, Inc. (ABC) is pleased to have an opportunity to submit comments on S 50, the Full Employment and Balanced Growth Act of 1978.

Our organization is a federation of 12,000 member firms engaged in the construction industry throughout the country. We follow with interest and make our position known on all legislation which could have a potential impact upon the construction industry.

As employers, we are aware of the unemployment problem facing the nation and are sympathatic with the intent of the legislation. However, we are gravely concerned that, if enacted, this proposal would touch off a new wave of inflation and further weaken the economic stability of the country.

Further, it is a dangerous precedent to determine the allocation of resources by the political process rather than in the market place. What is needed is a reduction in government expenditures and the stimulation of private industry to create lasting jobs.

One need only to examine the record of a number of other countries who have adopted government programs to curb unemployment to learn the futility of such approaches. The tragic case of Great Britian is a classic example of the failure of government to solve employment problems. The British have utilized the kind of schemes outlined in S.50 for years and the results are there for all to see. Soaring public debt, confiscatory tax rates and an annual inflation rate of 25 percent. Their once proud industrial complex has become depressed and unproductive.

Only massive infusions of government funds and the nationlization of key industries have kept many of their businesses even marginally viable. We certainly would be wise to learn from their experiences before we embark on a similar course which can only lead to the same disastrous results.

We are in agreement with the bill's objectives which would "foster and promote free enterprise; promote maximum employment, production and purchasing power; promote price stability, and encourage high rates of capital formation." However, we do not agree with the ways the bill proposes to achieve these objectives.

For the purposes of this statement, we will confine our arguments to the issue with which we are most familiar, that of the requirement of payment of Davis-Bacon wages on any job which uses funds provided for by the legislation.

While the prime objective of the bill is to put people to work, the inclusion of Davis-Bacon Act provisions governing construction will actually be self-defeating since it will result in fewer dollars being available to hire workers.

The Department of Labor, which is in charge of determining so-called prevailing wage rates under the Davis-Bacon Act by means of regulatory formulas, that many decry as inequitable, almost inevitably come up with the union rates as prevailing. In literally thousands of counties in the nation such rates are <u>not</u> prevailing. As a result any work done for the Federal Government, assisted or insured by the Government, therein is done at an inflated cost. The inflation naturally results in less money being available to hire the disadvantaged and the unemployed.

The recent stymie of the so-called "soft" public works program is a perfect example of how this mechanism works. In that case, it was proposed that certain portions of public works be made available for hiring the long-term unemployed and disadvantaged persons. There was a supposed agreement with leaders of the building trades unions that a bargain had been struck. However, when the real purpose of the bill draftsmen, contrary to the special interests of the building trades unions, became clear to the union leaders, the proposal came to a sudden halt!

Davis-Bacon rates, in the opinion of many economists, are definitely inflationary, for they affect not only federal, state and local construction jobs, but the impact of artificially increased wage rates pushes out to other sections of the construction industry. Wage increases pressures in the long run defeat not only the purposes of the current legislation but they increase private costs as well. Such increases are dampening if not fatal with respect to motivating industry and commerce to create new productive facilities the very area in which new productive, long-term useful jobs are made.

The interference in the market wage structure is damaging also to the competitive market, since many contractors are reluctant to undertake meeting Davis-Bacon requirements as detrimental to their own operations. Once wage rates are increased, it is extremely difficult to revise them downward.

Moreover, the Davis-Bacon Act requires not only the Secretary of Labor to set wages and fringe benefits. Under the theory of prevailing wages, the Secretary has seen fit also to extend his legislative mandate and determine work practices as well.

Standard construction trade classifications generally recognized by the Department of Labor tend to be traditional union classifications. Where these classifications are used, union work practices are also required even if only a minority of construction workers in a local area work under bargaining agreements.

Under this, a situation can arise where an employer normally uses a laborer to install a prefabricated piece of material, a very simple job. However, if under the local bargaining agreement carpenters have jurisdiction over this type of task, the employer must pay the laborer the prevailing wage for carpenters. This not only disrupts company payment practices, and stifles productivity, but, even more, there is no authority granted in the Act for imposing such requirements.

We can cite many examples where our members encountered serious Davis-Bacon problems in the last year, particularly in the area of construction definitions.

Another factor which must be considered in this legislation is its inflationary impact. It has been predicted that the bill could commit the Nation to six percent inflation or even worse. It is difficult, if not impossible for people to protect themselves against this kind of increase. Only a few of our citizens are protected by cost-of-living escalators. Stocks, bonds, saving deposits and life insurance policies normally do not yield interest rates high enough to offset this inflationary spiral. Inflation is actually a hidden tax that is particularly burdensome on persons living on fixed incomes. The inevitable results are higher interest rates, a reduction of investments in job-creating verntures and even higher levels of unemployment. In the public interest we should not allow this to happen.

In summary, while we are in concurrance with the laudable objectives of this legislation, we are compelled to conclude that it simply cannot be accomplished by legislation of this type. Accordingly, for the reasons cited, we believe, the Davis-Bacon provision of S.50 should not be included in the bill.

It would be a mistake to embrace an approach which has repeatedly failed in other countries, instead, let us put all able and willing Americans to work through our time tested and proven free enterprise system. This can be accomplished by creating a favorable economic climate where the competition in the market place will result in full employment at fair rates of compensation and give the consumer and taxpayer fair value for dollars expended.

We urge this Committee to oppose S.50 in its present form and take a new approach to the unemployment problem.

The Associated Builders and Contractors appreciate this opportunity to submit its views.

MACHINERY and ALLIED PRODUCTS INSTITUTE

1200 EIGHTEENTH STREET, N.W. WASHINGTON, D.C. 20036 202-331-8430

May 17, 1978

The Honorable William Proxmire
Chairman
Senate Committee on Banking, Housing
and Urban Affairs
Washington, D.C. 20510

Dear Chairman Proxmire:

In connection with recent public hearings by your Committee on the proposed "Full Employment and Balanced Growth Act of 1977," we wish to comment on this bill. It is requested that this letter, the full text of the attached memorandum, and the enclosed studies by George Terborgh, MAPI Economic Consultant, be admitted in the public record being compiled by the Committee. The studies are entitled "Inflation and Profits," updated to April 1978; "Corporate Earning Power in the Seventies: A Disaster," August 1977; and "Changing Theories of Fiscal Policy," April 1978.

MAPI's Study of the Proposed Legislation

The Institute, which is the national spokesman for the capital goods and allied products industries of the U.S., has followed the development of "full employment" legislation closely. The enactment of broad economic policies in this field would have obvious and far-reaching implications for the economic system of the U.S. and for our member companies. Although the attached memorandum entitled "Full Employment and the Balanced Growth Act of 1977" was published on February 6, 1978 before the House of Representatives passed H.R. 50, the comments offered in this memorandum are generally still relevant to the legislation before the Senate Committee on Banking, Housing and Urban Affairs. We call attention particularly to the conclusion of the memorandum which is reproduced below:

> Setting goals and targets in planning is, of course, desirable. Imposing inflexible standards is not. To the extent that the revised Humphrey-Hawkins compromise recognizes this, it is encouraging. Establishing the dual importance of price stability and full

employment is also appealing in concept as is the avoidance of wage and price controls. Moreover--and perhaps the most positive element of the new "Humphrey-Hawkins"--there is the recognition of the importance of private capital formation as an essential ingredient to increased employment.

Having said this, the question then becomes: what does Humphrey-Hawkins add? The goal of increased employment--reduced unemployment--was established in the "Employment Act of 1946." Since that time, and in fact much earlier, the government has never knowingly encouraged unemployment as a solution to inflation, or for any other reason. Moreover, certain target rates of acceptable economic activity are known and widely accepted. They are under constant review as conditions change and policy planning focuses on these.

Since this is the case, one could argue that the proposed legislation is merely redundant. Unfortunately this is not true. First, there is the danger that it might be perceived as the solution to a serious problem. It is not. Second, the unemployment goal it sets--4 percent of workers over 16 to be attained in 1983 if the legislation is passed in 1978--is unrealistic. The goal will not be met. The difficulty is that this failure could well precipitate unwise economic policy and programs resulting in increased deficits, inflation, and even more unemployment. The proposed legislation sets no specific price stability goal; inflation and unemployment are not considered to be of equal importance--language in the legislation notwithstanding--thereby really having only one target, which is the unrealistic unemployment goal. Further, if the intent in the process is to reduce central bank independence, an important check on inflation could be lost.

The notion of increased private capital formation is a good one; however, no specific mechanisms or changes are suggested. This, like price stability, comes out of the legislative proposal as so much "lip service."

Finally, to a certain extent the proposed legislation is misleading. Proponents claim it to be a significant and meaningful step forward--an important piece of major policy shaping and problem solving legislation. Others maintain that it is an exercise in rhetoric; nothing is really required; goals can be modified to suit existing conditions; and the Act is for the most part "toothless." One of these assessments may be correct; certainly they both cannot be. Either way, someone is being misled.

However, one thing is clear. Even though the bill has been "toned down," it may be a dangerous launching pad for extremely inflexible economic goals and programs.

<u>The MAPI Position In Brief</u>

The memorandum referred to represents a policy position of the Institute which is in opposition to the enactment of the proposed legislation, even in its modified form.

We do wish, however, to acknowledge that it has been a constructive exercise for the Congress and its cognizant committees, through considering such legislation, to examine some of the most important economic issues confronting this country. We refer particularly to inflation, unemployment and employment, the structural unemployment aspect of the total unemployment issue, capital formation, and reasonable coordination of economic policy making within government. Although we have not had an opportunity to examine the full legislative record, it appears that insufficient attention has been given to corporate profits which are the engine of our economic system and, more particularly, the impact of inflation on profits. With this in mind, we have, as indicated above, enclosed as a part of this communication the MAPI economic studies on profits and inflation.

<u>Issues Deserving Special Emphasis</u>

The Committee record is replete with comprehensive presentations by business and by those who support the proposed legislation. As already indicated, we have studied most, if not all, of this testimony before the Committee on Banking, Housing and Urban Affairs. Having engaged in this review, our position remains unchanged. It seems appropriate, however, even in such a brief communication as this one, to underline a few points which are referred to in the hearings but deserve further emphasis. They are as follows:

1. This country in a general sense is suffering in a number of public policy areas from the results of government "promising too much," raising expectations of the potential beneficiaries of such promises, and then being embarrassed by the failure to keep the promises and adopt cost-effective programs to carry them out. There is more than embarrassment involved under such circumstances because at times government feels obliged to take certain steps, in many cases for political reasons, which will be counterproductive.

2. The announced goal in the bill of a 4 percent unemployment rate by 1983 is not achievable and, in addition, represents the implied or direct promise that aggravates the unemployment problem and the morale of those who are unemployed. Aside from the lack of realism in stating a 4 percent unemployment goal by 1983, there is an implicit inconsistency between such a goal--even if it were achievable--and containment of inflation.

3. Some witnesses have questioned the desirability of using numerical goals for any purpose in the legislation. MAPI is concerned about overdoing so-called federal planning, and the corollary to that concern is that in most cases when federal planning is broadened and made more definitive, government bureaucracy--which is already far too large and costly--becomes almost overwhelming and unmanageable. It is extremely difficult to engage in effective national planning, even though such planning is flexible, under the aegis of a government which has grown to such an enormous size at the federal level alone and even more so when the federal system is considered together with state and local governments.

4. We are concerned about any further limitation of flexibility in the Executive Branch with regard to adopting national policy and goals. In this connection, there seems to be a tendency in the bill to attempt to bring Congress into a position of greater participation in the planning process or oversight of that process. We do not favor this trend. In this connection, we are negative in our view with respect to any increased role of the Joint Economic Committee of the Congress. Generally speaking, we support independence of the Federal Reserve Board, but certainly it would be difficult to argue against some coordination between the Federal Reserve Board and the Executive Branch in connection with economic planning and decision making.

5. As already indicated, as this legislation has been subjected to public hearings of the Congress and to independent study by organizations representing all interests in the country, improvements have been made in the proposed bill. Inflation has been given more prominent recognition. Capital formation as a very high priority has been embraced by the proposal. Unfortunately, this process of recognizing national goals and priorities has been carried to an extreme so that the bill is now burdened, as described by some within the Congress as a "Christmas tree." In our view, some of the provisions which are peripheral and of a lower priority should be deleted if the legislation is to be enacted at all.

6. We have referred above to the need for flexibility in the Executive Branch in connection with economic policy and related decision making. The Administration now states unqualifiedly that the number one economic problem in the United States is inflation. Since the proposed legislation was first introduced and especially in recent months, substantial progress has been made in reducing unemployment and very significant progress has

been made in increasing employment which, of course, can be achieved only through creating new jobs and maintaining jobs already in the system. It is absolutely necessary, as we have suggested previously, for the President to be able to make a shift in economic planning and decision making when changes in the economic picture of a substantial nature occur. Another example of such a fairly short-term shift is the current consideration of what action should be taken in the tax area.

7. Experience over the last decade with certain programs addressed to socioeconomic objectives, including special efforts to deal with unemployment and certain specific aspects of unemployment, have not been cost-effective. There seems to be a consensus on this point. Cost-effectiveness, particularly when this country is carrying an almost unbearable debt and year-to-year deficit, becomes critical. Cost-effectiveness analysis should be prepared and thought through before actions--legislative or executive in nature--are taken. Further, any related program, if it is promulgated, should be studied on a continuous basis from a cost-effectiveness standpoint. Government has failed pitifully in this regard. It follows that reduction in government spending not only has a critical bearing on inflation but also is a condition precedent to bringing government's size down to manageable levels.

Restatement of the MAPI View

Finally, we wish to repeat the last point made in the conclusion in our Memorandum G-98 which is not only attached as a part of this presentation but was transmitted for the record to the Senate Human Resources Committee on March 10, 1978: "Even though the bill has been 'toned down,' it may be a dangerous launching pad for extremely inflexible economic goals and programs."

We appreciate this opportunity to make what we hope is a useful contribution to consideration of the full employment and balanced growth proposals now before the Congress.

Respectfully,

Charles Stewart

President

MAPI MACHINERY & Allied Products INSTITUTE

MEMORANDUM

(202) 331-8430

1200 EIGHTEENTH STREET, N W · WASHINGTON, D C 20036

G-98

February 6, 1978

FULL EMPLOYMENT AND BALANCED GROWTH ACT OF 1977

(The New Administration-Endorsed "Humphrey-Hawkins" Compromise)

Modifications in Latest Version Represent Improvement; However, Bill Not Needed and Could Be Counterproductive

Introduction

The Employment Act of 1946 ". . . 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."/1 Since that time, this overall objective has been pursued with varying degrees of success.

With respect to employment, a generally accepted level of "full employment" has been associated with an unemployment rate of some 4 percent. This target rate remains even though the average annual rate in the postwar period of 1947-1977 has been 5 percent of the civilian labor force 16 years of age and over. Less than one-third of the time has the 4 percent rate been attained--roughly associated with wartime--and not at all since 1969. The rate for the 1970s thus far has averaged well over 6 percent with a 1975 peak of 8.5 percent.

This recent inability to even approximate a target unemployment rate of 4 percent has fostered several pieces of proposed legislation intended to amend--and generally make more specific--the Employment Act of 1946. Of these, the "Full Employment and Balanced Growth Act of 1976" (S. 50, H.R. 50) introduced by Senator Humphrey and Congressman Hawkins has become the most central./2

1/ Public Law 304 (S. 380), Sec. 2.

2/ Others include the "Equal Opportunity and Full Employment Act" (H.R. 15476) in 1974 by Congressman Hawkins and the "Balanced Growth and Economic Planning Act of 1975" (S. 1795, H.R. 7678) by Senator Humphrey and Congressman Harrington.

Various versions of this proposed "full-employment" legislation have received attention in Congress. For example, hearings were held by the Joint Economic Committee in the summer of 1975 under the title: "A Full-Employment Policy: An Examination of Its Implications." Moreover, "Humphrey-Hawkins" was a major part of the Democratic Party platform in 1976.

However, until very recently all this proposed legislation was apparently judged to be unacceptable by the several Administrations in office. This was the case until November of last year when President Carter sent a message to the Congress endorsing a much revised compromise "Humphrey-Hawkins" bill. Senator Humphrey and Congressman Hawkins stated that they were "pleased" with the agreement reached with the President on the compromise version and predicted favorable action by the Congress early in 1978. Hearings on this latest version, the "Full Employment and Balanced Growth Act of 1977", are being held currently in both the House and Senate. Congressman Hawkins plans to have the proposed legislation on the House floor by Easter.

In brief, the bill according to its sponsors now provides:

-- an unqualified affirmation of the right of all Americans to a useful job at a fair wage;

-- a new process for the coordinated and comprehensive development of national economic policy;

-- an interim goal of reducing unemployment to 3 percent among adults and 4 percent for the entire labor force as soon as possible and in any case within 5 years;

-- a commitment to achieve reasonable price stability as rapidly as feasible, and an anti-inflationary program to move the nation toward this goal; and

-- that if the President determines that the private sector and traditional types of public employment are unable to do so, the government will take direct job-creating action to meet the employment goals established as national policy.

After a brief review of the provisions of this latest version of the "Humphrey-Hawkins" bill, this memorandum presents an assessment and some concluding observations.

The "Full Employment and Balanced Growth Act of 1977"

Declaration of Policy

The "Full Employment and Balanced Growth Act of 1977" is designed ". . . to provide an open process under which economic goals and policies are proposed, reviewed, and established; to provide for yearly review of national economic policies to ensure their consistency with these goals to the maximum extent possible; and generally to strengthen and supplement the purposes and policies of the Employment Act of 1946."

Further, the Act:

-- declares that it is the continuing policy and responsibility of the federal government to use all practicable means, consistent with its needs and obligations and other essential national policies, to promote full employment, production, real income, balanced growth, adequate productivity growth, proper attention to national priority needs, and reasonably stable prices;

-- establishes as a national goal the fulfillment of the right of all Americans able, willing, and seeking work to full opportunity for useful paid employment at fair rates of compensation;

-- recognizes that inflation is a major national problem requiring improved government policies;

-- declares that although it is the purpose of the Act to encourage the voluntary cooperation of the private sector in achieving its objectives, no provisions of the Act are to be used, with respect to any portion of the private sector of the economy, to provide for government control of production, employment, allocation of resources, or wages and prices, except to the extent authorized under other legislation; and

-- declares as its purpose to maximize and place primary emphasis upon the expansion of private employment, and all programs and policies under the Act are to be in accord with that purpose. However, only to the extent that Americans age 16 and over and able, willing, and seeking work are not, and in the judgment of the President can not be provided with private job opportunities nor provided with job opportunities under other programs must the President establish reservoirs of public employment and private nonprofit employment projects which the Congress authorizes and provides funds for.

Major Provisions

Unemployment rate targets.--Central to the proposed legislation is the establishment of specific numerical goals in terms of target unemployment rates and a timetable for their achievement. In its latest version, for the calendar year in which legislation takes effect and the following year, the "short-term" interim unemployment rate goals are to be "consistent with achieving as rapidly as feasible the goals of full employment." In the first three years in which the legislation is in effect, the "medium-term" goal shall be to reduce unemployment among the adult civilian labor force (age 20 and over) to not more than 3 percent, and for the entire civilian labor force (age 16 and over) to not more than 4 percent within a period not to extend beyond the fifth calendar year that the legislation is in effect./1 Upon achieving the 3 and 4 percent goals, the goal then becomes one of achieving "full employment" as soon as practicable and maintaining full employment after it has been reached.

In the third year that the legislation is in effect, the President must review the numerical goals and timetables for the reduction of unemployment, report to the Congress on any obstacles to their achievement, and if necessary propose corrective economic measures toward achievement of such goals and timetables. At that time, he may also recommend that the existing goals be modified./2

Price stability.--The new bill views inflation as a serious concern, stating that: "[t]he objective of achieving reasonable price stability as soon as feasible . . . shall be sought by vigorous efforts. . . ." The proposed legislation outlines a seven-point program, including:

-- an effective information system to identify and analyze inflationary trends in individual economic sectors;

-- programs for increasing the supply of goods, services, labor, and capital in tight markets;

-- the establishment of stockpiles of agricultural commodities and critical materials;

-- encouragement to labor and management to increase productivity within the framework of full employment through voluntary arrangements;

-- recommendations to increase competition in the private sector;

1/ An earlier version of the bill called for achieving a 3 percent adult unemployment rate within 18 months after enactment. Later versions, prior to the current one, extended that period to 4 years for adults 20 years or older. These earlier bills were not as specific with respect to requirements for the 16-to-20-age group.

2/ No such review was provided in earlier versions of "Humphrey-Hawkins."

-- removal or modification of cost-increasing government restrictions; and

-- other such actions the President may deem desirable to promote reasonable price stability.

In all of this, the proposed legislation suggests that ". . . [i]n choosing means to achieve the goal for the reduction of unemployment and choosing means to achieve the goal of reasonable price stability, those means which are mutually reinforcing shall be used to the extent practicable."/1

"Economic Report" of the President.--The proposed legislation would require that, during the first 20 days of each regular congressional session, the President submit, along with the annual report of the Council of Economic Advisers, an "Economic Report" which would set forth:

-- trends in the levels of employment, unemployment, production, real income, productivity, and prices, and a review and analysis of recent developments affecting those trends;

-- annual numerical goals for five years for employment and unemployment, production, real income, and productivity;

-- the program and policies that the President considers necessary to achieve the goals listed above; and

-- the basic elements of the President's Budget--both the expenditure and tax side--as they relate to full employment and other economic goals.

Monetary policy.--Within one month after the transmission of the President's "Economic Report," the Federal Reserve Board must submit to the Congress an "independent" statement of its intended policies for the year ahead and their relationship to the "short-term" goals set forth in the "Economic Report." The Congress is to then take such action as it finds necessary to ensure closer conformity of the Board's policies to the purposes of the Full Employment and Balanced Growth Act of 1977.

Advisory Board or Boards.--Within three months after his first "Economic Report," the President is to establish an Advisory Board or

1/ The language of earlier versions of the bill was much different. In one we find: ". . . the President shall include the objective of holding the annual rate of consumer and other price increases to levels consistent with reasonable price stability." However, "[a]chievement of reasonable price stability . . . shall not be sought through any weakening of the goals and timetable relating to the reduction of unemployment." [Underscoring added.]

Boards with appropriate representation of labor, industry, agriculture, consumers, state and local officials, and the public at large to consult with the President, the Council of Economic Advisers, and other concerned parties./1

Job programs.--The direct employment-generating provisions of the proposed legislation are of three types.

1. In any countercyclical efforts undertaken, the President is to "consider" a "triggering mechanism" to phase in public works, public service, and community development programs to provide jobs in periods of rising unemployment and then they are to be phased out as unemployment is reduced.

2. The proposed legislation recognizes that even under generally favorable economic conditions unemployment for youth may remain a problem, and the President is instructed to ". . . improve and expand existing youth employment programs, recommending legislation where required."/2 These activities are to be coordinated with other manpower programs; to smooth the transition from school to work; and to prepare--disadvantaged and other youth--for regular self-sustaining employment.

3. After all portions of existing manpower training and employment programs are fully utilized and the President has made a judgment that sufficient private job opportunities can not be developed, the President must establish "reservoirs" of public and nonprofit private employment projects to be approved by the Secretary of Labor in the form of expanding existing employment and training projects and/or through creating such new programs as are determined by the President to be needed and which the Congress authorizes and provides funds for.

Coordination with state and local governments.--The proposed legislation calls for increased coordination of programs at all government levels. Obviously this particularly would be the case if countercyclical public employment or community development projects are to be undertaken. Federal funding associated with such activities is to take

1/ Beyond this, existing institutions are to be used for planning and review. This is unlike earlier versions of the proposed legislation that would have also, among other things, created new offices within the Department of Labor and the Congressional Budget Office.

2/ In an earlier version of the bill we find the stronger statement: "The President shall transmit to Congress . . . legislation creating a comprehensive youth employment program." [Underscoring supplied.]

account of the fiscal needs and budget conditions of the respective states and localities and their own efforts, with special attention to the rates of unemployment in these states and localities.

Capital formation.--A significant addition in the latest version of the proposed legislation is the recognition of the importance of capital formation in job creation. In the language of the bill: ". . . high rates of capital formation are necessary to ensure adequate rates of capacity expansion and productive growth; . . . an important goal of national policy shall be to remove obstacles to the free flow of resources into new investment. . . ."

Assessment of the Full Employment and Balanced Growth Act of 1977

Useful Modifications

In many respects, this latest compromise version of the bill is an improvement compared to earlier proposals. These modifications include:

-- Extending the time period for attaining the target rate of unemployment to five years--1983 if the legislation is enacted this year. Earlier versions of the proposed legislation required a much shorter time period.

-- Providing for review and possible modifications of the employment and other economic goals in the third year the legislation is in effect.

-- Less emphasis on the concept of centralized economic planning.

-- Greater concern for price stability--a change in emphasis insisted upon by the Administration as a key condition for compromise. The economic distortions that result from too rapid a rate of inflation retard growth and create even more unemployment.

-- Explicitly precluding wage and price controls.

-- Recognizing the importance of capital formation in increasing employment. The language of the Act is nonspecific; however, the intent is clear and certainly in the right direction. At the same time that increased capital formation creates new jobs, it adds to productivity and is anti-inflationary./1

1/ For a discussion of the relationship between fixed investment and productivity, see MAPI Capital Goods Review No. 102, "Fixed Investment and Productivity Growth in Major Industrial Countries, 1960-73," February 1976.

Negative Aspects

Possible misinterpretation.--There is a danger that some may view the passage of the proposed legislation as a sure solution to the problem of unemployment. In fact, the bill as structured actually requires almost nothing in the way of new program formation and certainly no guarantee that the unemployment rate will be sharply reduced. Proponents of the proposed legislation refuse to accept this interpretation. For example, Jacob Clayman, President and Secretary-Treasurer, Industrial Union Department, AFL-CIO, in testimony before the House Subcommittee of Employment Opportunities in January states: "To its credit, the Humphrey-Hawkins bill would bring us to the 3 percent [unemployment] level by 1983." There is a real danger in people thinking that the legislation requires something that it does not.

The same type of problem exists regarding the question of inflation. One of the key aspects of compromise needed for Administration endorsement was a definite emphasis on holding down the rate of inflation. Yet by setting a target unemployment rate goal with no corresponding goal for the acceptable rate of inflation, the bill has a clear bias in the direction of reducing unemployment vis-a-vis inflation. The bill's proponents argue in favor of this bias. For example, again in House testimony, AFL-CIO's legislative director, Andrew Biemiller, said that the anti-inflationary segments of the bill must be "consistent with the primary emphasis of this legislation on achieving full employment" and "We want this interpretation to be clearly established in the legislative record because there are some people who believe that full employment and fighting inflation should have co-equal status in the bill. We don't agree with any such interpretation and we oppose any efforts to force this bill to establish or to justify such an interpretation." Whatever the real intent of the bill is with respect to the employment-inflation tradeoff, it is clear that not everyone is reading the proposed legislation in the same way.

Lack of realism.--The bill adds specificity to the Employment Act of 1946 by setting target goals for unemployment--yardsticks for measurement--and demands annual accountability. These unemployment targets--not more than 4 percent unemployment for the civilian labor force age 16 and over and 3 percent of the adult civilian labor force (age 20 and over) to be attained by 1983 if the legislation is passed this year--are not realistic; they will not be achieved.

Less than one-third of the time in the 30-year postwar period--1947 through 1977--has the unemployment rate for persons aged 16 and older been 4 percent or lower, and those cases were roughly associated with wartime periods. In the first five years of the 1970s, unemployment averaged 5.4 percent, and in the most recent period--1975, 1976, and 1977--it has been 8.5, 7.7, and 7.0 percent, respectively.

Moreover, the argument that a 4 percent unemployment rate is unrealistic is based on more than historical precedent. Increases in the general level of economic well being itself, which implies the ability to accumulate savings, tend to modify the personal impact of unemployment. At the same time, improved social welfare and unemployment benefit programs--in 1975, 77 percent of the civilian labor force was covered by some type of unemployment insurance program compared to 57 percent in 1947--provide a cushion in the case of job loss. There is also the increase in the number of multiple wage earning families--58 percent of "heads of households" had at least one additional family member in the labor force in 1975 compared to 40 percent 20 years earlier--that permits a great deal of earning flexibility./1 Related to this is the significant increase in the number of young people and women in the labor force. For example, in 1955, 5.9 percent of civilian workers were between 16 and 19 years old; by 1975, 8.3 percent were of this age group. Over the same 20-year period, women--of all ages--in the labor force grew from 31 to 40 percent. Stating the situation for women differently, in 1955 less than 36 in 100 women were in the labor force compared to over 46 in 1975. Both women and younger workers--due to lack of skills or job experience--are more apt to be unemployed.

These changes are both sociological and demographic. The impact of the sociological part--for example, the adoption of a new "life-style" by women, to the extent that this has happened--is hard to predict. The demographics are not as difficult, and based only on these factors (e.g., a lower proportion of teenagers in the labor force) economists estimate that changes in the work force alone will reduce unemployment significantly by 1983. However, an overall unemployment rate of 4 percent is still highly unlikely by 1983.

Further, some would argue that it is not even desirable. It has been estimated that pushing the unemployment rate to 5.5 percent or below in today's economic climate could result in unsatisfactory rates of inflation. Moreover, the proponents of the bill--regardless of the legislation's proposed timetable--have urged for a very quick reduction of the rate as soon as the legislation is passed. This would surely compound the danger on the inflationary side. Even President Carter in his 1977 Economic Report to Congress set a goal of gradually reducing the unemployment rate, although the 1983 goal is roughly consistent with the proposed legislation. In the same vein, it is also to the credit of the Administration that as a condition for endorsing the proposed legislation a flexibility in goal setting--a review in the third year--was insisted upon. This recognizes the fact that as the inflation picture and other conditions change the unemployment rate goal may require modification.

However, any discussion of whether the unemployment rate goal is realistic or not based on changes over the past several years and may or may not be inflationary tends to mask a fundamental point. The important considerations in the matrix of economic relationships are not arbitrary

---

1/ For these and other reasons it should be noted that the unemployment rate is not an index of economic hardship.

goals but underlying market realities. These will be the dominant force in determining employment and price behavior in the future with or without the proposed legislation. On the employment side, the past record should be examined. Nonagriculture civilian employment numbered 89.3 million persons in December 1977. This represents an increase of just under 8 million jobs from the average of 1975, an achievement no government program could match. At the same time, the unemployment rate has dropped from a peak of 9.1 percent in May 1975 to 6.4 percent last December. Moreover, civilian employment as a percent of the noninstitutional population is at a postwar record--58 percent in December 1977 compared to a 1975 average of 55.3 percent. The fact that, even with this impressive record over the past two years, the unemployment rate still remains between 6 and 7 percent is probably the most telling indicator of how unrealistic the 4 percent unemployment rate goal is.

Possible government action.--An important concern must be the possible government response when--in the annual reviews--it becomes clear that the target unemployment rates are not going to be met. One provision included in the proposed legislation is the possible expansion of public employment./1 This could well be counterproductive. The past record for public employment is not good./2 Moreover, there are difficulties in properly timing government job programs in the employment cycle. There is both a recognition and implementation lag. Together they often cause programs to come into play too late. In addition, programs once established tend to develop their own constituencies, become imbedded and outlive any usefulness they may have once had. Moreover, when job programs are channeled through state or local governments--which is common practice--the net result is apt to be federal funding of local employment which would have occurred anyway.

More important, an effective public employment program--one that actually hired new workers--would be expensive. This is particularly the case since the bill provides that new workers would be hired for some public jobs at rates that would exceed those of many employed in the private sector. The associated increase in the federal deficit would be inflationary, and its financing would compete with capital needed for private sector job expansion--a situation in direct contradiction to the stated policy of the proposed legislation.

The inflation goal.--There is another contradiction in the proposed legislation. The bill clearly states the dual importance of price

---

1/ The bill does establish an "order of priority" for job expansion that puts expansion of conventional private jobs and expansion of private employment through federal assistance ahead of any type of public employment programs.

2/ In a "Report to the Congress" by the General Accounting Office in the spring of 1977 (HRD-77-53) we find the summary statement: "Much money has been appropriated for public service employment programs, but they have not reduced unemployment very much."

stability and full employment. However, only a target rate of unemployment is specified--no acceptable rate is set for inflation. This clearly suggests an order of priorities--regardless of the language of the bill. And, as stated earlier, the problem is not one of trading inflation for employment. The inflation generated by striving for unrealistic rates of unemployment will itself create still more unemployment. There should be equality of treatment for inflation and unemployment.

<ins>The role of the Federal Reserve</ins>.--The proposed legislation requires the Board of Governors of the Federal Reserve to transmit to the Congress an annual report setting forth its "intended policies" for the year ahead. Such reporting presumably is to ensure that central bank policy is consistent with employment and other economic goals. This is not only in sharp contrast to the basic principle of central bank independence, but could well make a mockery of it. Already, high administration officials have stated publicly that Federal Reserve autonomy and the goals of the "Humphrey-Hawkins" bill are not consistent. The clear implication is that monetary policy is to be used as a tool for employment policy.

This suggests--like so much of the other structure of "Humphrey-Hawkins"--that the real intent is that <ins>all</ins> policies be directed toward achieving the unemployment goals. If this <ins>is</ins> the case, the proposed legislation is a mistaken and dangerous endeavor indeed.

Conclusion

Setting goals and targets in planning is, of course, desirable. Imposing inflexible standards is not. To the extent that the revised Humphrey-Hawkins compromise recognizes this, it is encouraging. Establishing the dual importance of price stability and full employment is also appealing in concept as is the avoidance of wage and price controls. Moreover--and perhaps the most positive element of the new "Humphrey-Hawkins"--there is the recognition of the importance of private capital formation as an essential ingredient to increased employment.

Having said this, the question then becomes: what does Humphrey-Hawkins add? The goal of increased employment--reduced unemployment--was established in the "Employment Act of 1946." Since that time, and in fact much earlier, the government has never knowingly encouraged unemployment as a solution to inflation, or for any other reason. Moreover, certain target rates of acceptable economic activity are known and widely accepted. They are under constant review as conditions change and policy planning focuses on these.

Since this is the case, one could argue that the proposed legislation is merely redundant. Unfortunately this is not true. First, there is the danger that it might be perceived as the solution to a serious problem. It is not. Second, the unemployment goal it sets--4 percent of workers over 16 to be attained in 1983 if the legislation is passed in 1978--is unrealistic. The goal will not be met. The difficulty is that this failure could well precipitate unwise economic policy and programs resulting in increased deficits, inflation, and even more unemployment. The proposed legislation sets no specific price stability goal; inflation and unemployment are not considered to be of equal importance--language in the legislation notwithstanding--thereby really having only one target, which is the unrealistic unemployment goal. Further, if the intent in the process is to reduce central bank independence, an important check on inflation could be lost.

The notion of increased private capital formation is a good one; however, no specific mechanisms or changes are suggested. This, like price stability, comes out of the legislative proposal as so much "lip service."

Finally, to a certain extent the proposed legislation is misleading. Proponents claim it to be a significant and meaningful step forward--an important piece of major policy shaping and problem solving legislation. Others maintain that it is an exercise in rhetoric; nothing is really required; goals can be modified to suit existing conditions; and the Act is in fact "toothless." One of these assessments may be correct; certainly they both can not be. Either way, someone is being misled.

However, one thing is clear. Even though the bill has been "toned down," it may be a dangerous launching pad for extremely inflexible economic goals and programs.

MAPI

MACHINERY & Allied Products INSTITUTE

MEMORANDUM

(202) 331-8430

1200 EIGHTEENTH STREET, N.W. • WASHINGTON, D.C. 20036

G-70

Originally published January 1974
Revised and republished July 1974
December 1974
April 1976
October 1976
April 1977
April 1978

INFLATION AND PROFITS

by
George Terborgh
MAPI Economic Consultant

MACHINERY AND ALLIED PRODUCTS INSTITUTE

INFLATION AND PROFITS

The effect of rising price levels on the accounting of profits is not a new subject. During the sharp postwar inflation of 1946-48 it generated a lively discussion in accounting and management circles. This was revived, on a lesser scale, by the price run-ups of 1950-51 and 1956-57. But under the relatively stable price level of 1958-64 interest waned. It was widely believed that inflation was a thing of the past, that the after-effects of earlier inflation would gradually wear off, and that no corrective action was needed. This proved to be an illusion. By 1965 inflation was under way once more, and it has continued at a distressing pace ever since. It is now high time to take another look at the problem.

The Principle

The overstatement of profits during and after a period of inflation arises from the practice of charging only the historical cost of physical asset consumption (fixed assets and inventory). When the purchasing power of the dollar is shrinking, the charging of historical costs--reflecting earlier, and hence lower, price levels--is insufficient for the restoration of real assets used up in production. A proper reckoning requires the restatement of previously incurred costs in the dollars of realization, that is to say, in the revenue dollars against which they are charged. Only when costs and revenue are measured in the same dollars can the difference between them (profit) be correctly determined.

It follows that when the real cost of physical asset consumption is undercharged the shortfall is accounted as profit. It follows also that this much of the reported profit is fictitious, representing simply the understatement of costs.

The Project

The foregoing statement of principle refers to the conversion of historical costs into their equivalents in current dollars. This implies the use of an index of the general purchasing power of the dollar. Unfortunately from our standpoint, the official conversions are based on a multiplicity of specific price indexes purporting to reflect the current replacement costs of the individual items or classes of items processed. We refer to the Department of Commerce conversions, which are applied both to fixed-asset consumption (in the Capital Consumption Adjustment) and to inventory consumption (in the Inventory Valuation Adjustment) by means of such replacement-cost indexes. While we prefer the use of a single comprehensive index of prices, the overall results obtained from a multiplicity of specific indexes are not far different. In any case, we are constrained by the nature of the available data to use the latter, which represents a conversion of income-tax costs into current-cost equivalents, rather than into current-dollar equivalents./1

In the project in hand, we propose to compare current-cost depreciation with tax depreciation and current-cost inventory consumption charges with their tax counterparts. We can then see what difference the conversion makes in the profit figures. The study is limited to the corporate system because profit as such is not available for the unincorporated sector, and more specifically to nonfinancial corporations, the category principally concerned with physical asset consumption. It is limited also to the inflation of 1965-77.

I. FIXED ASSETS

The Department of Commerce computes annually current-cost depreciation on the fixed assets of nonfinancial corporations, using two writeoff methods (straight-line and double-declining-balance) and a variety of service-life assumptions. It has expressed its preference in service-life assumptions (85 percent of Bulletin F lives), and we shall use that assumption in conjunction with the double-declining-balance writeoff./2

A word on the choice of writeoff. Notwithstanding the Department's use of the straight-line method in its own current-cost calculations, we entertain no doubt that that writeoff is in most applications a grievously retarded measure of capital consumption, and that the double-declining-balance method is in general more realistic. This is not the place to argue the issue, which we have done at length elsewhere./3 Suffice it to say that this writeoff conforms quite well to both theoretical and empirical evidence on the typical course of capital consumption, especially for capital equipment (as distinguished from structures), which accounts for around five-sixths of corporate tax depreciation.

The following table compares the Department's computation of current-cost double-declining-balance depreciation with its estimate of the depreciation allowed for income tax purposes.

1/ For a discussion of this issue, see Realistic Depreciation Policy, MAPI 1954, Chapter 12.

2/ The double-declining-balance method is applied with a straight-line switch.

3/ Realistic Depreciation Policy, Chapters 3, 4, and 5.

Table 1

Comparison of the Current-Cost Double-Declining-Balance Depreciation of Nonfinancial Corporations With the Depreciation Allowed Them for Income Tax Purposes
(Billions of Dollars)

	(1) Current Cost DDB	(2) Income Tax Depreciation	(3) Excess of (1) over (2)
1965	$ 34.9	$ 36.4	$ -1.5
1966	38.7	39.5	-0.8
1967	42.9	42.9	0.0
1968	47.1	46.7	0.4
1969	52.3	51.3	1.0
1970	57.8	54.6	3.2
1971	62.8	58.7	4.1
1972	67.0	65.3	1.7
1973	73.7	70.5	3.2
1974	86.9	77.7	9.2
1975	103.2	85.3	17.9
1976	112.2	92.5	19.7
1977	121.1	99.6	21.5

Note that the excess of current-cost DDB over tax depreciation has grown from a negative amount in 1965 to $22 billion in 1977.

II. INVENTORY

As indicated earlier, the conversion of tax inventory consumption charges to their current-cost equivalent is computed by the Department of Commerce as the Inventory Valuation Adjustment (IVA). The calculation allows for inventory consumption presently charged for income tax purposes by LIFO and similar current-costing procedures, and converts only the balance under historical-costing systems. The results follow.

Table 2

Inventory Valuation Adjustment for Nonfinancial Corporations
(Billions of Dollars)

1965	$ 1.9
1966	2.1
1967	1.7
1968	3.4
1969	5.5
1970	5.1
1971	5.0
1972	6.6
1973	18.6
1974	40.4
1975	12.0
1976	14.1
1977	14.6

30-454 O - 78 - 24

Here again we have a gradual rise in the excess of current-cost over income-tax charges, culminating in this case in a sudden surge to nearly $40 billion in 1974, with a 1977 level of $15 billion.

III. ADJUSTMENT OF PROFITS

We are now ready to put the pieces together and adjust profits as reported for income tax purposes.

Table 3

Adjustment of Reported Profits of Nonfinancial Corporations
(Billions of dollars)

	(1) Profits Before Tax as Reported	(2) Income Tax Liability	(3) Profits After Tax as Reported (1) - (2)	(4) Under-Statement of Costs/a	(5) Profits Before Tax as Adjusted (1) - (4)	(6) Profits After Tax as Adjusted/b (3) - (4)
1965	$ 64.4	$ 27.2	$ 37.2	$ 0.4	$ 64.0	$ 36.8
1966	69.5	29.5	40.0	1.3	68.2	38.7
1967	65.4	27.7	37.7	1.7	63.7	36.0
1968	71.9	33.6	38.3	3.8	68.1	34.5
1969	68.4	33.3	35.1	6.5	61.9	28.6
1970	55.1	27.3	27.8	8.3	46.8	19.5
1971	63.3	29.9	33.4	9.1	54.2	24.3
1972	75.9	33.5	42.4	8.3	67.6	34.1
1973	92.7	39.6	53.1	21.8	70.9	31.3
1974	102.9	42.7	60.2	49.6	53.3	10.6
1975	102.3	40.8	61.5	29.9	72.4	31.6
1976	130.6	53.7	76.9	33.8	96.8	43.1
1977	141.8	57.0	84.8	36.1	105.7	48.7

a/ The sum of the excesses of current costs over tax costs shown in Tables 1 and 2.

b/ Since this is a retrospective recomputation of profits, it takes as given the corporate income taxes actually paid. If tax liabilities had been figured on the adjusted pre-tax profits, the after-tax effect of the adjustment would, of course, have been reduced by the tax saving resulting therefrom. But since they were actually figured on the reported profits throughout, there were no such tax savings. Adjusted after-tax profits are simply adjusted pre-tax profits minus actual taxes on reported profits.

Here is a startling picture. Adjusted after-tax profits started out in 1965 about even with the reported figure. They wound up in 1977 only 57 percent as large./1

Restatement of Retained Earnings

An even more startling picture emerges when we subtract dividend payments from adjusted after-tax profits to derive adjusted retained earnings.

Table 4

Adjusted Retained Earnings of Nonfinancial Corporations
(Billions of dollars)

	(1) Adjusted After-Tax Profits	(2) Dividend Payments	(3) Adjusted Retained Earnings
1965	$ 36.8	$ 17.2	$ 19.6
1966	38.7	18.1	20.6
1967	36.0	18.9	17.1
1968	34.5	20.7	13.8
1969	28.6	20.7	7.9
1970	19.5	19.9	-0.4
1971	24.3	20.0	4.3
1972	34.1	21.7	12.4
1973	31.3	23.9	7.4
1974	10.6	26.0	-15.4
1975	31.6	29.0	2.6
1976	43.1	32.4	10.7
1977	48.7	38.2	10.5

1/ It should be acknowledged that there is a slight duplication in combining the depreciation and inventory adjustments. Practice differs widely with regard to the treatment of depreciation, some companies charging it into cost of sales, others treating it as an expense. Overall figures on the relative prevalence of the two procedures are not available. To the extent that depreciation is included in the cost of sales, there is of course some duplication of the separate adjustment for depreciation. It is not important, however. Even if all depreciation were so charged, it would make up only 5 or 6 percent of total inventory-consumption charges, and the maximum duplication would therefore be this percent of IVA, a relatively insignificant amount. Since the actual duplication is only a fraction of this, it can safely be disregarded.

Over the past eight years adjusted retained earnings have been almost negligible (averaging about $4 billion a year). Nonfinancial corporations have been distributing nearly all of their adjusted earnings, their reported savings representing little more than the amount required to cover the understatement of costs.

Adjusted Profits and Retained Earnings in Constant Dollars

To make the horror story even worse, the dollar has been shrinking over the interval and it is necessary to adjust for this by stating the results in constant dollars. We use for this purpose the GNP deflator (1972 = 100).

Table 5

Adjusted Profits and Retained Earnings of Nonfinancial Corporations in 1972 Dollars
(Billions of Dollars)

	(1) Adjusted After-Tax Profits	(2) Adjusted Retained Earnings
1965	$ 49.5	$ 26.4
1966	50.4	26.8
1967	45.6	21.6
1968	41.8	16.7
1969	33.0	9.1
1970	21.3	-0.4
1971	25.3	4.5
1972	34.1	12.4
1973	29.6	7.0
1974	9.1	-13.3
1975	24.6	2.0
1976	32.2	8.0
1977	34.5	7.4

In constant dollars, the adjusted earnings of 1977 were only 70 percent of 1965. As for retained earnings, the comparison is even more dismal. Here the 1977 figure was only 30 percent as large.

IV. EFFECTIVE INCOME TAX RATES ON ADJUSTED PROFITS

Since the income tax liability (federal and state) is computed on overstated historical-cost profits it is obvious that the effective rate on profits adjusted for the overstatement is higher than the rate reported. The following table shows the difference.

Table 6

Effective Tax Rates on the Pre-Tax Profits of Nonfinancial Corporations as Reported and as Adjusted/a

	(1) On Profits As Reported (Percent)	(2) On Profits As Adjusted (Percent)
1965	42.2	42.5
1966	42.4	43.3
1967	42.4	43.5
1968	46.7	49.3
1969	48.7	53.8
1970	49.5	58.3
1971	47.2	55.2
1972	44.1	49.6
1973	42.7	55.9
1974	41.5	80.1
1975	39.9	56.4
1976	41.1	55.5
1977	40.2	53.9

a/ Column (2) of Table 3 as percentage of Columns (1) and (5), respectively.

It is obvious at a glance that effective tax rates on real profits have moved away from those on reported profits. In 1974 the rate reached 80 percent. For 1977 it was 54 percent.

V. WHAT DOES IT MEAN?

It is clear that American business has not yet learned how to protect itself against inflation. Overall, it has been unable to maintain normal margins even in the overstated profits of conventional accounting. In terms of real profits, the shrinkage has been drastic./I

It is difficult in many situations to protect even nominal profit margins in the face of inflation. The difficulty arises when price-setting takes place in advance of cost incurment. Under prevailing practice this is a fairly common phenomenon. There may be long-term fixed-price sales contracts outstanding; catalogs may be issued only annually or semi-annually; seasonal merchandise may be priced months in advance of delivery; long-cycle production may be quoted before work is started; etc. Unless such

1/ See Corporate Earning Power in the Seventies: A Disaster, MAPI, August 1977.

advance pricing is based on the costs that will be incurred later (as distinguished from those prevailing at the time of quotation), even historical-cost profit margins will be squeezed.

Overall, however, the protection of nominal margins is a minor problem compared with the protection of real margins. The lead of price determination over cost incurment varies widely from one industry to another. In many it is negligible, in some even negative. But the lead of cost incurment over receipts from sales, though likewise variable, not only averages far longer, but is almost universal. Correction for both leads is accomplished by pricing on replacement costs anticipated as of the time of sale. This is done by basing prices and prospective profit margins on those costs.

It must be acknowledged of course that such a pricing policy may be impracticable for an individual company in a market where the competition is pricing on understated costs. The real remedy lies in the reform of policy across the board. If all competitors are targeting their prices on fully stated costs, there is a better chance that they can make them stick.

Let us add in closing that the present situation is bad not only for business, but for the nation as a whole. Despite the suspicion and disfavor that attach to profits in the eyes of many politicians and of a considerable part of the public, it is vital that they be large enough not only to motivate the expansion of productive investment, but to finance a substantial part of it. It is frightening from the public-policy standpoint that the reinvestment of corporate earnings, realistically measured has become almost negligible. If this continues it will cost the country dearly.

Let us add further that the Alice-in-Wonderland accounting of costs and profits that now passes for orthodoxy is a problem not only for business management, but for the accounting profession, the regulatory agencies of the government, and, not least, for the tax authorities. It is high time for concerted action by all concerned.

It is gratifying in this connection that both the accounting profession and governments appear at last to be grappling with the problem. The Securities and Exchange Commission has required large companies to file supplemental statements on the current-cost inventory and fixed-asset consumption. There is much activity on the subject among accounting bodies here and abroad, and in several countries by government commissions.

These are first steps, to be sure, but we may hope that others will follow. We may hope also, and even more fervently, that the tax authorities will not be far behind. For the evils of undercosting are compounded by the present practice of taxing capital consumption as income. No reform of costing procedures can be more than partially successful so long as this practice continues./1

1/ See Inflation and the Taxation of Business Income, MAPI, January 1976.

MACHINERY AND ALLIED PRODUCTS INSTITUTE

RECENT MAPI STUDIES DEALING WITH CAPITAL FORMATION, "REAL PROFITS," AND THE IMPACT OF INFLATION AND RELATED ACCOUNTING AND TAX ISSUES

"Changing Theories of Fiscal Policy," by George Terborgh, April 1978

"The Favorable Impact of Direct Investment Abroad on the U.S. Balance of Payments: A Bright Spot in An Otherwise Dreary Picture," MAPI Capital Goods Review No. 108, April 1978

"Inflation and the Taxation of Capital Gains," by George Terborgh, March 1978

"Federal Anti-Inflation Policy," by George Terborgh, December 1977

"Corporate Earning Power in the Seventies: A Disaster," by George Terborgh, August 1977

"Thirty Years of Corporate Fixed Investment," MAPI Capital Goods Review No. 107, September 1977

"Unwinding the Present Inflation," by George Terborgh, March 1977

"Inflation and Profits," by George Terborgh, MAPI Memorandum G-70 of January 1974, Revised and Republished in July and December 1974, April and October 1976, April 1977, and April 1978

"The Sad Story of Corporate Profits," by George Terborgh, March 1976

"The Behavior of Prices, Labor Cost, and Profits in an Inflationary Economy," MAPI Capital Goods Review No. 106, June 1977

"A Mystery In Federal Profit Reporting," by George Terborgh, May 1976

"Inflation and the Taxation of Business Income," by George Terborgh, January 1976

"The Case for the Single-Index Correction of Operating Profit," by George Terborgh, October 1976

"SEC Amends Its Regulations To Require Supplemental Disclosure of Certain Replacement Cost Data," MAPI Bulletin 5418, March 26, 1976

"Fixed Investment and Productivity Growth in Major Industrial Countries, 1960-1973," MAPI Capital Goods Review No. 102, February 1976

"Corporate Financing of Economic Growth: Some Questions About the Mix of Internal and External Financing," MAPI Capital Goods Review No. 101, October 1975

"Corporate Saving and the Capital Shortage," by George Terborgh, MAPI Capital Goods Review No. 100, September 1975

"Another Part of the Story . . . Capital Formation and Exports," MAPI Capital Goods Review No. 98, June 1975

"Business Capital Formation--Putting It In Perspective (1925-1970)," MAPI Capital Goods Review No. 94, December 1973

"Inflows and Outflows Arising From U.S. Direct Investment Abroad, 1960-1975," March 26, 1978

"Capital Formation and Legislative Proposals for Tax Revision," March 30, 1976

"The Favorable Impact of Direct Investment Abroad on the U.S. Balance of Payments: Spending More To Get More," MAPI Capital Goods Review No. 103, June 1976

"Recent Changes In Capital Equipment Activity--A Puzzling Divergence In Two Widely Used Measures," MAPI Capital Goods Review No. 104, October 1976

CORPORATE EARNING POWER IN THE SEVENTIES: A DISASTER

by
George Terborgh
MAPI Economic Consultant

August 1977

MACHINERY AND ALLIED PRODUCTS INSTITUTE
1200 EIGHTEENTH STREET, N.W.
WASHINGTON, D.C., 20036

CORPORATE EARNING POWER IN THE SEVENTIES: A DISASTER

History is not given to sudden discontinuities, but the period of the seventies to date (1970-77), chosen for this analysis of corporate earning power, comes as close to one as we are likely to get. Certainly it is distinctive enough to justify separate treatment, its distinction being that real profitability has been at a disaster level throughout.

The reference to "real" profitability suggests that there are unreal or fictitious measures of earnings, and indeed there are. In fact the most commonly cited profits statistics are of this character. The reason is simple: they fail to adjust for the effect of inflation on the accounting of operating costs. Since this failure results in the understatement of these costs, the derivative profits are overstated, deceiving investors, politicians, academicians, and the public alike.

The present study attempts to gauge the magnitude of profit overstatement in the seventies and, for comparative purposes, over the preceding postwar period. A word on the line of march. Section I deals with the effect of inflation on the measurement of costs, and presents the record of profits before and after adjustment for this effect. Section II examines adjusted profit margins on both output and equity. Section III analyzes the failure of management to cope with inflation. Finally, Section IV considers the implications of this failure.

I. ADJUSTMENT OF PROFITS FOR INFLATION

The student of corporate earnings is offered these days two official profits series, both from the same source, the Department of Commerce. The first, and basic, series is derived (after several adjustments) from income tax data, which are based, with one exception, on historical costs./1 A second series is derived from the first by the application of the Capital Consumption Adjustment (CCA) and the Inventory Valuation Adjustment (IVA). These adjustments are the difference between the estimated replacement cost of the fixed assets and inventory consumed in production and the costs charged for income tax purposes.

Why the Adjustments?

The reason for the two adjustments is of course inflation. They are necessary because of the time difference between cost incurment

1/ The exception is the allowance of LIFO inventory accounting to the extent actually practiced, a method believed to cover currently about a quarter of corporate inventory. While this is really a deferred historical-cost system, its immediate impact is broadly equivalent to true current costing.

and cost recovery. If all costs were recovered at the time of incurment, no adjustment would be required. But it is the nature of business operations that there is a lag between the two. This lag, which may be referred to as "cost lead time," varies all over the map, ranging from years (fixed-assets), to weeks or months (inventories). But whatever its duration, the effect of inflation is the same: the cost of replacing the assets consumed in production is higher than the historical-cost charges for the purpose. The latter provide only a partial replacement in real terms.

Since there can be no true profit until the assets consumed have been fully restored (or until full provision for their restoration has been made), the failure of historical costing to meet this requirement results in the overstatement of profits. What gets reported under this procedure is a mixture of true profits and unrecorded costs. It is the object of the Commerce adjustments to subtract out the latter./1

Adequacy of the Adjustments

While the two Commerce adjustments are generally acceptable so far as they go, they are incomplete. For they ignore the lead time of costs not charged into inventory. We refer to the category usually accounted as "expense"--selling, promotion, research and development, interest, rent, royalties, taxes (other than on income), insurance, contributions, general administration, etc. That such costs are important is sufficiently indicated by the fact that for nonfinancial corporations as a whole they constitute 25-30 percent of the total. They too have an average lead time of substantial magnitude, which calls, no less than the lead time of inventoried costs, for inflation adjustment.

Unfortunately, no one has figured out a practical way to derive the average cost lead time of expensed items, and we imply no criticism of Commerce on this score./2 It is well to remember, however, that its

---

1/ Since we are using Commerce adjustments in this study, we have stated the rationale for the specific-replacement-cost approach. It seeks fixed-asset and inventory consumption charges that will restore the amounts withdrawn in physical terms. In pursuit of this goal, it employs a multiplicity of self-duplicative price indexes. Those familiar with our writings on this subject will realize that we prefer, on both practical and theoretical grounds, to adjust for cost lead time by the application of a single index of the general price level. Conceptually, this calls for capital maintenance in terms of general purchasing power, rather than in physical quantities. Fortunately for our present purpose, the overall results of the two approaches are not far different. For a discussion of the issue, see The Case for the Single-Index Correction of Operating Profits, MAPI, October 1976.

2/ The depreciation adjustment is carried out by breaking down depreciable assets into year-of-origin groups, restating each group at current replacement cost, and computing depreciation on the restated amounts. The cost lead time for inventories is derived from turnover rates. This measure is of course unavailable for expenses.

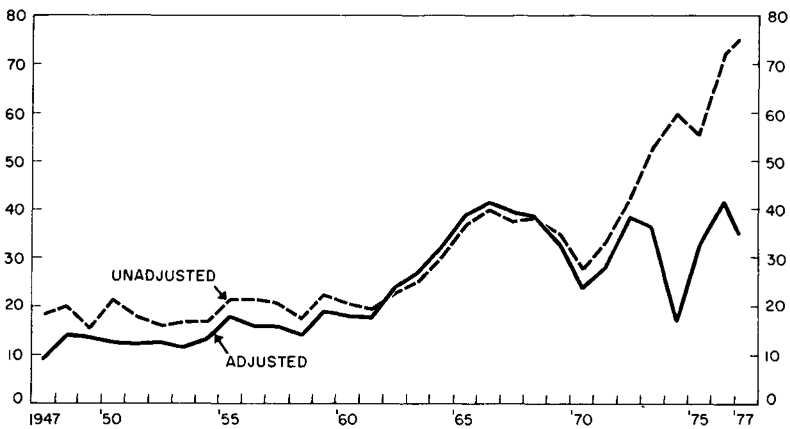
two adjustments yield a correction that is inadequate by an unknown, but certainly significant, amount, and that a full correction would yield adjusted profits even lower than those shown./1

The Results

With these preliminary explanations, we turn to the results of the Commerce adjustments, which appear below.

CHART 1

Adjusted and Unadjusted After-Tax Profits From the Domestic Operations of Nonfinancial Corporations, 1947-76/a
(Billions of dollars)



a/ Since the adjustments relate to physical-asset consumption only, and since there is relatively little of this in the financial sector, we shall deal throughout with nonfinancial corporations. The circled dots show the first quarter of 1977 at seasonally adjusted annual rates.

1/ There is another cause of undercorrection, though of much less importance, the use by Commerce of full-life straight-line depreciation as the basis for its inflation adjustment. The straight-line writeoff is in most applications a grievously retarded measure of capital consumption, the double-declining-balance method being in general more realistic. This is not the place to argue the issue, which we have done elsewhere. See Realistic Depreciation Policy, MAPI, 1954. For a correction of profits using double-declining-balance depreciation, see Inflation and Profits, MAPI, April 1977.

An interesting picture. The adjusted profits started out in 1947 at half the unadjusted, after which the two series gradually converged. They then ran along pretty much together until the late sixties, when accelerating inflation produced a divergence, explosive after 1972. Since that year, unadjusted profits have risen by more than 70 percent, while the latest figure for adjusted profits is actually off a little.

The substantial equivalence of the two in the early and middle sixties reflects in part the relatively low inflation rates of 1958-65, in part the increase in tax depreciation following the introduction of the Guideline Life System in 1962. The shortening of tax depreciation lives by that system, plus the availability of accelerated writeoff methods, kept tax allowances above the Commerce replacement-cost estimates for several years. The further boost in those allowances through the Asset Depreciation Range System of 1971 was soon overwhelmed by accelerating inflation, and by 1976 the CCA had grown to $16 billion./1

II. ADJUSTED PROFIT MARGINS

Chart 1 shows the absolute amounts of adjusted and unadjusted profits. To get an informative picture of what has happened to adjusted profits (with which we shall be exclusively concerned from now on), it is necessary to convert them into profit margins. Two such margins will be computed, one on gross product, one on adjusted net worth.

Margins on Gross Product

The first of these calculations appears on page 5.

From 1947-1969, profit margins ranged between 6 and 10 percent, averaging 7.75. From 1970-76, they ranged between roughly 2 and 5 percent, with an average of 4.25. By this measure, corporate earning power in this period was only 55 percent of its prior long-term average, and even in the most recent year (1976) it was no better than that. In the first quarter of 1977, it was only 44 percent as large.

Margins on Adjusted Net Worth

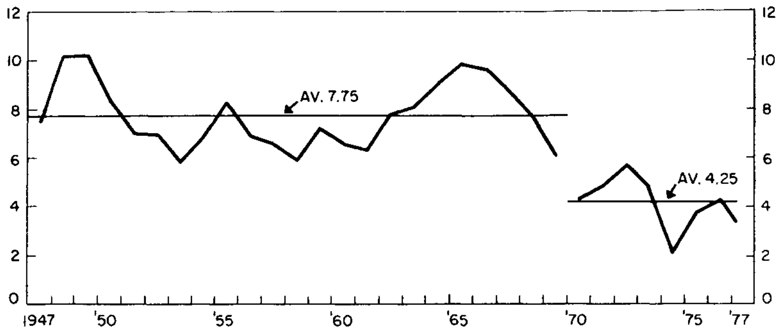
Suppose we look next at the second margin calculation, Chart 3 (also on page 5), which relates adjusted profits to adjusted net worth, that is to say, net worth with tangible assets (land, structures, equipment, and inventory) restated at estimated replacement cost.

The showing here is generally similar to the preceding one. Against a base-period average return of 5.90 percent, the 1970-76 period rates only 3.55, this time 60 percent of the base level. Again the 1976 figure is no better than the recent average. Worse still, the first quarter of 1977 is only 47 percent of base.

1/ It may be added that the CCA for book profits (not computed by Commerce) was at least $30 billion for that year, the difference reflecting the excess of tax over book depreciation.

CHART 2

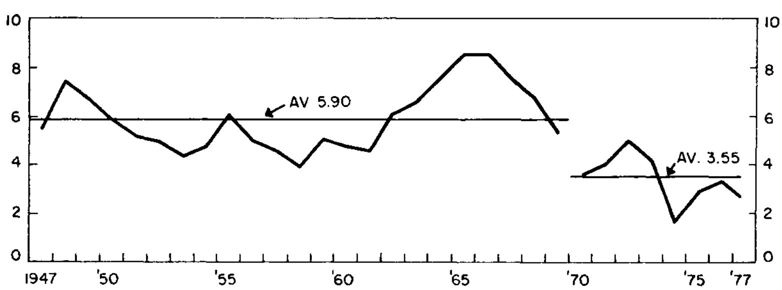
Adjusted Domestic After-Tax Profits of Nonfinancial Corporations as a Percentage of Their Domestic Gross Product/a



a/ It is customary to compute profit margins on sales rather than on gross product (value added), but the former is a duplicated figure, including purchases from outside the universe covered (here nonfinancial corporations) and transfers between enterprises within it. The gross product avoids distortions from shifts in the relative importance of these purchases and transfers.

CHART 3

Adjusted Domestic After-Tax Profits of Nonfinancial Corporations as a Percentage of Their Adjusted Domestic Net Worth/a



a/ Adjusted net worth is from the flow-of-funds reports (Federal Reserve Board), Balance Sheet of Nonfinancial Corporations, December 1976. Since the profits are from domestic production only, net worth was reduced by the excess of claims against foreign affiliates over obligations owed to them. Net worth is the average of opening and closing amounts. The 1976 and 1977 figures are partly estimated.

III. FAILURE OF MANAGEMENT TO COPE

It is evident that even after a decade of inflation American management (with some exceptions of course) has not yet learned to cope with it.

It is difficult in many situations to protect even nominal (historical-cost) profit margins in the face of inflation. The difficulty arises when price-setting takes place in advance of cost incurment. Under prevailing practice this is a fairly common phenomenon. There may be long-term fixed-price sales contracts outstanding; catalogs may be issued only annually or semi-annually; seasonal merchandise may be priced months in advance of delivery; long-cycle production may be quoted before work is started; etc. Unless such advance pricing is based on the costs that will be incurred later (as distinguished from those prevailing at the time of quotation), even historical-cost profit margins will be squeezed.

Overall, however, the protection of nominal margins is a minor problem compared with the protection of real margins. The lead of price determination over cost incurment varies widely from one industry to another. In many it is negligible, in some even negative. But the lead of cost incurment over sale, though likewise variable, not only averages far longer, but is almost universal. Correction for both leads is accomplished by pricing on replacement costs anticipated as of the time of sale. This is done by basing prospective profit margins on those costs.

It must be acknowledged, of course, that such a pricing policy may be impracticable for an individual company in a market where the competition is pricing on historical costs. The real remedy lies in the reform of policy across the board. If all competitors are targeting their prices on replacement costs, there is a better chance that they can make them stick.

It is probably fair to say that by and large American management has not even been trying to price on replacement costs. If it had been there should be by now some reflection of its efforts in the improvement of real profit margins. As we have seen, there is no such evidence in the record: real margins so far in the seventies have, if anything, been drifting downward.

Reasons for Not Trying

A major reason for this failure to try replacement-cost pricing is ignorance. Many managements--probably most of them in medium-sized and small companies--simply do not realize the phony character of the profits they are reporting. If their historical-cost margins fall in the target range, they think they are doing well, hence see no reason to alter their pricing policy. There is a second, and much smaller, group of managements that have been exposed to the gospel of current-cost pricing but reject it on principle. They still believe that a dollar is a dollar. Finally, there is a third group that accept the gospel on theoretical grounds, but for practical reasons do not apply it. Obviously none of these groups contributes to the restoration of real profit margins.

Among the practical reasons just referred to is the extraordinary difficulty of computing reliable replacement costs for individual companies, particularly in the case of fixed assets. This was forcefully illustrated by the results of the replacement-cost calculations mandated by the Securities and Exchange Commission (SEC) for the 1976 10-K reports of large corporations. There was the greatest diversity of method and approach (both left largely to the respondent), and much complaint about the cost of the operation and the uncertain validity of the results. The fact is that replacement costing is a headache, and most companies don't know how to do it.

The solution, in our opinion, is to give up the specific replacement-cost approach and correct for cost lead-time by the use of a single index of changes in the general purchasing power of the dollar. Not only would this vastly simplify the operation, it would facilitate the adoption of current costing for income tax purposes, a consummation devoutly to be wished./1

Effect of Disclosure

Many managements that accept current costing in principle are averse to the disclosure of current-cost profits in their financial statements. They may have substantial stock positions in their companies and fear the effect of disclosure on market prices. They may hold stock options, the value of which could be impaired. They may enjoy bonuses geared to present profit accounting, and so on. But even apart from self interest, they may feel that they owe it to outside stockholders to maintain this accounting, believing that they too would suffer from the disclosure of real profits.

Whether these fears are justified is an open question, long debated by securities analysts, accountants,and economists, though with little empirical evidence to go on. Fortunately, such evidence is now coming to hand. While the SEC forbade the formal restatement of profits by those participating in its 1976 project, the data on replacement costs in their 10-K filings and annual reports permit anyone else to do it, and securities analysts have been busy at it for months. Moreover, tabulations of sample companies have already been published./2

With what result? Notwithstanding a fantastic dispersion in the ratios of adjusted to unadjusted profits, the stock market response to the disclosure has been slight to negligible. Either the market has

1/ See Inflation and the Taxation of Business Income, MAPI, January 1976.
2/ See, for example, Business Week, The McGraw-Hill Publishing Co., June 29, 1977.

uncannily discounted the differing quality of reported profits, or it is relatively indifferent to this factor. In any event, management concern over the effects of disclosure appears to be exaggerated./1

If the SEC continues to mandate the estimation and reporting of replacement costs, the question of disclosure will become academic, for large companies at least. The adjusted earnings will be disclosed whether they like it or not. For those not subject to the mandate, the answer is different. If they fear the effect of disclosure on their stock prices, they can keep their estimated current costs an internal secret used only for pricing policy. The important thing, with or without disclosure, is that managements try to price on these costs. In the end, this is the only way they can cope with inflation.

Governmental Obstacles

Unfortunately, the federal government handicaps this effort by its adherence to historical costing for income tax purposes./2 Since the excess of current costs over tax costs is not deductible, it requires twice as much added revenue to build up current-cost profits as it would with deductibility. This doubles the difficulty of restoring real margins.

There is a second handicap imposed by the government. We refer to its propensity to publicize nominal profits and profit margins. While it uses adjusted pre-tax profits in the GNP accounts, it avoids the publication of adjusted after-tax profits./3 This means that if American management did manage to get its real profit margins up to normal levels, the nominal margins reported in official publications would appear abnormally, and embarrassingly, large. Notwithstanding their phony character, they would be used by politicians, labor leaders, and others to beat business over the head. If the government wants corporate management to cope with inflation, it had better switch to the publication of real profits.

After this recital of obstacles, it is evident that the generalization of efforts to price on current costs will be slow in coming. In the meantime American industry can be expected to continue with abnormally low real profit margins.

1/ An earlier tabulation of adjusted and unadjusted profits, this time by a different method of conversion, showed a comparable dispersion of results, with little stock market response. See Financial Accounting Standards Board, Research Report, May 1977.

2/ Except for the availability of LIFO inventory accounting when taken bookwise.

3/ See A Mystery in Federal Profit Reporting, MAPI, May 1976. Since this was written, two minor concessions have been made. Adjusted after-tax profits now appear in Business Conditions Digest, and in an inconspicuous addendum to one table on the GNP accounts. Elsewhere "profits after tax" are unadjusted.

IV. IMPLICATIONS

What if the real earning power of the corporate system continues at the depressed level that has characterized it so far in the seventies? The most obvious and certain effect will be a retardation of the growth and improvement of its productive capacity.

While the capital expenditures of nonfinancial corporations were well maintained in the early years of the seventies (before 1975) notwithstanding the low level of their real profits, this was accomplished by resort to unsustainable financing arrangements. Because the real retained earnings of the system averaged less than $7 billion a year over the full period 1970-76, and its net new stock issues less than $9 billion, most of its capital expansion was financed by borrowing, as a result of which its outstanding debt mounted at an average annual rate of roughly $60 billion.

This has resulted in a substantial rise in the overall debit-equity ratio on the historical-cost balance sheet of the system. While the ratio has remained fairly stable on its replacement-cost balance sheet, most credit appraisals (insofar as they turn on asset coverage) are based on the former. From their standpoint, therefore, creditworthiness has been impaired.

But this is only the tip of the iceberg. Far more important, as a rule, than the asset coverage of the loan principal is the earnings coverage of interest requirements. Here the deterioration has been drastic. The decline in the coverage multiple began in the second half of the sixties, reflecting falling profit margins (Charts 2 and 3), expanded borrowings, and rising interest rates; it then continued irregularly in the seventies./1 Note the following:

Earnings Coverage of Net Interest Payments,
Nonfinancial Corporations
(Multiples)

1965	11.8/a	1972	4.8
1966	10.6	1973	4.3
1967	8.7	1974	3.1
1968	8.1	1975	3.4
1969	6.1	1976	3.7
1970	4.0	1977 (1st q.)	3.4
1971	4.3		

a/ The 1965 figure is only slightly above the average for the first half of the decade (11.3). Prior to 1960 the multiples were uniformly higher than in 1965.

1/ The coverage multiple is adjusted pre-tax profits plus net interest payments, divided by these payments.

It is obvious that earnings-coverage multiples cannot continue indefinitely the decline of recent years. By the same token, the expansion of corporate capital cannot be indefinitely sustained by the inordinate borrowing that characterized the period. If the multiples do not improve, there will be increasing pressure on lenders and borrowers alike to cut back debt expansion, and with it the financing of new capital formation. To avoid this adverse development, it is vital to lift real corporate earnings from the depressed level prevailing so far in the seventies, and to raise real retained earnings from their even more depressed level. The higher earnings are necessary to increase the coverage of interest and facilitate further debt expansion; the higher retained earnings are required to reduce the need for such expansion.

The depressed level of real profits is bad not only for the corporations affected but for the nation as a whole. Despite the suspicion and disfavor that attach to profits in the eyes of many politicians and of a considerable part of the public, it is essential that they be large enough not only to motivate the expansion of investment, but to finance a substantial part of it. The present level falls short on both counts.

Would the Normalization of Real Profits Be Inflationary?

We should like in closing to comment briefly on a common objection to the restoration of real profit margins; namely, that it would be inflationary.

It is true, of course, that if nonfinancial corporations were suddenly to raise their real after-tax margin on gross product from the average of the seventies, 4.25 percent, to the base-period average of 7.75 percent (Chart 2), it would require an increase of 7 percent in the average of prices charged for that product. (Since the added revenue would not be shielded by added deductions, it would require this much to yield the 3.5 percentage-point increase in the after-tax margin.)

This 7 percent increase is misleading, however. For the added corporate taxes associated with the normalization of the real margin would permit an equal relief of personal taxes, either by their reduction or by the abatement of increases that would otherwise occur. This gain to personal disposable income would offset half of the price increase, leaving the net impact 3.5 percent.

Moreover, this would be a one-shot, nonrecurrent effect. Once accomplished, it would give no further impulse to inflation. Real inflation is generated by sustained and continuous forces, such, for example, as excessive monetary expansion or excessive wage increases, which can go on year after year./1 Without such forces, it would quickly come to a halt.

1/ See Unwinding the Present Inflation, MAPI, March 1977.

But this is not all. The restoration of real profit margins, even if attainable, would stretch over a period of years. It is not at all improbable that the gains in productivity during the transition period from the investment induced by the restoration would offset most or all of the price effects that would otherwise occur. In any event, the net impact on inflation would be small.

Conclusion

It would be pleasant to conclude this essay on an optimistic note, but we cannot, in honesty, do so. For reasons already set forth, the prospect for the normalization of real profits and profit margins is dismal. With the general disinclination of mangement even to try replacement-cost pricing, and the obdurate refusal of the federal government to recognize replacement costing for tax and regulatory purposes, the cards are stacked against success. Without it, the economy will continue to fall short of its growth potential, with serious consequences for production and employment alike. It is a spectacle to make angels weep.

CHANGING THEORIES OF FISCAL POLICY

by
George Terborgh
MAPI Economic Consultant

April 1978

MACHINERY AND ALLIED PRODUCTS INSTITUTE
1200 EIGHTEENTH STREET, N.W.
WASHINGTON, D.C., 20036

CHANGING THEORIES OF FISCAL POLICY

by

George Terborgh

It is always hazardous to assume that political actions are guided primarily by theoretical or philosophical principles. These do have some impact, varying from case to case, but in general the dominant motivation is political advantage. Certainly this is true of actions in the field of fiscal policy. Although it is customary for politicians to rationalize their decisions in this area by reference to prevailing theory, and to claim conformity thereto, their real motives are usually more practical.

This does not mean, however, that theory is of no consequence. Politicians are not immune to the contagion of widely held ideas, and when an orthodoxy develops on the proper role of fiscal policy they are likely to believe it themselves. Further--and more important--the fact that it _is_ an orthodoxy can affect the calculus of political advantage. The public, or at least its more articulate elements, may be critical of departures from accepted doctrine, thus creating an objective pressure to reinforce subjective belief. While the conformity of political action to prevailing doctrine is often loose, and sometimes nonexistent, theory undoubtedly has some normative influence.

Over the past 50 years there has been a succession of dominant theories or schools of thought on federal fiscal policy. These are, in chronological order: (1) annual budget balancing; (2) pump priming; (3) anti-stagnation budgeting; (4) the stabilizing budget; (5) fiscal activism; and (6) the present theory (at the moment nameless).

While our principal interest here is in present theory, it will help to put it in perspective if we review briefly the history of its predecessors.

I

EARLIER PHILOSOPHIES OF FISCAL POLICY

1. ANNUAL BUDGET BALANCING

Prior to the mid-thirties, federal budget deficits (except in time of war) were generally regarded as deplorable, if not downright sinful. Save for this single exception, the conventional wisdom called for annual balancing regardless of the state of the economy.

That this view was bipartisan is demonstrated not only by President Hoover's valiant, if vain, struggle to maintain a budget balance during the great depression, but also by Mr. Roosevelt's castigation of the unwanted deficits in the campaign of 1932 as a proof of fiscal irresponsibility. Notwithstanding their apparent agreement in principle, however, both presidents were overwhelmed in practice by the exigencies of the depression. Federal deficits persisted from fiscal 1931 to the beginning of World War II (after which, of course, they fell under the wartime exception). For 10 consecutive years the earlier canons of fiscal orthodoxy were honored in the breach.

2. PUMP PRIMING

It is not to be expected that a government will live in self-confessed sin for 10 years in a row. Repetition dulls the sense of guilt; rationalizations develop. As Pope put it:

> Vice is a monster of so hideous a mien,
> As, to be hated, needs but to be seen;
> Yet seen too oft, familiar with her face,
> We first endure, then pity, then embrace.

The embrace in this case was not long in coming. The first rationalization of peacetime deficiteering appeared during the economic expansion of 1933-37 in the form of "pump priming" theory. As its name implies, this envisaged the depression economy as a dry pump that needed priming by the stimulus of federal deficits. It was, of course, a basically optimistic view of the situation, implying a need for only temporary stimulation. It assumed that once the economic pump "took hold" the inherent dynamism of the system would carry it upward to full prosperity. What was needed was an initial push.

This pleasant dream was shattered by the sharp recession of 1937-38, which interrupted the recovery in midcareer (the unemployment rate before the decline being still around 13 percent). Apparently the pump refused to stay primed. But why? It was not long before an explanation was forthcoming in the theories of economic maturity and secular stagnation unveiled before the Temporary National Economic Committee in 1939.

3. ANTI-STAGNATION BUDGETING

In contrast to the cheerful optimism of the pump-priming theorists, the new revelation proclaimed a dismal doctrine indeed. We quote a thumbnail sketch from an earlier work:

> Formerly youthful, vigorous, and expansive--the theory runs--the American economy has become mature. The frontier is gone. Population growth is tapering

off. Our technology, ever increasing in complexity, gives less and less room for revolutionary inventions comparable in impact to the railroad, electric power, or the automobile in earlier times. The weakening of these dynamic factors leaves the economy with a dearth of opportunity for private investment, which is increasingly confined to the mere replacement of existing capital assets upon retirement. This replacement, and such limited expansion as remains, can be financed largely from the depreciation accruals and retained earnings of business enterprises, hence absorb little or no personal savings.

Meanwhile these savings accumulate inexorably, unaffected by the attrition of investment opportunity, and pile up as idle funds for which there is no outlet in new physical capital, their accumulation setting in motion a downward spiral of income and production. The decline of investment for expansion which characterizes the mature economy thus precipitates chronic oversaving, and ushers in an era of secular stagnation and recurring crises from which there is no escape except through the intervention of government, which must either tax out of existence the excess savings that are poisoning the economy or absorb them itself. In short, the private economy has become a cripple and can survive only by reliance on the crutches of government support./1

This, in the view of these stagnationists, was the reason for the aborted recovery of 1933-37. It was, moreover, a portent of the future. Save for the redeeming power of government support, they foresaw only a succession of long and severe depressions, punctuated by brief and anemic recoveries. The fiscal-policy implications of these doctrines were painfully clear. Most of the time, the federal government would have to absorb excess savings with its own deficits. This meant to the stagnationists both the enlargement of federal expenditures (euphemistically called "public investment"), and tax reductions if necessary, in order to provide the necessary absorption.

The golden age of the stagnationists was from 1939 to World War II. True, they continued their gloomy prognostications throughout the war, and especially when the great game of postwar forecasting warmed up, but their following failed to match their frenzy. The climate was inhospitable. The war had snapped the economy out of the doldrums, carried production into new high ground, and virtually eliminated unemployment. It was followed, after a brief reconversion period, by a peacetime boom. This experience went far to dissipate the depression psychology that provided so fertile a soil in earlier years. Moreover, by the end

1/ The Bogey of Economic Maturity, MAPI, 1945, pp. 2-3.

of the war economists of other persuasion had subjected stagnationist doctrines to critical analysis./1 Buffeted by these adverse developments, the cult never regained its prewar position, but instead faded rapidly into obscurity.

4. THE STABILIZING BUDGET

The waning of stagnationist philosophy opened the way for other views on the economic role of federal fiscal policy. While no consensus emerged, there can be little doubt that the dominant school of thought until the appearance of "fiscal activism" in the early sixties was the "stabilizing-budget" concept launched in 1947 by the Committee for Economic Development./2

The basic idea of the stabilizing budget was to set tax rates at a level that would yield a "moderate" surplus at high employment (defined as 4 percent unemployment), and then to leave them alone except for periodic adjustments to maintain this calibration and except for extraordinary emergencies. The object was to balance the budget over the business cycle. It was not contemplated that the rates would be varied in response to ordinary cyclical swings in the economy. The contracyclical effect was to be achieved primarily through the working of the "built-in stabilizers" and through monetary policy.

In promulgating this concept the CED expressly repudiated the alternative of "managed compensatory budget policy," described as "the policy of adjusting tax rates and expenditure programs as often as necessary and to the extent necessary to keep employment and the national income steady at a high level." Such a policy had to be predicated on business forecasts, a fatal defect in the then-existing state of the forecasting art. Moreover, frequent changes in tax rates were disturbing to business, and if mistimed might have a destabilizing effect on the economy./3

5. FISCAL ACTIVISM

This concept of fiscal policy, sometimes called the "new economics," came into dominance in the early sixties, under the leadership of Walter Heller, then Chairman of President Kennedy's Council of Economic Advisers. It is best expounded in the Council's own words:

1/ For example, The Bogey of Economic Maturity, already cited.

2/ Taxes and the Budget: A Program for Prosperity in a Free Economy (Committee for Economic Development, New York, 1947).

3/ We should add that this capsule description of the stabilizing-budget concept is not offered as a complete account of the CED position on federal fiscal policy, which had other aspects as well.

> Built into the Federal fiscal system are several automatic defenses against recession and inflation. . . . Tax revenues change proportionally more than GNP. Furthermore, certain Federal expenditures, such as unemployment compensation payments, are automatically affected by the state of the economy. . . . These built-in stabilizers moderate the severity of cyclical swings. . . . But if the forces causing the downturn are strong and persistent, they may not suffice to prevent a large and prolonged recession, Furthermore, they are blindly symmetrical in their effects. When economic activity quickens after a slump, the rise in Federal revenues begins immediately and slows the recovery in employment and incomes. For these reasons, the task of economic stabilization cannot be left entirely to built-in stabilizers. Discretionary budget policy, e.g., changes in tax rates or expenditure programs, is indispensable--sometimes to reinforce, sometimes to offset, the effects of the stabilizers.
>
> To be effective, discretionary budget policy should be flexible. In order to promote economic stability, the Government should be able to change quickly tax rates or expenditure programs, and equally able to reverse its actions as circumstances change. . . . If moderate fiscal action can be taken quickly and can be speedily reversed when circumstances warrant, the dangers of overstimulating or overrestricting the economy are much smaller than if fiscal responses are sluggish and difficult to reverse./1

It should be said that the "fine-tuning" version of fiscal activism propounded in 1962 by the Council was never effectively implemented, nor could it have been without bypassing the slow and erratic procedures of congressional enactment. This was recognized at the outset by President Kennedy, who introduced in 1962 a proposal authorizing him to reduce personal income tax rates by 5 percentage points at his discretion, subject to congressional veto within 30 days. The scheme was so overwhelmingly rejected by the House Ways and Means Committee that no succeeding President has dared to make a similar request.

It should be said also that the life of activist theory was comparatively brief. A few years later the Council was backtracking:

> In principle, such fluctuations [in private demand] could be offset by expansionary fiscal and monetary policies if the course of demand could be perfectly

1/ Economic Report, 1962, pp. 71-72.

> foreseen. But it can't and nobody is more aware of that fact of life than the Council of Economic Advisers. We have never claimed or attempted to engage in the practice known as "fine tuning." I freely plead guilty to the wish that our predictive techniques and our policy instruments were up to that high standard, . . . but in the present state of the arts, the application of fiscal and monetary policy offers us only limited protection against the impact of fluctuations in private demand./1

6. EFFECT OF EARLIER THEORIES

It is doubtful if the various fiscal theories that succeeded each other during the great depression of the thirties had much effect on actual budget results. As recalled earlier, the Hoover regime ran deficits notwithstanding its devotion to annually balanced budgets. The New Deal deficits of 1933-1937 were probably little affected by pump-priming theory, which served mainly to rationalize what the Administration was already doing. It is debatable also whether the mature economy doctrines had any significant impact on the deficits of 1939-40. Here too the role of theory was largely the rationalization of budgetary actions taken for other reasons.

To what extent was this true of the postwar stabilizing-budget doctrines? No one can say with certainty, of course, but there is reason to believe that their influence was appreciable, and possibly substantial. In the words of a former CED official, "In key respects the stabilizing-budget policy comes pretty close to explaining the practice of 1947-64. At least it comes closer than any competing theory of policy. . . . I would say that it was followed with many lapses and transgressions."/2

As for fiscal activism, we have already noted that it was never really implemented. The Council of Economic Advisers favored a stimulative tax cut in the summer of 1962, but the President declined to go along at that time. When the cut did come, it was for the fiscal year 1964, hardly an example of activism. In January 1967 President Johnson urged Congress to enact a restrictive tax increase for fiscal 1968 (an appeal renewed in August and November), only to have it deferred to fiscal 1969. Again, a poor example. Subsequent efforts to gear changes in the federal budget position to the alleged needs of the economy fared little better. Any resemblence to the theoretical requirements was largely coincidental.

1/ Arthur M. Okun (then Chairman, CEA), Issues in Preserving Prosperity, Economic Club of New York, March 6, 1968, pp. 3-4 (mimeo). The concept also came in for congressional criticism. See the statement by Wilbur Mills, then Chairman of the House Ways and Means Committee, The New Economics, MAPI, 1968, p. 169.

2/ Herbert Stein, then Vice President and Chief Economist (from correspondence).

II

PRESENT THEORY

In our earlier listing of fiscal-policy theories, we left the present one nameless. This for good reason: it is hard to label. Historically, it is a derivative of fiscal-activism theory; it is what remained after the flexible, or fine-tuning, approach was abandoned. Perhaps it can best be described as a sedated, or tranquilized, version of that approach.

This is obviously a change in the application of fiscal policy, not in its basic theory. The latter remains essentially the version propounded by the early activists. Since there is no difference in principle between frequent shifts in the federal budget position and once-a-year changes incorporated in the forthcoming budget (the prevailing pattern today), it has not been deemed necessary to rework the theory, and comparatively little has been done in that direction.

We observed earlier that there is often little relation between what theory calls for and what actually happens. Certainly it has been true of this modified version of fiscal activism. Presumably, it has shared the assumptions and expectations of its predecessor that its application would result in an irregular alternation of budget deficits and surpluses./1 Yet if we were to infer the theory from actual fiscal behavior, we would have to describe it as a theory of continuous deficiteering. The entire decade of the seventies (including 1978 and 1979) will show an unbroken string of deficits. If the string is extended through 1982, as now projected, it will complete a period of 22 consecutive years with only one surplus./2

Neo-Stagnationism?

The only one of the earlier fiscal-policy philosophies that could rationalize such behavior is the theory of secular stagnation. The stagnationists alone premised the necessity for almost continuous deficiteering, in keeping, of course, with their views on the chronic weakness of the private economy and the consequent need for sustained government support. What we have done over the past couple of decades is to apply stagnationist policy without espousing the theory that rationalized it. The theory died a generation ago, and it is safe to say that few of those responsible for subsequent deficiteering even gave it a thought. Yet the stagnationists could not have conceived in their wildest dreams a more faithful application of their policy prescription.

1/ An assumption shared, you will recall, by the earlier stabilizing-budget school, which contemplated a balance over the business cycle.
2/ Fiscal years, unified budget basis.

This is well exemplified by recent developments. We have now completed three full years of recovery from the recent recession and are approaching the point where the expansion of the economy, which has averaged 5.5 percent per annum over the interval (in real GNP), should be tapered down toward a more sustainable rate. Yet the budget for fiscal 1979 (starting October next) calls for a deficit of $60 billion. This during the fourth and fifth years of recovery. But that is not all. Deficits (hopefully diminishing) are expected to continue through 1982.

This projection of massive deficits into the advanced stages of recovery (and beyond) may be attributed by some to the cowardice and irresponsibility of politicians, but it is well to remember that the program has been vigorously supported by eminent fiscal-policy theorists, their thesis being, apparently, that the private sector lacks the energy and vitality to recover in the face of the "fiscal drag" from declining federal deficits./1 Having become addicted to the fiscal stimulant during the recession, in other words, it cannot kick the habit without traumatic consequences.

In one respect, this implicit stagnationism is more extreme than the original version. While the proponents of that version premised a dearth of investment opportunities in the private sector, and distilled their pessimism therefrom, they never held that recoveries from recessions required undiminished federal deficits all the way up to (and even into) the succeeding boom. Yet their current successors, most of whom strongly reject the idea of inadequate investment opportunities, appear to have adopted the thesis for the present recovery (through 1979 at least), if not, indeed, more generally.

Fuzzy Picture

As noted earlier, present fiscal-policy theory is poorly rationalized and hard to label. While fiscal behavior during its period of dominance has conformed to the expectations of the stagnationists, the fact that it has not been motivated by their doctrines leaves us guessing. What is the rationale for the continuous deficiteering we have indulged in over the past couple of decades? Or to come down to date, what is the rationale for running undiminished deficits into the fifth year of recovery? Why is it that the economy cannot do this time what it has repeatedly done before: recover in the face of an improving budget position?/2 If the private sector has become too weak to overcome "fiscal drag," what is the nature of its malady? We are not told.

1/ The "private sector" as used here is really the non-federal sector, including state and local governments.

2/ It did so in all previous postwar recoveries save the one following the minor recession of 1969-70, when a sizable deficit persisted throughout the move.

In the absence of answers to such questions, contemporary fiscal theory remains fuzzy. It would be a great service both to politicians and to the public if it were more clearly articulated.

III

CONCLUSION

As its title indicates, this essay is a quick review of the fiscal-policy philosophies, or schools of thought, that have successively attained dominance over the past half century. This is not the place for a systematic critique of these changing orthodoxies, which we have offered elsewhere.[1] We should like, however, to close with a few observations on deficiteering in general.

It Has Been Oversold

There is a tendency among the proponents of deficiteering to regard it as a sure-fire panacea for whatever ails the economy. This is an illusion. We noted earlier that in the great depression of the thirties there were deficits in 10 consecutive peacetime years. They were, moreover, relatively large, averaging 2.6 percent of GNP, not far from the estimated average for fiscal years 1975-79. Yet the period ended with an unemployment rate of 15 percent. It took World War II to pull the economy out of the doldrums. Something was wrong with the system that counteracted and frustrated the fiscal stimulus. The same must be true of today's economy under the massive deficiteering of recent years. If it needs undiminished support into the fifth year of recovery, it must have maladies that do not respond to fiscal medicine.

One possibility rarely considered by fiscal theorists is that the maladies may be, in part, a side-effect of the medicine itself. Far from being a panacea, deficiteering can set up countervailing forces that reduce the overall, or _net_, stimulus to a fraction of the theoretical impact, and a variable fraction at that. Much depends, for example, on the way the deficit is _financed_. If it leads to a more rapid expansion of the money supply than would otherwise be appropriate, it can inject a stimulus (at the risk of inflation of course) without countervailing offsets. If, on the other hand, it is financed from the capital market, it raises interest rates above what they would be in its absence and diverts savings from other claimants, to the detriment of private capital formation, especially in interest-sensitive sectors. Moreover, it raises the threshold (required return) for equity commitments. This weakening of the investment sector of the economy runs counter to the strengthening of the consumption sector through the deficit and reduces the net stimulative

1/ _The New Economics_, MAPI, 1968.

effect. While the reduction is likely to be small during recession and the early stages of recovery, it becomes increasingly substantial as the expansion develops. In the present situation, the deficits projected for the fourth and fifth years of recovery are likely to yield a low net-benefit ratio.

We are speaking here of the short-run benefit. Over the long run, sustained deficiteering can have a negative effect on the economy. By reducing the amount of savings available to the private sector, and with it the amount of private investment, it slows the secular growth of productivity and output to the detriment of all. This can be particularly serious in the case of the United States, which has one of the lowest investment-to-GNP ratios in the industrialized world.

Rethinking Needed

We have not mentioned the practical difficulties in applying current fiscal-policy theory--the inevitable reliance on economic forecasting a year or more ahead, the uncertainty as to what the economy would do in the absence of fiscal stimulation, the equal uncertainty about the size of the deficit appropriate to the given situation, etc. These and other application problems can be as important as the theory itself, but since the latter is our concern here, they are only noted in passing. One thing can be said with certainty, however: they can bedevil the implementation even of a correct theory.

As for contemporary fiscal-policy theorizing, it is often simplistic to the point of naivete. Not only has it been oversold to the public and to politicians; it has been overapplied in practice. If the economy needs all the fiscal stimulation it is scheduled to get in the years immediately ahead, something is wrong with it. Whatever the retardative factors--monetary policy, inflation, low real profits, high interest rates, depressed equity values, low business confidence, overregulation, adverse trade balance (the list could be extended)--they need separate diagnosis and treatment. They cannot be eliminated simply by running the fiscal pump full blast, particularly when this aggravates many of the maladies it seeks to cure.

We remarked earlier that the exponents of contemporary fiscal-policy theory would do the public a favor by clarifying it. We may add that they would do it an even greater favor by rethinking it.

O