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REVIEW OF THE ECONOMY AND THE 1975 BUDGET

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HEARINGS

BEFORE THE

COMMITTEE ON THE BUDGET HOUSE OF REPRESENTATIVES

NINETY-THIRD CONGRESS

SECOND SESSION

SEPTEMBER 17, 19, AND 25, 1974

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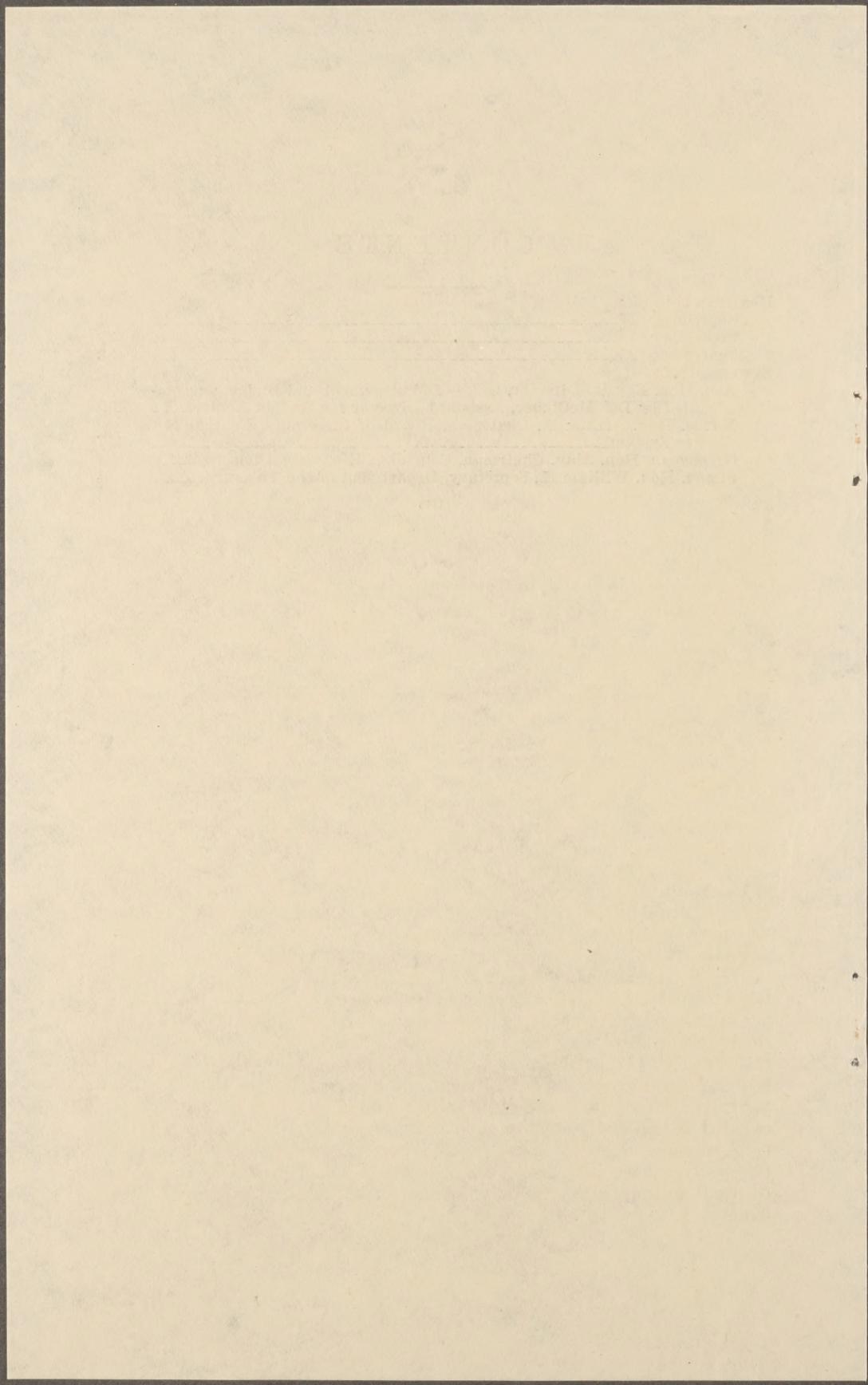
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REVIEW OF THE ECONOMY AND THE 1975 BUDGET

TUESDAY, SEPTEMBER 17, 1974

HOUSE OF REPRESENTATIVES,
COMMITTEE ON THE BUDGET,
Washington, D.C.

The committee met, pursuant to notice, at 9:30 a.m., in room 2359, Rayburn House Office Building, Hon. Al Ullman (chairman of the committee) presiding.

Chairman ULLMAN. The committee will be in order.

This is the first hearing of the new House Budget Committee and we are here to question the Secretary of the Treasury, Mr. William E. Simon, on the problems of the economy as they relate to our assignment here in the Congress.

Let me welcome you, Mr. Secretary, before this committee. This is a first, and you have been chosen to give us advice and also to take the brunt of our questions during a most difficult time in our economy.

Next year, this committee will begin the historic task of producing a unified congressional budget, something Congress, in all its long history, has never before succeeded in doing. We will need the best advice and the most accurate information we can get. So I hope that this will be the first of many informative and productive sessions.

Next I want to pay a well-deserved tribute to the Task Force that arranged this series of hearings, to Congressman Neal Smith, its chairman, and his colleagues, Martha Griffiths, Thomas Ashley, Robert Giaimo, Parren Mitchell, Elford Cederberg, Joel Broyhill, and Delwin Clawson.

We are greatly indebted to them. Because of their special efforts on our behalf, I hope the committee will agree with me that Mr. Smith and Mr. Cederberg should receive priority recognition in questioning the witnesses at these hearings.

Even though this committee's formal responsibilities do not begin until we consider the budget for fiscal year 1977, there is an urgent need for us to hold these hearings at this time.

Our Nation's economy, indeed the world's economy, is at this moment in a critical and precarious state. What is ultimately done with the fiscal 1975 budget will have a profound impact on the economy and, to a significant degree, will determine the conditions we will face next year. Our committee must therefore immediately begin to make a careful analysis of our present dilemma and of the possible alternative solutions open to us. Now is not too soon to acquire the depth of perspective necessary for judicious consideration of the complexities of fiscal and monetary policy, national priorities, and economic conditions.

Now, let's face the ugly truth. We are in deep, deep economic difficulty; our economy is totally out of kilter. To describe our condition as galloping inflation is to use a phrase as antique as the horse-and-buggy days in which it was invented. We do not have a galloping inflation; we have something very close to jet-propelled inflation.

Moreover, much to the consternation of those accustomed to horse-and-buggy economic thinking, we are simultaneously in the grip of an increasingly serious recession. We face increasing unemployment and forecasts of even higher rates of unemployment next year, unchanged or falling levels of real output, housing starts at half the level of 2 years ago, steep increases across the board in wholesale prices, even more increases in the interest rates on mortgages and loans to consumers and small business, and fears of a liquidity crisis because lenders have no reserves available for loan applications.

What is this administration's response to the crisis? At the very time when our economy should be expanding, at the very time when we desperately need capital to increase productivity in area after area, we are facing a Government-induced capital crisis. Our tight money policy has virtually shut off the funds our economy desperately needs both for increased productivity in areas of critical shortages and for meeting our pressing energy, environmental, and social needs.

The main burden of the administration's monetary policy has fallen on the housing industry and its suppliers, with secondary effects in the home furnishings industry. The unemployment rates in residential construction reflect a depression. As the situation becomes worse—and it is becoming worse—other industries affected by housing will join in this depression.

In the face of these fundamental economic weaknesses and crying demands, the administration's response seems to me to be totally unfocused, to have no relation to the Nation's needs. Instead of an overall plan to deal with the manifold complexities of our situation and to take into account the many facets of our economic distress, the administration still relies on that tired simplistic panacea, a tight money supply.

The economic policy of this administration has faced up neither to our Nation's long-term economic needs nor to the desperate international economic situation. The world's economy is in an enveloping crisis. Inflation even worse than ours is rampant all over the globe, and the stability of democratic governments everywhere is threatened because of it. At a moment when this Nation should be exercising its responsibilities for leadership of the free world, there is a vacuum of meaningful leadership to pull this Nation together.

Surely the time has come to toss on the garbage heap the old, trite, outmoded economic concepts that clearly have failed us. To control what is potentially the most devastating inflation in our history, we need imaginative and humane leadership. I have yet to see any sign that that is forthcoming.

Budget cuts, yes. This committee intends to give leadership to meaningful fiscal reform. But by itself, without the full gamut of discipline that is necessary, it can be as counterproductive as overreliance on tight monetary policy.

Mr. Secretary, tell us why we are spinning helplessly in this whirlpool of inflation with no meaningful national policy for survival. We will be very glad to hear from you.

Mr. RHODES. Mr. Chairman, before you hear from the Secretary—

Chairman ULLMAN. I am very happy to recognize the ranking minority member, the distinguished Minority Leader of the House, Mr. Rhodes.

Mr. RHODES. I am a little amazed. I thought I was in the Budget Committee until the chairman read his politically inspired statement, which makes it apparent that I am in the Joint Economic Committee.

Now, Mr. Chairman, if this committee is going to be dominated by politics, it will not do its job—I promise you that right here and now. The job of this committee is to try to make some fiscal and budgetary sense in this Government; it is not in the realm of the economy except fiscally, and if the Secretary is to be called here to talk about the budget—and I am certainly in favor of him talking about it and I hope that he will—I would certainly hope that we could refrain from getting the committee involved in clichés such as depressions, recessions, and getting into political arguments over just what we have as far as the economy is concerned.

We are interested in only one phase of this economy and that is the budget, a very important phase. As I have done before, I pledge to you my sincerest efforts in trying to get this budget under control, but if I am going to be exposed to any more political diatribes like this, then you may be sure that cooperation will end almost immediately.

Chairman ULLMAN. I am sorry my remarks have roused the ire of my good friend the minority leader, who has been such a stalwart supporter of this whole budget effort. But let me say that the problems of this Nation are far greater than most of us have thus far been ready to admit.

I will be the first to admit that they are not entirely the fault of this administration; they are the fault of the Democratic-controlled Congress as well. That is one of the reasons we have established the Budget Committee. They are in part, certainly, the fault of previous administrations that have been Democratic. I am the first to admit that, and to recognize it.

But I do say that at the present time the administration now in the White House has the awesome responsibility of looking at the situation that we are presented with today, and of giving us the kind of leadership that we need down there to pull it together. And it is your job and my job here on the Hill to make sure that, to the extent that we can influence policy here, we put more responsibility into congressional procedures so that we can carry our share of the load.

But, Mr. Secretary—yes, I would be happy to yield to the ranking majority member, Mr. Whitten of Mississippi.

Mr. WHITTEN. Mr. Chairman, I regret the colloquy that has taken place, except I know, having known both of you gentlemen so long, that this is for the moment only. The very organization of this committee, having been one of the joint cochairmen in the original study, was in recognition of the bad situation that our Nation faces at home and abroad. And as you have said, there are many, many causes for it, but if we are going to do anything about it, we must recognize all of them. Having recognized, we must dig into the causes and goodness knows there is enough fault to go around.

So, I think, having made these three or four statements, that we can take off on our original purpose. We must recognize the serious situation we face. The fact that this committee was created is a recognition of that situation, and the fact that Congress has taken this stand is a recognition that Congress has a share in the national policy and that we should not wait for recommendations by an executive branch, in all cases, before we move.

For the first time in history, as I understand it, Congress will have a budget office of its own; it will have the chance to be prepared in making decisions and moving with its own leadership, so that we will once again have three equal branches of the Government.

I say again, it is a pleasure to work with you both. I know you will work together.

Chairman ULLMAN. I thank the gentleman.

That introduction, Mr. Secretary, I think you well recognize, is stimulated by the tremendous concern that some of us have, I think most Members of Congress have, as to where this economy is going.

All too often we have dealt with kid gloves when we should be talking gut issues about an economy that is in real trouble, and that certainly is the only motivation in my opening statement.

So, Mr. Secretary, we would be very happy to hear from you.

STATEMENT OF HON. WILLIAM E. SIMON, SECRETARY, DEPARTMENT OF THE TREASURY

Secretary SIMON. Thank you, Mr. Chairman and members of this committee.

I am glad to be here this morning to participate in these first hearings of the House Budget Committee. I have been an enthusiastic supporter of budget reform since I first came to the Treasury, and I am pleased to see that you are moving so very promptly to implement the Budget Reform and Impoundment Control Act of 1974.

This is an important time for the Budget Committee to begin its work. In my judgment, there is nothing we can do that is more important for the economic welfare of the American people than to reduce the very rapid momentum that has built up in the growth of

Federal expenditures. We need a strengthened decisionmaking process to impose discipline on the budget. The need for more effective control over Federal expenditures has been apparent for some years, but the emergence of intolerably rapid rates of inflation has recently brought the issues into much sharper focus.

How did we get into this inflationary mess? I will not try to retrace all the causes of the current inflation, or try to fix the blame one place or another. Without too much risk of oversimplification, I think it is fair to say that the price explosion of 1973-74 is primarily attributable to (a) a series of severe temporary shocks that originated mostly outside the U.S. economic system and (b) almost a decade of excessively stimulative fiscal and monetary policies.

The outside shocks are, by now, familiar to all of us. The worldwide agricultural crop failures of 1972, enormous pressures on the prices of internationally traded raw materials, the devaluation of the dollar, and the Arab oil embargo. In addition, the end of the controls program has been operating as an additional temporary force to raise some prices and wages faster than otherwise would have been the case. Taken together, these temporary factors may explain upward of one-half of our current rate of inflation.

All these special factors, as important as they have been, are of a temporary, one-shot nature. Had our general economic policies not been too stimulative, the outside shocks would have had only a one-time effect. Once they had worked their way through the system, the inflation would have settled down again to a tolerable rate.

But our general economic policies have, in fact, been far too stimulative for a long period of time. Let me give you two examples of how policy changed in the mid-1960's.

First, on the fiscal side: from 1955 to 1965 Federal expenditures rose at roughly a 6-percent annual rate. From 1965 to 1974, Federal expenditures surged to a 10-percent annual rate of growth. This rapid spending growth created huge Federal deficits which, coming as they did during periods of high business activity, added enormously to economic demands. These deficits were, therefore, directly responsible for creating strong upward pressures on the price level.

Second, monetary policy also broke out of a previously established pattern. From 1955 to 1965 the money supply grew at a 2½-percent rate. Since then, the growth rate has more than doubled to a 6-percent annual rate. It is no accident that during the earlier period we had a rather stable price performance, but since 1965 we have had the worst peacetime inflation in our history.

What has and is happening, then, is that the excessive budget deficits and the excessive growth of money and credit in recent years prevented the "temporary" price pressures from running their course and fading away. Instead, much of the inflation from the outside shocks is or soon will be deeply embedded in our entire system. It is or soon will be embedded into the pattern of wage settlements and into the

structure of interest rates. It is or soon will be embedded into the economic expectations of consumers, of workers, of investors, of businessmen—everyone.

And because this inflation is becoming so deeply embedded, squeezing it out of the system will be a long, tough process. It is a more difficult challenge for economic policy.

Our only viable primary policy, in my opinion, is to apply the necessary fiscal and monetary discipline persistently and consistently to keep total demands on the economy within the limits of its capacity to produce.

This will also help us achieve the premier long-term goal of economic policy, which is to make sure that during the next decade our economy generates the enormous volume of savings and investment that will be necessary for Project Independence, new mass transit systems, housing, environmental improvement, and all the other capital requirements of our society. I believe that we will have to raise the share of national output devoted to savings and investment by a substantial margin.

It is not widely recognized that our investment performance has been relatively poor. Since 1960, plant and equipment spending in the United States was only 15 percent of total output, whereas France invested 18 percent, Germany 20 percent, and Japan 27 percent. And furthermore, for gross domestic investment (which includes inventories, housing, and public investment), the proportions for 1973 were United States, 17 percent; France, 26 percent; Germany, 25 percent; and Japan, 37 percent.

It will not be a simple matter to raise our investment share; quite the contrary. We will have to change our many policies that encourage consumption at the expense of savings and investment. Among the most important changes that we will have to make is to maintain regular surpluses in the budget, so that the Federal Government would be adding to the supply of savings available to the private economy, instead of using up those savings—as we have been doing in 13 of the past 14 years. If we could maintain, on average, a budget surplus equal to even one-half percent of GNP, we would add about 3 percent to the flow of savings available to the private sector. And the chances are that over the longer term we will need an appreciable budget surplus to augment the stream of private savings.

On this point, I think we should remember that the Federal Government has a greater impact on the financial markets than is indicated by the deficit in the unified budget. For one thing, the Export-Import Bank and the Postal Service are not included in the budget and, correspondingly, their credit demands do not get included in the budget deficit. Much more important, there is a large volume of credit that is guaranteed by Federal agencies—to assist public and private housing, urban and rural development, shipbuilding and railroads,

health, education, small business and other functions. These all represent demands that we in the Government place on financial markets. It is not often realized how large these demands are; in fact, in many years the net borrowings for these programs exceed the deficit in the unified budget, as shown in the table below. (Note that these figures do not include the borrowings of the federally sponsored agencies: the Federal National Mortgage Association, the Home Loan Bank System, and the Farm Credit System.)

[In billions of dollars]

Fiscal year	Unified budget deficit	Additional Federal credit	Total
1971.....	-23.0	-16.8	-39.8
1972.....	-23.2	-18.0	-41.2
1973.....	-14.3	-15.6	-29.9
1974.....	-3.5	-16.8	-20.3
1975 (estimated).....	-11.4	-14.9	-26.3

If the sponsored agencies are also added in, the Federal presence in the credit markets reaches rather startling dimensions. In the fiscal year 1973, total Federal and federally assisted borrowings accounted for about 60 percent of all the funds raised through borrowings in the capital markets. This concerns me greatly. I hope that your committee will take a large view of its responsibilities and look beyond the budget, as it is conventionally defined, to the off-budget outlays, credit guarantees, and Government actions generally that commit economic resources and add to the already heavy pressures on our capital markets.

Let me emphasize that the fight against inflation will take years. There are no shortcuts, no acceptable quick solutions. The balanced application of fiscal and monetary restraint is the answer. Balance is the word I wish to stress. When the budget is weak and overstimulates the economy, the monetary authorities have no choice but to bear the entire burden of stabilization policy. This places heavy strain on our financial markets and imposes a disproportionate adjustment on particular sectors, such as housing. More fiscal restraint would remove the need to press monetary restraint quite so hard.

There are those who question the effectiveness of restrictive fiscal policy to counter these fundamental inflationary pressures. In my view, however, the evidence of experience is clear that fiscal restraint applied consistently and in tandem with monetary restraint can bring inflation under control.

Inflation is an exceedingly complex process and no simple chart will ever be able to give us the answer to the inflation problem. I believe, however, that the attached chart captures the essence of the budget's contribution to the control of inflation. It can be seen that the actual budget position (top panel) does not correlate closely with the rate of inflation (bottom panel). This is where the full employment budget

proves itself to be a useful guide to economic policy. The full employment calculation adjusts the budget data to remove the impact of the economy on the budget, and thereby brings out the impact of the budget on the economy. When the full employment budget position (middle panel) is compared to the rate of inflation, a fairly striking pattern emerges. There is a strong general relationship between the two. In the broad sweep of things, it is clear that sustained and sizable budget surpluses are associated with below-average inflation and sustained and sizable budget deficits are associated with above-average inflation.

There are 2 years during the 26-year span covered by the chart in which the inflation is far higher than can be accounted for by fiscal policy. These years are 1950-1951 and 1973-1974, which were the two occasions when commodity inflation (food and industrial raw materials) had an extraordinarily large, one-time impact on the general price level. Aside from these two occasions, the relationship strongly supports the general notion that budget deficits are inflationary and budget surpluses are not inflationary.

ECONOMIC ADJUSTMENTS

Any well-conceived anti-inflation program must also have regard for the casualties of inflation and for those whose earnings may be interrupted for a time by a program of disinflation. Without getting into detail, let me say that I believe we can gradually reduce inflation without suffering massive unemployment. For a time, we will have to live with more unemployment than we would like, but it will not have to be a large amount. To deal with this contingency, we have proposed improvements in our system of unemployment compensation, and I again urge congressional passage of that legislation. The administration is also considering whether or not an expansion of the present public service employment program would make a useful contribution to economic stabilization. This is one of the issues on which there has been much discussion, and considerable controversy, at many of the conferences we have held thus far on inflation.

Strains in the financial markets have had particularly adverse effects on the housing and utility industries. In May we put forward a \$10 billion program to augment the supply of mortgage funds, and on September 11, Federal officials and State utility regulators met to explore solutions to the critical financial problems facing the utility industry.

The surging costs of fuel, construction and money have placed intense financial strains on both industries, producing dangerously low earnings for many companies. In the utility industry, regulatory lag has intensified the problems. While State and local regulatory bodies have jurisdiction to act, the administration is examining what might be done to speed up the needed changes. The administration believes that raising utility rates now to a level sufficient to cover the real economic costs of providing those services is deflationary in the long run.

The expansion of credit in the housing industry and tax and other Federal initiatives in the utility industry are exactly the kind of solutions which are required now to lay the foundation for gradual disinflation. Some of the necessary economic adjustments will be painful and at times will raise prices in the short run, but all will have a common long-term goal—reducing and eventually eliminating inflation.

WHERE TO CUT

It is easy for me to come before you and say that we must cut the budget. The next step, however, is the tough one: Where should the cuts be made? What specific programs are to be eliminated or at least stretched out? This is the nub of the issue, and although the general idea of cutting the budget has gained in popularity, that is almost certainly not true for individual programs. Specific budget cuts are never popular. Nobody wants to see their own high-priority areas cut back; that is entirely understandable. But the time has come when we must make some hard choices.

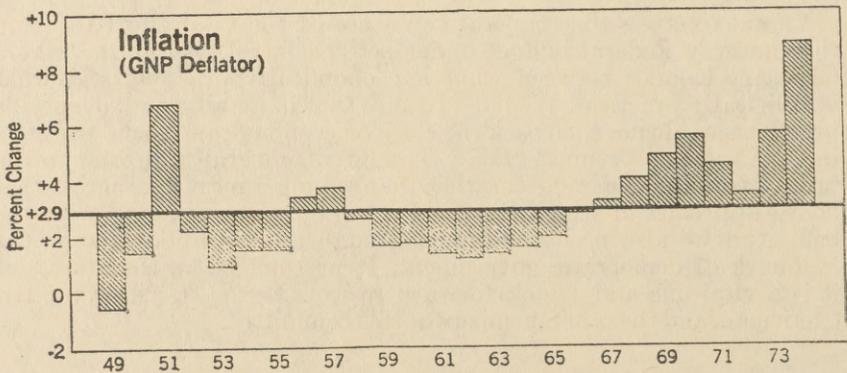
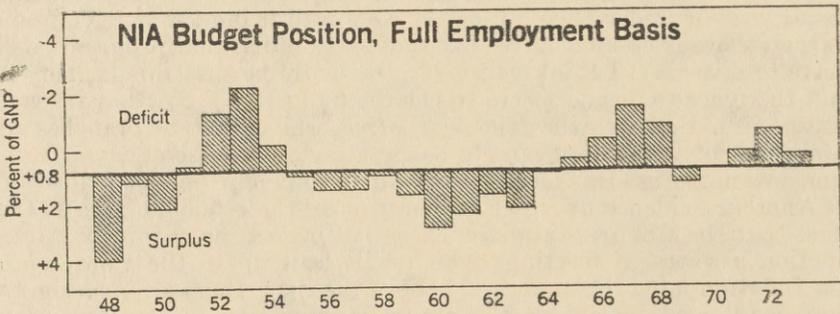
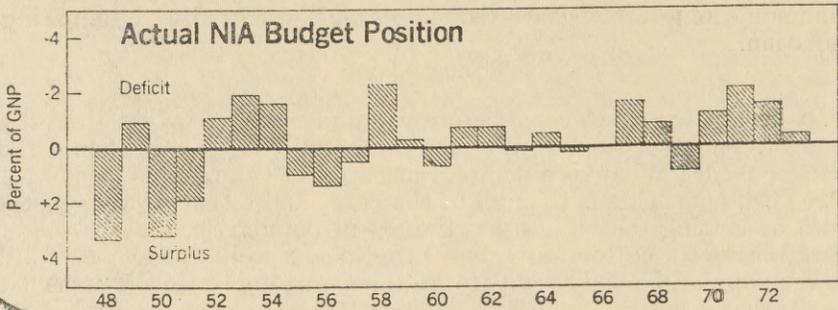
President Ford has announced that our target is a figure in this fiscal year of under \$300 billion. If we are to bring the budget in on target, there is no alternative but that some individual programs will have to give way. I think you will agree with me that this hearing is not the place to decide where to cut the budget. We now have a new mechanism that provides the legislative and executive branches of Government with the means to cooperate closely on budget matters, and we should use this mechanism to determine our budget priorities.

Another evidence of closer cooperation in the economic area is the fact that the Congress and the executive branch have jointly set in motion a series of meetings which will lead up to the Conference on Inflation later this month. I believe these meetings are making an important contribution to the economic education of the American people; the difficult and complex nature of the inflation problem is clear for all to see.

I want to stress the cooperative nature of the vital effort to bring the runaway Federal budget under better control. We must strike a necessary balance between what is economically practical and what is politically practical. We must be sure that in making cuts in specific programs we do not turn back the clock on economic and social progress in this Nation. We must take a thoughtful, careful approach to the task of pruning the budget, rather than taking a meat axe, across-the-board approach in which the good programs get cut along with the bad. And we also need the kind of tough give-and-take that is the hallmark of democratic government. It will not be an easy task but it is a vital one and I look forward to working on it with you, Mr. Chairman, and the other members of this committee.

[Attachments to statement follow:]

THE BUDGET AND INFLATION



NOTES TO CHART

Panel 1.—The budget data shown here are the actual surpluses and deficits, on a national income accounts basis, for calendar years expressed as a percent of Gross National Product. Note that these data are plotted on an inverted basis in order to provide an easier visual comparison with the inflation rate.

Panel 2.—These budget data are the same as in Panel 1 except that the surpluses and deficits have been adjusted by the Federal Reserve Bank of St. Louis to a full-employment basis by standardizing the figures to a constant 4 percent unemployment rate. The bars are plotted—for the purpose of better displaying the relationship between the budget and inflation—as deviations from the average surplus for 1948–73 of 0.8 percent of GNP. (Panel 1 was not plotted this way because the average was virtually equal to zero.)

Panel 3.—Inflation is represented here by percent changes in the GNP deflator from the previous year. In effect, therefore, the inflation measure is charted with a 6-month lag compared to the budget data in Panels 1 and 2. The bars are plotted as deviations from the 1949–74 average price increase of 2.9 percent.

Source of data : U.S. Department of Commerce.

Secretary SIMON. I would be delighted to answer any questions you have, Mr. Chairman.

Chairman ULLMAN. Thank you very much, Mr. Secretary, for a very thorough economic statement.

I am going to call on the distinguished chairman of the Task Force to begin the questioning, and I will remind the committee that we are operating, under the rules of the House, under the 5-minute rule.

Mr. Simon, unfortunately, must go to a Cabinet meeting later this morning, and we would like to get him away as soon as possible after 11 o'clock. So let's be expeditious in our questioning. It is a pleasure for me to begin the questioning with our distinguished chairman of the Task Force, Congressman Neal Smith of Iowa.

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

Mr. Simon, this budget that we are looking at now, the 1975 budget, planning for it started about a year ago. I think the administration started its budget process at least as far back as October of last year, for the 1975 budget.

Of course, the budget includes both expenditures and revenue estimates. Now, in the course of these hearings we hope to hear from others, especially, as to expenditure estimates. But one of the principal purposes of having you as a witness is to give us some estimates of revenues, or some new estimates. After all, it has been about 9 months since the last estimate was placed before the Congress.

I would say this: that I think everybody on the committee, and I do not propose to debate it at all, everybody on the committee might have different ideas as to where we should prune the budget, but we can all agree that it is important to be prudent, not just that there is some pruning to be done.

Now that there has been a statement from the White House that we should reduce spending below \$300 billion for psychological reasons. That would be a \$5-billion reduction. Now what are you estimating in the way of revenues as compared to a \$300 billion expenditure?

Secretary SIMON. Mr. Smith, our fresh revenue estimates are approximately \$297 billion, but I stress that that is approximate because revenue statements very, very seldom come in on target. It depends on so many events. We are not able to forecast right now the level of business activity, consumer activity, and so forth. One must guess the behavior of many components of this complex economy to come even close.

If you look back on the history of estimates, they have never been exactly on target. Some years they are closer than others, but I do not consider the past record a very reliable indicator. That is a ball park number, Mr. Smith.

Mr. SMITH. Mr. Simon, as a matter of fact, history does support you. Since the unified budget process started in 1969, I think, the average error has been \$9.6 billion. Now yesterday in Pittsburgh, at one of the minisummit meetings, we had estimates from some people in the private sector that if the money supply is not adjusted some, loosened up some, that it might run as much as \$25 billion.

Would you give us some idea of what range of error you think there may be in these revenue estimates?

Secretary SIMON. I think when you talk about the \$25 billion, you are talking about the budget deficit, Mr. Smith.

Mr. SMITH. That is right, but primarily because they think there is going to be a reduction in revenue.

Secretary SIMON. I think that should also include, Mr. Smith, the off-budget items that I referred to in my testimony. You know, last year we talked about a budget deficit of \$3.5 billion, which on a unified basis is correct. However, when one adds in the off-budget financing items which have in the short run the same inflationary impact on our economy, the actual budget deficit was \$20.3 billion and this year, if the budget deficit remained the same as submitted last January, \$11.5 billion, when the off-budget requirements were added in, the deficit would be in the \$25-billion area. That is what we are trying to cut back on right now. That is why I think it is important to emphasize that there have been concerns voiced not only domestically, but internationally in long conversations with my counterparts, the Finance Ministers of the European Community two weekends ago, that the fiscal restraint that we are adopting presently is going to drive us into a recession or a depression, the effects of which will be felt worldwide, recognizing the economic interdependence of nations today.

I really think that when one analyzes the facts that the facts just do not support this argument. Even if we cut our budget \$5 or \$6 billion in fiscal year 1975, the expenditures will still be in the area of \$298-\$299 billion. And this is \$30 billion in excess of what we spent in the last fiscal year, which is an increase in excess of 10 percent in Federal expenditures and which is clearly higher than the average that I presented in my testimony: from 1955 to 1965, it was 6 percent.

Of course it has ballooned at 10 percent in the past 10 years. That is what we have to work on, and we have to do it carefully so that we do not do any economic damage. But we also recognize that there are going to be those who will bear a disproportionate burden of the costs of disinflationary policies. And we must assist these people in the housing area, and the unemployed by the measures I suggested.

Mr. SMITH. Well, now, you helped to point up the problem of arranging priorities, making sure that we do not cut where the expenditure would be for a program that increases production. We have to make sure we do not cut some program which will, in fact, reduce employment substantially, such as manpower training. Perhaps others will cite similar programs—programs which help generate revenue through the tax system. That was the purpose of my questions.

You are estimating \$297 billion in revenues. Of course, reduction of revenues would affect us just as much as increases in expenditures as far as the deficit is concerned, and also the lag in capital for the private sector.

What range would you say that it might go above 297 or below it?

Secretary SIMON. I would say you are looking at a margin of error of somewhere in the 2-percent area on this fiscal year. But then again, I would hate to be pinned down to that, because that is based on all these events that are so uncertain at this point, as far as the growth in our economy during this present fiscal year.

Mr. SMITH. That would only be \$5 billion up or down, then?

Secretary SIMON. It could be more than that, on either side. It is a judgment at this time which at best is most uncertain, Mr. Smith.

Mr. SMITH. I think my time is up.

Chairman ULLMAN. Thank you, Mr. Smith.

Now the distinguished ranking minority member on the Task Force, the gentleman from Michigan, Mr. Cederberg.

Mr. CEDERBERG. Thank you, Mr. Chairman.

Mr. Secretary, you were not here, but you no doubt are aware that years ago we were on what we called an administrative budget. Then about in the middle sixties, if I recall correctly, a Commission was appointed; I think that the chairman of our Appropriations Committee and the ranking member at that time were members of that, as well as others from the executive department and outside of government, and they decided that we should go on what is known as the unified budget.

I have always had some reservations about that because that, I think, gave a false illusion to the country about the budget. As you say the unified budget, 1973-74 was \$3.5 billion in the red. Now if you took the \$3.5 billion and equated that with the old administrative budget, what would that deficit be; do you have any idea?

Secretary SIMON. It would have been about \$18 billion in fiscal 1974.

Mr. CEDERBERG. And these additional Federal credits—are some of those included in that \$18 billion?

Secretary SIMON. Yes, sir, some of them.

Mr. CEDERBERG. So when we go to the country and we say that in 1974 we only had a deficit of \$3.5 billion, we mean really that the cash flow was \$3.5 billion light; is that not about right?

Secretary SIMON. That is correct, sir, and it does not measure the full inflationary impact.

Mr. CEDERBERG. Does not measure the exact impact of our deficit?

Secretary SIMON. That is correct, sir.

Mr. CEDERBERG. So what we have been doing all of these years since we went to the unified budget, in my opinion, has been deluding the American people that our budget deficit has been substantially less than it actually is?

Secretary SIMON. I prefer to be a little more charitable to you people than that, seeing I was not here when that was adopted. I do not think you adopted it with the purpose of deluding the American people, but that certainly is the result because it does not exert the proper discipline.

People look at the budget deficit and say, "Gee, \$3.5 billion is not very much with the size of the GNP and the size of our budget." But as it affects inflation it has a much greater impact.

Mr. CEDERBERG. I do not think anyone wanted to delude anyone. I think really if you look at the Commission's hearings, economists thought it was an easier way to equate exactly what was going on by just taking the total amount of income and the total outgo and that is your deficit. But we have, personally I think we have, made a mistake in doing so, because in the budget document itself we really do not emphasize enough what the total deficit is. It is there, if you want to read the fine print, but what do you think about going back to the old administrative budget?

Secretary SIMON. I would like to at the very least, which is possible, at least asterisk in the meantime the unified budget to show the effects, or show the exact dollar amounts of our—

Mr. CEDERBERG. Do you think we ought to put it in bold, bold red figures there?

Secretary SIMON. Yes, sir.

Mr. CEDERBERG. Instead of bold black, make it red?

Secretary SIMON. If you remember, the Kennedy Commission in 1967 recommended against, although the specific wordage I have forgotten, the off-budget type financing. Starting in 1965 and 1966, representing the banking community as I did on many occasions before many of you gentlemen, I testified in opposition to these financing practices and the proliferation of same and what it was doing to the interest rate structure in our country. I think it is time we began to take a look at how to manage these matters in a better fashion.

Mr. CEDERBERG. Is it not also true that in those areas that are not really included in the administrative budget is that where you have your escalating expenses coming in future years?

Secretary SIMON. Yes, sir.

Mr. CEDERBERG. In most instances.

Secretary SIMON. Yes, sir.

Mr. CEDERBERG. Can you give me any idea now, and probably this should be a question for the Director of the OMB but you may be able to answer it, what the anticipated budget requests would be in 1976?

Secretary SIMON. We are really most preliminary on that right now—we are working on it.

Mr. CEDERBERG. If we cut the budget to about \$300 billion as we would like to do, and that is not an easy job either, but if we did that, with our built-in escalators, the 1976 budget with all of the uncontrollables that are in it will at least be \$325 billion?

Secretary SIMON. That is correct.

Mr. CEDERBERG. Is that a reasonable statement?

Secretary SIMON. Well, I do not—you had better get that from Mr. Ash. I will ask Roy when he comes up here to be prepared to speak specifically to what the uncontrollables would add from this year to next year if nothing were done.

Mr. CEDERBERG. I am not going to pursue this much further.

Secretary SIMON. I agree on the uncontrollables and the increased amounts. For example, take a look at our water resources program—and I am not just picking that out because I oppose that program, through the growth in demand and with the expansion of the program, it is budgeted at about \$3 billion now. Everything has grown in much the same way; everything continues to grow.

We have not paid enough attention to how we are going to pay for them. That is all I am suggesting—not deciding on the programs, but taking a good look at how we are going to pay for them.

Mr. CEDERBERG. My time is up. I think this is one of the real problems that this Budget Committee is going to have to face up to.

Secretary SIMON. Yes, sir.

Mr. CEDERBERG. I just hope we can do it. That is all.

Chairman ULLMAN. The ranking majority member of the committee, Mr. Whitten of Mississippi.

Mr. WHITTEN. Mr. Secretary, I have dealt with this subject for a good many years here in the Congress on the Appropriations Committee, and I was a member of the joint committee that made the study on congressional budget procedures. I think we are talking about budget here—and we should—but behind the budget is policy, and that is programs. And what is disturbing to me perhaps more than any

other thing, is that for the last 8 or 10 years you and your predecessors on that side of the table have tied spending to the gross national product. But when we analyze and question you about the gross national product you include, as a part of it, services of no value, wasteful spending.

You take foreign aid, where foreign countries get the goods and we get the money back—our own money back for our goods—so we have less goods and more money. Now, all of that adds to the gross national product and we have justified spending because the gross national product was growing. Of course it grew as you threw your money away, so to speak.

I am making the argument in simple terms. This committee was set up with two things in mind, as I understood it: That we recognize that no Congress is going to tie its hands as soon as it gets to town with a new Congress, and no executive branch is going to fail to support the policies which it espoused in its election. This committee was set up on the basis that if we had a target, early in the session, that we were going to shoot at in the way of trying to balance expenditures with income, to the greatest degree that we could afford to, that we needed a group that could help supply us with information in the legislative branch. But then, having set that target, we firmed it only at the end of the session—or toward the end—when with a new fiscal year beginning October 1, we would match the expected income against the outgo. There are two ways to handle that: One is to cut back the outgo, which you have been talking about; the other is, if the people demand it, that we raise the money to pay for it.

Now, what we have been doing for years here is printing money as a Nation to pay for it. We have taken gold from behind our paper money; we have taken silver out of our currency. I think your budget this year doubles foreign aid, and I am not talking about foreign aid in principle, I just mean it is 100 percent inflationary, because you grant foreign aid in dollars; they take our dollars which we print without anything behind them except full faith and credit; they give us our money back, they get our goods, and we have fewer goods and more money.

It is just simple to me that we have just been on the road to inflation with policies like this. Again, we tie our spending levels to the GNP which grows as you waste money. When we do that, we pay for it with printed money, no silver in our currency, and again, no gold behind our paper money.

I think we are going to have to review all these various programs we have. I happen to sit on the defense expenditures subcommittee and I find all my colleagues do not agree. But we are supporting a military establishment rather than defense. And every dollar that is wasted—which is included, as you know from your side of the table, in the GNP—only makes money cheaper. So we end up where our problem is that our money is just getting cheaper and cheaper and cheaper.

Now another factor that I think you must consider—and again I am trying to reach over your shoulder to the policies—after World War II we defended Japan. We said, “You can put all your money in your economy.” So we spent all our money which we borrowed to defend Japan.

We said to Western Germany and to Western Europe, “We will

defend you," so we spent billions of dollars which we borrowed, while they put their money into their economy. Now they are bringing our money back over here and competing in the local markets for land, for stocks in corporations. When Dr. Arthur Burns was before us, I asked him, "What do you think about West Germany and Japan buying into the United States?"

He said, "I think it is good. It shows they have confidence in us."

I said, "What if they are paying you with our own IOU's?"—which is what they are doing.

He said, "Well, that might make a different situation."

Now I am asking you what you, in the executive branch, are doing by way of reviewing the policies you have recommended, and which many times the Congress has increased I hate to say, so that we may stop it. While we, on this committee, are trying to deal with the end product—that is, balanced income and outgo—what are you doing to reach back and see how we got ourselves in this fix? What can you recommend that will help us to stop it, while we on this committee are trying to balance income and outgo?

Secretary SIMON. That is exactly what we are attempting to do in what we call the reordering of priorities. We are looking ahead into the next decade and longer and we are recognizing what we believe to be the cause of the present problems that we have. I briefly outlined these in my opening statement.

Mr. WHITTEN. My time is up. I hope we may expect continued reports from you as time passes.

Secretary SIMON. Yes, sir.

Mr. WHITTEN. Because I take note of the fact that in this budget you are recommending greatly increased expenditures for foreign aid.

Secretary SIMON. Yes, sir.

Chairman ULLMAN. Mr. Broyhill?

Mr. BROYHILL of Virginia. Mr. Secretary, I do not think there can be too much argument with most of the points you made in your statement this morning. Certainly we can all agree with you that it is not easy to cut the budget, so to speak.

Then you stated this is not the time and place to discuss where the budget should be cut. But I think we can discuss the general policy of how we are going to go about cutting the budget. Sooner or later we are going to have to perform that task if we are going to do any good at all.

I have always felt it is a lot easier if we consider what the easiest—none of it is easy, but it is easier to cut the newer programs that have not become embedded in the budgets of the respective States and communities and become a way of life, and a damn sight easier, Mr. Secretary, not to start new programs, than it is to cut out the old.

You know there is no point in talking about cutting back on social security or veterans benefits, things of that nature.

But we did just a couple of years ago inaugurate a new program for which there was no great demand; that is, revenue sharing.

That costs about \$6 billion a year. It has not become too much of a habit or embedded in the budgets of the respective States and communities. It seems to me that this would be an area that we could make a tremendous cut and place a portion of this responsibility back on the local and State officials.

One of the objections that many of us voiced to revenue sharing to start with was that we were providing the funds to be spent without providing the responsibility on the part of those officials to face up to their constituents in raising the money.

So I think we will have a darn sight lesser problem, let's say, than cutting back on grants to education, in cutting back on revenue sharing, though the net result would still be the same. When you cut back on education, you could say take it out of revenue sharing; but politically I think you will find it a great deal easier to cut back on revenue sharing because it is one of the new programs and because it is not earmarked for any specific problem.

It is good to slow down on new proposals, not that we have to bring the Government to a halt, and look into better solutions of the problems. But one of the things that President Ford said in his address to the Congress was that one thing we must get through before the Congress adjourns was a national health insurance program.

I don't think there is any quarrel about the fact that we need to do more in that area, but in the light of the budgetary problems I wonder whether that is an emergency when 95 percent of the people are covered for their health services and in the poll that has been presented to the Committee on Ways and Means it is listed as 16 to 17 in the order of priorities of concern on the part of the American people.

So I am wondering why we can't get some positive response from the—positive is not the word, but let's say some concern from the administration—in cutting back on revenue sharing which is a tremendous expenditure and proceed a little more casually on those new programs that are further going to compound the problems with which we are confronted.

Secretary SIMON. Mr. Broyhill, I agree it is obviously easier to cut the newer programs before they become embedded in our system. This should be used as a discipline to putting in other programs in future budgetary years.

It is also going to be extremely difficult for all of us to agree here on the specifics of the budget cuts. Everybody has their pet peeve—for Mr. Whitten, it is foreign aid; for you, revenue sharing, and for somebody else, many of the other programs that we have in our very large budget.

With regard to revenue sharing, the purpose of revenue sharing was to decentralize the control of the Federal Government with the idea that State and local governments could make their local decisions on how money could best be spent better than the Federal Government could.

Our preliminary studies of the results show that it is a program that has gained in popularity; it has done many, many worthwhile things for State and local governments and we believe that it should be continued.

But these hearings are going to be held.

As I testified before Senator Muskie, we are still compiling a great deal of data on the success of the revenue-sharing program and we will be hearing more later this year.

Mr. BROYHILL of Virginia. I don't agree with that interpretation of revenue sharing. In fact, there are some of us who originally proposed revenue sharing; that was the concept we had in mind, that it would

be used in lieu of grants-in-aid so it would be a grant with no strings attached to it. But, by the same token, we would cut back on some of the other specific grants; but we haven't done that, Mr. Secretary, so the result is we have revenue sharing as an extra grant on top of what we have been passing out to communities and I don't think we are obtaining the effect that the administration at the time was seeking.

I see that my time has expired. I thank you, Mr. Chairman.

Chairman ULLMAN. The Chair recognizes the distinguished Majority Leader of the House, Mr. O'Neill.

Mr. O'NEILL. Mr. Chairman and Mr. Secretary, you made reference to pet peeves. I certainly have pet peeves: military spending, tax shelters, and neglect of housing, in particular. I am new on this committee as far as economics is concerned. I have never served on Ways and Means or Appropriations. I have listened with interest to your testimony and I will reserve the balance of my time, Mr. Chairman.

Chairman ULLMAN. The gentleman from Illinois, Mr. Michel.

Mr. MICHEL. Thank you, Mr. Chairman.

Mr. Secretary, first let me compliment you on your very comprehensive statement here. I would hope that when the full summit conference is held, where all the American people can be a party to this, that some of these very complicated things you talk about here can be spelled out in clear and concise, everyday language, if possible.

I think it is difficult for the average citizen to really grasp what you are talking about with respect to the need for investment capital; what we are talking about with respect to savings and personal restraint on the part of people, as well as the Federal Government.

This period we are in now is considerably different from other recessions I have known. I remember the one in 1958 so vividly. It was the first time I was running for re-election. Half of my class was flushed down the tube, and there was a considerable trauma in this country because of the unemployment rate.

For the last year I have been hearing these people talk about terrible unemployment rates that went up from 4.6 last October to the present level of 5.2 or 3, maybe 4. There are predictions it could go to 6 percent. Contrasted to some of these prior recessions, if that is what you want to call them, we have big inventories being built up of manufactured goods.

Isn't part of the difference today that there are shortages practically everywhere we turn?

Secretary SIMON. Yes.

Mr. MICHEL. I go to one plant and they have orders for 2 years ahead in my district. Another plant is the same way. Automobiles are coming back again now that people can get the gasoline. It really isn't all the dire prediction some have pictured it being, is it? There are so many shortages, but with demands still being there, it isn't the kind of situation where everybody's inventories are built up to the extent that there is no alternative to laying off people because the product won't move and there is no purchasing power.

Mr. SIMON. I couldn't agree more. Shortages do exist in a range of industries.

There is one thing that is reminiscent to me of the energy crisis when so many statements were made and everybody was focused on that

major national problem we had. There was a great deal of emotion on that subject. There is a great deal of emotion about inflation and what caused it and who is to blame and we are going through the same things we went through at that period.

We have many people making many dire forecasts and very positive statements about: We are in a recession. We are going to have a depression. It is unavoidable. There is going to be financial collapse.

Such statements at this point in time just help to erode further the confidence in the Government, which we need so desperately from the American people. At this point, we need to show them that we not only have the willingness, but the ability to fight inflation.

Now, with regard to recession in the present period we are in right now, the National Bureau of Economic Research, which is the official body that calculates or defines the official recession, certainly does not define this as a recession in depth, duration, or diffusion, as far as the basic strength to this point is concerned—which you point out correctly.

As far as unemployment is concerned, in 1958, during that recession, unemployment reached 7.5 percent. During 1961, it reached about 7 percent. Our unemployment rate is far from that level. The capacity in many of our major materials industries today is up in the 90, 91 percent area, which demonstrates we are operating flat out. One dramatic illustration of that was during the embargo when there was a sharp dropoff in automobile demand on the part of consumers and we know how the automobile industry was affected during that period. Yet the steel industry, during that period was operating at full tilt, which shows if we had added the automobile demands on top of that, of course, there would have been upward pressures on prices. What we have to do is to have a comprehensive economic policy that not only deals with the short run—with fiscal and monetary policies in balance, so monetary policy does not bear the full brunt of the battle against inflation—but in the intermediate and long term to begin to provide the savings and investments our economy will need to grow. In this way the prosperity of the American people can be assured and we can continue to give the American people everything that they need, or almost everything that they need, at reasonable prices.

I stress the reasonable prices.

Mr. MICHEL. Thank you.

Chairman ULLMAN. The distinguished gentlewoman from Michigan, Mrs. Griffiths.

Mrs. GRIFFITHS. Thank you very much.

I would like to ask you, Mr. Secretary, what is the growth of the funds in this country in the last 15 years that escape income taxation? By that I mean social security for example. That money doesn't pay income taxes. You paid in social security deductions, which is a tax, but the income was not taxed either to the business nor was it taxed to the individual.

What I would like to know is, what is the growth in this in the last 15 years? What is the growth in pension funds? Ten years ago, I believe, I ran a hearing when there was \$4 billion in pension funds, and now it is, I think, \$126 billion. The interest on pension funds is not taxed.

All of the other items that are being built up in the country, unemployment compensation and so on, these are not taxed first, as income. What would that do, if it were taxed originally, in lowering our deficit?

Secretary SIMON. Mrs. Griffiths, I must admit I have never heard that brought up before and I obviously don't have all of the numbers. I will supply that for the record because I am very interested in that number too. I think it would be quite substantial.

[The following was supplied for inclusion in the record:]

Question. What is the growth of funds in the last 15 years that escaped taxation? This would include pension funds, social security, unemployment compensation, etc.

Answer. Major social insurance funds operated or administered by the Federal Government include the 4 OASDHI funds, Railroad Retirement, the retirement funds administered by the Civil Service Commission, Veterans Administration life insurance funds and the various unemployment compensation funds. As of June 30, 1960 the assets of these funds amounted to about \$50 billion. As of June 1974 they amounted to about \$115 billion. During the same period, assets of state and local government retirement funds increased from \$18.5 billion to an estimated \$88 billion. Assets of private pension plans have increased from about \$50 billion to an estimated \$190 billion during this period.

Question. How many people have nontaxable incomes? For example, people receiving unemployment.

Answer. As of April 1974 there were about 54 million beneficiaries under various government programs involving nontaxable cash transfer payments. Of these about 31 million received benefits under the Old Age, Survivors and Disability program or the Railroad Retirement program. About 11 million were receiving payments under the AFDC program. About 3 million received general assistance or supplementary security income, after eliminating those who also received OASDI. Between 6 and 7 million persons received benefits under the various Veterans Administration programs for age, disability and survivor benefits and for educational allowances. If all double counting of recipients could be eliminated there would still be at least 50 million persons dependent to some extent on nontaxable government payments.

As of February 1974 there were 2.4 million recipients of unemployment compensation. Since in most cases such benefit payments cannot exceed 26 weeks, the total number of recipients in the course of a year would be considerably greater, possibly 7 or 8 million.

Mrs. GRIFFITHS. I think it is highly possible that at present rates this is where money is going. If you had that money first taxed at the present rates, there would be no deficit.

[The following was supplied for inclusion in the record:]

Question. How much would we receive in tax if these untaxed funds were taxed? What would it do to the deficit?

Answer. Assuming the rate of return on assets is about 6 percent of book value the investment income of public and private social insurance funds in 1974 comes to about \$24 billion. Taxed at a corporate income tax rate of 45 percent the potential tax would be close to \$11 billion. Since pension and other fringe benefits may be regarded as a substitute for salaries and wages a marginal rate of 23 percent is probably more appropriate, implying a potential revenue gain of about \$5½ billion. In the long run the tax on social insurance funds would result either in increased contributions and taxes to support the funds or a reduction in benefits, either of which would have further tax consequences.

Mrs. GRIFFITHS. Now, I would like to ask you another question. I don't believe you are going to handle inflation by the old methods. I just don't think it is going to work. I think that the old theories are out the window. Even if we were to go to 50 percent unemployment, I don't think you are going to force down wages and it is not necessarily true you are going to force down prices.

The problem today, it seems to me, is that prices are controlled by a very few people. They all have accountants and they all determine how much they can handle the item for, so they just don't lower the price. And the people who are still working are protected by unions in many instances, and they are not going to lower the wages either.

I have been looking for a long time at what we consider taxable income in this country, and, believe me, there are a lot of people living far better on nontaxable income at the lower level of society than are living on taxable income.

A man in Michigan on unemployment compensation in this country is doing considerably better than when he is earning \$6,000 on which he pays taxes. What does the Treasury do about that? How many such people are there?

Secretary SIMON. That is a matter for the committee you sit on, the Ways and Means Committee, in studying tax reform measures and attempting to have an equitable tax system in this country which we in Treasury feel very strongly about, recognizing there are also political constraints.

Mrs. GRIFFITHS. I don't have that political constraint on me now, so I would like an answer.

Secretary SIMON. As you know, Mrs. Griffiths, we don't either. We suggested this year—Mr. O'Neill brought up the tax shelters—a very stringent limitation on artificial accounting losses, a tax proposal in March 1973, which would have effectively done away with tax shelters and we lost that battle.

You took a step in that direction which you are to be commended for, but we would have rather gone all the way.

Mrs. GRIFFITHS. I voted with you, and I hope you start talking to those people on your side of the aisle.

Secretary SIMON. Well, we are trying. We need your help too, thank you.

Mrs. GRIFFITHS. Well, I helped you.

Secretary SIMON. I feel compelled to say this, that nobody feels stronger than we do about the need for a minimum tax that everyone should pay and share a reasonable burden in our income tax system because if we don't have a credible income tax system that depends on voluntary compliance of the American people, the country in the long run is going to be the loser and they are going to lose confidence in that also.

Mrs. GRIFFITHS. I think another thing you ought to do is check to see how many Federal employees are drawing either a salary or a pension, who are not supporting their own families. We are then paying for them and we are supporting them in welfare. That isn't taxed either.

I think it would also be a good idea if you talked to the Census Bureau. The Census Bureau doesn't even consider food stamps as income. They are exchangeable almost completely for money at their face value.

Secretary SIMON. That is correct.

[The following was supplied for inclusion in the record:]

Question. How many federally employed people are drawing salaries or pensions but are not supporting their families? We are supporting them through unemployment/welfare programs.

Answer. We know of no data which would enable us to answer this question.

Mrs. GRIFFITHS. I think we need to look at some of these things with a different view than we have ever looked at them before.

Secretary SIMON. I agree with you Mrs. Griffiths.

Chairman ULLMAN. The gentleman from Ohio, Mr. Latta.

Mr. LATTA. Thank you, Mr. Chairman.

I want to commend you, Mr. Secretary, for your comments, particularly the comments you made about scare talk. I think a lot of these statements that are being made could help us into a recession or into a depression.

I welcome your comments on productivity.

Speaking about the budget-cutting hearings that I hope will take place, have you ever given any thought to having budget-cutting hearings outside of Washington? In talking to some of the people who report to Congress, for example, when I was home, I talked to a sheriff. He was not complaining about having too little Federal money; he was talking about having Federal money pushed on him which he didn't need.

He stated that he had some \$41,000 forced on him to hire two deputies he didn't need and didn't want. It was because of some Federal programs.

I think that there are so many places like this where they are forcing Federal money on local governments and on State governments that they don't need, don't know how to spend, that we could cut without hurting anybody. I am sure this sheriff is not going to spend that \$41,000. They don't even know how to turn it back.

Now they want to give him new equipment for the two deputy sheriffs he doesn't need and will not hire.

These are things I think you can come up with by having budget-cutting hearings outside Washington. The American people are so interested in this they will come in and testify and open your eyes as they have opened up mine.

Secretary SIMON. I agree with you, Mr. Latta. I think we have many, many such programs just like that.

Mr. LATTA. In furtherance of what the gentlelady from Michigan mentioned about some of the welfare programs, we hear more complaints about the abuses in the food stamp program than all the other programs put together. Every time you turn around you are hearing about abuses in this program.

Now, we could save literally millions of dollars by checking on these abuses.

I want to make one further comment. The thing that disturbs me about inflation, and I think probably it should disturb you, is that we are all the time talking about excesses in the Federal Government, the largest contributor to inflation.

There is no doubt about that, but we also have some excesses in the private economy. I have reference to contracts that annually provide for wage increases without corresponding increases in productivity.

I was amazed to look at U.S. News and World Report this week to find that the increased average wage in this country is constantly increasing and the productivity of that same wage earner is going down. Now, this is inflationary.

I think you ought to take a look at it and see if we can't do something about this. I think we ought to have wage increases based on

increased productivity. Then we can start moving on the inflation in the private sector.

Secretary SIMON. That is correct, Mr. Latta. The price and wage sides are two sides of the same coin and both can be measured as inflationary. There is no doubt about that.

If we had the ability to control inflation to a great degree in the Government, which I believe that we do, except for the extra factors that I mentioned that have a one-time effect—this obviously is going to reduce wage demands as well.

I think the last couple of years has shown responsible action on the part of the unions, and labor in general, in wage demands and now, of course, they are in a difficult position because of their loss in real income last year. This is causing us concern because it is going to write into our economy a higher rate of inflation than we can tolerate.

Mr. Latta. Thank you, Mr. Chairman.

Chairman ULLMAN. The gentleman from Texas, Mr. Wright.

Mr. WRIGHT. Mr. Secretary, let's talk about basic economics. Inflation has been classically defined as too much money chasing too few goods. Will you agree, as a general proposition, that debt, both public and private debt, is by its very nature inflationary because it results in the use not only of the money in our pockets to bid up the price of goods, but adds to those factors money that we don't yet have, next month's and next year's income, to feed the fires of today's inflation?

Would that seem to you a reasonable proposition?

Secretary SIMON. Mr. Wright, I agree your formula is what has occurred in this economy for a prolonged period of time.

In talking about the creation of debt by our private sector, I would say that debt in itself, whether it is raised through absolute debt or in the equity sector of the market, is not inflationary per se.

It depends on whether it grows excessively compared to the growth in our economy. Debt must grow prudently as corporations plan for the future, to increase productivity and anticipate the increased demands of the population in this country.

Mr. WRIGHT. Certainly a prudent growth in debt is understandable if it relates to a commensurate growth in our gross national product or family income, whether it be Government or a family. But that isn't what we've had.

You have made a case for reducing Federal expenditures and thereby reducing the Federal deficit. You have suggested in your presentation to us today that we should run a Federal surplus equal in effect to about one-half percent of the gross national product. That would be about \$6 billion a year?

Secretary SIMON. Yes, sir. \$7 billion a year.

Mr. WRIGHT. In other words, that much to apply to the reduction of the Federal debt rather than the continued growth in the Federal debt, is that right?

Secretary SIMON. That would be marvelous.

Mr. WRIGHT. I think that would probably be the best thing we could do psychologically to restore the faith of the public in the proposition that the Government is willing to do its share.

Secretary SIMON. I think actually, as I said in my statement, it does add to the national flow of savings by a significant amount as well.

Mr. WRIGHT. Let me ask this further question: You referred to the fact that private debt, when excessive, also has an effect on the inflationary impact. I think you would recognize that private debt has certainly grown at a much more rapid rate, in fact, than public debt. This is true, is it not?

Secretary SIMON. The debt has, yes.

Mr. WRIGHT. The total private debt has grown more rapidly in fact, as a percentage figure, than public debt. Is that not true?

Secretary SIMON. That is correct, but when one measures that on the growth in our GNP in the last decade, one could say it is not inflationary.

Mr. WRIGHT. You could say the same thing about the public debt measured against GNP.

I am wondering if any thought has been given to the institution of something in the nature of regulation W, which worked rather well during the Korean period, to require mandatory down payment of a certain percentage on the acquisition of most durable goods. Has any thought been given to that as a means of curbing the credit card binge?

Secretary SIMON. It has been discussed from time to time. I have discussed that and many other things with Arthur Burns in recent weeks. I think that the general feeling is that if regulation W had been implemented in January, February, or March 1973, that would have been the time to implement it. This is a possibility that did occur, yes.

Mr. WRIGHT. I have one more question, then. Those who are in policymaking positions as advisers to the President have for a period of about 5 or 6 years been approaching it from the standpoint of raising interest rates as a curb against inflation, and manifestly that hasn't worked, really.

You present us a chart here that shows the correlation between Federal deficits and the rate of inflation. You can make a similar chart showing a correlation between the interest rates and the rates of inflation.

In 1968 the prime rate was a little bit under 6 percent or thereabouts, the annual rate of inflation was just a little below 5 percent or thereabouts. Today the prime rate is almost 12 percent and the annual rate of inflation better than 11 percent at the present moment. I think surely we can see that it is that medicine that is making us sick, in addition to creating an unprecedented number of bankruptcies, foreclosures, and bringing the housing market to a virtual halt.

I am saying this: As one member of this committee, I will go along with you and with the President and will do my utmost to see if we can budget something in to pay a little bit on the national debt and have a surplus. Not just a balanced budget. But I think the executive department of Government has a concurrent responsibility to start bringing these interest rates back down. I don't think we are ever going to get the economy on a healthy level again as long as we are paying 9-percent interest to those who can put up \$10,000, for example, and denying that privilege to those who can't, and all of us as taxpayers are paying that 9-percent interest. Can you give us some assurance if we will go along on reducing or eliminating the deficit, or hopefully laying aside something for a series of annual payments on the debt, that you in the executive branch will use the powers inherent in your branch to start bringing interest rates back down?

Secretary SIMON. I can say a couple of things.

First of all, on the reduction of the deficit and even moving to a surplus, I would most strongly support you and make that recommendation to the President.

Let me talk for a moment about interest rates in our economy.

The level of interest rates is set, really, by two major factors—three, perhaps.

One, the degree of monetary restraint that is implemented by the independent Federal Reserve System during inflationary periods. One can say that, going back to 1964, the last decade, with the fiscal and monetary excesses and the lack of fiscal restraint, that the Federal Reserve has felt compelled to wage the battle of inflation alone through this very blunt instrument of high interest rates.

Mr. WRIGHT. It hasn't worked, has it?

Secretary SIMON. I agree it is a blunt instrument and puts a disproportionate burden of the battle of fighting inflation on certain sectors of our economy such as housing in particular. But it is another thing to look at what happened in the mid-sixties between the off-budget financing, the activity, the hyperactivity in our economy at that time, compounded by large budget deficits to finance the Vietnam war, and consequent deficits elsewhere.

This put an inflationary expectation, not to mention the real rate of inflation, into the minds of the American people and the investing public, and the institutions that buy all of the debt securities including our own. They have demanded an inflationary premium in interest rates if they are willing to put their money up and lend it, anticipating that the Federal Government was not going to do anything about inflation on the fiscal side. They wanted to make sure they were compensated when they were repaid with the same dollars they invested. What we have to do is wring out that inflationary expectation and show that the Government indeed is serious about doing something about inflation, and it cannot be done alone through monetary restraint. We have to give the Federal Reserve a hand, so this blunt instrument is not used in isolation, through fiscal measures and a few other long-term policies, which will bring on increased capacity and productivity in this country.

Mr. WRIGHT. Mr. Secretary, you seem to be saying that exorbitant interest rates are the result of our other problems. I think on the other hand that they constitute a major cause of our other problems. My time has expired. Thank you, Mr. Chairman.

Chairman ULLMAN. The gentleman from North Carolina, Mr. Broyhill.

Mr. BROYHILL of North Carolina. You said "total Federal and federally assisted borrowings accounted for about 60 percent of all the funds raised through borrowings in the capital market."

That is to say, in 1973, 60 percent of all available credit in the private sector was used by borrowings by the Federal Government or borrowings assisted by the Federal Government. Recently I read the

figure was perhaps higher than that; that we have 75 percent of private credit in some way sopped up by Government action. Perhaps that figure was including State action and local borrowings as well. I am not sure.

Of course, we do know that the Federal Government has a far greater impact on the financial markets to deprive the private sector of the availability of credit than is indicated just by the deficit alone.

Secretary SIMON. It all depends on what measurement you wish to use. You can, if you want to, add in State and local governments.

I wish to be simplistic in my explanation of 60 percent, approximately, of federally sponsored Government and U.S. direct Treasury borrowing in our capital markets. It demonstrates the tremendous growth in our demands on the capital market sector. It shows that we are squeezing out other people who become disadvantaged, who are disadvantaged, who are forced to move into the commercial banking system and pay higher rates than they ordinarily would have to pay, as the utilities are having to do presently. It puts extraordinary demands on the commercial banking system. They are forced to pay exorbitant rates compared to what they used to borrow in the capital market.

Mr. BROYHILL of North Carolina. There are some items not even included in the budget, for example, the Export-Import Bank. We had a colloquy on the floor of the House on this the other day. This committee, I understand, intends to go into that in some detail.

There is a large volume of credit guaranteed by Federal agencies in the areas of housing, education, rural development, urban development, small business, railroads, and so on and so forth.

I have been told that this information is not maintained in the Congress in any one place. I am sure that each agency that is involved in these activities is keeping records of this. I would think one of the purposes of this committee would be to compile the statistics and the information on the federally assisted borrowings, and to compile and maintain accurate figures along this line.

I would like to ask the chairman if he would give permission to hold the record open at this point to include a statement or chart or table to detail your statement that 60 percent of the available credit is used in some way by Federal actions.

I am thinking particularly of showing not only the trends in the past years, but also what is included in this picture.

Secretary SIMON. I will submit that for the record and go back, Mr. Broyhill, to 1964. If my memory serves me, and it probably doesn't that well, I think the Federal and federally sponsored agencies, or the Federal agencies took about 12 percent at that point.

Chairman ULLMAN. Without objection, the record will be held open for further clarification on that point.

[The information referred to follows:]

NET FUNDS RAISED IN THE SECURITIES MARKETS BY MAJOR SECTOR

[In billions of dollars]

Fiscal years	U.S. Government securities	Federally-sponsored agency securities	Total ¹ (1)+(2)	State and local government securities	Corporate and foreign securities ²	Total ¹ securities (3)+(4)+(5)	U.S. Government and federally sponsored agency securities as a percent of total securities (3)÷(6)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
1964.....	2.5	1.7	4.2	5.2	3.8	13.2	31.8
1965.....	3.8	1.5	5.4	6.9	5.2	17.5	30.8
1966.....	1.6	4.1	5.7	7.3	9.2	22.2	25.8
1967.....	1.8	.2	2.0	6.0	12.2	20.3	9.9
1968.....	20.5	3.2	23.8	7.2	15.1	46.1	51.6
1969.....	— .4	4.2	3.8	12.0	14.7	30.5	12.4
1970.....	4.2	10.8	14.9	9.7	14.8	39.4	37.9
1971.....	20.3	2.9	23.2	15.0	23.0	61.3	37.9
1972.....	20.7	7.5	28.2	15.6	15.8	59.7	47.3
1973.....	21.5	11.2	32.8	12.6	10.5	55.9	58.6
1974.....	4.1	18.0	22.0	16.1	13.6	51.7	42.6

¹ Numbers may not add to totals due to rounding.² Excludes equity securities.

Source: FRB flow of funds. Office of the Secretary of the Treasury, Office of Debt Analysis

NET FEDERAL AND FEDERALLY SPONSORED CREDIT AGENCY BORROWING FROM THE PUBLIC,
FISCAL YEARS 1973 AND 1974

[In billions of dollars]

Agency	1973	1974
Federal agencies:		
Treasury.....	19.0	2.1
Export-Import Bank.....	.4	.7
Tennessee Valley Authority.....	.5	.4
Other.....	— .6	— .2
Federally sponsored credit agencies:		
Banks for cooperatives.....	.5	.1
Federal intermediate credit banks.....	.5	1.3
Federal land banks.....	1.5	2.0
Federal home loan banks.....	4.3	6.3
Federal National Mortgage Association.....	1.8	4.9
Total.....	28.0	17.8

Note: The figures in the table include Federal and federally sponsored agency borrowing from the public as reported in special analysis C of the U.S. budget and in monthly Treasury Bulletins. The figures do not include federally guaranteed borrowings, certain of which are included in the FRB flow of funds data because of the method of financing.

Source: Office of the Secretary of the Treasury, Office of Debt Analysis, Nov. 25, 1974.

Chairman ULLMAN. The gentleman from California, Mr. Leggett.

Mr. LEGGETT. Thank you very much, Mr. Chairman. Mr. Secretary, I want to congratulate you on being the first witness before this committee, and for giving us your views on the state of the economy and perhaps the awesome task before this committee.

I think—I will preface that by saying I have great respect for you and the work you have done, particularly in your prior job, and I would hope that that performance will carry over in your performance as Secretary.

However, I would say that what we have said here today is really not much. I think that your predecessors for the past 5 years have said more or less about the same thing. We have got to control spending; we have got to control credit; we have got to perhaps better interrelate with the Fed. We may or may not look at military.

I am looking at a chart showing what we have done in the Congress this year. We haven't got a full report, of course, on the 1975 budget, but the House has cut \$6.3 billion from what the administration has recommended.

The Senate has cut \$8 billion. There are probably another couple billion dollars that are going to be cut out of that budget as compared to the administration request. Still, I would suspect that the administration will make some recommendations to further impound appropriations made by the Congress, which then will rather radically emasculate what your original budget projections were to the Congress last January, albeit perhaps by your predecessor. It just seems to me there is nobody running the store.

We are all waxing wise and eloquent about economy and productivity and things like that, but as a practical matter I think the things that Mrs. Griffiths has said, that unemployment has virtually little relation to inflation, is correct.

In California I have got the highest wage rates for blue collar workers in the United States, and I still have more people on the bench than any place in the United States because we have labor bargaining power unrelated to employment. We have built-in controls in Federal employment. In spite of what the administration has recommended, we are probably going to have a 5.5 percent increase take effect October 1. As far as pricing goes, we have geared ourselves to the "Great Society" and we are prepared to pay 35 cents per gallon for gas, or 45 cents or 55 cents or 65 cents, and all of this has had very little effect on the total utilization of the product.

It seems to me that if we are going to rely on our old college economics to get control of this economy and to rely on these cliches that you presented on lack of investment, and investment compared to foreign countries not being competitive, I think we are just spinning our wheels because we know very well that Japan, who you cite here as having greater domestic investment than any of the other countries, has far more inflation than any of the other economies around.

Our major problems, as I see them today, are: Food production, which is going through the roof—we have rice production in my district, I think we are getting 150 or 200 percent of parity, and I am sure the corn people, with some crop devastation, are going to get about the same; your office has evidenced little restraint with respect to the pricing of energy, and I think we have got to put a lid on domestic energy, provide proper incentives, maybe get the Government into that business, if private enterprise is not prepared to do the job; I think we have to totally reconsider the problems of wage/price controls. As I recall, phase II was not nearly as bad as the catastrophe we are currently experiencing.

As I read the Dow Jones, it is at 623 this week; if you deflate that with regard to the cost of living deescalators in 1969 when we were enjoying about 1,024, we get to a real Dow Jones of about 400, which means that our real value market holdings are about 40 percent of what they were 5 years ago.

Our national debt has gone up from \$325 to \$485 billion over the past 5 years. Still you come in here and say "We are not in a recession. Things are not so bad."

I noticed the other day we had a 45.5 percent annual escalation in the wholesale price index. Fortunately that hasn't been a consistent annual figure, so we have only had a 68-percent rise in wholesale figures since 1967, but I recall the old days of the early sixties and the late fifties when wholesale prices, in spite of inflation, only went up seven-tenths of 1 percent a year.

I think we have to radically change our ways. Certainly we can't mimic any other national economies. I have just come back from Europe. You have to pay \$11 over there for a pair of tennis shoes. Every economy in the world is going utterly crazy. We have got to do something about it.

Secretary SIMON. You have said many things and many of them I agree with. I don't want to take the time to comment on everything, but there are a couple of things I would like to comment on.

First, you said my predecessors have come up here and said we should control spending. Well, maybe that is correct although I don't remember a concerted effort on the part of anybody in Government—and I don't sit downtown and point my finger at Congress or you people—

Mr. LEGGETT. Do you recall the Bow amendments?

Secretary SIMON [continuing]. Because we are all government as far as the people and others are concerned.

The fact of the matter is, if it was suggested, it wasn't done and the budget deficits of the last 10 years, even the last 5 years, certainly are testimony to that fact.

In Phase II the economy was operating at less than full capacity so that gave the appearance of wage and price controls working, with the slack that we had in our economy.

You talk about not controlling the prices of energy. We have had a strict price control system, albeit we have not been able to get oil and gas cheaply in this country due to precipitous actions on the part of the oil producers that caused a relatively sharp increase here in the United States.

I say "relatively" because it was much sharper in other countries who rely more on imports than we do. The increase in price has cut demand rather extensively. The earlier estimate of U.S. petroleum imports for this time of year was 7.7 million barrels a day. We are now importing about 6.3 million barrels a day or 18 percent less than had been projected. The price has resulted in a cutback and that is good.

One last thing. You said I came here and said things aren't so bad. I didn't say that, sir.

The inflation rate is not bad; it is horrible. Everybody knows that. All I was trying to say is that we are not going to have a depression as some people are forecasting today. I think we have to make responsible statements to the American people and tell it like it is to the American people so they will understand our problems, get some handle on how long it is going to take to cure, and also recognize that there is a plus to our economy because we have many strengths inherent in our economy today. All I was trying to say was just try to get some balance.

Mr. LEGGETT. My time has expired.

Chairman ULLMAN. The gentleman from California and member of the Task Force, Mr. Clawson.

Mr. CLAWSON. At page 5 of your statement you make this comment: "A balance of fiscal and monetary restraint is the answer."

There are some exceptions to this method of controlling inflation. How long has it been since we have tried this balanced effort you have described?

Secretary SIMON. The late fifties and early sixties, Mr. Clawson, was the last time we had any budget balance or budget surplus.

Mr. CLAWSON. We really haven't tried it for a long time is what you are saying?

Secretary SIMON. We haven't. People say we are in a new ballgame, those old things don't work any more, let's just throw them out the window and let's try all of these new gimmicks. I think the fund of economic knowledge suggests that tight fiscal policy doesn't take care of a shortfall in food or an explosion in energy; and the two devaluations of the dollar, while it strengthened our trade position, had an inflationary consequence.

Over the long run, it is clear that excessive demands on the part of the Federal Government are going to create pressures on prices, No. 1, and the consequent deficit financing that occurs during periods, prolonged and continuous periods of budget deficits, are going to have pressures on interest rates.

Worst of all, Mr. Clawson, is that this erodes the confidence of the American people in the Government's ability to control inflation.

Mr. CLAWSON. I have heard some reservations made about GNP and the comparisons that are used frequently with GNP. That is the total production of goods and services of both the public and private sector, is it not?

Secretary SIMON. Yes, sir.

Mr. CLAWSON. Would it not be more reasonable for us to compare them if we separated the two and had the GNP of the private sector completely separated from that generated by the public sector in making some of our comparisons?

Secretary SIMON. We can do that. We even went a step further than that because of the negative growth as evidenced in the second quarter—two periods of negative growth is the classic definition of a recession. One wants to look at gross product versus gross national product. Domestic product growth was positive in the second quarter. It moved into the negative posture due to the takeover of one of our oil companies, or a percentage of one of our oil companies in the Mid-east. There are some economists who can't understand how we can measure something that happens over in a far corner of the world into a figure on the definition of a recession here in this economy.

Yes, any of those useful breakdowns would help explain this. Yes.

Mr. CLAWSON. One other question in connection with budget. We hear so much about the mandatory spending as related to the discretionary spending. Is any effort going to be applied on the mandatory spending problem in the budget?

Secretary SIMON. Yes; the administration will be sending up a list of our suggestions for specific budget cuts that will require legislation. I take it this is going to be one of the purposes of this committee, to work together to identify the priorities. We have got 74 percent approximately today of our budget that can be termed uncontrollable, if one accepts the definition of uncontrollable as something that has

been legislated and can't be touched. But I think we have to constantly look at the priorities in this country and maybe change some pieces of legislation.

Mr. CLAWSON. In this connection could we balance the budget even if we don't look at the mandatory spending program?

Secretary SIMON. I am sorry, I didn't hear that.

Mr. CLAWSON. Could we balance the budget even if we don't begin to look at the mandatory spending programs?

Secretary SIMON. No.

Mr. CLAWSON. Since 75 percent of it is in that category.

Secretary SIMON. It is conceivable, but I don't believe it is practical to balance the budget without going after some of the uncontrollables, if you will.

Mr. CLAWSON. One last question: We have understood there is going to be some pump priming in connection with employment. The public employment program occurring simultaneously with a reduction in force in the Federal employees. Can that be reconciled and, if so, how do you reconcile it?

Secretary SIMON. Well, the idea of public service employment, which the President has not made a decision on, is to recognize that there are those who bear a disproportionate burden of inflationary policies and we must take care of them if the unemployment figure rises to 6 $\frac{1}{4}$, or whatever the figure which would implement it.

You know there has been a terrible temptation during periods of low economic growth to expand demand by tax cuts and other measures when unemployment rises. We never give our fiscal policies or monetary policies an opportunity to really work and that is one of the reasons that we have inflation still with us. So we have to take care of these special sectors that are affected by inflation policies and if we do make that additional expenditure for public service employment—if that is what the President decides to do—then we must look elsewhere in the budget to find those revenues.

Mr. CLAWSON. Thank you, Mr. Secretary.

Chairman ULLMAN. The gentleman from Maryland, also a member of the Task Force, Mr. Mitchell

Mr. MITCHELL. Mr. Secretary, you will be delighted to learn that I ask very simple questions, far removed from the esoteric area of high economics.

Is it possible for this budget committee, or for your office, to do an effective job in cutting the budget so long as off-budget items are not included in the total budget picture?

For example, Export-Import.

Let me phrase it another way: Would it not facilitate the work of this committee and the work of your office if we had a picture of every expenditure by the Government and every revenue penny into the Government included in one budget?

Secretary SIMON. Yes, sir, it would, Mr. Mitchell.

Mr. MITCHELL. Then on the matter of Export-Import, for example, you would recommend its inclusion in the budget?

Secretary SIMON. I would recommend, as I said in response to a question before, that at the very minimum we ask that the full expenditures be shown in our budget. I believe we should work toward not discriminating, whether it is Export-Import or whatever else

is designed to do a specific thing. We should work on putting them all in the budget.

Mr. MITCHELL. That is my position. Everything should go in.

Secretary SIMON. You will find areas of disagreement on this.

Mr. MITCHELL. I have been shocked and troubled by the persisting balance of trade deficit that this Nation has experienced. In the last 6 months we saw a short spurt where it appeared that we were recovering just a little bit in terms of our balance-of-trade deficit. But then that has, to the best of my knowledge, quickly evaporated and we are again in a deficit situation.

In order to deal with that situation, in two instances we devalued the dollar. If this situation persists where we are once again in a balance-of-trade deficit, will that not call for further devaluation of the dollar which, in the long run, is inflationary?

Secretary SIMON. No, sir, it will not.

Mr. MITCHELL. Why not?

Secretary SIMON. Let me explain that for years, going back to the Bretton Woods Agreement at the end of World War II, the U.S. dollar was overvalued to strengthen the other economies in the world—which was a good idea.

The only problem is, like most good ideas, what is worth doing is worth overdoing and we maintained these policies too long.

The devaluations that occurred in recent times made U.S. goods and services more competitive in the world and we, indeed, moved into a surplus at the end of last year, because we are competitive with the world.

Mr. MITCHELL. But we don't have that surplus now?

Secretary SIMON. Let me tell you what has occurred since then. The effects of the quadrupling of the oil prices has put our balance of trade in some difficulty right now. Our expenditure for imported oil for this year will be approximately \$25 billion. That compares with some \$8 billion last year.

However, this is offset to a great degree by our agricultural exports. While we will probably not export the quantity we exported last year, the price has risen so the dollar effect is the same. It is uncertain at this point how much investment flow will come into this country that is also an offset. It is very difficult to judge whether we will be in a slight deficit or slightly positive balance—overall balance of payments position—at the end of the year. That would be my judgment.

Mr. MITCHELL. I hope you are right. I have a strong feeling that you are not. I absolutely respect your sagacity and wisdom, however.

Secretary SIMON. That is why I said "judgment."

Mr. MITCHELL. One last question. I listened very carefully to all your statement, but I never got quite a handle on some positive things that you wanted to recommend.

For example, at page three, the paragraph beginning "This will also help—" skip down to the last sentence: "I believe we will have to raise the share of national output related to saving and investment by a substantial margin."

I do, too, and I am sure most of the members of the committee agree with this. But how would you do this?

Secretary SIMON. The major thing I say later on in my prepared statement, one of the principal ways to do it is to create a balance or

slight surplus in the budget to increase the flow of savings in this country. A half of 1 percent of GNP as a surplus would increase savings by 3 percent, and that has a marked effect. Bringing down the inflation rate itself is an incentive on the part of the American people to save because obviously what incentive is there to save today when interest rates in a thrift institution are at 5.5 percent with a double digit inflation rate?

There are many regulations that really discourage savings in this country—impediments to savings. We have a regulation that penalizes the thrift institutions when market rates escalate, as we have seen three times since the credit crunch in 1966. We encourage consumption, as we have for 20 years in the regulation of natural gas which today is in very short supply, with reserves declining every single year. They have declined, and gas is still at a very artificially low price related to the world price of oil or for any alternative supplies that are going to come on line in the foreseeable future.

There are just a few of the things.

You could look at tax reform to give incentives for savings that have been suggested. Whether it is personal savings or not—there are many ways to do it.

Mr. MITCHELL. This is really not a question, but rather a statement that I want to make. I think one of the glaring deficiencies in our domestic policies is a tendency to ignore a large category of people who are not consumers now, simply by virtue of the astronomically high unemployment rate. I am talking specifically about the blacks in America who experience an unemployment rate twice the national average. When you break it down by category, say ages 16 through 24, black male, you are talking in some instances of a 39 or 40 percent unemployment rate.

It is obvious that this gross unemployment reduces the consumption power of a large category of people. I am making that statement in the hope that this committee and your office will not tamper with those programs designed to make that present unemployed group a consuming, producing group.

You alluded to it in your statement, but I merely want to reemphasize my concern in that area.

Thank you, Mr. Chairman.

Chairman ULLMAN. Mr. O'Neill has an additional question.

Mr. O'NEILL. Mr. Secretary, I was informed recently about an investment house that is putting a group together to undertake a multi-million-dollar coal and gas liquefaction program. I was informed by a gentleman that he could put \$300,000 into this program. He would get an annual 18-percent return: \$54,000 a year. Because it is a research and development program, he would get a \$1 million tax shelter for a period of 3 years.

He checked the reliability of the \$54,000 a year he would get and there was no question about it.

He would get the \$1 million tax shelter and, a credible accounting firm would certify that Internal Revenue would OK a matter of this type.

Is this what it takes for us to get into research on coal and gas liquefaction?

Secretary SIMON. It certainly is not, Mr. O'Neill. I would love it if we could at the end of this hearing—

Mr. O'NEILL. Could such a thing as this happen?

Secretary SIMON. I am not familiar with those numbers, but they certainly seem exorbitant to me.

There again, going back to your beef mentioned before, our limitation on accounting losses that we recommended, would bar that ever happening. We do not need incentives such as you described to go into the liquefaction field.

Mr. O'NEILL. Certainly if things like this are going on, the Government is not doing its share, either at your level or at our level.

Secretary SIMON. I want to get the particulars of that, please, Mr. O'Neill, and I will respond to exactly what that program is.

Mr. O'NEILL. Thank you.

Chairman ULLMAN. Mr. Secretary, one of the reasons I was hard on you in my opening statement was that over the years, even though both the Congress and the Executive have a basic responsibility here, the Congress has handed its responsibility over, bit by bit, to the executive branch in the field of policy. I think you recognize that.

We in this committee are trying to help bring some of that policy authority back into the Congress through a new budgeting mechanism. I appreciate your support and your cooperation in our effort. Hopefully, through these new mechanisms, we can reestablish some of the basic policy authority in the Congress, so that this can truly be a joint effort between the Executive and the Congress. I wanted to make that clear.

Let me ask, first, about a problem that confronts us and a serious problem in budgeting: the problem of revenue shortfalls. When you have an economic policy such as we have now—and we have seen it in the past, we saw it in the late fifties, we saw it again during the last 4 years—it is almost unthinkable that, in the kind of economy we had between 1968 and 1972, we had almost a \$100-billion increase in our national debt. It is unbelievable. Yet one of the basic reasons for it is that when you slow the economy up through excessive credit restrictions and restrictions of the money supply, you inevitably go into an economic decline that results in a sharp revenue fall-off and additional expenditures in public service jobs and so on.

It seems to me that this committee is getting into business at a time when, because of this credit restriction, the economy is going down, and we will in the next year or two suffer serious revenue shortfalls.

Now, cutting the budget and cutting spending \$5 billion really has no relationship to a \$20 billion fall-off in revenue, which could happen, and that is what worries me. That is one of the problems, and one of the reasons that we have to look at the long term. We have to maintain a basic stability of growth in the Government or else we will get into cyclical patterns that will lead inevitably to revenue shortfalls and increased expenditures to compensate for them, and further and further increases in our national debt.

Will you comment on that?

Secretary SIMON. Mr. Chairman, first of all, as for your opening statement, all that does is just evidence the concern that everyone has for the terrible problem of inflation. I do not take those things personally, because I am just as determined as you are to do something about it and I am just as concerned as you are.

As for the committee itself, I consider the legislation that created this committee to be absolute landmark legislation. I think it is without

a doubt the healthiest development in this country in many, many years, and I say that from my over 20 years of banking experience and my concern over the lack of cooperation between the executive and the legislative which is now going to be, I think, brought into being due to the fact that you people are here.

There is no doubt that if monetary policy alone is left to do the job, as I said before, this blunt instrument of reducing inflation distorts. That is why what we are calling for is a balance between fiscal and monetary policy, where monetary policy does not have to bear the brunt; where, if Federal expenditures grow at a healthy rate, this will allow monetary policy to be moderated, if you will. This is what we have to do over a long period of time.

Chairman ULLMAN. Would you not agree that, in addition to fiscal and monetary policy, we need more policies across the board—in credit, taxes, and in every other economic area—and that there is no answer short of hard answers for all Americans if we are going to get out of this inflationary mire that we are in?

Secretary SIMON. I certainly applaud that statement, Mr. Chairman, yes, sir.

Chairman ULLMAN. So what we are looking for is more policy, what we are concerned about is a vacuum in the area of policy, and what I hope this committee can do is join with you in setting overall goals and setting forth the basic policies to accomplish those goals.

Secretary SIMON. I agree, sir.

Chairman ULLMAN. A report that just came out of the International Monetary Fund is extremely disturbing. We all know that the world is engulfed in inflation. But what they are saying is that the world is in the throes of a virulent and widespread inflation, combined with a deceleration of economic growth in reaction to the preceding high rate of expansion, and a massive disequilibrium in international payments.

They go on to say that this situation constitutes perhaps the most complex and serious set of economic problems to confront national governments and international communities since the end of World War II.

Do you agree with that?

Secretary SIMON. Yes, sir, I most certainly do, with the worst peacetime inflation in our history.

In the IMF report I must admit I was struck by the statement of warning that if the world—if the United States—is to cop out in its battle against inflation and be worried more about unemployment and deflation—the temptation always exists to shift prematurely as we have done so many times in the past and to work on creating demand during periods of economic slack—this in the long run is going to be the worst possible policy that we can follow. I suggest it would not even be just the long run, it would also be the short run.

We must do as you suggested in your statement, explain to the American people there has to be some medicine that we have to take because of the excesses of the past decade—especially those areas that have caused the problem we have today—and we have to do this in moderation for a sustained period of time.

Chairman ULLMAN. Would you agree with me that the American people are ready for hard answers, but that the difficulty is they see

so many segments of the economy that are escaping, scot-free, that are making it big in inflation, and that is why they are reluctant to go the hard answer route?

But if they saw an overall program based on more than one policy consideration, as I indicated, so that everyone shared in these hard answers, do you not agree they would participate?

Secretary SIMON. Yes, we have to spread this just as equitably as we possibly can. I agree with you, Mr. Chairman.

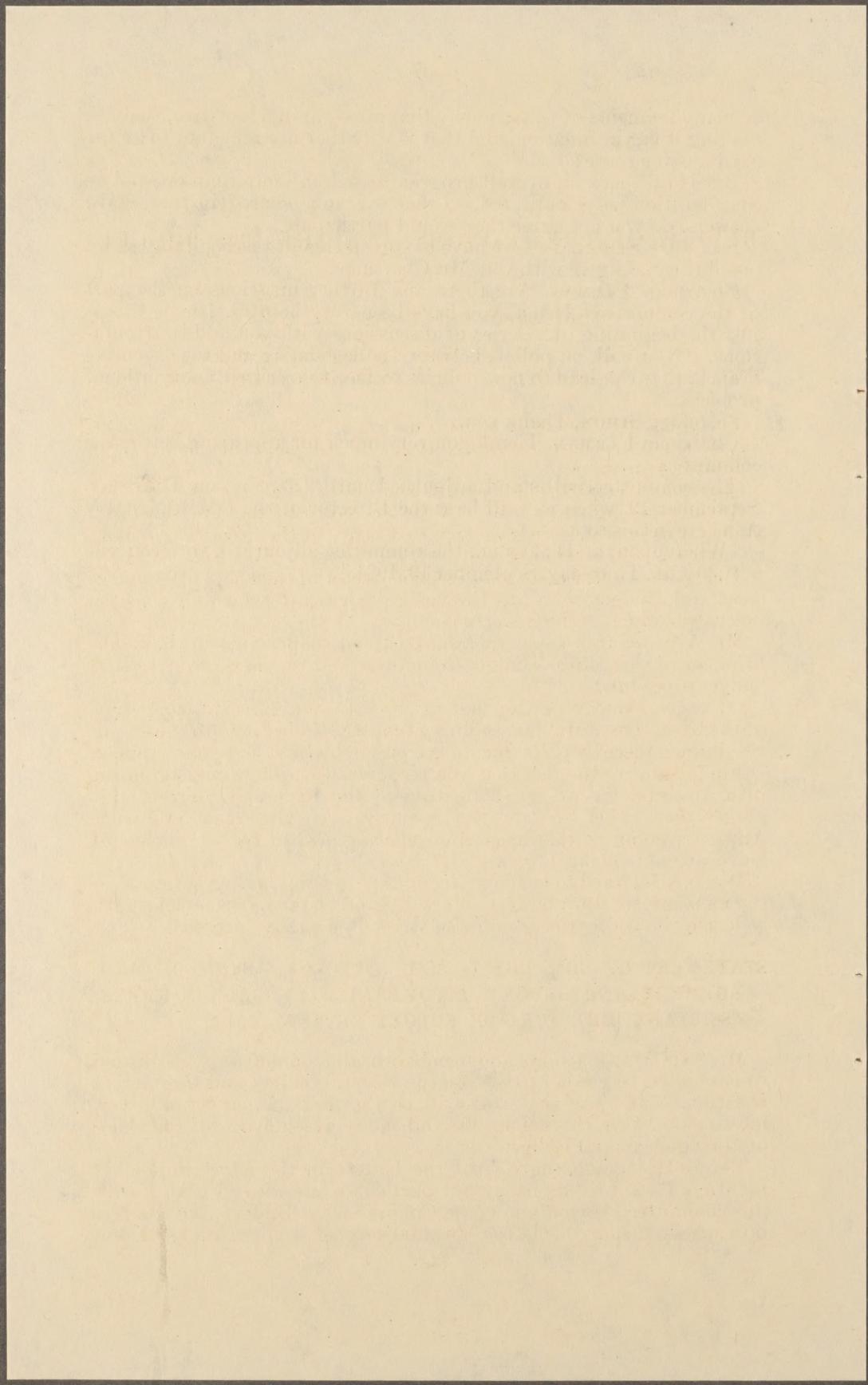
Chairman ULLMAN. Are there any further questions on the part of the committee? If not, you have been very helpful. I hope this is just the beginning of a series of discussions with you and confrontations, if you will, on policy, between the legislative and the executive branch, that can lead to new policies to face this critical international problem.

Secretary SIMON. Thank you.

Chairman ULLMAN. Thank you very much for appearing before the committee.

The committee will stand adjourned until 9:30 a.m. on Thursday, September 19, when we will hear the Director of the OMB, Mr. Roy Ash here in this room.

[Whereupon, at 11:30 a.m., the committee adjourned, to reconvene at 9:30 a.m., Thursday, September 19, 1974.]



REVIEW OF THE ECONOMY AND THE 1975 BUDGET

THURSDAY, SEPTEMBER 19, 1974

HOUSE OF REPRESENTATIVES,
COMMITTEE ON THE BUDGET,
Washington, D.C.

The committee met, pursuant to notice, at 9:30 a.m., in room 2359, Rayburn House Office Building, Hon. Al Ullman (chairman of the committee) presiding.

Chairman ULLMAN. The committee will be in order.

At our opening session we had the Secretary of the Treasury, Mr. Simon, during which time we explored many of the broader economic policy areas of Government.

Today we are fortunate to have the Director of the Office of Management and Budget, who has the basic priorities responsibility in the executive branch of the Government.

Mr. Ash, we appreciate your support and cooperation in the establishment of this House Budget Committee and this new congressional budget procedure.

Of course, you recognize that in a sense we are recapturing some of the basic constitutional authority that we handed over to the executive branch piece by piece during the past 100 years. But your support, I think, is due to the fact that you recognize this job of managing the priorities and the overall budgeting of the Federal Government is bigger than either your branch or our branch alone can cope with. And it is going to take maximum effectiveness in both branches of Government to make it work.

We look forward to hearing you on the pressing matter before us at the moment, the 1975 budget. We will appreciate your comments. We welcome you before the committee, Mr. Ash. You may proceed.

STATEMENT OF HON. ROY L. ASH, DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET, ACCOMPANIED BY DALE McOMBER, ASSISTANT DIRECTOR FOR BUDGET REVIEW

Mr. ASH. Mr. Chairman and members of the committee, I am pleased to meet with you today to discuss the Federal budget and the current inflation. I am sure that this will be the first of many productive meetings between this committee and the representatives of the Office of Management and Budget.

Before discussing the role of the budget in the effort to combat inflation, I want to emphasize our particular interest in working with this committee. As you know, the Congressional Budget Act sets certain specific requirements for consultations between the Budget Com-

mittees and the Office of Management and Budget. Beyond that, it is clear that we have a common interest in the development and review of the Federal budget. I pledge our constant cooperation with this committee in finding ways to meet our common objectives. I can promise you that the staff of the OMB will work closely with your staff in developing an understanding of the budget system and in providing information on specific budgets. There is much work before us. Both my staff and I look forward to working closely and cooperatively with you on all of these matters.

There is widespread agreement that inflation is the top priority domestic problem that faces us today. It is in the best interest of the Nation, therefore, that the executive branch and the Congress cooperate in a determined effort to bring this country back to a period of relative price stability through responsible Government action.

As you know, the President is convening a series of economic conferences leading to an economic "summit" later this month. The administration's current economic policies are being thoroughly discussed at the conferences. These policies have both short-run and longer-run aspects. In the short run, they are designed to restrain the growth of demand relative to the growth of supply by holding down Federal spending, and by moderating private demand—primarily by moderating the expansion of money and credit. The Federal Government also will use its influence wherever appropriate to help bring about voluntary restraint in price and wage decisions. The Council on Wage and Price Stability will have primary responsibility for this activity.

In addition, measures are being taken to counteract inflation by stimulating increases in production, in productivity, and in supplies—especially supplies in the crucial areas of agricultural commodities (weather permitting) and energy. Project Independence, the return of millions of acres of farmland to production, and sales of excess materials in Government stockpiles are all elements of a broad effort to assure adequate supplies of food and other farm products, energy, and other goods for which serious shortages threaten.

A sweeping review of effects of Government regulations on productivity and prices would be an essential part of any longer range plan. It would have the objective of developing recommendations for changes that will lead to increased productivity. This involves areas as diverse as antitrust policy, building codes, regulation of transportation and of financial institutions, trade policy, and environmental standards. Some aspects of Government policy in these spheres may have significant unnecessary effects of holding us back from doing our best when it comes to production and prices.

It appears clear that a budget policy of stringent but realistic restraint will be one of the several major policies that evolve from the summit meeting. And so it should.

We must realize that there is no instant cure for inflation. The American economy is like a giant ocean liner in that its momentum is enormous. A change in direction—even giving the wheel a hard turn—will not produce much of an immediate change in position. It is some time before the difference in steering makes a significant difference in course. It is the longer-run aspects of our policies that are the more significant.

Our current emphasis on moving toward fiscal restraint continues the policy of the recent past. For fiscal year 1973, the administration set a goal of holding outlays to below \$250 billion. As you may remember, actual outlays were only \$246½ billion, and the deficit was more than \$11 billion below the \$25½ billion estimate in the original budget for that year. In fiscal year 1974, a deficit of only \$3½ billion was realized, as compared with the original estimate of \$12½ billion. The trend of restraint is clear, and is reflected in our present goals:

For fiscal year 1975, to bring the budget in below \$300 billion, and

For fiscal year 1976, to present a budget that holds to approximately \$330 billion.

A reduction in 1975 spending to below \$300 billion will not be easy. A variety of forces threaten to push spending higher than the \$305 billion level reflected in the budget.

The Congress has already enacted mandatory authorizations that will add an estimated \$1½ billion to 1975 spending, and it has before it other mandatory authorization bills that would add another \$2.3 billion. These pending bills include major increases for veterans' education benefits, mass transit operating subsidies, Trade Reform Act benefits, civil service annuities, and relocation assistance. Without arguing the merits or the desirability of any of these proposals, it is clear that in the current economic situation the Nation can ill afford an additional \$3.8 billion in Federal spending.

The Congress has not enacted legislation proposed in the budget that would effect some \$748 million in economies. These proposals include tightening administrative procedures and marginal or duplicative eligibility criteria for social security and public assistance, and obtaining insurance reimbursement for some veterans' medical services. This legislation requires unpopular decisions, but the alternative way of cutting spending is no more attractive.

The President has also proposed the postponement of a Federal pay increase for 3 months. This proposal will reduce 1975 outlays by nearly \$700 million. The President recognizes that this action is controversial, but he is convinced of its necessity. Failure to defer the pay raise would make it harder to hold the line on other Federal spending.

As is customary in its consideration of appropriation bills, the Congress is contemplating some increases and some decreases.

The Congress is now completing action on the Defense appropriations bill. That action would appear to reduce spending this year below the budget by about \$1.7 billion. Further cuts in Defense spending are unwarranted. Defense programs measured in constant dollars already have been reduced by one-third since 1968, and defense manpower has been cut by over 1.3 million from 3.5 million to 2.2 million. The forces programed for 1975 are at the minimum level necessary for our national security and the continuing success of arms limitations negotiations. Any further reductions would upset the balance of power throughout the world. Our national security would be jeopardized and our hopes for further success in arms limitations dashed.

An increase in spending is threatened under the Labor-HEW appropriation bill. While this and other increases may have merit when considered individually, cumulatively they are inconsistent with serious budget restraint.

Cooperative efforts of the executive branch and the Congress are essential if we are to turn back pressures for spending increases. They are critical to moving the budget below the current estimate.

This administration is resolved not only to work with the Congress to prevent spending increases but also to find ways to reduce spending now planned. In examining those options, several realities must be faced.

The first reality is that most of the Federal budget is mandated by law and by past contractual commitments. A table that I will submit along with my testimony shows the composition of outlays in terms of the degree of discretion which can be exercised by both the executive and legislative branches.

The use of the term "discretionary" in the table refers to programs in which changes can be made without change in substantive law.

Reading from the table, let me observe that of the budget estimate of \$305 billion in total, only about \$92 billion can be considered discretionary. Of this total, \$57 billion is for Defense, which I have discussed previously.

Of the remaining \$35 billion of nondefense expenditures, \$20 billion is for personnel costs—an item on which it is difficult to save a great deal in the short run, although the proposed deferral of the Federal pay raise and the planned reduction of Federal civilian employment will reduce it somewhat. Only \$15 billion out of a total of \$305 billion remains for truly discretionary action. The composition of outlays makes the budget far more difficult to reduce than one would expect judging merely from its size.

I would be glad to discuss this table in greater detail as we proceed with these hearings. It will be included in the record.

A second general reality in curbing Government outlays is one of timing. The spending pipeline for Federal programs is often a long one. It sometimes takes years after we shut off the funding spigot for the flow out of the end of the pipe to stop. Typically, measures to cut back or terminate programs produce little, if any, savings in the short run. Indeed, spending may rise even as employment is reduced and operations are consolidated as a consequence of transitional costs. Nevertheless, it is important to make such changes to obtain longrun savings. Again the metaphor of the ocean liner is apt. Large effects from current changes in course do not appear for quite some time.

My point, then, is simply that there is a practical limitation to our ability to reduce outlays greatly in any fiscal year once it is well underway—except by the most Draconian measures. In the longer term, much more can be achieved. The effects of turning off the pipeline do materialize; the laws underlying entitlement programs can be changed; and the past year contracts are not yet made.

Hence, the measures we have taken in the past few months, and such measures as we take in the months immediately ahead, will have a much greater impact on fiscal year 1976 and subsequent years than on the current year.

In my discussion, I have noted a number of obstacles which make it difficult to find ways to reduce the Federal budget. The fact that these obstacles exist does not lessen the administration's commitment to either a policy or an effective program of outlay restraint. To be

realistic, we must recognize that major budget reductions require tough decisions by both the Congress and the administration. But those tough decisions must be made. They must be made if we are to curb spending this year and also rein in Government spending in the longer run.

Thank you, Mr. Chairman.

Chairman ULLMAN. Without objection, the table will be included in the record.

[The table referred to follows:]

Fiscal year 1975 budget—Composition of outlays

	<i>Billions</i>
Mandatory spending:	
Contractual obligations:	
Net interest.....	\$23.0
House subsidies and insurance, farm supports, etc.....	5.8
Other prior-year obligations.....	53.1
Defense	(23.0)
Nondefense	(30.1)
Subtotal contractual obligations.....	81.9
Entitlement programs.....	142.1
Legislative and judiciary.....	1.1
Total, mandatory spending.....	225.1
Discretionary spending:	
Defense	57.1
Personnel	(37.0)
All other.....	(20.1)
Nondefense	35.1
Personnel	(20.0)
All other.....	(15.1)
Total, discretionary spending.....	92.2
Offsets (offshore oil and receipts and contributions to employee retirement funds).....	11.8
Total.....	305.4

Chairman ULLMAN. I am going to reserve my questions until later, Mr. Ash. I am somewhat disappointed that you are not bringing to us a schedule of reductions that would accomplish the purpose that we have in mind. The chairman of our Task Force in the 1975 budget is the gentleman from Iowa, Mr. Smith. I will call on him to start the questions.

Mr. Smith?

Mr. SMITH. Thank you, Mr. Chairman.

Mr. Ash, I would like to update our figures a little bit and get a new estimate as to the basis for the figures.

Secretary Simon told us that he is now estimating revenues of \$297 billion. Nine months ago it was \$294 billion. Of course, things change in 9 months. I think the latest estimate we had from you was in May. At that time you were estimating new budget authority of \$324.5 billion and expenditures of \$305.3 billion.

Have you adjusted those figures since that time?

Mr. ASH. First as to revenues, the budget officially had in it \$295 billion. There was at one time a reestimate to \$294 billion. Now it is about \$297 billion. It is very difficult to estimate revenues precisely for a period as far ahead as the rest of this year. However, at this time that is our estimate.

As to outlays, the final total is probably more uncertain than it will be at any other time during the course of the year. There are some threats that would increase the budget well above the \$305 billion. At the same time we all should take actions—and the administration is taking them—to reduce it below \$305 billion. The President's goal is to do everything that he can to reduce outlays to a point below \$300 billion.

Let me tell you some of those threats that we worry about.

Mr. SMITH. But solely focusing on the administration's budget requests, has your estimate changed?

Mr. ASH. Our estimate of ultimate outlays?

Mr. SMITH. Yes.

Mr. ASH. If we were to submit a budget and the programs to achieve it, of course, we would attempt to accomplish the President's goal and objective of below \$300 billion. To foresee what the Congress will do is a little difficult.

Mr. SMITH. I am not getting into that at all. You gave us the figure of \$305.4 billion.

Has that figure changed since May?

Mr. ASH. That figure has not changed. I am merely saying that that figure presumes a number of actions of the Congress which we cannot predict.

Mr. SMITH. I understand, and it did at that time too.

Mr. ASH. That's right.

Mr. SMITH. Right.

That would mean if there is \$297 billion in revenues, and expenditures are \$305 billion, there would be about an \$8 billion deficit. In addition to that, however, trust fund surpluses are about \$8.5 billion, so that the Federal fund's deficit would be about \$16.5 billion. Is that correct?

Mr. ASH. Yes; that figure would be about right for the trust funds.

Mr. SMITH. But the net amount to be raised through issuing new obligations would still be about \$8 billion?

Mr. ASH. About \$8 billion.

Mr. SMITH. Your earlier estimate was based on a 7-percent inflation rate.

Have you changed that?

Mr. ASH. The earlier estimate wasn't based on any standard inflation rate. As you know, the budget doesn't contain within it any indexing in the sense that programs are automatically indexed according to one number. Different programs have their own indexing effects, and each was applied for what we believed it to be.

Mr. SMITH. But you must assume some inflation rate, and I understood you had assumed a 7-percent rate earlier.

Mr. ASH. No, sir. Each program is calculated on its own. Let's take, as an example, Defense. The Defense budget doesn't explicitly contemplate any inflation rate. We merely look at the expected programs, the expected cost of those programs, the expected pay of Defense personnel, calculate that, work that over, and that number becomes the budget number with no consideration specifically of inflation, merely the consideration of the expected costs of those programs that are proposed within the budget.

Mr. SMITH. Have you changed your estimate since last May as to what the inflation rate will be this year in any of these programs?

Mr. ASH. The economic outlook is for higher inflation rates during the rest of this fiscal year for the economy as a whole than were foreseen from last May, but that isn't the way the budget is built up. The budget is built up by looking at specific, individual programs and their expected outlays, inflation or not.

Mr. SMITH. In presenting the budget, I understood you used the 5.5-percent unemployment rate estimated last May.

Have you changed that rate?

Mr. ASH. We used 5.5 percent in the February budget. In May's mid-session review, we increased that by about one-quarter of 1 percent, and revised outlay estimates to accord with that new number.

Mr. SMITH. You are still using that?

Mr. ASH. The latest published estimate assumes the same figure we used in May.

Mr. SMITH. So that you are using the May revision as the basis of your estimates?

Mr. ASH. In the \$305 billion, we are using the May revised numbers. If the unemployment rate is higher, outlays could go higher.

Mr. SMITH. I think you had earlier used a 1.6-percent decrease in corporate profits as your assumption.

Have you changed that?

Mr. ASH. The Treasury Department has the specifics. I have their data which we can quote from. I don't know if that was discussed with Secretary Simon or not.

The budget was predicated upon calendar year 1974 corporate profits before taxes of \$124 billion. It now looks like corporate profits before taxes will be higher than that.

One of the things that is happening, though, is that we contemplated in the budget a greater tax rate on those profits. We submitted proposed tax legislation. That legislation isn't at this moment passed, so the new estimate of revenues includes a "loss" from this failure to pass that tax legislation.

Mr. SMITH. You also used an estimate of growth in GNP of 1 percent.

Have you changed that?

Mr. ASH. The number is not far different from what it then was in total GNP. Let me see what number we did include in it.

The GNP estimated number was \$1,455 billion for fiscal year 1975. The number for fiscal year 1975 now is of course, higher than that. The increase is due entirely to higher than anticipated inflation.

Mr. SMITH. I see my time is up. I have a number of other questions.

Chairman ULLMAN. You have to leave shortly, do you?

Mr. SMITH. 10:30.

Chairman ULLMAN. Why don't you take 2 or 3 additional minutes.

Mr. ASHLEY. Mr. Chairman, if it meets with the approval of the membership, I will be happy to yield my time to Mr. Smith.

Mr. SMITH. If that is all right, I would appreciate 2 or 3 more minutes.

Chairman ULLMAN. Why don't you proceed for an additional 3 minutes.

Mr. SMITH. The estimate you have today assumes a delay in the Federal pay raise of \$700 million; is that right?

Mr. ASH. The number that we were working with, the \$305 billion, does not assume that. The delay is intended as one of the ways that

we can deal with inflation by reducing Federal outlays below \$305 billion. The personnel reductions now taking place in the Federal Government, along with that proposed deferral of a pay increase would reduce outlays by \$1 billion.

Mr. SMITH. Then you are not taking into account the effect of that action, then, in the \$305.3 billion figure.

Mr. ASH. We are not; you are correct.

Mr. SMITH. Reducing personnel by 40,000 would result in a savings in this fiscal year of \$300 million in expenditures. Are you including that?

Mr. ASH. No, sir. The \$305 billion that you quote—that we are using as a reference point—is the figure that we officially submitted on May 30, when we submitted our midseason review. Since then many things have happened. The \$305 billion should be clearly identified as the number submitted in May. Since that time no other number has been adopted because, as I have indicated, there is so much going on in the appropriations process. What we can do is submit a list of things that may add to and may subtract from the budget.

Mr. SMITH. Is this 40,000 reduction in personnel you talked about to be in addition to the 33,000 that was mandated in the Defense bill last spring, or is the 33,000 included in the 40,000?

Mr. ASH. This 40,000 net reduction brings Federal civilian full-time permanent positions down to 1,928,000. It takes into account a number of things that work simultaneously. It includes in it the 32,300 reduction of civilian positions in the Defense Department. It includes further reductions in other departments and agencies. It includes the absorption of considerable additional workload—estimated to be about another 10,000 positions—imposed by legislation since the time that employment numbers were estimated in the 1975 budget. Thus, it is a 50,000 reduction from the number we most recently were working on, because earlier legislation this year added the need for 10,000 positions to the Federal rolls. We are saying we are just not going to add those positions. We will get the work done without additional personnel.

Mr. SMITH. It sounds like we might pick up a little more there, then.

To date Congress in completed action has voted cuts in appropriations requests, staff tells me, which will result in a reduction of about \$400 million in expenditures for this fiscal year. This could make a substantial difference in the 1976 budget, conceivably.

Mr. ASH. It is very important that we look ahead to 1976 spending.

Mr. SMITH. Other actions, in conference at the moment, would reduce the outlays more drastically. To date legislation has been passed this Congress, staff informs me, which will add about \$1.5 billion of expenditures. The way I rapidly figure it, using your figures here and only taking into account completed congressional action to date, we come to a net, after adding and subtracting, of about \$306 billion of expenditures against income of \$297 billion. However, Secretary Simon said that the revenue estimate could be off by as much as \$5 billion one way or the other; so we are talking about from \$4 billion all the way to \$14 billion of either new borrowing, new revenues to be raised, or reduction in existing programs.

The question is which approach to adopt, and I will have to leave that to other members of the committee to explore. I understand that

you don't have specific suggestions today. However, you did talk in your statement about program delays. As a matter of fact, I think that just compounds the problem.

At this time I will yield.

Chairman ULLMAN. Thank you, Mr. Smith.

Mr. CEDERBERG?

Mr. CEDERBERG. Mr. Ash, we are talking about a \$305 billion spending budget for this fiscal year, and the attempt is to reduce it to \$300 billion; is that correct?

Mr. ASH. Yes, sir, that is correct for 1975. We do—indeed we must—also plan ahead to future years.

Mr. CEDERBERG. In trying to reduce the \$5 billion, how much administrative action can be taken to bring about this reduction, and how much of this will require congressional action?

Mr. ASH. Mr. Cederberg, most of it will require congressional action. The possibilities for executive action alone are limited. Of course, we are working on what we can. But the laws are such these days, particularly on the programs we call entitlement programs, that it is illegal not to spend virtually all of that \$305 billion. To reduce spending requires either legislation by the Congress to change programs, or alternatively, concurrence by the Congress with Presidential deferral and rescission actions.

Mr. CEDERBERG. We have just completed the defense appropriation conference report, which reduced the defense appropriation about \$4.9 billion, and that translated into spending reductions in this fiscal year will be about \$2.6 billion—so that is an action that really the Congress will have taken.

Mr. ASH. That is right. That is an action the Congress is taking.

Mr. CEDERBERG. Can you, on the other side of the coin, tell me what built-in increase actions Congress has taken in this fiscal year or that you see on the horizon will increase the expenditure level in the fiscal year?

Mr. ASH. Yes, sir. Let me take one that at the moment I believe is being misunderstood and therefore reported incorrectly. That is the Labor-HEW appropriations bill.

I have been reading that the present congressional action on the Labor-HEW appropriations bill would reduce outlays from the President's budget. Quite the contrary. It will increase outlays above the President's budget. The "reduction" has been done with a form of mirrors.

There have been reductions in mandatory programs; that is, reductions in the estimates of amounts that would be spent under mandatory programs. At the same time, new programs that would require additional amounts of money have been increased.

We will be paying those additional amounts of money for the new programs being created. Then, a little later in the year, bills under the mandatory programs are going to come in anyway, whether or not we reestimate them downward. We will be paying those "extra" bills with a supplemental, because we will have an obligation to pay. The net effect of the Labor-HEW action now in process would be to increase the President's budget by several hundred billion dollars. The actual sum depends upon whether it comes out nearer the House or nearer the Senate version.

Mr. CEDERBERG. You mean hundreds of millions?

Mr. ASH. You are right, hundreds of millions of dollars. I guess I slipped.

Let's pick another item, the trade bill now being considered. It has many advantages from the point of view of trade, but nevertheless carries with it a disadvantage. That is the readjustment benefits to workers. We estimate this would cost about an additional one-half billion this fiscal year. That is a big increase.

Let's think of another item—veterans' educational benefits. Depending again on how that bill finally comes out, it will add several hundred million dollars to the President's budget.

Mr. GIAIMO. Mr. Cederberg, would you yield at that point?

Mr. CEDERBERG. Yes.

Mr. GIAIMO. Mr. Ash, I am intrigued by these additions to inflation which veterans, workers, and those who are the recipients of assistance of one form or another from the Government because of age, disability, unemployment, and so forth—I am intrigued by the statement you are making that they add to the budget and therefore contribute to this inflation. But now would you tell us what in this fiscal year has been added to the budget as a result of expenditures in Southeast Asia, as a result of foreign aid requests by the administration—as a result of these two alone?

Mr. ASH. The Congress has reduced both of those in fairly considerable amounts.

Mr. GIAIMO. Never mind what the Congress has done. Isn't it a fact that the administration has asked for several billion dollars more in foreign aid and military aid?

Mr. ASH. Not more. These other programs I have been talking about are substantial increases. The foreign aid programs haven't been large increases. They have been continuations of programs more or less at earlier levels.

Mr. GIAIMO. You mean you are not asking for any more in aid this year than in the past year?

Mr. ASH. Let me get the exact numbers for you.

The effect of the budget authority translated into outlays for 1974 was estimated in the budget to be \$2.45 billion for economic and financial assistance. The budget proposal for 1975 was \$2.67 billion, a slight increase. Then if we take international security assistance, which should be looked at as well, outlays there are \$1.4 billion in 1974 and \$1.5 in 1975. These programs are increasing more or less as everything in the budget increases. My concern is with increases beyond those planned. Remember that from 1974 to 1975 outlays will increase by some \$30 billion even if we bring the budget in below \$300 billion. We are not talking about decreases from last year, we are talking about containing the increase.

Mr. GIAIMO. Are you taking into consideration the increased moneys being requested, or that will be requested, in the supplemental for the Middle East, for the Arab states, for Israel and all of those?

Mr. ASH. These are not prospective increases.

Mr. GIAIMO. Those that will come forth in future supplementals for this fiscal year.

Mr. ASH. I would suggest it would be a very good investment if we can contribute to our national security, through Mid-East moneys.

Mr. GIAIMO. That is not the point. The point is they are going to make a contribution to inflation. They will be an inflationary factor in the budget.

If you will yield for one more question on the same point, Mr. Cederberg.

You are talking about methods of increasing and decreasing the budget. As you well know, the question is where do we increase and where do we decrease. Your budget figure for fiscal year 1975, as I recall, adds to the third largest item in it after Defense and income subsidies—that is, interest that the U.S. Government pays, in the neighborhood of \$30 billion; is that right?

Mr. ASH. Yes, \$30 billion, of which only \$23 billion is paid to the public. Seven billion is paid to trust funds, that is from one pocket of the Government to the other.

Mr. GIAIMO. Don't tell me who it is paid to. It is paid to banks and those people who lend money to the Federal Government.

Mr. ASH. Not \$30 billion. Part of the \$30 billion, \$7 billion is paid by the Government to itself. Moreover, the Federal Reserve Board returns to the Treasury \$5 billion in interest it collects.

Mr. GIAIMO. \$30 billion is what the United States pays out in interest during fiscal year 1975; is that right?

Mr. ASH. Not pay out of the Government but pays in total, partly to another part of the Government. I'll be glad to talk about any of these figures, but I just want to make sure it is clear we are talking about the same thing.

Mr. GIAIMO. The point is that those estimates were made a year ago; is that right?

Mr. ASH. The budget estimates were made last winter.

Mr. GIAIMO. At the time that you made the estimates on your budget requirement for interest, what rate was the Federal Government paying for money?

Let me throw in another question.

Was it paying the rate it has been paying for the last several months?

Mr. ASH. No. We have been borrowing at higher rates than at the time the budget estimates were developed and our estimates of interest on the public debt have accordingly been revised upward.

Mr. GIAIMO. My question to you then is that if we continue as we have this year, I think you are paying in the neighborhood of 9 percent now for short-term money, isn't that right?

Mr. ASH. For short-term money, yes, sir.

Mr. GIAIMO. If this continues, or even stays in the general neighborhood of 9 percent, how much is that going to add for interest expenditures to the \$30 billion fiscal year 1975?

Mr. ASH. The answer, of course, depends on just what actually happens to interest rates. Perhaps \$1 billion.

Mr. GIAIMO. Less than \$1 billion?

Mr. ASH. Perhaps, if you count from the \$23 billion base.

Mr. GIAIMO. All right, let's go to the 23 base.

Mr. ASH. Then, my guess is \$1 billion, a bit more than \$1 billion probably.

Mr. GIAIMO. Are you saying that these high interest rates that we are paying will only add about \$1 billion to the budget estimate of \$30 billion?

Mr. ASH. Remember that the \$305 billion number we were talking about earlier, which was our May 30 estimate, already anticipates a \$1 billion interest increase to the \$30 billion.

Mr. GIAIMO. You did that sometime in May, I think.

Mr. ASH. Yes.

Mr. GIAIMO. So you have already added \$1 billion for increased interest expenditures.

Mr. ASH. Over and above what the February budget had estimated.

Mr. GIAIMO. Now you are saying that you might have to add another \$1 billion?

Mr. ASH. That is quite possible.

Mr. GIAIMO. Possible or most likely?

Mr. ASH. It depends again on what interest rates do. One banker in this country, an eminent banker, has said that interest rates might be back to 7 percent by year end.

Mr. GIAIMO. Isn't it true that it would be very difficult for the Government to see that interest rates go down?

Mr. ASH. One of the objectives of fighting inflation is to get interest rates down. One of the ways to do that is reduce Federal expenditures, thus getting the Federal Government out of the credit markets. This will reduce the demand for credit, and should drive down interest rates.

Mr. CEDERBERG. I think my time has expired.

Mr. GIAIMO. I think your time is up. I just received a note indicating that.

Thank you.

Chairman ULLMAN. Mr. Whitten.

Mr. WHITTEN. Mr. Director, we have been subjected to the views of numerous economists through the years. We all realize we live in a political world and that the country is dominated by two political parties and give and take is always there. I point out here that when you come to inflation, I think it is basic economics, that fewer goods divided into more and more money, comes out "inflation." It is then not merely what you spend but whether you get true value for it, so the goods balance the expenditure.

I don't question that we need to give attention to spending, but I was intrigued by your position, and that of many others, that we cannot cut Defense. I have served on that subcommittee since 1943 except for about 2 years. I wish to assure you that we must not cut Defense, but to cut the Military Establishment is something else.

For your information, as of today we are paying a bonus of \$2,000 to young men who put in 15 weeks of training on a 4-year contract. Then, in order to get a renewal, we pay up to a \$10,000 bonus. We have 300,000 troops in Europe and 248,000 dependents, with schools, teachers, and so forth. Not only that, but in Defense, and this is a matter of record, they have \$6.9 billion not even committed, not even obligated in carryover funds.

I would just point out that involved here is a matter of maintaining the Military Establishment, and not real defense.

Then we come again to whether you are getting anything for your money. For instance, take foreign aid. Whatever its merits may be as a matter of foreign policy, it is 100 percent inflationary. We give the countries the money. They use that money to buy our goods so we

have more and more money and fewer and fewer goods. Fewer and fewer goods divided into more and more money equals out a higher price and on its face is 100 percent inflationary.

I noticed—and my colleague from Connecticut probably noticed it too—you compared foreign aid as limited to this year's expenditures, but you ignore your request for future commitments that we intend to make. That, at least, is my understanding, and I am making a discourse here rather than asking you a question, because I have a very limited time and we are meeting on another bill which was vetoed on what I think was some misinformation on the part of OMB.

On foreign aid, as I say, again they get the goods. We get our own money back to add to our supply of money and fewer goods supplied domestically. So where you apply this reduction in spending is going to largely determine whether it has the desired effect on inflation or not. If you get something solid for it, where the goods offset the expenditures, elementary economics says that's OK. Yet it is these solid things such as public works which you would cut while protecting inflationary spending such as needless spending in the name of defense and foreign aid.

Now I come to two or three items before the committee which is to meet across the hall to vote out a bill that has been vetoed. In that bill the Federal Trade Commission advises me, as chairman of that subcommittee, that they need \$1,014,000 to carry on lawsuits that they have against major oil companies. They tell me that they have authority but you sent down a budget request for only \$400,000, leaving them out of balance by \$650,000 if they are to meet the need.

In the original bill for agricultural, environmental, and consumer programs that we passed through the Congress, your office counted on using \$100 million of section 32 funds. You recall that under section 32 of the AAA, 30 percent of the import duties are set aside primarily to promote the production of food. Under the laws that the Congress unfortunately passed these funds may be used to buy food. In my opinion, they are taking money that is set aside by law to produce food, and using it to use up the food we have. I am not objecting to what they might feel is necessary for food, but when you use the money that is there to produce food, you are reducing the supply—which is highly inflationary as well as highly dangerous.

In the original bill which was vetoed, \$100 million for the food purchased was added by the Senate at the request of a Cabinet officer—Mr. Butz, the Secretary of Agriculture, with the approval of OMB we were told—so as not to deplete section 32, and preserve the funds for food production. For the time being the increase by the Senate was offset by the money on hand. Certainly we as a Congress and as the legislative branch are entitled, if the administration is going to support these two items, to have a budget estimate submitted to us to offset it, but we are just told we should do it; that it is OK. If we didn't provide the necessary funds for the Federal Trade Commission, we would be accused of not supporting the lawsuits filed by the executive branch against the major oil companies in an effort to help meet the energy problem. We did meet this need; yet the bill was vetoed and these items I mention were given as the causes.

In this bill that we just got through marking up, mentioned by Mr.

Cederberg, and I am on that Defense Subcommittee—I say again it is the Military Establishment at issue. True defense should be a mobile force that is ready to strike, with a trained Reserve and Guard, equipped with modern weapons, available to be called into action. But we should quit trying to keep the status quo with every fringe thing in the world.

You have approved and recommended to the Congress money so that we can provide caterers to serve people in the service. I don't know how we would fight if we ever got beyond the delivery point of the local baker. The Secretary of Defense says that it is demeaning for folks in uniform to do KP duty. I don't know how you would ever fight with that kind of a setup in the Army.

As you know, and with your approval, they are asking us now to reduce the educational requirements for troops. As I recall, a few years ago we were asked to greatly raise the pay because of these highly sophisticated modern weapons. We needed highly educated troops.

Now you know what you are asking us. You are asking us not to insist on 50 percent of them being high school graduates. You are asking us to remove that so you can get numbers. In the bill for Defense Appropriations you had \$177 million, as I understand it, so you could send a recruit's family with him overseas. We did manage to cut that item out of your recommendations.

Of course, if we got into a war who knows whether they would renew their contracts. Most of them wouldn't, I would think.

The point I am trying to get to is this: What are you doing to help us cut the spending where it will cut inflation? If you spend for schools, roads, and flood control projects you have a richer country, you have goods for it and you have something to back up your money. If you spend it under section 32 to produce food, the people can find food products in the stores. If you spend production money for food stamps to take out the limited supply of food that you have got in the stores, you make bad matters worse. That is highly inflationary. I am saying we should be talking about where you spend far more rather than how much you spend.

I would like you to direct yourself to this lawsuit against these six major oil companies, where you have now recommended \$275,000 of the \$650,000 which the Federal Trade Commission says it must have.

Too, on the section 32 funds, your administration, through the Cabinet officer, says you have got to have more money so we won't deplete section 32. We gave it to you. Then you come back and veto it saying it was because of the \$100 million. I don't know how you can run a business that way.

Mr. ASH. I am not sure I can answer all that in one sentence.

Mr. WHITTEN. I doubt if you can answer it in a book, but go ahead.

Mr. ASH. The veto of the bill wasn't for the reason that you have suggested. We have had an earlier discussion on it, and I know that we don't agree exactly, but I can assure you the President did not veto the bill because of that \$100 million item that you mentioned.

Mr. WHITTEN. Perhaps we can put that one back then, if that is not a factor, because we are to meet at 10:30—8 minutes from now.

Mr. ASH. The President vetoed it for the total. Our staff and yours have worked out what I think was quite a different understanding as to what that \$100 million was and wasn't.

Mr. WHITTEN. We are meeting in 8 minutes.

Can I ask you the pointed question: Is it all right then for us to restore that \$100 million?

Mr. ASH. The Department of Agriculture really should speak to that subject, not me.

Mr. WHITTEN. Can they count on your backing if they do speak to it as they have before and asked for it in a personal letter to me from the Secretary of Agriculture?

Mr. ASH. The President will have to look at the bill in its entirety when it comes down. I haven't a firm idea what the total will be.

Mr. WHITTEN. So the \$100 million is still in the package.

Mr. ASH. We have to look at the totals. I know our staffs have discussed how we counted it up differently. We could spend a fair amount of time discussing this.

Mr. WHITTEN. How about the lawsuit against these major oil companies where the cost of fuel has gone sky-high and the lawsuit is pending, and the FTC, says they need this \$650,000, but you send up a budget request for \$250,000 or something like that. I am not pulling your leg. My committee members are right across the hall and are going to mark up in 6 minutes.

Can we include that without a recommendation for veto from you?

Mr. ASH. Our recommendation is that the number that was submitted on behalf of the Federal Trade Commission is the proper one to do the job.

Mr. WHITTEN. You think as the Director of the Office of Management and Budget that your management is far better informed on what the Federal Trade Commission needs to carry out these lawsuits than is the Federal Trade Commission, is that correct?

Mr. ASH. I can say one thing. If we added up all of the requests and all of the lists of desired items from all the departments and agencies—including the Federal Trade Commission—the budget would increase tremendously. Somebody has to look over the agencies' shoulders asking questions and making analyses.

Mr. WHITTEN. The Federal Trade Commission does so very, very many things; but with gasoline and electric rates and gas, all of the fuel and energy having gone up as much as 100 percent, wouldn't you figure that there would be some place better to cut that money than to hold back on the money necessary to pursue these lawsuits that they have already filed against the major oil companies—

Mr. ASH. We are not cutting it.

Mr. WHITTEN [continuing]. Which dominate the world in this area?

Mr. ASH. We are not cutting the money. The question is how much additional we allow.

Mr. WHITTEN. You are cutting back the figure which they say is essential to properly prosecute those cases.

Mr. ASH. Again I am saying that if this administration and this Congress merely adopted the requests of every department and agency the total would be horrifying.

Mr. GIAMMO. It isn't every agency.

Mr. WHITTEN. I come back to the fact that in the case of the Federal Trade Commission, isn't it better for you to approve the money for this purpose, as vital as it is to inflation, where, because of somebody's action, things have increased in price over 100 percent, and cut back somewhere else as against cutting back in this area where they are going out to correct that inflationary spiral?

Mr. ASH. It is our conclusion and recommendation to the Congress that the full job the Federal Trade Commission contemplates doing can get done for a lesser amount of money. We believe the job should be done. We believe we shouldn't overspend the taxpayers' money in doing it. We have provided as a recommendation the amount we believe is adequate to do that job.

Mr. WHITTEN. The taxpayer has to spend it for needless increases in fuel. It's gone just as much as if he paid it to the Federal Trade Commission to stop the great increase in the cost of electricity and fuel. It is the same people. The people and the taxpayers are one and the same.

Mr. ASH. Sure, they are. We believe that that job can be done with a lesser amount of money.

Mr. WHITTEN. Who, in your shop, is expert in the area of Federal lawsuits against six major oil companies? To my knowledge it never happened in history, so I wonder where you found in your shop people who are experts in that area.

Mr. ASH. We have sufficient expertise, we believe, to make the right kinds of inquiries, the right kinds of analyses, to ask the right questions, to test the answers for reasonableness, to test them against other data, and to come out with data regarding each and every department of the Government which annually gets printed in the budget. The result is not perfect, of course, but it is much better than merely adding up department and agency requests and submitting those.

Mr. WHITTEN. What were the other reasons that you had for vetoing the bill?

Mr. ASH. The fact that the bill in total exceeded the amount that was budgeted for 1975 outlays by about \$150 million.

Mr. WHITTEN. All of which was money which had heretofore been appropriated by the Congress. After Senate increases, it was one-fourth of 1 percent above the budget. You understand it was below the budget on the House side. After the Senate additions it was one-fourth of 1 percent above the budget despite the increases.

Now you went back and listed in your veto message funds that Congress had heretofore appropriated which were budgeted in many instances, but which had been impounded, so you counted all of those as though it was new money in this bill. That just simply isn't so.

Mr. ASH. Given the President's strong commitment to do everything that he can to restrain inflation, he has been vetoing bills that would exceed the Federal budget. There is no way to find all the savings in one bill. One must look at all bills.

Mr. WHITTEN. How many regular money bills have you vetoed already this year?

Mr. ASH. I don't know the number exactly, but I am certain—

Mr. WHITTEN. One—agriculture.

Mr. ASH. It was the first one that came down with a large increase. He has vetoed other bills. The marshals bill—

Mr. WHITTEN. Only one, and that likely because only 5 percent of our people are engaged in agriculture, though it is the key to our economy, the base on which all the others must rest.

Mr. ASH. It is the first appropriation bill with a large excess that has come down. He can't veto other increases before they arrive.

Mr. WHITTEN. Can you give me any degree of assurance that if we put this money in there for this section 32, which is the set-aside by law to promote the production of food, which is the only answer to the shortage, and if we in turn provide the funds which the Federal Trade Commission says is necessary to pursue this lawsuit against these six major oil companies, which quite definitely are involved in the world supply of oil and are quite definitely up to their ears in these increases in prices—can you give me any assurance that if this committee in a minute adds those two items that you would not recommend a veto, because of those two items?

Mr. ASH. I can't give you assurance one way or the other as to individual items. The President's position on that agriculture bill is to look at the total.

Mr. WHITTEN. These two items have to do with the Federal Trade Commission.

Mr. ASH. It really depends on what the totals add to. If again the bill comes down as substantially over the budget, then I am sure that the President will—

Mr. WHITTEN. You can give me no assurance on these two items?

Mr. ASH. Not separate from a look at the total; no, sir.

Mr. WHITTEN. Together with them? You can't do it separately. Can you do it with them?

Mr. ASH. I think that if the total of the bill would result in outlays of less than that submitted in the President's budget—

Mr. WHITTEN. Even though it is less than one-third of 1 percent?

Mr. ASH. Ones of smaller amount have been vetoed. There is no way to find all the savings in one big amount, whether it be in a household account or whether it be in a Federal account. One has to look at all the little bills and add them up. There is no silver bullet that can solve the whole problem of inflation.

I might add, sir, that in one part of your question. I think you talked about the long-range effect of foreign assistance rather than about the outlays. I think it is very significant to note that while budget authority in 1974 for total foreign assistance was \$8.18 billion, the President submitted, in the 1975 budget, not \$8 billion for budget authority but \$4.873 billion, an almost 39.9 percent reduction of budget authority for foreign assistance, a major reduction.

Mr. WHITTEN. Mr. Ash, I have the highest respect for you and the position you have. I don't envy you and I doubt if you envy me, but let's get back.

Wouldn't it be much more sound, with the inflation that we are facing, to cut out this foreign assistance, cut it down to the absolute bone, because it is 100 percent inflationary? You can see when they get the goods and all we get is our own money back, that that is where you should work first to scale back and not on these things which produce food for the American people.

Mr. ASH. You can see that the President's budget had a very substantial reduction in foreign assistance, 39.9 percent in 1 year, more than virtually any other program has been reduced.

Mr. WHITTEN. You told Mr. Giaimo that it was substantially the same spending as last year.

Mr. ASH. That is on a cash outlay, because that derives from the previous year's congressional actions.

Mr. WHITTEN. It is the cash that you put out that is hurting us now, isn't it?

Mr. ASH. But you were making the point that if we are truly going to curtail expenditures—and I agree with this point—that we must take actions now that bear on future years. Those are taken through the budget authority process, and in that budget authority process that will bear upon future years in significant amounts, there was a very large reduction.

Mr. WHITTEN. One question and then I will quit, timewise and otherwise.

Don't you agree that insofar as the effect on inflation is concerned, it is of the utmost importance where you cut as against merely cutting?

Mr. ASH. It certainly is. I absolutely agree.

Mr. WHITTEN. Thank you, Mr. Director.

Chairman ULLMAN. Mr. Michel?

Mr. MICHEL. Mr. Ash you and your predecessors for the last 10, 12, or 15 years have had one of the toughest jobs in government. You sit as the President does at the pinnacle here, the only one really getting a good picture of where revenue is coming from and how much has got to be spent.

For far too long the Congress up here has looked only at how we could personally aggrandize ourselves with the general public by bestowing on them one program after another, and not being able to bite the bullet to raise the taxes to fund those programs. That is why you have got a committee like this supposedly set up in this House, and in the Senate; just newly organized. We are not really efficiently operating yet and won't be probably for another year. We are going through a trial run, a dry run, and I am going to be real curious to see, when we get down to the final analysis, how this committee and the Congress itself shares the responsibility you have had to practically assume all yourself with the executive branch.

You can't spend a dime or authorize it, can you, Mr. Ash, until the Congress first authorizes it?

Mr. ASH. That is right.

Mr. MICHEL. Right?

Mr. ASH. That is absolutely right.

Mr. MICHEL. You can't spend a dime for foreign aid unless the Congress says we are going to spend it for foreign aid; right?

Mr. ASH. That is absolutely right.

Mr. MICHEL. You can't spend it for food stamps until we say "Spend it;" right?

Mr. ASH. And then when you say "Spend it"—

Mr. MICHEL. And if you withhold it and a citizen files a suit, you have to pay up, don't you?

Mr. ASH. We certainly do.

Mr. GIALMO. Will the gentleman yield at that point?

Mr. MICHEL. If it isn't as long as it was for my friend Mr. Cederberg.

Mr. GIALMO. Did the Congress authorize the money you spend for expenditures in Cambodia?

Mr. ASH. Surely.

Mr. GIAIMO. Really, for Cambodia?

Mr. ASH. For—

Mr. GIAIMO. For Cambodia?

Mr. ASH. The Congress authorized it in a way that made it available for use in Cambodia.

Mr. GIAIMO. I yield the balance of my time.

Mr. MICHEL. The gentleman who just preceded me, Mr. Whitten, expressed some concern with respect to the agriculture bill and I too am going to have to participate in a rewrite of that. I don't think it has been clearly established here that that bill was more than a half billion dollars over the budget.

Mr. ASH. I don't think the excess was that large.

Mr. MICHEL. Was it not?

Mr. ASH. Not a half billion dollars. My recollection of the number, and I don't have it in front of me, is about \$150 million in 1975 outlays.

Mr. MICHEL. My figures are in error simply because several of the cuts in that bill, so-called cuts in my opinion, were very phony. When we reduce the commodity credit corporation by an amount necessary to restore the capital impairment of CCC, it is really a phony cut.

It is like the other thing you referred to earlier with respect to public assistance. That is just as phony a cut as we could possibly make in the field of health, education, and welfare.

My colleague said it is just one-third of 1 percent. Therefore, it is just negligible. It is one-third of 1 percent of what figure? If you are talking about \$300 billion, then you are talking about \$1 billion. If you are talking about a dollar or a few dollars, it is something completely different. So we get all caught up all the time in percentages with no relationship to what the benchmark is.

I would like to go, if I might, to the Defense item.

You mentioned, Mr. Ash, that there is going to be some cut. You mentioned the possibility of a \$1,700 million cut. From what you know of the action taken thus far in the House and Senate, and in the conference, most of that visible cut that the press has been talking about is really in future obligations and outlays rather than in this current fiscal year's spending, is it not?

Mr. ASH. There is a larger effect over the course of years than in the current year alone.

Mr. MICHEL. Isn't the quickest way to get a cut in Defense expenditures by a cut in personnel?

Mr. ASH. It is a relatively quick way. There is no instant way, moreover; all cuts have a little lag. But nevertheless it is a quick way.

Mr. MICHEL. And currently what is the percentage of the Defense budget that is going into personnel allowances, benefits, et cetera?

Mr. ASH. Well, over 50 percent now in the Defense budget is for personnel costs rather than material costs, and operating costs.

Mr. MICHEL. You mentioned, but very briefly, deferrals and rescissions.

Has there been a formal presentation yet made to the Congress by the new administration, meaning the Ford administration, with respect to deferrals and rescissions that might be in the offing?

Mr. ASH. It is expected that this week, maybe even today, there

will be submitted the first package of deferrals and rescissions called for under the new legislation.

Mr. MICHEL. Would you give us an idea, a ball park figure? If you don't have it right at hand, submit it for the record.

Mr. ASH. I can tell you that first package, which is a listing of those items that have already been reserved, will add up to about \$20 billion of obligational authority. Hypothetically, if not supported by the Congress, they would add \$600 million to outlays for the current year. Let me stress these are reserves already made, not new actions.

Mr. MICHEL. Would you want to spell out for us the difference between a deferral and a rescission?

Mr. ASH. I would like to. As you know, under the new legislation, if the President believes that a program or a prospective expenditure of any kind should not be made at all, he will submit a message to the Congress calling for a rescission of the moneys available for that program.

If the Congress does not act within 45 days of continuous session by both Houses, then the President may no longer continue to withhold those moneys, but must release them.

On the other hand, if the President believes that a contemplated expenditure should be deferred until a later time, then he submits a report of proposed deferrals, and at the same time withholds these funds from obligation. Then unless one House of Congress acts to overturn his deferral, he will continue to defer those moneys.

Mr. MICHEL. And we are to get that list within the next several days?

Mr. ASH. Yes, the first group will reach you very soon, and there will be another one following it just a day or 2 or 3 after. Together they would add to about \$24 billion. Together they will have more than 100 items involved. There will be plenty of work for all of you soon.

Mr. MICHEL. Let me conclude here with just one other area. That is in that public assistance item.

As I recall, the budget came up to us this year at \$13.2 billion. Several years ago, we were up over \$14 billion, and no thanks to the Congress that figure was really reduced. It was strictly by tight management downtown, and getting the word out to the States that they were going to have to tighten up, that we were able to effect those economies.

The Senate, I see, is \$1.2 billion below the budget figure in public assistance. I wonder if you have any up-to-date estimates that would indicate if that ends up being the final figure in conference, what kind of a supplemental request are we going to have to have then to make up the difference? Then it is going to be pictured as the administration spending more money over and above what was originally contemplated after everybody has forgotten about this hearing. That is what makes it all so ridiculous and a big sham.

What is that figure?

Mr. ASH. You have expressed exactly how it is likely to unfold, unless we make clear at this time that the appropriation bill really exceeds the budget. It is not less than the budget. Our current estimate of what public assistance outlays will be is very close to that originally included in the budget. It may fall short \$100 million or so, but it will be about the budget number.

Mr. MICHEL. And part of that is due to increased medical costs under Medicaid, in the servicing of the poor people around the country that we are obliged to take care of, and the States in a matching amount, and we have no other recourse; isn't that true?

Mr. ASH. That is right.

Mr. MICHEL. That is all, Mr. Chairman.

Chairman ULLMAN. Mr. Wright.

Mr. WRIGHT. Thank you, Mr. Chairman.

Mr. Ash, let's go back briefly to your responses with respect to foreign aid. You made the comment just a bit earlier that in fiscal 1974 there was available for spending some \$8 billion in this field and that the administration was really tightening the belt; you say only \$4.8 billion was requested in fiscal 1975, leaving the impression the administration was asking for what might amount to a \$3.2 billion reduction.

What was appropriated in fiscal 1974?

Mr. ASH. In 1974, total budget authority—

Mr. WRIGHT. No. What was appropriated? What was asked for and what was appropriated?

Mr. ASH. I am not sure I have the data.

Mr. WRIGHT. The Congress appropriated substantially less than what was asked for, if I am not mistaken.

I think we appropriated in 1974 a very low amount. Something in the neighborhood of \$2 billion sticks in my mind, if we do not consider the special aid to Israel. If we appropriated that in fiscal 1974, the OMB is asking for an appropriation of \$4.8 billion in fiscal 1975. That amounts to an increase. I can say to you I believe categorically that the Congress appropriated substantially less than \$4.8 billion for general purpose Foreign Aid in fiscal 1974.

You would accept that as a fact, would you not?

Mr. ASH. I think at this point we can all be helped by Mr. Dale McOmber who lives with the numbers so intimately.

Mr. McOMBER. We agree there was a reduction last year. We don't have figures that compare with your \$2 billion appropriation.

Mr. WRIGHT. Would you agree that what Congress appropriated last year was substantially less than the \$4.8 billion requested?

Mr. McOMBER. Yes; however, that amount was included in the total \$8 billion.

Mr. WRIGHT. Let's talk in terms of appropriations from 1 year to the next. You can't logically compare the amount in the pipeline, \$8 billion, to what you are asking for this year.

Mr. McOMBER. The number represents a total which includes not only the appropriations you are talking about.

Mr. WRIGHT. It represents what is available for expenditure from all sources. Let's compare apples with apples. What is appropriated 1 year and made available next year.

Mr. McOMBER. We don't have available figures that would compare with the figures you are talking about.

Mr. WRIGHT. Of course, there is something in the military bill that has something to do with foreign aid, too.

Mr. McOMBER. Yes, sir.

Mr. WRIGHT. By way of appropriation, what you are asking for does not represent a substantial reduction. It represents, I believe,

a substantial increase over what Congress appropriated last year. What you are asking us to appropriate this year represents a substantial increase.

Mr. McOMBER. If you are talking just about the foreign assistance appropriation—

Mr. WRIGHT. That is exactly what we are talking about.

My 5 minutes are all gone and I don't get to ask you any more questions.

Mr. GLAIMO. I yield you mine.

Mr. WRIGHT. Thank you very much.

The point is, if I may take one minute—

Chairman ULLMAN. You certainly may.

Mr. WRIGHT. We must be honest with one another. We must not compare what is in the pipeline or available for expenditure from various sources with what is being requested as an appropriation this year when in fact it is an increase.

Mr. ASH. That \$8 billion is not the amount in the pipeline. That is another number which may be more or less. What I was quoting was the budget authority for last year.

Mr. WRIGHT. You are asking for an appropriation which exceeded what Congress appropriated last year, are you not?

Mr. ASH. Yes, sir.

Mr. WRIGHT. That is all I was asking. Congress in past years has followed the policy of creating new programs which do have an effect on the budget, but the fact remains you are the people who submit the budget request.

For fiscal 1973 you forecast a deficit of \$25½ billion; and for 1974, a deficit of \$121½ billion. Now we all have to work together if we are going to do these things. I am not trying to place blame; I am simply saying it is not a job just for the Congress, but for the administration, for this committee, and your office.

Mr. ASH. Fortunately, there are now the Congressional Budget Committees which, together with the executive branch, can share the concerns we have been discussing. I hope we can use this type of forum to share a responsibility that none of us like. Certainly I could never get elected to do the job I have to do. I hope the rest of you can continue to be elected and do the same kind of job.

Chairman ULLMAN. Mr. Clawson.

Mr. CLAWSON. I have just received a call. My body is needed to make a quorum over in the Rules Committee.

Mr. Ash, on page 6, you indicate \$92 billion is discretionary; but that \$57 billion is for specific defense costs.

"Of the remaining \$35 billion of nondefense expenditures, \$20 billion is for personnel costs—an item on which it is difficult to save a great deal in the short run, although the proposed deferral in the Federal pay raise and the planned reduction of Federal civilian employment will reduce it somewhat. Finally, only \$15 billion out of a total of \$305 billion remains."

Mr. ASH. Yes, sir. I can submit a list of what that \$15 billion comprises.

[The list referred to follows:]

DISCRETIONARY NON-DEFENSE OUTLAYS, 1975

(Excluding Personnel Costs)

<u>Program</u>	<u>1975 Outlays</u> <u>(\$ billions)</u>
Health (largely research and training).....	2.2
NASA research and development.....	1.5
Foreign aid (largely P. L. 480 and Indochina reconstruction).....	1.3
Atomic energy.....	1.2
Child nutrition program.....	1.2
Education programs.....	1.1
Comprehensive manpower assistance.....	0.9
Extended unemployment benefits (proposed legislation).....	0.8
Veterans medical care.....	0.8
Federal aid highways.....	0.7
Housing and Community Development Act.....	0.6
Coast Guard operating expenses.....	0.5
Corps of Engineers and reclamation construction.....	0.5
Department of Justice.....	0.4
Payments and loans to the District of Columbia.....	0.4
All other.....	<u>1.0</u>
 Total, discretionary non-defense outlays.....	 <u>15.1</u>

Mr. ASH. Fortunately we have a few other things to work. But I must say we in the executive branch can't do it alone. We do need congressional concurrence and action.

We have before the Congress now the pay deferral. It will be of some advantage, assuming the Congress does not override it.

It behooves us all to reexamine the so-called entitlement programs where we have no control short of legislation. We must broaden the base over which we can make choices and judgments.

Mr. CLAWSON. You are suggesting that we take a hard look at mandatory spending programs?

Mr. ASH. I certainly am. We are in the process of having a series of meetings with the Congress arising out of the President's meeting with bipartisan leadership about a month ago. It led to meetings I had with Mr. Ullman and some members of this committee. Last Tuesday night the President had a working dinner meeting at the White House and had 30 Senators to get their point of view. We hope to have their opinions soon. We want a view broadened from the Congress.

We don't want a hardened list. We want to try to develop some feeling from both Houses of the Congress as to what programs might be the best ones to work on. Then we can try to develop a set of cuts which will succeed. We want to work through a consultation process, and develop a list which could be agreed to as a basis of action.

Mr. CLAWSON. I recall an old statistical saying. There were two fellows working together. One mentioned there were so many unemployed, in the millions; so many receiving social security; so many in the military; so many women and children receiving aid; and finally, it gets down to you and me and I am darn tired of carrying more than my end of the load.

Mr. ASH. It sometimes seems like that.

Mr. CLAWSON. In foreign aid, as far as I am concerned you can eliminate all of it. Some of the questioners are those who have voted for it; I never have. But I would like to ask you to submit for the record all the Treasury trust funds drawing interest. That includes the social security trust fund, FDIC, all those trust funds that are actually getting that high interest rate to augment their funds as a result of borrowing to finance the Federal debt.

Mr. ASH. We will submit such a listing.

[The listing referred to follows:]

Holdings of Federal securities by major¹ trust funds

[Preliminary data as of June 30, 1974; in millions of dollars]

Judiciary Survivors Annuity Fund.....	\$9.0
Federal Old-Age and Survivors Insurance Trust Fund.....	37,717.3
Federal Disability Insurance Trust Fund.....	8,194.6
Federal Hospital Insurance Trust Fund.....	7,864.4
Federal Supplementary Insurance Trust Fund.....	1,230.7
Unemployment Insurance Trust Fund.....	12,121.4
Foreign Service Retirement and Disability Fund.....	103.4
Airport and Airway Trust Fund.....	877.8
Highway Trust Fund.....	7,599.2
Office of the Comptroller of the Currency.....	37.9
Government Life Insurance Fund (VA).....	650.8
National Service Life Insurance Fund (VA).....	6,915.2

Holdings of Federal securities by major¹ trust funds—Continued

Civil Service Retirement and Disability Fund.....	\$33,331.1
Federal Employees Health Benefits Fund.....	245.8
Federal Employees Life Insurance Fund.....	1,396.8
Retired Federal Employees Health Benefits Fund.....	29.1
Federal Deposit Insurance Corporation.....	5,860.1
Railroad Retirement.....	4,549.1

Total trust funds, including smaller funds not listed above... 129,744.6

¹ Only trust funds holding \$5 million or more of Federal securities are listed.

Source: Preliminary statement of receipts and outlays of the U.S. Government for period from July 1, 1973, to June 30, 1974.

Mr. CLAWSON. Do you know the total amount?

Mr. ASH. The total amount of interest is \$7 plus billion. As of the end of the last fiscal year—June 30, 1974—the trust funds held approximately \$130 billion in Federal securities.

Mr. CLAWSON. Then you add to that all that is paid by the Federal Reserve System, because all their surpluses go back into the Treasury, do they not?

Mr. ASH. Yes; automatically.

Mr. CLAWSON. That will also be submitted in this table?

Mr. ASH. Yes.

Chairman ULLMAN. Can you submit it for the record of this hearing if we hold it open?

Mr. ASH. Yes, sir.

Chairman ULLMAN. Without objection we will hold it open.

[The table referred to follows:]

ESTIMATED INTEREST PAYMENTS IN FISCAL YEAR 1975

	Budget	Midsession review (May)
Interest on the public debt.....	30.5	31.5
Other interest.....	.2	.2
Deductions for offsetting receipts.....	-1.6	-1.6
Interest function.....	29.1	30.1
Interest received by trust funds.....	-7.1	-7.1
Net interest.....	22.0	23.0
Deposit of earnings by Federal Reserve Board.....	-4.7	-5.1
Net impact of interest.....	17.3	17.9

Chairman ULLMAN. Mr. Ashley.

Mr. ASHLEY. I am aware of the provision which requires submission of revised estimates twice a year, which takes effect for fiscal 1977. Is that your impression of the statute?

Mr. ASH. Let Mr. McOmber answer that.

Mr. McOMBER. We are expected under the law to begin submitting those revised estimates in calendar year 1975.

Mr. ASHLEY. I was wondering if perhaps, as this committee is making a bit of a dry run in its efforts to be helpful in getting a grip on the budget, you contemplate trying to get revised estimates that would be useful not only to you but certainly to us? I go back to your colloquy with Mr. Giaimo with respect to net interest of \$23 billion which very clearly is probably going to be more than that. If that is true with

respect to interest, it probably is true with respect to any one of a number of the items included in your fiscal 1975 budget projection of outlays; wouldn't that be so?

Let me just ask you, with respect to housing subsidies—the action that has been taken basically by the President earlier this year to bolster the sagging homebuilding industry by pumping moneys into Fannie Mae, Freddie-Mac, and so forth—are those amounts represented in this figure?

Mr. ASH. In the \$305 billion number we are making an assumption as to what Congress will or will not do and many other things. One assumption is that the Federal Home Loan Bank Board will repay the Treasury by June 30th the amounts which are advanced earlier for those programs. That is an assumption.

Mr. ASHLEY. I am given to understand there is some reason to question this assumption. Are you simply proceeding on the basis of this assumption?

Mr. ASH. We are proceeding on that assumption, hoping it is a valid assumption. But at this time of the year, as I indicated, there are a lot of possible variations from any budget number. We have so many things going on in the legislative processes. In this case the change of interest rates that derive from changes in economic assumptions are significant.

Mr. ASHLEY. You mentioned, too, Mr. Ash, that for the remainder of this fiscal year we can anticipate increases over the budget amounts in certain areas of Federal spending; as a matter of fact, they may be requested by the President.

I was in Atlanta at the presummit conference on housing and construction. I was amazed to find the 70 homebuilding representatives, I believe to the man, were insistent that there be additional billions of dollars pumped into this particular sector of the economy which is enormously depressed at this time, as you know.

I suppose it can be said there is at least the strong possibility there will be White House recommendations for increases.

Mr. ASH. There are tremendous pressures of all kinds to spend more money. Those pressures have to be put in the context of inflation. The worst thing for the housing industry would be to take a fiscal course which would lead to higher interest rates.

Mr. ASHLEY. I am sure that is understood. However, if we continue to produce no housing for lower income families and if the moratorium continues, where the demand is substantially greater than the supply, that in itself is inflationary. Isn't that why the median priced single-family house is \$35,000 today?

Mr. ASH. I do not think that is as much a reason as other factors. However, the cost of financing is certainly a big cost to home buyers.

Mr. ASHLEY. I was referring a moment ago to the median price used home; existing stock. I was not talking about the high interest rate computed into the amortization. I really think in order to establish perspective, we have to say as you have, that the pumping in of additional moneys does have short-term inflationary consequences, no question. We are also faced with the fact in this particular sector there is a curtailment of supply faced with increasing demand and the consequence there is inflationary.

Mr. ASH. At the moment the inventory of unsold housing is at a quite high level. This suggests that the demand is not as great as it

would be under more normal circumstances. Part of the reason might be the high interest rate.

Mr. ASHLEY. In your statement I am interested in why you used the adjective Draconian. By Draconian, you mean we are pretty well reduced, aside from defense cuts, to the \$15.1 billion in programs that really are designed to help people that are the worst impacted by inflation? Is that what you mean by Draconian?

Mr. ASH. Let me give you an example. Let's take the Federal highway program. We spend annually something over \$4½ billion. On the other hand, if we stopped all new highway construction, every bit of it, as of the beginning of the fiscal year, we would only save \$700 million in outlays. Most of the highway outlays in any 1 year, some 85 percent, are fulfilling contractual obligations of prior years. This goes also for public works and virtually all programs that have any lead time in them. That is the nature of these programs.

Mr. ASHLEY. What I am getting to is on page 3 of your statement where you say something about the policy of the recent past. I must say as I look back at the recent past, going back to the guns and butter policy of Johnson, I do not see any fiscal restraints at all. If I mention him, I must mention our most recent President minus one who certainly didn't exercise great fiscal restraint on the spending side in the year before the 1972 election.

I do not know what we mean by the recent past here. I do not think the record has been very good. Taking what you have said about fiscal restraint together with the difficulty in coming up with budget cuts which will successfully attack inflation now, my question would be, why hasn't more emphasis been given to a mix of budget cuts that might have an anti-inflation bias promptly, together with a tax increase which most certainly has a prompt anti-inflationary consequence? I do not quite understand why all the emphasis I find in your statement has been on cutting the expenditure side. I am perfectly willing to bite that bullet, but as I view it, in a probably unsophisticated way, it means that we together should pursue that which will most promptly crush inflation. It would seem to me that a well devised increase in taxes would have to be part of the package. Wouldn't you agree with that?

Mr. ASH. The previous administration last February did submit a proposed tax package which, among other things, increased the tax on oil companies as a part of raising some additional revenue.

Mr. ASHLEY. What I am talking about, Mr. Ash, I don't mean to interrupt you, but we do remember one of the promises that was kept, perhaps because it was one that was kept, and I am talking about the campaign promise that there would be no increase in taxes, and the business community took that seriously. With the possible exception you referred to, that promise remains intact.

I wonder if there is any justification to that?

Mr. ASH. Certainly, Mr. Ashley. You have heard and seen some of the presummit meetings and I am sure this issue will again be discussed at the summit meeting. There are views which suggest a tax increase should be considered. There are contrary views as well that perhaps a tax increase would do nothing to dampen inflation. It would just let us all off the hook, and we would spend more Government money than we should. The net effect would be a bigger Government rather than a bigger economy.

Mr. ASHLEY. In a GNP of \$1,004 billion the private sector's proportion is 67 percent of the total; Federal Government is 21 percent. I just do not track you on your last response.

Mr. ASH. Federal outlays were about 19 percent of GNP from 1961 to 1968. We stepped up outlays in fiscal 1967 to take over 20 percent. Even as the Federal share was growing, State and local governments were increasing their share even faster. Now Government spends about one-third of GNP.

Mr. ASHLEY. All Government?

Mr. ASH. All Government spends about one-third of the gross national product of this country.

There was a step-up in real dollars of Federal Government outlays of 50 percent from 1961 through 1968. The outlays of the Federal Government from 1968 to now have been almost exactly flat in real dollars.

Why did we have deficits when the outlays in real dollars have been relatively constant? The Tax Reform Act in 1969 and further changes in 1971 reduced the level of revenue collections. Had those tax acts not gone into effect, we would have been sitting here today with a bigger Government.

Mr. ASHLEY. In terms of closing the anticipated deficit of somewhere around \$5 to \$8 billion, is there any advantage to relying solely on spending cuts as distinct from a combination of spending cuts and tax increases?

Mr. ASH. By and large, the deficit has the impact, not the gross on either side.

Mr. ASHLEY. Thank you.

Chairman ULLMAN. Mr. Hastings.

Mr. HASTINGS. There was some question as to the lack of a deficit. You seemed to have answered that in your last statement.

Mr. ASH. For the short run. The key for the longer run is at what level shall Government operate. Shall increased revenues simply be transformed into bigger Government?

Mr. HASTINGS. It could have well been a rhetorical question. I have yet to see a Member of Congress running a campaign to increase taxes. In your exchange with Mr. Clawson, you certainly agree and from your statements as I read from them, concerning the entitlement programs mandating expenditures by Congress, one in the process of being developed is Labor-HEW.

What is the request for Labor-HEW?

Mr. ASH. \$33.5 billion was the 1975 budget request for budget authority.

Mr. HASTINGS. The chart I have indicates that Labor-HEW showed a reduction in the House of \$106 million. With no final action of course, the Senate \$629 million. Is that consistent with your figures?

Mr. ASH. Yes.

Mr. HASTINGS. Yet you say the current trend would indicate you would have some displeasure with the final action.

Mr. ASH. It is because this was done with mirrors in the sense that the public assistance part of the budget was merely estimated down from what it will undoubtedly be.

Mr. HASTINGS. Whose mirrors were those, ours or yours?

Mr. ASH. We would like to say they are not ours. Then somebody else can figure out whose they are.

Mr. HASTINGS. At what level would you find the Labor-HEW totals acceptable?

Mr. ASH. What we would like to see as the ultimate outcome of the Labor-HEW appropriation bill is that the amounts included in the budget—and which we still believe are valid—for public assistance be left unchanged. We would like to see the total be within the amount submitted, and there be no new estimate of public assistance.

The public assistance obligations aren't going away just because we re-estimate them. We will have to pay them. As Mr. Cederberg said, we will have to send up a supplemental request if there is a downward re-estimate. Then it will be said, "There's the President increasing the budget."

Mr. HASTINGS. This afternoon we are going to conclude action on a health manpower bill, about \$250 million over the budget request. I hear a lot about biting the bullet around here but that bill will come out because it is one of those motherhood issues and it will be approved and it will present a problem to you as to whether or not you can confirm the necessity for it. Those are the type of things which right today not only in this committee but in other functions we are going to have to pay attention to.

I might say one of the problems here is the development of more health professionals in the country. Yet this Congress is not willing to take a new look at those types of things. I think an alternative program ought to come from your people. When we say we should cut these programs out, it is difficult to cut down a medical school. I happen to believe there are better ways to subsidize scholarships for doctors, but to cut the payments to the medical schools out in 1 year, I do not think is the proper way. I rather think we should go toward alternatives and I think it would be constructive for us to have those alternatives included in your recommendation.

Mr. ASH. Last year, in moving toward special revenue sharing, one of the problems was transition. We had to work with the Congress to find mutually acceptable ways to make these transitions without having a traumatic effect on those involved.

Mr. HASTINGS. I would hope in these meetings that the White House and your people are going to hold with the senior members of these authorizing committees these kind of specifics will be discussed so this committee can then do a more effective job.

Thank you.

Chairman ULLMAN. Mr. Giaimo, I think you have about a half minute.

Mr. GIAIMO. In your response concerning the effect of the reduction in the Defense budget of almost \$5 billion, I believe you said that the immediate effect on outlays in fiscal year 1975 would be minimal. Do you recall that?

Mr. ASH. The affected outlays from that would be approximately—

Mr. GIAIMO. The reduction as you know is about \$4.9 billion.

Mr. ASH. Yes, sir. The effect on outlays in that fiscal year would be \$2.6 billion. Offsetting that is an increase of \$.9 billion caused by the higher cost of fuel. There is further reduction of \$.3 billion from the second supplemental. The net reduction in defense outlays from the budget with all of these items is \$2 billion.

So if we are talking about reducing \$305 billion we now have about \$2 billion before us.

Mr. GIAIMO. A reduction of about \$4.9 billion in authority would result in an outlay reduction of about \$2 billion. So, we are pretty

close. That is not minimal. There is \$2 billion we can find in these efforts to have restraint in our Federal budget, wouldn't you agree?

Mr. ASH. Well, \$2 billion, of course, is not a minimal number to anybody. There are all kinds of increases, though, that have been enacted or are in process of being enacted which exceed that.

Mr. GIAIMO. I understand that, but in the makeup of this budget we are looking for places where we can exercise restraint, both your office, the President, and the Congress. As we look around, as you know, there are many fixed items in a budget that you can't touch. Then the big conflict between us is going to be most likely which are the greater priorities. I do not think there is any disagreement in that. You make statements about veterans payments and some of the others in the Labor-HEW budget which affect those people in our society not in the best position financially to cope with inflation.

Mr. ASH. I didn't make suggestions.

Mr. GIAIMO. No, you mentioned it. Some of us are saying there are several places you can look in the budget to reduce and share the burden equally to assist those least able in our society to bear the harshness of inflation. Prime candidates would be foreign aid and defense spending.

Let me get figures before you on foreign aid. In fiscal year 1974, as I have had my staff check out, the appropriation for all of your foreign aid was \$5.8 billion which included in it a one-shot appropriation for aid to Israel, you will recall, and Cambodia which together came to about \$2.5 billion. That was a one-shot deal last year.

So your normal foreign aid was about \$3.3 billion in 1974, plus the emergency \$2.3 billion. Is that right?

Mr. ASH. That is about right.

Mr. GIAIMO. This year you are going from that \$3.3 billion to your request of \$5.2 billion. Now that \$5.2 billion didn't include that emergency \$2 billion for the Middle East war last year. Isn't it a fact you are going from a level of \$3.3 billion in 1974 to \$5.2 billion in 1975?

Mr. ASH. We operate with different budget concepts than you are apparently using here. We don't have with us data which could confirm or deny those numbers.

Mr. GIAIMO. Do you want to supply it for the record?

Mr. ASH. We also have to get clear what definition you are using.

Mr. GIAIMO. My figures come from the Appropriations Committee staff and, if you will, you can check with them.

Mr. ASH. We will get the definition.

[The material referred to follows:]

FOREIGN ASSISTANCE RECONCILIATION

The foreign assistance totals of \$5.8 billion in budget authority referred to by Mr. Giaimo is the sum of the amounts appropriated in the 1974 Foreign Assistance and Related Programs Appropriation Act for the items listed on Table A. As this table indicates, the most comparable 1975 figure to the referred \$5.8 billion is \$5.2 billion. The following special items are included in the 1974 total: \$2.2 billion for emergency assistance for Israel and \$150 million for emergency assistance for Cambodia. In the 1975 total, the comparable special items are \$722 million for the Special Assistance program for the Middle East and \$150 million for Indochina Postwar Reconstruction Assistance.

Mr. Ash's reference to \$8 billion in 1974 compared to \$4.8 billion in 1975 related to the total for Foreign Assistance as shown on page 167 of the 1975 Budget and indicated at the bottom of Table A.

Multiple definitions exist for foreign assistance, and consequent confusion occurs when differing concepts are used in the same context. For example, all

items included in the Foreign Assistance and Related Programs Appropriation Act are not foreign assistance in a true sense (i.e., assistance to refugees in the United States and Peace Corps). Moreover, foreign aid funds are included in other appropriation acts (i.e., Military assistance, service funded, and P.L. 480.)

By the same token, the totals on page 167 of the 1975 Budget include Advances, foreign military sales, which is a trust fund for cash military sales and, therefore, not properly considered assistance. Those totals, however, do not include the State Department's refugee programs, Military assistance, service funded, and P.L. 480, which are considered foreign assistance.

Presented in Table B, is a listing of accounts appropriately considered foreign assistance. This table shows 1974 budget authority requested of \$9.3 billion, 1974 budget authority enacted of \$8.8 billion, and 1975 budget authority requested of \$7.1 billion. If the special items referred to above are subtracted from these totals, the respective figures would be \$6.9 billion, \$6.5 billion, and \$6.3 billion. In either case, the 1975 budget authority requested for foreign assistance is less than that requested or enacted for 1974.

TABLE A
[In thousands of dollars]

Description	1974 BA	1975 BA
FUNDS APPROPRIATED TO THE PRESIDENT		
International security assistance:		
Military assistance.....	\$450,000	\$925,000
Foreign military credit sales.....	325,000	315,000
Security supporting assistance.....	112,500	63,000
Indochina postwar reconstruction assistance.....	450,000	789,800
Multilateral assistance:		
International financial institutions (excludes maintenance of value).....	788,380	870,000
International organizations and programs.....	145,500	178,600
Bilateral assistance:		
Functional development assistance program.....	578,699	868,300
Grants and other programs.....	284,551	103,400
Overseas private investment corporation.....	25,000	25,000
Contingency fund.....	15,000	30,000
OTHER AGENCIES		
State Department:		
Migration and refugee assistance.....	14,304	9,470
Assistance to refugees from the Soviet Union.....	36,500	
HEW:		
Assistance to refugees in the United States.....	129,000	60,000
Peace Corps.....	75,965	82,256
Amendment for special assistance program for the Middle East and Indochina postwar reconstruction assistance.....		872,500
Subtotal, regular appropriation bill excluding emergency security assistance for assistance for Israel and Cambodia.....	3,430,399	5,192,326
Emergency security assistance:		
Israel.....	2,200,000	
Cambodia.....	150,000	
Total comparable foreign assistance appropriations.....	5,780,399	5,192,326
Special items included in supplemental appropriations bill:		
State Department:		
Migration and refugee assistance.....	52	
Peace Corps.....	1,275	
Item proposed for later transmittal (proposed legislation) in the budget.....	120,635	135,635
Items not requiring action in the foreign assistance appropriation bill:		
Funds appropriated to the President:		
Multilateral assistance: Maintenance of value, separately authorized.....	1,448,633	
International security assistance:		
Military assistance, contract authority.....	200,000	
Advances, foreign military sales trust fund, contract authority.....	3,658,600	4,095,700
Technical assistance trust fund.....	7,500	7,500
Deduct items not in funds appropriated to the President chapter but included in the foreign assistance appropriation bill:		
State.....	-50,856	-9,470
HEW.....	-129,000	-60,000
Peace Corps.....	-77,240	-82,256
Items not in the budget:		
Special assistance program for the Middle East and Indochina postwar reconstruction assistance.....		-872,500
Offsetting receipts.....	-2,849,926	-3,534,066
Total, foreign assistance in funds appropriated to the President chapter.....	8,110,072	4,872,869

Note: Unless otherwise indicated all items and amounts shown were taken from the 1974 and 1975 columns of the 1975 budget.

TABLE B

[Dollar amounts in millions]

Budget chapter	1974 requested BA	1974 enacted BA	197 requested BA
Funds appropriated to the President:			
International security assistance:			
Military assistance grants	\$685	1 \$700	\$925
Foreign military credit sales	525	325	315
Security supporting assistance	100	112	63
Offsetting receipts	-125	-109	-161
Subtotal, regular programs	1,185	1,028	1,142
Emergency Cambodia assistance	² 200	³ 150	-----
Emergency Israel assistance	2,200	2,200	-----
Special assistance program for the Middle East	-----	-----	722
Subtotal, special programs	2,400	2,350	722
Total, international security assistance	3,585	3,378	1,864
Indochina postwar reconstruction assistance	629	499	940
International development assistance:			
International financial institutions	1,222	4 2,237	1,006
International organizations and programs	152	146	179
Bilateral assistance	988	773	881
Total, international development assistance	2,362	3,156	2,066
President's Foreign Assistance Contingency Fund	30	15	30
Department of State: Migration and refugee assistance and assistance to refugees from the Soviet Union	9	44	9
Department of Defense: Military assistance, service funded	2,100	1,123	1,450
Department of Agriculture: Public Law 480	554	554	778
Total, foreign assistance	9,269	8,769	7,133

¹ Includes \$250,000,000 contract authority under sec. 506 of the Foreign Assistance Act.

² The Congress directed use of sec. 506, of the Foreign Assistance Act, in lieu of funding for this account.

³ This amount was appropriated but never authorized and has therefore lapsed.

⁴ Includes \$1,500,000,000 maintenance of value.

Mr. GIAIMO. My point is, if you exclude that one-shot factor, \$2.5 billion, your regular foreign aid program is increasing from \$3.2 billion to \$5.2 billion, and we know where it is. President Nixon was always talking about the \$2 billion plus that was needed with all these new starts with Arab nations and so forth. We are in an economic emergency here and the big disagreement is whose belt gets tightened. My people back home are struggling very hard and are very unhappy these days, and they are looking to us to give them some relief from inflated prices.

One final thing if I may. Your speech deals mainly with budgetary restraint as the great tool that combats inflation. Is that correct?

Mr. ASH. Just one of a number of tools necessary.

Mr. GIAIMO. What are some of the others?

Mr. ASH. Clearly, monetary policy is an important part, also increasing supply.

Mr. GIAIMO. What about credit allocations?

Mr. ASH. That is up to the independent authority of the Federal Reserve Board. It is a matter being discussed in the summit meetings. Also, there is the matter of regulation, the degree to which excessive regulation increases inflation.

Mr. GIAIMO. What about the possible need for some wage and price controls in those areas of the economy where there is no free market and where prices are imposed by big business and big labor?

Mr. ASH. I don't know whether wage and price controls have themselves been productive in solving the problem of inflation over any

reasonable period at all. They tend to be perverse and increase demand. That generates inflation once wage and price controls are removed.

Mr. GLAIMO. Thank you, Mr. Ash.

Chairman ULLMAN. Mr. Leggett.

Mr. LEGGETT. Thank you, Mr. Chairman.

First of all, congratulations on having the courage to come before our committee as the second witness, Mr. Ash. We are pleased to have you.

Have price controls on energy been effective in keeping the price of energy down? You can answer that "Yes" or "No." I think I understand the ramifications.

Mr. ASH. It is difficult to answer "Yes" or "No." Yes and no is the answer.

Mr. LEGGETT. One of the problems which occurred with our wage-price control is that it didn't cover everything; right?

Mr. ASH. That was one of the disadvantages.

Mr. LEGGETT. I have a big agricultural district out in California. Our rice growers are enjoying something like 150 percent parity, but that price was totally uncovered by any of our price control regulations. Of course, we have the same situation in corn and wheat and a great number of other commodities. With the world situation the way it is, it doesn't look like any of those commodities will get down to a reasonable price this year or even next year.

Mr. ASH. If we had better weather this year, I am sure we would have lower prices. We can't budget the weather.

Mr. LEGGETT. Not to overdo one subject, but we are going to have on the order of 25 percent more rice this year and no plan to sell it domestic or international.

Mr. ASH. But it trades off in the marketplace with other crops which are in short supply.

Mr. LEGGETT. It is just going to be stored and we are still going to have a high price.

Mr. ASH. It may be that under Public Law 480 rice will be the crop shipped in larger amounts to make up for wheat and corn which may be in short supply.

Mr. LEGGETT. Your whole thesis here in getting control of the economy has been to restrict expenditures. We haven't really speculated on wage-price controls other than the last bit of dialog we had here. It seems to me, as I stated to Secretary Simon, we are doing pretty much business-as-usual which has resulted in a major catastrophe. It may not be all the Government's fault or OMB's or certainly not all your fault, but we do have the situation where cutting the budget is not new.

We were concerned with the impoundment action last year. The Library of Congress gave me figures. We had impoundments on the order of \$18 billion of spending authority last year. Some of this was set aside by the courts, and I guess some of it was spent last year, but we have decontrolled a large part of the economy on your recommendation and that of other economists in Government.

Over the last year we have had the second largest escalation of wholesale prices in history and all the things which have occurred and all the ground swell we have seen developing in the economy indicates things are going to get much, much worse before they get better.

It seems to me nobody is running the store as far as really getting control of our economy. The theory of the administration is to exert as little general control as possible; allow as much laissez faire to take place as possible. Despite the fact we are selling fewer cars than before, GM dogmatically charges an extra \$500 last year and \$500 again this year.

We have found we can have very, very high unemployment, particularly in blue collar areas and still have the highest wages in the country. I think perhaps the only area we have really bargained in is when we started bargaining at Rockwell International on the B-1 employment program.

As Mr. Ashley has indicated, a \$3 or \$4 billion cut in Federal outlays or expenditures, in light of our GNP and very large State and Federal spending, is psychological more than anything else. You can comment on that.

Mr. ASH. Certainly we are paying the price for excesses that go back a number of years. Even if we put aside the fact the Arabs raised the price of oil, which contributed significantly—

Mr. LEGGETT. We have increased from \$340 billion to \$495 billion national debt—over 50 percent over the past 5 years.

Mr. ASH. The debt owned by the public has come down from about 60 percent to 25 percent of GNP in the last 20 years.

Mr. LEGGETT. That is because you swiped \$140 billion from the trust fund.

Mr. ASH. The law says they must invest it in securities and they do.

Mr. LEGGETT. Is there any program of investing?

Mr. ASH. The funds are invested in Federal securities.

Mr. LEGGETT. Does your administration do anything other than rotating the money which is involved?

Mr. ASH. To open up that subject can get us into a long discussion of the concept of social security.

I want to make the point that we are not talking about business-as-usual: quite the contrary. As you know, one of the very first things President Ford did was to get himself fully into the mainstream of dealing with economic issues. Second, he set about having a series of discussions with broad segments of this society to get their viewpoints as to what might be done. He is seeking to get their concurrence, to get an understanding of the issues, and most of all to come out with a set of programs that will be not business-as-usual. They will deal with the reality of some very tough problems this country faces.

Mr. LEGGETT. I think the average social security recipient pays in \$15 for every \$100 he receives. So to call it an insurance program is inaccurate. It is essentially a welfare program. But if you run into a railroad retirement fund you have a—

Mr. ASH. The railroad retirement fund is in very bad shape actuarially. We are seeing it right now. Yet look at congressional action. It is doing nothing to solve the problem.

Mr. LEGGETT. We put it off to next year. We hope to resolve it.

Mr. ASH. We have pleaded, trying to make a point. We don't seem to be very effective in making points.

Mr. LEGGETT. In your statement you are saying that further cuts in defense spending are unwarranted.

It appears to me that many of the budget requests of the Department of Defense appear to be generally not monitored by your department. I would like to ask you some general questions about that because I

have some admissions from people out of your department and I want to kind of see how we track.

How many people do you have overall, professionals, in the OMB for all agency monitoring?

Mr. ASH. We have about 400 professional people.

Mr. LEGGETT. Out of those 400 people, how are they generally apportioned?

Mr. ASH. About one-fourth of those who deal with programs and agencies deal with defense and international issues. This is largely defense.

Mr. McOMBER. It is right around that number.

Mr. ASH. And that is the number dealing in that area.

Mr. LEGGETT. How many retired military personnel?

Mr. ASH. I know of none.

Mr. LEGGETT. I am concerned that the Congress could cut \$5 billion out of the defense budget. You would appear to be rather oblivious to the credit we deserve and minimize the effect.

Mr. ASH. The Defense Department is spending many dollars. Being a very complex organization, it is always subject to work-over to get dollars out.

Mr. LEGGETT. How can you make the statement then that further spending cuts are unwarranted?

Mr. ASH. Mr. Whitten made a good point earlier. We must maintain a strong defense, but there are opportunities to reduce outlays by being more and more efficient with what we spend. For the first time in many, many years—since 1961, I understand—OMB and the Defense Department have a number of joint analyses. These are inquiries into specific areas of defense where we seek to increase the efficiency and decrease the cost. We have the good fortune at this time to have a Secretary of Defense who was formerly with the OMB. He sees things as we see things. "Let's get these operations all cut down to the most efficient level." We are working with him and his staff with good cooperation, as opposed to earlier years where OMB and Defense were at odds. I am sure we could pick a number that we could subscribe to and that Jim Schlesinger would subscribe to whereby the cost of running the establishment could be reduced. We are looking closely at the defense budget and we contemplate some of those savings this year.

Mr. LEGGETT. We have now 35,000 men in Thailand. Those men are generally considered to be without a mission because they are precluded by Federal law from carrying on air activity over a specific area and the Thais have indicated they don't want them in their intra-country activity. Secretary Schlesinger stated he has a program to bring them back. Eight months have gone by since he so advised my committee, the Armed Services Committee. How deeply does your office get into the management of that personnel?

Mr. ASH. I personally can't add anything additional to what Secretary Schlesinger has said. Our department did concern itself—limited by its resources, of course, to this issue. We attempt to pick the main targets for action and attention, and we do work on the kinds of things you suggest. I am not at this time conversant with all the specifics on the matter you inquired about.

Mr. LEGGETT. That is the fact. Considering 35,000 personnel comprise half-a-billion dollars expenditures anyway, maybe more, and considering the limbo that area is in, it is just a microcosm of our defense posture.

I am strong on defense. If your department is undermanned and unable to offer very strong opinions and exert very strong points vis-a-vis the Department of Defense, I think these are areas to be reviewed. To make the statement that further defense cuts are unwarranted when James Schlesinger might say 25,000 men can come home and be deactivated from Thailand to Moscow, is not a statement which can be backed up.

Mr. ASH. I did not intend to say further cuts in our outlays. We must continue to scrutinize the defense budget. Secretary Schlesinger is doing it as well. The outlays in that area do contain a lot of opportunity for increasing efficiency.

Mr. LEGGETT. We have determined that 12 AWACS aircraft was a pretty healthy number to take on in 1 year. I think the Congress agreed on this. To what extent would your 100 professionals be involved?

Mr. ASH. We work on it. I personally spent time with the Secretary in putting together the budget on the AWACS program.

Mr. LEGGETT. Did you approve the budget?

Mr. ASH. It is the President's budget. My position is to recommend to the President what the budget should be. The President either accepts or rejects those recommendations and then decides the budget.

Mr. LEGGETT. That is all.

Chairman ULLMAN. Mr. Adams.

Mr. ADAMS. I am sorry I was not here during your presentation.

Do you believe a \$4 to \$5 billion deficit or surplus in an economy of the size we have now has a substantial effect on the inflation of the Nation?

Mr. ASH. There are three effects that can come from a \$5 billion outlay reduction. The first is the calculated decrease in the inflation rate from a \$5 billion reduction. This is much less than 1 percent.

There are two other important effects. If the Federal Government, by reducing outlays by \$5 billion, is into the credit markets by \$5 billion less, then that can make more money available for private needs and hold down interest rates. If we reduce the demand for money, other things being equal, we are going to reduce interest rates.

The most important effect is the one for which this committee has been created. I alluded to it in my statement as the effect in outyears.

Mr. ADAMS. Out?

Mr. ASH. Years beyond the current one. I liken the budget to an ocean liner. Even if you turn hard right rudder, you might not see much of a perceptible difference a mile down the road. But in 10 miles or 100 miles, you do notice the difference.

If we are going to have any degree of fiscal control and responsibility, we have to look not only at the effect on the current year, but especially at the effect of our efforts on future years. A \$5 billion reduction now could well make a much larger difference in 1977 or 1978.

Mr. ADAMS. You are talking about the rising level of core budget expenditures as opposed to one-shot or 1-year operations. We are all aware that the budget level is rising because we are building in a core and working on a rising plateau. But I was trying to get at this year's budget, 1975, and what to look forward to in 1976.

I hope we don't differ on whether there is any such thing as a free market on money. Assuming this were true, couldn't your No. 2 point be counteracted by a selective increase in the amount of money available through the Federal Reserve System to offset the \$5 billion

or whatever surplus might be available so that you would not get an increase?

I am not trying to argue with you, but I am telling you I am willing to trade off a balanced budget for the availability of credit on the basis you satisfy the urge for the reduction of Federal expenditures on one hand but we don't kill the economy in housing and elsewhere.

Mr. ASH. If we in the Federal Government reduce our outlays, and gain more control over Federal Government expenditures, the independent Federal Reserve Board may perceive it. That could well lead to an easing of monetary policy which could in itself reduce interest rates.

Mr. ADAMS. You do agree, do you not, that the Congress does have the power, which we have not exercised basically since 1952, to control the manner in which the Federal Reserve Board handles the channeling of credit as with regulation W, Q, and so on? In other words, we could by statute require a channeling of credit if the Congress and the President in their wisdom decided?

Mr. ASH. Yes; it is my understanding that that could be done.

Mr. ADAMS. Thank you, Mr. Chairman.

Chairman ULLMAN. Thank you, Mr. Ash. Just a couple of brief questions having to do, first, with beyond 1975.

You are talking about a \$320 billion budget next year, and you are talking about a balanced budget. But historically after we have gone into a recession revenues have fallen off drastically, creating some of our major budget deficits. Don't you foresee in this coming year that same kind of falloff? It is due to our revenue system, the income tax. If it were based on the flow of goods, as in other countries, it would be more stable. An income tax structure is not stable in economic declines.

Mr. ASH. Our number for "free-fall" outlays next year under existing legislation and program levels and indexes is over \$340 billion. That would be the figure if we did nothing to constrain existing programs. So we have a gap of a significant amount we must deal with before we get to next year. We must deal with it this year if we are not to have problems we can't handle next year.

Chairman ULLMAN. If the inflation factor were not in the revenue picture, it would be a drastic circumstance.

Mr. ASH. It certainly would be.

Chairman ULLMAN. We remember an almost unbelievable debt increase due to economic backsliding, due to economic loss. This is one of my concerns for the coming year. This Budget Committee has to face up to a dry run next year and a full operation the year after. We are at the tail end of a tight money cycle. I think it is highly unrealistic to think we can balance the budget.

Did you indicate that you intend to balance the budget next year?

Mr. ASH. My statement contained in it a target of outlays for next year of \$330 billion. I have just indicated that a "free-fall" level would be over \$340 billion. Thus we have a very substantial task before us—a restraint of \$10 billion or more.

Chairman ULLMAN. If we add nothing: if we just follow through on spending and the economy takes its course with increased unemployment and shortfalls, we could easily go into a \$30 or \$40 billion deficit posture.

Mr. ASH. We might fall into the range of from \$10 billion up to \$20 billion. But who knows what the economy will be when we get to fiscal 1976? That's a major uncertainty.

Chairman ULLMAN. How do you budget if you don't get a handle on economic policy? If you continue this cyclical pattern, budgeting becomes totally impossible. That is one of the reasons this committee has to be concerned with overall economic policy. You have talked about \$24 billion. Mr. Smith is handling a task force to bring to the Congress some concrete proposals this year to help reduce the total expenditures and bring the budget more in line. You have talked about \$24 billion in rescissions which all of us know are in long-range programs. That would involve how much in current expenditure reduction?

Mr. ASH. That \$24 billion would do nothing to bring the expected \$305 billion to a lower level. We need congressional concurrence to retain the budget at that level. Let me remind you again that this \$24 billion does not contain new cuts.

Chairman ULLMAN. It involves future programing for years ahead, more than expenditures.

Mr. ASH. By far the biggest amounts are for the highway programs, water and sewer programs under EPA. Those comprise over 80 percent of the total \$24 billion.

Chairman ULLMAN. But when we are talking about the 1975 budget we really can't look at the rescissions can we? What about deferrals?

Mr. ASH. The combination of this whole \$24 billion obligation authority list would only have a \$615 million effect in 1975. So we must look way beyond the list now coming up.

Chairman ULLMAN. In other words, what you are proposing now in the way of rescissions and deferrals is not an answer to—

Mr. ASH. That's right. We need congressional concurrence on these items just to stay at \$305 billion.

Chairman ULLMAN. These will only guarantee we wouldn't go above \$305 billion?

Mr. ASH. That is right.

Chairman ULLMAN. In the case of deferrals, are these decisions based just on overall reductions or are they based on the merits of an individual program?

Mr. ASH. That first group we were talking about is no more than the amounts which heretofore have been reserved on our books. They represent nothing new, no new programs. They are merely reporting for the first time under the new legislation the amounts accumulated from reserves which have taken place up to the moment.

Chairman ULLMAN. And the additional things?

Mr. ASH. We will make a case for each item. We will offer the reasons for which we propose deferrals or rescissions. The merits of each will be discussed.

Chairman ULLMAN. The merits of the program.

Mr. ASH. The merits of each of the rescissions and deferrals, not just the dollars.

Chairman ULLMAN. Not cutting for the sake of cutting.

Mr. ASH. That is right. Each program will be described on its own merits, and the reasons for deferral or rescission presented on its own merits.

Chairman ULLMAN. Next, a general thing. It is my hope that one of the effects of having this committee will be to bring us into a posture where we can have an honest budget. The system of obligational authority under which we have been operating has just been loaded down with gimmickry, phony cuts and all kinds of other things. Some of the confusion has not been deliberate, but can be traced to the very

nature of the budget process itself which is so deceptive. One problem is typified by the unified, combined budget as against the Federal funds budget, which is really what we are discussing here in our examination of annualized expenditures. We have to put every dollar of Federal expenditures under a single tent each year, so that we will be in a position to look at every dollar. Sometimes it is very difficult to get that kind of close look in the budget you send down. It is our hope that, through interaction between your agency and our committee, we will be able to gain a much more simplified, direct and honest look at the whole of the annual budget as far as expenditures are concerned.

Would you endorse that?

Mr. ASH. I am sure our staffs already have been working together toward budget classifications. We will continue to work toward making sure that we have a good medium of communication through the way that the budget is presented, identified, described, and classified. I am sure this will be one of the advantages that will come from the birth of this very committee.

Chairman ULLMAN. Finally, Mr. Smith—and I am going to recognize him in a minute—has a responsibility with his Task Force to bring us a concrete program. It is my feeling that we have not made any significant progress in this hearing toward answers, toward a program that will get us to the \$300 billion figure. Wouldn't you agree that we have not gotten our teeth into anything concrete that will get us to that figure in this meeting today?

Mr. ASH. I haven't observed a consensus at all as to what might be the reductions that could be made and win a supporting vote.

Chairman ULLMAN. We had hoped that you would bring us some recommendations.

Mr. ASH. As you know, Mr. Chairman, the President himself plans to meet with you and others. Originally the meeting was on his schedule for next week. I hope that it still will take place then. We want to get the discussion going between the executive and the legislative so that we can find some meeting room in the middle, if there is a meeting place. If it can't be found, we should move anyway. But we first should seek a direction to move in that we both agree on the right direction to take.

Chairman ULLMAN. It is certainly my hope that that kind of meeting will take place. It is also my hope that Mr. Smith will be involved, and that we can develop some kind of a program that we can focus on by that time. With that, I will recognize Mr. Smith.

Mr. SMITH. Thank you, Mr. Chairman.

I want to say, first of all, that I think most of the members of the committee with whom I have talked do not consider deferrals as a substitute for recessions in trying to arrive at some kind of a program that ultimately will help to reduce the number of dollars to be raised on the public market. It just isn't a substitute program. So that leaves us with the discretionary program as the likeliest route.

In February you estimated in your budget that the discretionary spending for defense would be \$58.5 billion and for civilian programs \$26 billion, but the figures today were \$57.1 billion for defense and \$35.1 billion for civilian programs.

What accounts for this difference?

Mr. ASH. I don't have the February numbers in front of me.

Mr. SMITH. Apparently you have reclassified a number of civilian programs too. If you don't have that—

Mr. ASH. We will be glad to provide a statement for you that reconciles the two tables.

Mr. SMITH. Will you do that as soon as possible?

Mr. ASH. We surely will.

[The table referred to follows:]

FISCAL YEAR 1975 BUDGET—COMPOSITION OF OUTLAYS

[In billions of dollars]

Description	Budget estimate	Change	Senate debt hearings ¹	Remarks
MANDATORY SPENDING				
Contractual obligations:				
Net interest.....	22.0	1.0	23.0	Interest on the public debt increased due to higher than previously anticipated interest rates.
Housing subsidies and insurance, farm support, etc.	5.6	.3	5.8	Mainly disaster relief (+0.1) and housing assistance (+0.2).
Other prior-year obligations... Defense.....	52.3 (22.1)	.8 (.9)	53.1 (23.0)	Largely prompter payment of procurement contracts and the effect of higher food and fuel costs in fiscal year 1974.
Nondefense.....	(30.2)	(-1)	(30.1)	Many small reestimates.
Subtotal contractual obligations.	79.9	2.1	81.9	
Entitlement programs.....	140.7	1.3	142.1	Increases in unemployment benefits (+0.8), veterans compensation (+0.6), civil service retirement (+0.1) and the food stamp program (+0.1) are partially offset by slower spending for medicaid (-0.2) and railroad requirement benefits (-1).
Legislative and Judiciary.....	1.0	(?)	1.1	Amendments and supplementals, which by law must be transmitted without change, account for this increase.
Total, mandatory spending.....	221.6	3.4	225.1	
DISCRETIONARY SPENDING				
Defense.....	58.0	-.9	57.1	Delays in enactment of the fiscal year 1974 supplemental and the fiscal year 1975 appropriation bills are mainly responsible for this reestimate.
Personnel.....	(37.0)	(-)	(37.0)	
All other.....	(21.0)	(-9)	(20.1)	
Nondefense.....	33.4	1.6	35.1	Increases in the areas of extension of unemployment benefits (+0.8), housing initiatives (+0.5), feeding programs (+0.2), EPA construction (+0.1) and other general increases are offset partially by a sale of Farmer's Home Administration assets (-0.8).
Personnel.....	(20.0)		(20.0)	
All other.....	(13.4)	(1.6)	(15.1)	
Total, discretionary spending.....	91.4	.8	92.2	
OFFSETS				
Offshore oil and receipts and contributions to employee retirement fund.	-8.6	-3.2	-11.8	Higher than anticipated offshore oil receipts (-0.3) and increased contributions to the Civil Service Retirement and Disability Fund (-0.2).
Total.....	304.4	1.0	305.4	

¹ Estimates are consistent with the revised estimates of the 1975 budget released June 12, 1974 before the Senate Finance Committee on the public debt limit.

² Less than \$50,000,000.

³ The amount printed in the budget for relatively controllable outlays for civilian programs was \$25,900,000,000. The amount contained in the Director's September testimony before the House Budget Committee for total discretionary spending in the February budget was \$33,400,000,000. The differences are as follows:

Relatively controllable outlays for civilian programs contained in the February budget.....	Billions
Deduct the offset (thus resulting in an addition to outlays) included in the February relatively controllable outlays for off-shore oil receipts and royalties.....	\$25.9
Add the estimate made in June 1974, for 1975 civilian personnel administering entitlement programs. (This estimate was made only in June. A comparable estimate was not included in the February budget.).....	5.0
	2.5
Total, budget estimate for discretionary spending as cited by Mr. Ash in September testimony.....	33.4

Mr. SMITH. In addition to that, Mr. Chairman, it seems to me you have given us the task of trying to figure out some way to reduce the number of dollars the Government must raise in the public market and coming up with a program in cooperation with the administration. Admittedly, as Mr. Adams and others have said, the spending involved is hardly the major reason for inflation, but it has a psychological effect. Whatever the effect, we want to try to do something about it. Therefore in arranging these hearings, we, first of all, invited the Secretary of the Treasury. I was particularly interested in getting an update of his revenue estimate. I thought he gave us as definitive an accounting as he could. He estimated that there would be an increase of \$3 billion over what he had estimated last February, but admittedly there is a margin of error there of about \$5 billion one way or another.

Now it is your turn, Mr. Ash. We have to have updated and revised figures on spending too, and to understand fully any changes in the different assumptions used: unemployment assumptions, inflation assumptions, assumptions such as these. We need to have some definitive answers and definitive figures.

I don't think we have gotten them yet. How soon can you provide us with revised figures?

Mr. ASH. We can readily provide data of that kind. As I was indicating in earlier comments, at this time of year the factors most affecting the outlook are a list of swing items such as whether a certain piece of legislation will be passed. What we do at this time of the year is to keep that list in front of us. Any individual can calculate a total for himself based on his judgment about what will happen for each item. We can certainly give you the list of possibilities.

Mr. SMITH. I understand, but adjustments in your budget caused by adjustments in your original assumptions—that is what I am really interested in getting at.

Mr. ASH. It would be very easy to put it together. We can take the budget as we presented it in the midsession review. That brought it up to date from the budget submission a few months earlier. We can then take these May 30th numbers and then put down the pluses and minuses which could unfold from each of a number of different things that may happen.

Mr. SMITH. We don't have our Congressional Budget Office staff yet. Therefore we are going to have to rely heavily upon existing committee staff. Existing committee staff does have figures as to what Congress has done with your budget thus far in the course of the year. We too can make adjustments. But we need to have your revised list of figures in the light of all the changes that have occurred. It certainly is nobody's fault. You didn't know what was going to happen.

Mr. ASH. I can tell you roughly what those would add up to. At this stage, if we were to start with 305, the May 30 number, and put down, say, 15 or maybe even more specific possibilities, the range from taking all of them at the lowest level to taking all of them at the highest level would be from something under 300 to something up to 310. From that point it is up to each of you to subjectively say "I think that one will go this way and this one will go that way." Out of that you come up with what you think the final total might be. To go below 300 requires an assumption that there will be congressional

action and concurrence. We don't know whether or not we will obtain this.

Mr. SMITH. That really would be no change from what you had before. But we know there have been changes since then. For instance, we know there is change in the interest rate assumption.

Mr. ASH. Some of the estimates have greater firmness, than others. As an example, we just talked about the Defense bill that is now coming into its final stage. We can now narrow down with a fair amount of precision the range of possibilities for it. We can also put down with reasonable precision the reduction of Federal Government employees from that contemplated in the budget. We cannot put down with precision, at least until after today is over, what will happen to the deferral of the Federal pay raise.

Mr. SMITH. What I am really interested in is just an update of the figures that you originally used to make up the 305.4 figure—for example, unemployment benefits, extension of veterans' disability benefits, interest on the debt, unemployment trust fund, the housing programs. Update the same figures you originally used, in the light of today's more realistic economic assumptions. In other words, you have got the advantage of several months of hindsight, and I assume you would have changed by now the interest rate assumption that you are using.

Mr. ASH. Yes.

Mr. SMITH. There has been some change in the unemployment figure that would be used, and similarly with some of the other assumptions. We really need that figure so that we can have something, although it may prove to be in error.

Mr. ASH. I think a more extensive list would be more useful to you.

Mr. SMITH. Make it as much more extensive as you can, but we need those figures as soon as we can get them in order to begin deliberations. We really can't intelligently discuss what we are shooting for until we get an update on those figures.

Chairman ULLMAN. Supply them for the record.

Mr. ASH. We can surely do so.

Mr. SMITH. Just as soon as you can, please. That is all.

Chairman ULLMAN. When could you get those to Mr. Smith? This is Thursday.

Mr. ASH. Next Monday or Tuesday, or thereabouts. We keep these items in front of us. By and large, we need only to put them down.

Mr. SMITH. Continue to revise them but in the meantime please get us your revised figures in as much detail as they are at the moment and then furnish us with subsequent revisions as they become available.

[The table referred to follows:]

1975 outlays

	<i>Billions</i>
June estimate-----	\$305.4
Congressional changes:	
Enacted legislation:	
Appropriations-----	(-0.1)
Transportation and related-----	-0.2
Public works and AEC-----	0.1
All other-----	⁽¹⁾
Mandatory authorizations-----	(1.3)
Veterans educational benefits—extend delimiting period (P.L. 93-337)-----	0.6
Small business direct loans (P.L. 93-386)-----	0.4
Child nutrition and school lunch (P.L. 93-326)-----	0.2
All other (P.L. 93-347; 416; 351; 314; 387; 368; 350)-----	0.1
Pending legislation:	
Appropriations-----	(-2.4 to -2.3)
Defense-----	-2.6
All other-----	0.2 to 0.3
Mandatory authorizations-----	1.3 to 2.7
Veterans education benefits (H.R. 12628)-----	0.5 to 0.8
Trade Reform Act Act worker readjustment bene- fits (H.R. 10710)-----	0.3 to 0.8
Rice support payments (H.R. 15263)-----	0.3
Operating subsidies for mass transit (S. 386)-----	0 to 0.2
Full Civil Service annuities with survivor bene- fits (S. 628)-----	¹ to 0.2
Relocation assistance (S. 261)-----	0. to 0.2
All other-----	0.1 to 0.4
Reestimates:	
Interest on the public debt ² -----	1.0 to 2.0
Unemployment benefits ³ -----	0 to 0.5
All other-----	(-2.0 to +2.0)
Higher fuel costs—Defense-----	0.9
Federal Home Loan Bank Board forward commit- ment program to assist housing-----	0.0 to 2.5
Higher prices-----	0.1
All other reestimates-----	-3.0 to -1.5
Total-----	304.5 to 311.4
Reduction necessary to get below \$300 billion ⁴ -----	-5.4 to -12.4
Current target-----	299

¹ Less than \$50,000,000.

² The current estimate of interest on the public debt for fiscal year 1975 is too low by \$1,000,000,000 to \$2,000,000,000. This range of estimates is consistent with short-term interest rates of 7 percent to 8½ percent for the rest of the fiscal year.

³ The unemployment trust fund estimate is likely to be as much as \$500,000,000 above the current estimate. The range shown is consistent with fiscal year 1975 unemployment rates of from 5.7 percent to 6.0 percent.

⁴ The administration is now discussing potential reductions with various Members of the Congress.

Chairman ULLMAN. Are there further questions?

If not, we very much appreciate your appearance before this committee, Mr. Ash. We look forward to many future appearances, and also to a close working relationship. I think this can only work if we begin to build a working relationship between the two branches.

Mr. ASH. I thank you, Mr. Chairman, for the opportunity to be with you, and also for your observation that we would like to do our part. You and I and other committee members should meet together as often as business demands. In addition our staffs should work closely together, because there is much that we have ahead of us and none of us have an easy job.

Chairman ULLMAN. Thank you very much.

The committee is adjourned until next Wednesday, September 25, at 9:30 a.m.

[Whereupon, at 12:20 p.m., the committee was adjourned, to reconvene at 9:30 a.m. Wednesday, September 25, 1974.]

REVIEW OF THE ECONOMY AND THE 1975 BUDGET

WEDNESDAY, SEPTEMBER 25, 1974

HOUSE OF REPRESENTATIVES,
COMMITTEE ON THE BUDGET,
Washington, D.C.

The committee met, pursuant to notice, at 9:35 a.m., in room 2359, Rayburn House Office Building, Hon. Al Ullman (chairman of the committee) presiding.

Chairman ULLMAN. The committee will be in order, please.

At this third session in our series of hearings on the 1975 budget, we are pleased to have with us as our witness this morning Alan Greenspan, who is Chairman of the President's Council of Economic Advisers. Let me say, Mr. Greenspan, we welcome you before the Budget Committee. We appreciate the fact that you are very deeply involved at the present time in planning for the economic summit conference and in important policymaking decisions that are underway down at the White House. We are glad to have you.

We will attempt to get through the hearings as expeditiously as possible so that you can return to your other duties.

I believe this is your first appearance before a congressional committee; is that right?

Mr. GREENSPAN. That is correct, Mr. Chairman.

Chairman ULLMAN. In view of that, we doubly appreciate your appearance. You are assuming your duties at a most difficult time to be in charge of the Nation's economic policy. With the country in the state of economic disequilibrium that we face today, it is indeed a challenge.

Those of us on the Budget Committee, a new committee on the scene, charged with responsibilities that have never been assumed in the Congress before, are in the same situation with respect to this economic challenge as you are.

As is the case with any new undertaking, we are just putting together staff. We are in the process of structuring the procedures and delineating responsibilities that are not fully detailed in the enabling legislation. We look forward to your advice and help in making it possible for us to do this in the best possible and most effective way. Although our committee is in a sense recapturing basic economic and fiscal powers that have gradually been handed over by default to the executive branch, we have received support from the executive branch and have welcomed it. I know you have personally indicated to me your desire to cooperate and support us in this effort.

I think you recognize that the problems of this country are so vast and complex that the executive branch alone obviously cannot put it

all together. I think you are looking for help and assistance and in some cases guidance in this overall effort to put the country's economy back together.

These are difficult times. I challenged Secretary Simon, rather harshly, when he was here the other day about a lack of policy on the part of the administration. I recognize you are newly arrived here and are in the process of formulating your economic policies. But I want to urge you to bring us more policy than we have had in the past, because there is no way you can correct the kind of economic problems we have in this country with monetary policy alone. Recently it seems we are being urged to rely more on fiscal policy, but here again over-reliance on fiscal policy would be a mistake because by itself it cannot put the country's economy back together.

We have to have an overall national policy with respect to growth and inflation. As you have said so often, it has to be a long-range policy. You are not going to get results in 6 months or 1 year, but we have to have the policy stated now clearly and loudly, and then we have to express that policy in every field of economic activity of the Government—which means not just monetary and fiscal policy, but credit policy and whatever allocations might be necessary. It means wages and prices must be included. Such policies must be fully backed by the administration and hopefully by the Congress. If we on this committee can help you coordinate these policies with the Congress maybe we can get this country's economy put back together.

Again we welcome you before the committee and we will be very pleased to hear you.

STATEMENT OF HON. ALAN GREENSPAN, CHAIRMAN, COUNCIL OF ECONOMIC ADVISERS

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

First, let me say I fully associate myself with the remarks you have just made. I look forward to working with you. Clearly the task ahead is of truly monumental proportions. I think it would be a mistake if we did not recognize that at the beginning.

I especially want to associate myself with the remark you made with respect to the necessity of now putting into place policies for the purpose of the longer term. As we all recognize our problems have been created over a period of many years and it is going to take a very coordinated effort between both the executive and the legislative branch to resolve them. I think that the sooner we begin to fashion forceful and formidable policy remedies the better.

I believe that the President has clearly indicated this view as well.

Mr. Chairman and members of the committee, I believe the Budget Reform and Impoundment Control Act of 1974 to be potentially one of the most important pieces of legislation ever enacted by the Congress. As a consequence, I consider it a privilege to be asked to participate in these opening hearings of the House Budget Committee. Controlling the thrust of Federal expenditures is an essential and, in my view, key component of any anti-inflationary program. Without strict fiscal discipline in the years ahead, no program to suppress inflation, no matter how elaborate, can succeed.

This morning I would like to trace the linkage as I see it between fiscal policy and inflation. In order to trace this link, I find it most useful to start with the end result, inflation, and work backwards.

I would like to call your attention to the attached chart. It shows the close relationship which has existed during the past nearly two decades between so-called unit money supply and general price level in this country. Unit money supply as used here is the ratio of the so-called M-2 definition of money supply to real GNP (which includes currency in the hands of the public, demand deposits and bank time deposits excluding large denomination certificates of deposit).

As you can see, the price level tracks very closely over the period with unit money supply. Much of same conclusion would be applicable with other definitions of money, or other definitions of liquid assets, although additional technical refinements need to be taken into account.

Although there is a sound theoretical and historical basis for expecting a close relationship, I am somewhat surprised at how close the correlation is.

Nonetheless, a close relationship between unit money supply and prices has been observed in this country as far back as our statistics will reliably carry us. Much the same relationship has been observed in the major industrial countries of the rest of the world.

Simply stated the reason for this relationship is that if there is more money in the hands of people in comparison with the amounts of goods being produced currently, on average each dollar will be able to buy less, or observedly the higher will be the price level. If, in fact, there were a fixed ratio between unit money supply and the price level, it would imply that income velocity, that is, the ratio of the current dollar GNP divided by money supply is a constant.

This relationship suggests the policy target of a basic anti-inflationary policy. We must lower the rate of growth of unit money supply if we are going to return our economy to a more viable noninflationary environment. There are obviously two elements to this ratio. Unit money supply growth can be lowered if we (1) reduce the rate of increase of M-2 and/or (2) accelerate the rate of increase of U.S. capacity to produce. The Federal budget policy affects both the numerator and denominator of unit money supply.

Before I go into tracing these relationships, I should first like to examine some of the implications of the tie between unit money supply and prices. The close correlation tells us something quite significant. It first of all says that the price level is at root a financial phenomenon. It says that averaging out periods of two to three years the general price level, defined as the implicit deflator of the gross national product, is determined essentially independently of its underlying price components. Put another way, one's first inference is that if the total price level is determined independently of the individual prices which make up our price index then any rapid rise in, say, farm prices would be expected to be offset by either declines or a smaller rate of increases in other prices. While such a concept is formally true it can, nonetheless, be deceptive.

Although the evidence for the most recent period is not easy to come by, I believe it is safe to conclude that the sharp rise in oil and

agricultural prices during the past year and a half have affected the general price level. The reason is that the increased demand for credit produced by having to finance the higher valued inventories, along with the implications of this for interest rates and financial market tensions, induced the Federal Reserve to at least partially respond and accommodate a greater increase in the money supply than probably would have been the case were it not for the surges in oil and farm prices. The effect on the total price level, however, was doubtless much less than would be indicated by a simple analysis of their statistical or arithmetical contribution to changes in the price indexes. Some suppression of price increases in other areas apparently also occurred.

This most recent experience raises a very important aspect of the relationship between unit money supply and price, namely that it can work in both directions. While the narrow money supply, and to a lesser extent M-2, is technically capable of being controlled with reasonable precision by the Federal Reserve, pressures often push the Fed to accommodate much larger increases than it would otherwise sanction.

This leads us to the next layer of causation. What are these pressures on the Federal Reserve? Why has there been a tendency in recent years for the increase in the money supply to so far exceed the growth in the economy? Let me begin by saying that I have thought for sometime now that Federal Reserve policy was probably somewhat more expansionary than was necessary during 1972 and during some other periods and my moving from New York to Washington has not changed my view of history. However, in recent years there have been some very powerful pressures on monetary policy. Foremost among these is a tremendous acceleration in the demand for bank loans by private business. As banks have attempted to meet this demand, they have scrambled to accumulate the reserve balances required to support the deposits associated with the increase in loans. The Federal Reserve has virtually full control over commercial bank reserve availability but it faces the difficult problem of how fully the demand for credit should be accommodated. If it does not accommodate the reserve needs and hence the demand for credit, the sharp rise in interest rates would have been even more substantial, enough to discourage many, if not most, of the bank loan applicants. This would, of course, have led to a possibly greater retrenchment in economic activity and perhaps marked financial distortions—consequences that the Federal Reserve has in the past considered unacceptable.

In practice over the years it appears that the Federal Reserve has sought to follow a middle course neither fully accommodating surging loan demand nor completely ruling out the need to do so.

But, to the extent that the Federal Reserve attempts to avoid rapidly rising short-term interest rates, it will of necessity tend to create money supply growth in excess of the underlying trend of the productive capacity growth of the economy.

Clearly if loan demand is moderate, the problem of accommodation does not arise. So in our search for the source of inflationary pressure we must ask what has caused bank loan demand to mushroom.

While it is difficult to separate the exceptionally complex elements by far the major factor, in my judgment, has been the spillover of credit requirements from the capital markets by private business who have been unable to fully meet their credit needs owing to the rising

proportion of our basic savings flows preempted by governments: Federal, State, and local. I am referring not only to the direct borrowings of these governmental bodies but also the borrowings of the many federally sponsored agencies outside of the budget, and the borrowings of private companies needed to finance the facilities mandated to meet pollution control standards and similar legislative mandates.

This type of borrowing has some special characteristics which have a quite different type of effect on capital markets and interest rates than does the vast bulk of borrowing by private industry and individuals. Such government sanctioned borrowing is, in economic jargon, essentially interest inelastic, meaning for example that the U.S. Treasury will borrow whatever is required to cover its deficit wholly independently of the prevailing rate of interest as will most State and local governmental units and the off budget federally sponsored credit agencies.

What this means is that such borrowings tend to have first claim on the flow of private savings and hence leave less available for the normal borrowing requirements of the private sector. Unwilling and unable to compete with the public sponsored borrowings, private borrowers have been forced to the commercial banks for accommodation.

There are obviously many other elements in the process which I have not touched upon such as the impact of worldwide inflation on U.S. price levels, structural rigidities, the effect of inflation itself on savings patterns, and the effect of inflation on economic growth per se, just to start what can be a very long list. But I believe that the major source of the pressure on our money supply growth and price level has been the acceleration in Federal and federally sponsored borrowings.

What I wish to emphasize this morning is that in my view the critical element in any anti-inflationary program has got to be a leveling off, or even more desirable a reduction, in the proportion of private savings flows preempted by governmental agencies. It is important to restrain both the growth in Federal expenditures on a unified budget basis, and off budget financing and credit guarantees as well.

I mentioned earlier that part of any anti-inflationary program is to increase the rate of growth in the productive capacity of our economy but it is clear that the same process of credit preemption has also been a key obstacle in financing capacity growth. Ideally the Federal Government should be adding to savings instead of preempting them through surpluses in the unified budget and reductions in the expansion of credit guarantee programs. The increased availability of savings flows into capacity increasing investment must be the second prong in an anti-inflationary program. There are, of course, many more elements in such a program, but I have restricted myself this morning to those which are of most immediate concern to this committee.

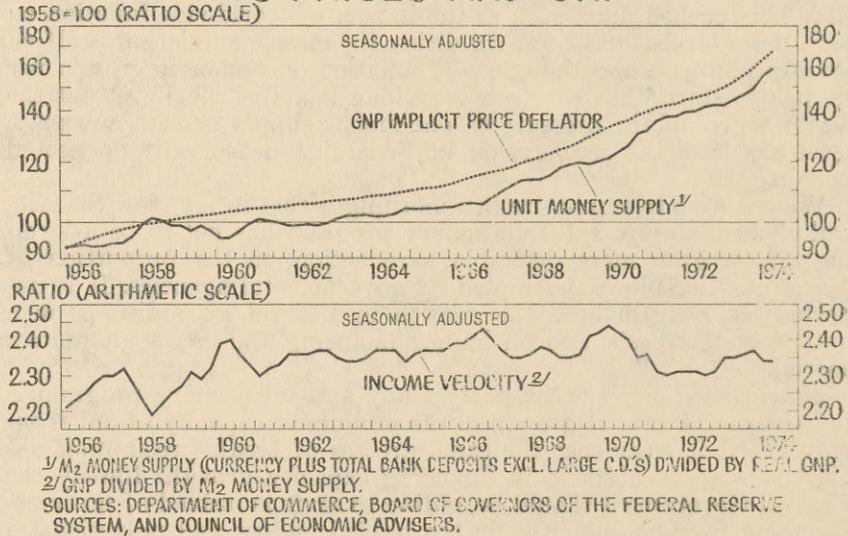
In summary, therefore, I urge that the greatest discipline in budget processes be initiated. Obviously the first order of business is the fiscal 1975 expenditure levels. In reviewing the fiscal budget for areas of reductions, it is important to recognize that cuts which affect only fiscal 1975 are far less significant for long-term budget

control than those which would also have a major impact on fiscal 1976, 1977, and later years. Budget reforms in my judgment must be focused on reducing the long-term rate of growth in Federal outlays. As a consequence, many seemingly small items in fiscal 1975 can have very large effects in later years and it is these changes which I believe require special consideration.

I find the analogy that Roy Ash used here the other day most useful in this context. What he says with respect to the American economy is equally applicable to budget processes. It is "like a giant ocean liner in that its momentum is enormous. A change in direction—even giving the wheel a hard turn—will not produce much of an immediate change in position. It is some time before the difference in steering makes a significant difference in course. It is the longer run aspects of our policies that are the more significant."

Gentlemen, I trust that you will put the full weight of your endeavors on curbing excessive rates of increase in Federal expenditures so that the major force underlying our inflation will eventually be stilled.

MONEY SUPPLY AND ITS RELATIONSHIP TO PRICES AND GNP



Chairman ULLMAN. Thank you, very much, Mr. Greenspan. I must apologize because we are in the final process of wrapping up the tax reform bill in the Ways and Means Committee and Mr. Mills is not going to be there, I have to depart for that assignment. We have a task force that has been responsible for looking at the 1975 budget. Congressman Neal Smith of Iowa is the chairman of that task force. I am going to ask him to take the chair and recognize Members for questioning. The fact that I am leaving bothers me greatly because there are many questions I would like to ask. I hope that I can get back in time to do that. If not, let me again express my appreciation for your

coming before us and bringing to us a very able paper. It is going to take some study. You have discussed some rather basic economic assumptions that we might want to challenge, but you have done so with great credentials.

Mr. Smith, will you take the chair?

MR. SMITH [presiding]. Mr. Whitten.

Mr. WHITTEN. Thank you, Mr. Chairman.

I appreciate the opportunity to comment and to ask some questions at this time. The Appropriations Committee is meeting at 10:30 and I have the bill that is before the committee so I, too, have to leave. First, may I commend you, Mr. Greenspan, because I have served on the Appropriations Committee since 1943 and during that period, we find that the appropriations in the Congress have annually been below the budget. Unfortunately the Congress, through other means, has spent over and beyond the amount that has gone through the appropriations process. I am glad, particularly here, to hear from you, a man from your side of the table in your capacity, use the words "real GNP." In fact, they have all agreed that under the definition of gross national product they presumed you would not spend it for services unless they were valuable and you would not spend them for goods unless you needed them. That is a tremendous assumption. The more you throw away the bigger the GNP. The more services you buy that are worthless, the bigger the GNP. This theory has been regularly presented in the years I have been here. I have pointed it out.

Somehow the news media and Members in the Congress have not picked the matter up. For the first time you use the word "real GNP." in other words, valuable services and valuable goods. Am I right in the reason for your using the word "real"?

Mr. GREENSPAN. First of all, I do agree with what you are saying. I am using here the "real GNP" in the conventional sense of the word, the physical volume of goods and services and not their dollar amount.

Mr. WHITTEN. It is the material, the solid?

Mr. GREENSPAN. Yes, sir.

Mr. WHITTEN. Then I notice that you go down and say that inflation then is a measurement of goods into the available supply of money. Is that roughly what you have said?

Mr. GREENSPAN. Yes, sir.

Mr. WHITTEN. That means if we are to pull in inflation the place to start in cutting back spending is where we are not getting our dollar value in supply of goods. In my opinion you have pointed your finger directly at foreign aid and needless spending in the name of defense.

I recall here a few years ago in the defense subcommittee that the Secretary of the Army announced publicly that he bought \$100 million worth of trucks to promote the economy. This was shortly after World War II. We had acres and acres of trucks all around the world. For me, and I do not say this with any claim of being thorough in any knowledge but having a basic understanding of prelaw economics, this prompted me to question those who are economists. If you buy trucks you do not need when you already have an adequate supply, when you spend money you do not have for things you don't need—obviously, you are adding to inflation.

Let's analyze where in foreign aid, you give foreign countries the money. They take the money, then come back and buy our goods. Our goods are gone, the money has come home, then we have fewer goods being chased by more money. That is 100-percent inflation. Then we have the military. We forget defense frequently and concentrate on the Military Establishment. I have learned, having served on the Defense Subcommittee since 1943, except for 2 or 3 years, many of the expenditures are a deterrent to actual defense. In Europe, for instance, we have 248,000 dependents. We managed to get it out of the bill that just recently passed the House and Senate. They had another \$78 million approved by the Bureau of the Budget so the recruits could take their families with them. The purpose was to obtain recruits. If the recruits have six children and a wife, it is a dangerous situation if he goes out of shot range to see the wife and family. We are trying to deal with inflation by inflation. The more money we have and the fewer the goods, the higher the price. If we are going to correct it, we have to look and see where that situation is developing.

Now I realize I am doing most of the talking here because I am going to have to go to a committee which handles the Food and Drug Administration, and many others, the Agriculture Appropriations Subcommittee. I feel we have made a serious mistake through the years in trying to get prices up by creating shortages. We should have ample production to meet the needs.

Take food stamps. Lots and lots of people can make a real argument about the need of many people to have more food. But if you print food stamps but don't increase the supply you have increased the demand which makes a limited supply show up in bigger terms pricewise.

That money should be spent in producing more and more food because if you have a shortage you will have higher prices. I am sorry I will not be here to hear your answer but I assure you I will read it with great interest.

My 5 minutes are up and I have this other assignment. I have tried to raise points which I hope you will touch on in the process of your presentation. I will follow them up with great interest. I want to commend you for tangling with the real questions, the real GNP. Spending money for nothing makes the matter worse.

Mr. SMITH. Mr. Rhodes.

Mr. RHODES. I will yield to Mr. Cederberg since he has to leave soon.

Mr. CEDERBERG. I have the same problem as Mr. Whitten. I have to attend the Agriculture Subcommittee.

I want to commend you for your statement. I have been here 22 years. I have listened to many Chairmen of the Economic Advisers. The problem is—I think if you go back and read most of their statements they come more or less to the same conclusion that you have—the Federal Government cannot continue to spend more money than it takes in because if it does it has to go out in the money markets and compete with people who have other requirements in the area of housing, et cetera. I think the tragedy is that we have had all this expert advice from all spectrums of the economic community from both parties and the Congress has never paid any attention to your testimony.

Mr. Chairman, don't get the illusion that this Congress is going

to pay much more attention to your testimony than the others have. I think the record is pretty clear on that. If I understand the words you are saying, it is that the Government, this Government and State and local governments, can no longer preempt money that is needed for capital improvements including housing and other areas and expect other than high interest rates and high inflation and probably even greater unemployment. Is that a reasonable statement?

Mr. GREENSPAN. Yes, sir.

Mr. CEDERBERG. Is that what you are trying to tell this committee?

Mr. GREENSPAN. Yes, sir.

Mr. CEDERBERG. Whether or not we take your advice is going to be our responsibility. While I personally have some reservations as to whether or not this Budget Committee we are sitting on here today will be able to accomplish what we want it to accomplish, facing some very basic and realistic facts and looking back at the past history, I wish I could be more optimistic than I personally am because I happen to be one that agrees with you. We just cannot go on this way. But if there is one thing that this committee formation will do, it will put the blame right exactly where it belongs, right here in the Congress. So we are going to find out within the next few months whether or not this Congress has the will to face up to this situation and look at the long-term problem which is, as you point out, the actions we have taken over the past 5 or 6 years have resulted in some of the problems we have today. If we do not correct the problems now to the best of our ability, then as we look ahead the coming years, as you have indicated, the problem is going to magnify.

I think it is an interesting fact that while we have a \$305 billion budget this year, even if we hold at that spending rate there is no way with all of the built-in increases except this administration is going to have to come in with a budget in the area of \$335 billion at a minimum next year, probably much higher. So I appreciate your being here.

I do not want you to be too optimistic. I am delighted that you are telling us the facts. All we have to do is take the proper actions. If we don't, the responsibility is right here in this Congress.

Mr. SMITH. Mr. Ashley, Mr. Leggett wanted time. But it is up to you.

Mr. LEGGETT. I have to leave in about 3 minutes. Will you yield to me?

Mr. ASHLEY. I will be happy to have you proceed out of turn.

Mr. LEGGETT. Thank you.

I have heard what you said and the laudatory comments about your background and of course what my colleagues here have said. I am not in a position to take any other position particularly about your credentials. But I don't see in the statement that you presented to this committee that we have a lot new going for us.

You talk about loose money bringing inflation. That is not really a great new revelation to the Congress of the United States. We dealt last year with impoundments of a magnitude of some \$18 billion. Some of those were set aside by the courts but the effect was had on Government spending. Still, we have had an escalation of the wholesale price of some 45 percent last month at an annual rate. Now it seems to me that while we have had inflation in previous administrations we have never had the inflation in wholesale prices we have had over

the past few years. You can correlate inflation with a great number of things, but it seems to me the things that lead to escalation in wholesale prices is, one, energy and, two, the escalation in raw agricultural products which were really more or less behind the eight ball for some 15 years.

Now, I was rather amazed to hear a speech reported by the Deputy Director of FEA the other day where my good friend Mr. Ligon indicated that there were a great number of ways where the oil producers might avoid the limitations on price as mandated by the Congress and by the Energy Administration. It seems to me that you have indicated here that energy and oil are inflationary factors. What are you doing in these two prime areas of agricultural production and energy to control inflation? I think the old rules that we all learned in college economics of high unemployment breeding deflation don't work anymore. You have big union bargaining. You have big General Motors pricing. I think we are going to have to get to some more formidable action on the part of your agency before we reverse the spiral that seems to really be gaining like a cyclone over the past few months, but which unfortunately is not really very dramatically reflected in your chart.

Mr. GREENSPAN. First, Mr. Leggett, let me indicate to you that there is actually a significant difference here in whether you believe that the current inflation is primarily the result of the tremendous run-up in agricultural and oil prices or whether these are some more fundamental causes operating. Because while it is certainly true that the agricultural price outlook has not improved in the most recent period there is no evidence that the oil price situation will now get significantly worse or at least we certainly hope not.

If all that was involved here was farm products and oil, we could expect to rapidly return to an essentially noninflationary environment eventually when these rates of increase simmer down.

Price changes for farm products, for oil and in fact many more products unquestionably do affect the price level but, I am afraid that even if the rate of increase in farm prices and oil prices ceased overnight or that prices here began to decline, our basic inflationary environment would still be there. It would still be there largely because inflation is essentially a financial and not a commodity problem. That in no way says that food and fuel, the issues you raise, are not important.

Even though I have only been in the administration for a very few weeks, there has been very considerable amount of time focused on precisely the problems that you are raising. They are not easy, as you of course well know, but I do hope that some significant improvements in the outlook for both of these sectors will be forthcoming.

Mr. LEGGETT. Don't you think these items are essentially psychological barometers when basic raw agricultural products go through the roof and basic energy costs go through the roof? This is psychological. It affects everybody. Many times when people raise prices, they do not raise it just the amount of their cost increase, but they geometrically increase their price. The actions of General Motors, \$500 last year and \$500 this year, until you did some jawboning over there, and I do not think the \$50 we saved on the General Motors average price increase is going to affect inflation other than psychologically. Don't you think that the \$5 billion that Congress might save through im-

poundment procedures, et cetera, as it might affect a \$1 trillion economy, don't you think in large part that is psychological, too?

Mr. GREENSPAN. No, Mr. Leggett, I do not, for several reasons. If it were only \$5 billion for fiscal 1975, and that is where it ended, I would certainly agree with you. If that is all that is involved, the effort might not be worth it. However, \$5 billion of reductions during fiscal 1975 in programs that would amount to significantly more than that over the next 2 and 3 years would be very important. I would also agree that budget savings often do not appear significant when measured against the total aggregate GNP, which is a huge number. However, the relevant comparison here is not the GNP but the savings flows of the economy and this is a much smaller total against which \$5 billion is a very important element. So I do not deny that there are psychological elements in this, but psychology can go just so far.

The only meaningful way in which changes in psychology have some really useful impact, is if they are based upon or anticipate changes in the real world. As a consequence, if a significant curtailment in the rate of increase in expenditures in the unified budget were initiated, I think that what we would find is that the money markets would anticipate that this would mean significantly less borrowing by the Federal Government.

We would be likely to find that interest rates could—I don't know if I would forecast this directly because I frankly do not know, but there is a good chance interest rates would fall. This would be by far the best thing the housing market could conceivably get. That has been a huge industry in this country and has very real effects throughout our economy. Now psychology in that sense would reduce the so-called inflation premiums in interest rates because people would expect there would be less pressure and less borrowing and less inflationary pressure. But that psychological change would have real effects. The psychology or the changes in psychology which are not based on real forces or real events peter out very quickly and have negligible and I think sometimes even negative consequences.

Mr. SMITH. Mr. Broyhill.

Mr. BROYHILL of Virginia. Mr. Greenspan, let me associate myself with the remarks of Mr. Cederberg in commending you on an excellent presentation here this morning. I feel it is a basic review course in economics to emphasize the necessity of exercising appropriate fiscal restraint at the Federal level in order to curb inflation. Of course, that is one of the primary purposes for the creation of this committee.

Mr. Greenspan, whether we like it or not, this is not only an economic problem, but it is a political problem, because whatever this committee does, they are going to have to live with the consequences and there is going to be concern on the part of every member of this committee and every Member of Congress as to whether or not they are going to have the support of the people back home in proposing the various cuts; that is to say, reducing the proposed expenditures in the future, new programs that have not been started yet. One of the high officials in the previous administration stated that the inflation was largely the fault of the American people. Of course, this was an improper statement for him to make because it was not the fault of the American people. I do feel the American people have control of a large aspect of this by insisting that their representatives in the Congress do what is necessary to

cut back on unnecessary expenditures, at least to support them in what they are trying to do. Just the other day I suggested here on this committee that we consider cutting back on revenue sharing. Right off the bat the local officials raised Cain about it. They said it is their money to start with. Well, it is not their money. We have a national debt approaching half a trillion dollars. So this revenue-sharing program itself is a deficit-sharing program or sharing of money we are borrowing that creates this deficit. I feel that we will not be able, I am confident we will not be able, to properly do what we need to do until the American people realize they have to support their elected officials in these efforts and go a little further than that, and insist that they do that.

In all these political campaigns over the period of years we find ourselves going out and competing with each other. Who can offer the people the most of the goodies of life with their money or with borrowing against the future? To that degree the American people have a tremendous control over what the Government does insofar as exercising fiscal restraint. I realize they do not have control over the Federal Reserve or the Arab nations increasing the price of oil or the international crop failure back in 1972, and so many other things, but they do have control in that area. I want to ask you, Mr. Greenspan, in what other ways can the American citizen assist us in curbing inflation? I realize industry and labor can exercise better restraint in price controls and wage controls, but what can the housewife or Mr. America on Main Street, U.S.A., do individually that might make a marked contribution to curbing inflation?

Mr. GREENSPAN. Well, I think that the average housewife's major contribution is to support the sensible policies of her Government. Obviously, there is very little that she can do on her own. Her basic problem right at the moment is trying to balance her budget. One of the great casualties of inflation has been the certainty, or I should not say certainty, but the lack of uncertainty that most families have had for many years with respect to planning their long-term future. There were a lot of unknowns but there was a certain stability one could count on. One could plan one's family and future with some sense that you knew what the future held. But when you get involved in a highly inflationary environment, it really is very difficult to determine even the next month or the next 2 months, whether the basic necessities of food, clothing, rent, health, et cetera, will be available. In other words, will you have enough in your budget to meet the costs which continually change every 2 minutes, it seems? As a consequence of this, the certainty, or I should say more exactly the sense of ability to know what you are doing has been largely removed from the American housewife. I do not think she can now plan easily because she does not know what her grocery bill will be 3 or 4 or 5 months from now. That has deprived the American household of a sense of certainty which I think few have realized the importance of—the sense of being able to live in a state of knowing at least roughly what your costs of rent are going to be and what your costs of necessities are going to be in the reasonable future. That unfortunately has been one of the major casualties.

Mr. BROYHILL of Virginia. I was interested in hearing you make that observation because the housewife does have a problem in meeting the

family budget. She realizes this is also the problem we are having at the Federal level.

I think that the Congress has underestimated the American people in that they do not understand this problem, and that they will support the Congress as a whole in a sincere effort to do what is necessary to bring about a halt to this inflationary spiral. I confess, I say they will support them, but everybody has their own Achilles' heel or their little pork barrel project including the gentleman who is speaking right now. But, if the American people are made aware of these problems they will realize that there must be reasonable restraint and they will support the Congress in this endeavor; then I think we will do the job. If we don't do it, then we may as well abolish this committee.

Mr. SMITH. Mr. Ashley?

Mr. ASHLEY. Thank you, Mr. Chairman.

Dr. Greenspan, let me try to clear up something that may or may not be important in your colloquy if that is what it was with Mr. Whitten.

You seem to agree with his definition of real GNP. The gross national product is the value, isn't it, of the goods and services produced annually?

Mr. GREENSPAN. That is correct.

Mr. ASHLEY. So the value is measured in terms of dollars?

Mr. GREENSPAN. That is correct.

Mr. ASHLEY. So the real GNP would be dollars minus inflation?

Mr. GREENSPAN. Exactly.

Mr. ASHLEY. When Mr. Ash was before us, he said that, as far as the Government role, short term, is concerned in arresting inflation, that it really didn't make much difference whether, for example, since we are talking short term, the fiscal 1975 budget deficit was closed by cuts in Federal spending, or increases in tax or a combination thereof.

Do you agree with that?

Mr. GREENSPAN. It depends on what? You mean makes no difference? Obviously it does make a difference.

Mr. ASHLEY. Makes no difference in terms of the anti-inflationary consequence.

Mr. GREENSPAN. It is difficult to know. I would say as a general rule and for small magnitudes it probably makes very little difference. It is certainly true that the actual amount of borrowing is exactly the same, and to the extent that the borrowing impact is causative, as I discussed in my remarks earlier, it makes no difference whether you meet deficits by increasing taxes or cutting expenditures, except insofar as the growth of the economy is affected. Both the level of the tax burden and the so-called incidence of the taxation can have differing effects on the production and the growth characteristics of the economy. As I also indicated earlier, it is both the money supply impact and real GNP, if you will, or capacity, that is relevant.

Mr. ASHLEY. I suppose there are some spending activities that are more inflationary than others.

Mr. GREENSPAN. Yes, I was about to get to that, Mr. Ashley. Although this is difficult to prove it is probably the case. It is both a question of the total volume of spending and its composition.

Mr. ASHLEY. We don't seem to have gotten any good advice in this regard, Dr. Greenspan, from Mr. Ash or anybody else. Not from Mr. Ash because he doesn't take the view it is of that degree of importance. But nobody has come in and suggested from OMB or from anywhere else, to the best of my knowledge, the types of spending activities that are the most inflationary. It would seem to me that that would be useful, just as it would be useful if somebody could give us the basics of a modest tax program that would have anti-inflationary consequences.

Mr. GREENSPAN. One of the problems you have is it is not easy to make those determinations. Economists can say that there are differences in principle because they know what their models demonstrate, but it is quite difficult to make a determination of the inflationary impact of one type of expenditure versus another.

I don't want to overemphasize the differences in the inflationary impact of the various types of expenditure. The composition of spending is a very minor factor when compared with the total level of spending and the way in which it is financed.

Mr. ASHLEY. I understand what you are saying. Measured simply from the standpoint very short term of the 1975 budget, the implications aren't great. It is downstream—

Mr. GREENSPAN. Exactly.

Mr. ASHLEY.—that there is concern. I quite understand that. You have indicated that sensible economic policy would shift some of the burden off monetary and put it on fiscal policy.

Mr. GREENSPAN. Yes, sir.

Mr. ASHLEY. Assuming that this is done, assuming that there is moderation in Federal spending, and presumably some kind of a more balanced tax policy, isn't it a fact that we are going to be looking at a shortage in credit for some years to come? Isn't demand for credit really going to be heavier than supply can accommodate?

Mr. GREENSPAN. This is a very serious question which we are in the process of looking at.

First of all, we do know that inflation is one of the major causes of what appears to be a shortage of credit because it is the nominal or current dollar figures for the GNP that have to be financed through bank loans, bonds, consumer credit, mortgage credit and the like. At the moment, of the extraordinarily heavy credit demands on our system, virtually all reflect the financing of inflation, and not real growth.

There is no doubt that we have got some very serious problems, and this is one of the reasons why I think it is essential that the rate of inflation be brought under control as soon as possible.

Mr. ASHLEY. Yes.

Mr. GREENSPAN. Because this is one of the problems.

Mr. ASHLEY. Mr. Chairman, if I could just finish this line. It won't take but a moment, I think.

If we can agree that the picture at least is blurred in terms of the probable continued demand for credit, I still have a problem with your fixation, as it seems to me, that the private market really is the best distributor of credit, and that human beings, at least those in Government, should keep their hands out. It just seems to me that during such periods as this, and very likely the ongoing period that

we will be looking at, market allocation of credit, if you want to call it that, that is really what it is, is extraordinarily discriminatory, and that there are many units in our private sector that are receiving credit for activities that are questionable, either socially or otherwise, and that there are units or sectors of our private economy that are going credit-begging that are more worthwhile.

If you could give me some help on that; and then, finally, what actions, what governmental actions, do you think could have a meaningful short-term success in curbing inflation, that we can take?

The reason I ask this is because last weekend Hobart Rowan pointed out that if the deficit gap were closed, this might have the consequence of deflating our economy, of curbing inflation by something in the nature of only one-tenth to one-twentieth of 1 percent.

What actions can we take, if that is so, short term, that would cause people to say our Government in Washington has acted well, and the consequences are visible?

Mr. GREENSPAN. First, as to your first question, Mr. Ashley, let me say that at this stage there are extraordinary distortions in the private credit markets which reflect, in my view, the inflationary pressures with which we are now confronted. That is, we have some types of things that go on with these exceptionally high interest rates which we have never seen before.

To my mind, the only way to resolve this extraordinarily distorted financial structure in a fundamental sense is to bring the inflation rate down and rebalance the system.

Credit allocation is not an easy thing to do. Our markets are so sophisticated that what happens if you attempt to divert a certain amount of credit into one area, is that you are really siphoning something off in some other area.

Mr. ASHLEY. But that happens with the operation of the market, doesn't it?

Mr. GREENSPAN. Sure, it does and what anyone who attempts to allocate credit is going to find immediately is precisely this sort of thing. Unless you control the whole system right from scratch, and I know of no one who advocates that, it is very difficult to avoid these so-called displacement effects. That is one of the reasons why I think that it is so terribly important to look at the inflation issue as the major distorter of the allocation of our credit. It is hobbling the homebuilding industry, as we all know.

I don't want to keep coming back to this, but I frankly believe that we just haven't fully explored how many problems that we have now got directly or as a consequence of this inflation.

With respect to your second question about what can the Congress do in the short term, which will be of a major impact, I must say, Mr. Ashley, I don't know of any reputable economist who at this point has a program which he would say will immediately reduce inflation, increase the real growth, and lower the unemployment rate in a stable and enduring way.

I wish I knew a recipe like that. In fact, it is because no recipe like that exists that our problems are as serious as they are.

Mr. ASHLEY. What you are saying is that there isn't a short-term policy or program.

Mr. GREENSPAN. In a short-term sense, there is no basic solution to this problem. I think we are fooling ourselves if we believe it does exist. That, however, does not give us an excuse to say well, if we cannot cure it in the short term, let's forget it. I don't think this country has a choice of whether to come to grips with our inflationary problem. The structural distortions are such that I don't think our economy can sustain itself under these double digit inflation figures.

Mr. ASHLEY. What you are saying is that the long-range program for curbing inflation really can't have, as you envision it, short-term beneficial, short-term—

Mr. GREENSPAN. That is correct.

It might have some. I don't know how to forecast this because it is a very unusual sort of circumstance. If we have a credible policy to reduce the pressures on the capital markets, say, by reducing a great deal of the federally sponsored borrowings, it is possible. The markets might interpret this as being a very credible activity and they might then respond in a way which reduces the inflationary premium and the long-term rate of interest and that would certainly have a very dramatic effect on the housing industry.

It would resolve a number of problems which the electric utilities are now having. A solution in the short run is very unlikely, but I would say that a major improvement is quite possible.

Mr. SMITH. Mr. Rhodes?

Mr. RHODES. Thank you, Mr. Chairman.

Mr. Greenspan, I wish to express my appreciation to you for your fine statement and your answers to questions.

I am interested in what, I gather, is your basic premise that inflation of the economy really is a function of finance. I wonder if that general proposition doesn't need some modification.

Do you believe that political decisions don't distort the operation of that general rule?

Mr. GREENSPAN. When I say it is directly a financial thing, what basically causes financial distortions or problems is another question. Certainly political decisions have a very major and in fact have had very major effects on that. That is going one layer lower in the area of causation.

Mr. RHODES. Of course I think you have to get into another layer to really understand what our inflationary situation is. I regard inflation more of an effect than a cause. Something else caused inflation. Inflation is the effect. One of the political decisions, which I think has contributed to our inflation, is the decision of the Arab countries concerning oil. That was a political decision. It certainly wasn't economic. If it had been economic, I doubt if they would have made that decision. In the long run I think it will prove to have been not beneficial to them.

You mentioned the effect of the off-budget financing of the Federal Government. This is a political decision which in effect preempts certain areas of the economy and gives preference insofar as financing is concerned over other areas. The Federal Government, in other words, decided it would finance, or cause to be financed, these particular areas to the exclusion of others. To that extent, political decisions do distort the general rule, isn't that correct?

Mr. GREENSPAN. I would certainly agree with that, Mr. Rhodes.

Mr. RHODES. So it is important as to just what we do in the field of political decisions. If we are in reality to control inflation, is it then necessary for us to go back to the rather basic suggestion made by Mr. Whitten that we confine our activities through the Federal and private sectors to areas which are income producing or which are non-inflationary?

Mr. GREENSPAN. I would think that in looking basically at the budget as a whole the most critical thing is the total. Certainly the composition of the budget has an effect on inflation, but I would say the compositional change is of a much lower order of magnitude than the total.

Mr. RHODES. Would you agree or would you not that it would be beneficial, if there were any way to do it, to channel credit into areas of the economy in which, No. 1, there is a weakness or, No. 2, there is a demand which cannot be met by the existing facilities? For example, the steel industry, as I understand it, is operating almost at 100 percent of capacity. I would imagine from the condition of the money market that the steel industry would have problems financing any great amount of expansion.

Would it be beneficial, if it were possible, to channel the available credit into that type of industry?

Mr. GREENSPAN. I think that whenever you attempt to do that, Mr. Rhodes, you have secondary effects. I would be more inclined to allow the market process to create the sufficient amount of facilities. Once you begin to attempt to make the extraordinarily complex judgments as to how much, when and where, I think you are invariably led toward trying to do this not only for the steel industry but then for industry X, Y, or Z. I would be very concerned about our moving in that direction, because I do not think that is the preferred way of resolving that particular problem.

Mr. RHODES. I just have one more question. It concerns the provision of capital for expansion of the economy in the correct areas. Obviously one of the reasons that we are capital short is that people don't save enough, and perhaps one reason they don't save is because they find it more convenient or more congenial to spend, which I guess also means that we haven't given them adequate incentive to save.

Do you have any thoughts as to whether or not it would improve the general economy if we could give the American people more incentive to save?

Mr. GREENSPAN. There is just no question that the more we save in this particular type of environment, the better. There are difficulties in making determinations of what types of actions will produce additional savings. In fact, many of the studies that have been made have come up with the conclusion that it is very difficult to change the aggregate amount of savings as a percent of income of our total economy. This is one of the reasons why I indicated, toward the end of my formal remarks, that it would be better even than just balancing budgets to create governmental surpluses, because in a sense it is difficult to change the private savings flow in any significant way. The Government can, in effect, run surpluses that would add to the private savings flow. I would think that would be the quickest way to create the underlying savings that we need, rather than find means, which are very difficult, to engender major changes in savings of individuals.

I certainly would look very favorably upon anything which did

that, but I must say that what the evidence suggests to date is that unless something extraordinary is done, you don't radically change the savings patterns of the American people.

Mr. RHODES. Then, of course, a political decision would have to be made whether or not we should take money from the taxpayers to over-balance the budget or whether we should cut taxes and let the taxpayer do what he wishes with his own funds, either to save or spend.

I understand the problems, Mr. Greenspan.

Mr. GREENSPAN. Thank you.

Mr. SMITH. Mr. Giaimo?

Mr. GIAIMO. Mr. Greenspan, I don't want you to leave here this morning feeling that we are all delighted with what we are hearing. There have been accolades from the other side of the table as to the fine work that you and the administration have done, but there are some of us who would take a contrary view, and as has been stated here by some, there are political implications in this area.

Do I understand that basically what your message is is that what we have to do—the primary, the single most important thing that we have to do in order to bring inflation under control—is to reduce the Federal budget?

Mr. GREENSPAN. I would say more exactly to reduce the claims that the Federal Government has on the capital markets.

Now obviously that can be done either by reducing the rate of increase—nobody I think is talking about reducing the level of expenditures. I think the major action which the Government can take which would affect the money markets, the capital markets, the money supply increase, and so forth, is to reduce the rate of increase in Federal expenditures.

Mr. GIAIMO. But that isn't going to have any immediate effect.

Mr. GREENSPAN. In the very short run? I would agree.

Mr. GIAIMO. Let's get back to that short-run discussion you and Mr. Ashley were having.

What you are recommending now isn't going to have any effect on it in the short run, is it?

Mr. GREENSPAN. I would doubt that it would have any significant effect in the short run.

Mr. GIAIMO. All right.

Mr. GREENSPAN. With the exception of the comment I made with respect to the possibility that it could affect the interest rate.

Mr. GIAIMO. But I don't hear any suggestions coming from you or the administration as to what you are going to do about some of the short-term problems.

Let's take one real short-run problem, the lack of mortgage money. Do you have any suggestions there?

Mr. GREENSPAN. I will say that that is being considered by the administration.

Mr. GIAIMO. Well, it is being considered for a long time. In the meantime, people are desperate.

Do we have any suggestion from the administration for a short-term solution?

Mr. GREENSPAN. I would say that HUD is working on a program, and I hope that at some point it will be completed.

Mr. GIAIMO. They have been working on the program for at least a year, Dr. Greenspan.

Mr. GREENSPAN. I have only been here a couple of weeks.

Mr. GIAIMO. In other words, you are still studying that.

Let me ask you something else.

Do you have any short-term solution to the fantastic increases in food prices which have been going on from week to week?

Mr. GREENSPAN. No. I wish I did.

Mr. GIAIMO. Fine. Then I am going to get back to what are your short-term suggestions from the administration? You know the American people don't understand the involvement of Government in the credit markets and all of that. Credit allocation is something they can understand, but what you are talking about is going to take effect in the future, and we have been hearing rosy promises about things that are going to level off in 4 months, in 6 months and so forth. We have been hearing this for 3 years.

Incidentally, this inflation did not begin, as you suggested with an earlier questioner, when we had the tremendous increase in the food and fuel as a result of the Arab embargo.

Mr. GREENSPAN. I agree with that.

Mr. GIAIMO. Or as a result of the wheat sale to the Russians. It wasn't the impact of those two things alone that brought it about. We have been getting rosy promises, but what are your suggested solutions to some of the immediate problems? You have none?

Mr. GREENSPAN. I personally don't know of any way that you can significantly affect the rate of inflation in the very short run. That is certainly true.

Now if ways do exist, if somebody has developed something, and I know of no economist who has, I would very much like to hear any particular proposal which would successfully come at this.

I only know that short runs become the long runs relatively quickly, and I think that I would certainly agree that the inflation problem has been badly underestimated, and I think it has been a mistake. I think we are now paying the price of too many short-term decisions about this whole process. I think it is long overdue that we come finally to grips with the problem. Unfortunately at the moment it is a long-term problem, and it is only long-term solutions which can credibly work at it.

Mr. GIAIMO. Do you realize what you are saying to the American people when you say that inflation is a long-term problem and we, the Government, have no short-term solution? In effect, what we are saying is let inflation run its course so that it will ultimately work itself out, as you well know that eventually in the long term it will. But this is a *laissez-faire*, do nothing approach to inflation in the short term. You let it shake out. You shake out those who get shaken out, such as they are, for example, in the mortgage industry and the home building industry. You get the borrowers who are on the border line. They get shaken out. The economies readjust themselves cyclically, as you well know, but when you do it the way in which you are suggesting, the Government does nothing to ease the pain. The result of which is that the burden and the hardship is being borne by those least able to afford it and to endure it.

Mr. GREENSPAN. Short-term policies to ameliorate the effects which you are suggesting are under very serious consideration.

Mr. GIAIMO. Sure.

Mr. GREENSPAN. But let's distinguish between the questions of policies which assuage the difficulties which everyone is interested in and the easy assumption that we know things which we don't know.

I wish I did know something which would achieve a credible and enduring reduction in the rate of inflation overnight. Everyone is terribly concerned about how to confront this problem. That is one of the reasons we had this summit. We are trying to get the best ideas which we can.

We have been exposed to some very, very useful ideas but unfortunately at this stage, we do not and have not had anything which, as the President has indicated, will give us a quick fix.

Mr. SMITH. Mr. Latta?

Mr. LATTA. Thank you, Mr. Chairman.

Let me just suggest something that this Congress could have done, Mr. Greenspan, in the short run. It could have postponed for 3 months the 5.5-percent salary increase for Federal workers, and set an example for all Americans. When we can't do anything here in this Congress to help "cool off" our inflation, how can you expect people to do anything out in the hinterlands. I was amazed, as were the people in my district, that the U.S. Senate would not wait for 3 months for a Federal pay increase of 5.5 percent to go into effect. I think this is something that could have been done by this Congress, by not acting and letting President Ford's 5.5 deferral go into effect.

Speaking about the short run, let me suggest something else that this Congress can do. It seems apparent to me that we are going to probably recess here on the 16th of October, come back in on the 11th or 12th of November and be here until Christmas eve. That will give us plenty of time to review some of these appropriations we made in fiscal year 1975, and cut out any fat whatsoever in every appropriation bill that we have, because I agree with your statement when you say "Without strict fiscal discipline in the years ahead, no program to suppress inflation can succeed."

I agree with that 100 percent.

When we look at the Federal budget going up year after year, we can't blame them downtown because this Congress appropriates every single cent that is spent downtown, and if we don't appropriate that money, they are not going to spend it. So for political reasons, with the election just around the corner, it is not going to do us any good to try to hoodwink the American people into believing that they are spending money downtown that we are not appropriating.

I think one thing that this committee ought to do, and I am talking about this particular committee, if it is going to be worth its salt, is to start looking at the hard realities rather than the politics of the thing, and do something that we can do to help the economy. That is to cut down spending out here.

Let me ask you this, and I have been following some of your announcements.

What effect does this negativism or this pessimism that seems to pervade every place in the paper that you turn—what effect does that have on the economy of the country? Don't you think that has a detrimental effect?

Mr. GREENSPAN. Of course it does.

Mr. LATTA. Then why are such statements being made that we have got a couple of years of inflation ahead and it is going to get worse and unemployment is going to go up. Why don't we look at some of the positive things? The number of people employed in this country, for example, today as opposed to just 5 years ago; the rate of unemployment in this country today as opposed to what it was, say, after the Korean war.

Mr. GREENSPAN. Let me express to you what I think we need more than positive statements. I think what we need is to basically tell it like it is.

Mr. LATTA. I think that is true.

Mr. GREENSPAN. And I think that what you can very soon find is that if you don't call the shots the way you see them, with the inexorable turn of the calendar, you get veered off very quickly into the wrong direction. I would very much like to sit here or wherever I am sitting and say that things are improving, that the problems are simmering down. I really would like to say that. Unfortunately that is not what the facts are, and while I do grant that people are not made happy by remarks like that, I think it is far more important that we tell it straight to the American people.

Mr. LATTA. Don't you think, Mr. Greenspan, they have a tendency to close up their pocketbook whenever they read those things in the paper to the effect that doomsday is just around the corner, and that hastens doomsday if it is on the horizon?

Mr. GREENSPAN. I would certainly suggest that doomsday is an overly extreme position. In fact, as I recall, at the September 5 opening of the summit, one of the positions I took was to eschew precisely what you are suggesting—namely, that all this doomsday and gloom was grossly overdone, which I do believe it is.

Mr. LATTA. I am glad to hear you say that.

Mr. GREENSPAN. There is a tendency around, unfortunately, to take what is not a good situation and pretend that it is on the verge of disaster and this I think is doing considerable violence to the facts.

Mr. LATTA. Now with regard to the private sector, we, in this country, have adopted a procedure in wage contracts in the last several years that we have automatic increases, not based on the cost of living increases but if you just stay alive and stay on your particular job for 1 year, you are going to get a wage increase, and the next year you are going to get a wage increase, not based on productivity.

Would you address yourself to this type of a wage contract and whether or not in and of itself it is not inflationary?

Mr. GREENSPAN. One of the great things that we have got in this country is an exceptionally good collective bargaining system. The way in which wages are determined I think is by far the best that I can imagine, and I would doubt very much that I could find any evidence that the collective bargaining process per se is inflationary.

Mr. LATTA. That is all, Mr. Chairman.

Mr. SMITH. Dr. Greenspan, I am going to ask a couple of questions right now.

You know there is a strong suspicion in Washington, it has been growing I think in the past couple of weeks—it doesn't happen to coincide with your coming here—that there is some kind of an orchestrated determination to blame inflation on people's programs and perhaps to

justify a business tax reduction. I don't know if it is justified or not but there is a suspicion. I hear it on the floor more and more all the time. I think it stems from the fact that everyone in the administration seems to be pointing right at a few billion dollars of Government expenditures without really putting it in perspective.

Now if a few billion dollars of Government expenditures were the cause of our inflationary problems, why do other countries have inflation even greater than us? They are not bound by our budget.

Mr. GREENSPAN. First of all, true enough I have only been here a few weeks, and I have heard the same sort of stories that you have. I have seen no evidence of any such orchestration, and to my knowledge that has got nothing whatever to do with policy of this Government.

The reasons for inflation in the rest of the world are tremendously complex, largely because most of the countries in Europe are very heavily dependent on imports and exports to and from their neighbors.

It would be, for example, very difficult for a country like The Netherlands, which is very heavily foreign trade-oriented, to be immune from the inflationary pressures or other pressures of its immediate neighbors.

Overall inflation in the world is nonetheless still closely related to financial factors. They are a lot more complex abroad, however, than in the United States.

Mr. SMITH. Isn't it also related to their dependency upon foreign oil which has increased in price? I don't see those graphs in your presentation but there is a relationship, isn't there?

Mr. GREENSPAN. Of course. I think, however, that the inflation in Europe really began well before the oil price increases. There is no question that inflation has been exaggerated very substantially by the increase in oil prices, but that has been in relatively recent periods. The inflation problems that they have had in Europe started well before then.

Mr. SMITH. I understood you to say that oil is a financial problem, not a commodity problem. Well, I have difficulty understanding that, because when the price of foreign oil tripled, the demand upon the resources of other countries tripled. When they tripled the price of oil which the United States must pay that meant some of our resources must flow to these other countries unless those other countries invest in capital expenditures here.

Mr. GREENSPAN. Right.

Mr. SMITH. And this has got to have an impact.

Mr. GREENSPAN. Oh, certainly.

Mr. SMITH. A tremendous impact.

Mr. GREENSPAN. I am sorry, Mr. Chairman, I didn't wish to imply that it had no impact. I would subscribe to exactly what you have said.

Mr. SMITH. It is a major cause, isn't it, of inflation?

Mr. GREENSPAN. Well, it is a major cause; it is a major cause of the short-term inflationary pressure, but what I was trying to indicate was that that price increase in a sense had to be accommodated by an increase in the money supply. If for some reason the Federal Reserve chose not to accommodate that increase, what would have happened would be that the availability of funds to carry inventories in nonoil items would have gone down, inducing significant declines in activity and other distortions, so it is a complex problem.

I am not saying that the impact of the oil price increases in the United States has not been large. It has been very large, but I hesitate to indicate that it is something which, if all of a sudden it were to go away, would cause our inflation problem ipso facto to disappear.

Mr. SMITH. But when they tripled their price, what they in effect said was "You give us three times as many goods as you have been giving us for the same amount energy you always got from us."

Now that has got to come out of our economy as a whole. Somebody has to use less.

Mr. GREENSPAN. That is right.

Mr. SMITH. And to get someone to use less, to squeeze them out, the price goes up.

Mr. GREENSPAN. Yes.

Mr. SMITH. To squeeze out some people.

Mr. GREENSPAN. Yes.

Mr. SMITH. Now all of this has a tremendous effect upon our entire economy and I just don't hear this being explained. Instead of that, we have people pointing all the time at a few billion dollars of Government expenditures. I want to tell you this. We are going to, as we have in the past, reduce Government expenditures below the budget considerably. By the time this year is up, I am satisfied that expenditures will be down \$5 billion and requested obligational authority considerably more than that. But we have done this before. This is not unexpected. But inflation is here and now. I just think that if we can't do something about it on a short-term basis, the least we can do is explain to the people what the big causes are, and not use this as an opportunity to divert attention and to jump on those programs that we have always been against, and promote those programs we have always been for.

Mr. GREENSPAN. Mr. Chairman, actually both explanations are correct. They are not mutually exclusive. There is no doubt that the rise in oil and in fact in agricultural prices has been a major factor in worsening the short-term inflation during the last year or year and a half, but it is also true that underneath those relatively transitory elements a significant financial inflation has been building for numbers of years. Even if we were to somehow wipe away the oil and farm price problems this basic underlying financial rate of inflation still will have to be diffused.

Mr. SMITH. One more question on this at this time; then I hope to question further later after others have questioned. These shortages on top of other causes, however, have convinced the business community it seems to me—and I was at one of the many summit conferences and have been looking at those inventory statistics—have convinced them that it is good to hoard inventories of scarce materials. Inventories of scarce materials have gone, I understand, from \$26 billion up to \$28 billion in a relatively short period of time. Most of the businessmen admit they are hoarding these inventories of scarce materials because they think they will cost more later on and it's just good business to do so. If we could, somehow, understand the impact of these increased prices, or figure out a way to generate more overseas sales, or reduce our use of energy; if we would zero in on the energy problem, use more coal instead of oil—these kinds of things—wouldn't it have an impact beyond the problem that can be isolated as being energy-related?

Mr. GREENSPAN. I would certainly agree with that, Mr. Chairman.

Mr. SMITH. Mr. Mitchell?

Mr. MITCHELL. Thank you, Mr. Chairman.

Mr. Greenspan, I came on to this committee with a lot of punch and vinegar in my system, willing to learn, knowing some things. But as a result of the hearings up to this point, I am rather pessimistic. I think I am pessimistic because all of the witnesses and many of my colleagues are apparently working on the assumption that inflation can be cured by leaving the present structure and functioning of the economic system intact, and I don't think that that is the case.

I think that what is needed, somewhere down the line, is a dramatic, radical, if you will, overhaul of certain aspects of the structure and functioning of our economic system.

Let me give you one illustration of what I am talking about. Before I do that, let me say that I am inclined to agree with you and the others. There is no short-term cure for inflation. We are talking about long-range developments and strategies.

Now to get to my illustration.

For about 3 years some of the best thinkers in this country labored and produced what was ultimately known as the Hunt Commission report, a very sound document suggesting a restructuring of some of the economic institutions of this country.

Based on my reading of the report, it is clear to me that if the restructuring takes place, over the long haul, there would be at least two things occurring: One, a reduction in interest rates across the board and, No. 2, a greater flow of money within the whole economic system. Unfortunately no witness before this committee has spoken about implementing any of the recommendations of the Hunt Commission report, and the Congress has just sat here languishing, really not even addressing the report. I don't think we have had hearings on the Hunt Commission report.

Would you agree with me that, in the long-run, some restructuring of financial institutions, as suggested by some of the recommendations in the Hunt Commission report, would be valuable in fighting inflation?

Mr. GREENSPAN. I certainly would, Mr. Mitchell. In fact, I was a member of the Hunt Commission, and I subscribe to all of the recommendations as I recall all of the panel did. It was one of those very rare commissions in which there was a unanimous vote, but I wish to associate myself with your remarks, which I agree with wholly. I, too, am somewhat discouraged that further progress has not been made in this area.

Mr. MITCHELL. Could I interpret your statement to mean that maybe, perhaps, the administration might put on a push to see that the Hunt Commission recommendations are implemented?

Mr. GREENSPAN. As you know, Mr. Mitchell, there is a Treasury bill which does encompass the more important elements in that Commission report, and at least as I understand it, that it has the support of the administration.

Mr. MITCHELL. Pushed by the administration?

Mr. GREENSPAN. Yes, it certainly has. It is a question where it stands at this stage, and I frankly don't know.

Mr. MITCHELL. Despite my pessimism, we still have a job to do on this committee. Essentially, as I understand it, the job is to set priorities, priorities in spending, priorities in reducing the budget. With that in mind, I hope you will bear with me while I try to trace through some concepts. I think we need some sort of philosophical context in which we are going to make those reductions.

Everybody is talking about cutting out some of the domestic programs, reducing the welfare programs, et cetera. It seems to me, that the genius of this country has been so great that we have now created a situation in which 1 man can do the job of let's say 20. One man can produce the food that 20 produced some years ago. So what in effect we have created really is a situation where there will be, in my opinion, a relatively permanently unemployed class in America, simply because of our genius.

If that thesis holds, if it is cogent, then it means that there must be built into the Federal budget programs and projects dealing with that growing category of people which will be permanently unemployed.

Would you respond to that?

Mr. GREENSPAN. I don't agree with that, Mr. Mitchell. I think that we have had grave concerns in our history many times, I think back in the 1890's and many times since, that we were going into what was called secular stagnation. It is a term which was used in the 1930's and it has come up on a number of occasions when the outlook of our country appeared as one in which there would not be enough jobs. It was not that long ago. I have forgotten the exact time, maybe 10 or 15 years ago, there was considerable concern that so-called production worker or blue-collar type of employment in this country had peaked out.

Mr. MITCHELL. May I interrupt you just a minute. I am aware of the historical factors associated with this.

Are you aware of the fact that indeed much of that did take place, but we have simply covered it over by Labor Department manipulations in which we don't count all the unemployed?

You know every person who has been with the Labor Department before any committee on which I serve has said, "There are those that we don't even know about." I am saying that this did indeed take place, maybe not to the maximum extent, but it did indeed.

Mr. GREENSPAN. My recollection, Mr. Mitchell, is that the total employment—I will put it this way—the labor force participation as a percent of the population as such has actually not changed all that much. In fact in many respects it has gone up. I mean the number of women in the work force has grown very rapidly.

Mr. MITCHELL. Right, but it does not count those that the Labor Department classifies as permanent dropouts from the manpower market.

Mr. GREENSPAN. Yes; that is true enough.

Mr. MITCHELL. I submit to you that that number is increasing and because that number is increasing, it is not consuming and demanding goods and therefore it is contributing to the problem that we confront, not totally, but significantly.

Mr. GREENSPAN. To that extent there is no doubt that one of the problems in our labor force calculations is that certain people who drop out of the labor market are not counted as unemployed. They

are not counted in the labor force and they won't be. I don't know what the numbers of those are.

Mr. MITCHELL. No one else does.

Mr. GREENSPAN. That may be, yes.

Mr. MITCHELL. The Labor Department does not.

Let me move on to another question, if I may.

Suppose we cut \$5 to \$10 billion from the budget. Suppose we were able to do that tomorrow morning. What would be the effect of that cut on the inflation rate in the next 6 months, or the next 12 months, or the next 18 months?

Mr. GREENSPAN. It is very difficult to make calculations like that. There have been in fact a number of econometric models which have attempted to confront that problem, and I think the group of economists discussed this on Monday in New York at the second meeting we had. The results show that the effect was small as far as those particular models are concerned. However, one of the things that as an—

Mr. MITCHELL. May I interrupt just to clarify something in my own thinking?

Then the pressure to cut back \$5 billion now in the budget will, in your opinion, have no appreciable effect on the inflation rates in the next 6 months. Is that a fair statement?

Mr. GREENSPAN. It depends on what you mean by "appreciable." Certainly I would put it this way: Significant effect? Probably not.

Mr. MITCHELL. Minuscule effect, probably yes?

Mr. GREENSPAN. Well, no, no. I really don't know, but let me put it in another form. I have never argued, and I think it would be inappropriate to argue, that a cut in the Federal budget or a cut in the rate of increase or something like that will have an immediate effect. I don't believe that and I don't know anybody who really believes that. I think it could affect the interest rates pretty quickly.

Mr. MITCHELL. My time is up and I hope you will appreciate the fact that I didn't even mention anything about Wall Street brokers.

Mr. SMITH. Mr. Adams?

Mr. ADAMS. Thank you, Mr. Chairman.

Mr. Greenspan, I first want to say that I asked Mr. Ash that question. He said a \$5-billion cut plus or minus this year would offset inflation something like .01 percent as I recall—a very, very small effect. But I am not satisfied over the last 3 years with what has been going on governmentwise or private sectorwise.

I have a proposal to make to you this morning based on a position that a number of us have in the House which may surprise some of my colleagues, but I think we are going to have to reach an accommodation between the so-called conservatives and liberals on a policy.

Before I do that, I need to know your position because I read you quoted in the paper, and I understand about quotes in the paper since it happens to all of us, but I would like to hear from you so I know whether or not they are accurately reporting your statement. Do you believe that in the United States today the free market system of supply and demand controls prices, first in oil?

Mr. GREENSPAN. Given the oil cartel which is being constructed by the OPEC nations, I would say that that is scarcely the case.

Mr. ADAMS. Of course not. Autos?

Mr. GREENSPAN. I would say essentially still yes.

Mr. ADAMS. You think there is competition price-wise in autos and the supply and demand sets price?

Mr. GREENSPAN. Yes, I really do.

Mr. ADAMS. I disagree but I wanted to know that.
Third, steel?

Mr. GREENSPAN. I would say yes.

Mr. ADAMS. Fourth, major utilities?

Mr. GREENSPAN. No.

Mr. ADAMS. Fifth, major regulated industries such as transportation?

Mr. GREENSPAN. No.

Mr. ADAMS. All right. To what percentage do you believe we still have a free market price oriented supply demand system in existence in the United States: 50 percent, 40 percent, 30 percent?

Mr. GREENSPAN. I do not have the actual number, Mr. Adams. I would say it is still the vast majority of the total system.

Mr. ADAMS. I want you to understand what my position is because it has to do with what I am going to propose to you. I happen to belong to the economic school that believes you water the economic tree at the bottom, not at the top, and that this is the way that traditionally in the past we have come out of stagnation or out of times where our productive capacity is not being used. That is why I am not satisfied with the last 3 years of economic proposals of the administration. I think they water the economic tree at the top. I think that system is wrong and gone. I do not think we in Government ought to sit, as Mr. Giaimo says, and wait for inflation to burn itself out. That is why I asked your position on the free market economy. I do not want to make you a free market economist if you are not one.

I do not think this country runs in a free market in a major portion of its commodities. I did not mention agriculture because the investigations we tried to do among the six sisters in the agri-business is so hard that we do not know whether they are squeezing both ends or one end. I think the Russian wheat deal was a perfect example of it. I think there are others involved, too.

Suppose those of us who have this position, and we are interested in priorities as was mentioned by Mr. Mitchell, suppose that we agree that this committee between now and when we are to finally complete our functional work, which is October 1, 1976, for the fiscal year 1977 budget, that we balance that budget. In other words, we do not allow the expenditures to rise. Next year you are looking at \$330 billion in spending and your receipts as I recall are coming in hopefully at \$320 or about \$315 billion dollars. Is that about right? In other words, you are looking at core expenditures which will leave you about \$10 billion short.

Mr. GREENSPAN. I don't know the official figures at this stage.

Mr. ADAMS. I talked with Mr. Ash about it. We have met with economists for months now. If you want to argue the figure with me I will accept your argument, but suppose we worked now on fiscal year 1975 and we try as the chairman mentioned to go back \$5 billion. Say we started with the Defense bill to try and drop that back. We would work on the core expenditures so they do not rise to \$330 billion but instead maybe we might be able to hold it within \$1 bil-

lion or \$2 billion of balance. By fiscal year 1977 starting October 1, 1976 we have it balanced. What we are saying to our conservative friends is that is what you want, we will do it. Now will you give us the trade off of taking the monetary policy and adopting an allocation system whereby we require through the Federal Reserve System and through the Federal Deposit Insurance system an allocation of credit and fix interest rates that can be paid on all deposits—not just what is covered under regulation Q. In exchange for doing that for the banks—in other words, we would reduce the whole level that is to be paid by law—the banks would be required to allocate on a percentage basis so much for housing, so much for commercial loans, so much for regular business loans. Then over and above that they could charge anything they wanted.

Now, would you buy that kind of a trade off?

Mr. GREENSPAN. I do not think we would be able to do what you are suggesting. At least that is my view, but obviously this is something that is related to the realm of the Federal Reserve, not the Council of Economic Advisers. So if you are asking my opinion, as an economist, as to how that would work, I must say I do not understand your plan fully but I think that there would be very significant distortions.

Mr. ADAMS. You are familiar with what Governor Brimmer suggested for the Federal Reserve allocation of reserves.

Mr. GREENSPAN. Yes.

Mr. ADAMS. Now basically that could be our starting point. We use regulation Q. I was interested in your comment that the Federal Reserve System basically controls commercial banking. The biggest argument made against credit allocation is that the Federal Reserve does not control commercial banking significantly, so that we would have to expand the Federal Reserve jurisdiction, probably through the Federal Deposit Insurance Corporation, to cover State-regulated and other institutions.

Mr. GREENSPAN. I indicated they had control over bank reserves.

Mr. ADAMS. Do you think the Federal Reserve basically controls the commercial banking system interest rate system in the United States?

Mr. GREENSPAN. Not interest rates. It does basically control the extent of credit, certainly. But interest rates as we have found are much more difficult in this sense. We have found over the years as you certainly know, Mr. Adams, that the acceleration in bank credit has by generating inflationary expectations in the money market, induced a level of interest rates which has actually been very high, currently, relative to what it would have been at the same degree of credit expansion 10 or 15 years ago.

Mr. ADAMS. Let's take a very simple situation in the credit market. An investment banker or a commercial banker needs a certain percentage on which to make his money or his profit, be it 2 percent or 1 percent above what he is paying for his money.

If you put your price that you are paying for money at 4 percent and he is charging 6 percent, he makes the same amount of money as if you have your money at 10 percent and he is charging 12.

Now, I do not happen to believe that there is a free market in money in the United States. Do you?

Mr. GREENSPAN. Yes, sir, I do.

I think that it is not only in the United States, but I think it is worldwide. The interrelationships, for example, between the markets in London, Tokyo, and New York are really exceptionally tight both in respect to the interest rate patterns and the movements of funds.

Mr. ADAMS. Who do you think is the dominant factor in the free world money market, the United States or a consortium outside?

Mr. GREENSPAN. The United States certainly still is, but that is not to say that these vast Eurodollar markets and Eurocurrency markets that exist throughout the rest of the world are not very big and important. We do not have the capability as I see it, of insulating ourselves from the rest of the world so far as our financial system is concerned.

Mr. ADAMS. You have indicated a number of things we cannot do. I go back to the position Mr. Mitchell has taken. You say there will be distortions if the Government allocates credit. In the opinion of many of us in the Congress during the last 3 years at least we have had terrific and terrible distortions in the credit market by letting the system alone. We are tired of that. We think that whatever distortions we may produce by allocating credit cannot be much worse than those which have been produced by leaving the whole credit system alone. There is no reason, in my opinion, why in the United States, a saver who can save \$1,000 should get 4 percent on a pass-book and somebody who has \$10,000 should get 12 percent because the Government says, "Well, it is all right to pay varying amounts, and we have to be careful not to distort the money market by causing a flow from savings and loans elsewhere."

We have already let the credit market kill the savings and loans. We have already let the market kill the individual small saver who does not know where to go. We have let it kill the stock market. Who is going to invest in the stock market on a gamble at 12 percent when he can go in and invest funds either in a Government-guaranteed loan which I agree with, or one of the other types of instruments where he has a secured investment and is getting about a percentage point or two more?

Now, you may not like my proposal on monetary policy. But I am saying we are willing to accept the position of the conservatives and balance the budget, because I do not think it makes a darn bit of difference, but that is what people think. In exchange, will you give us the correction in the monetary area, which will correct the stagnation we have?

Mr. GREENSPAN. Let me say, as a private citizen, up until a few weeks ago, I certainly shared your view that the wide differential between interest rates paid to small depositors and large depositors was wholly inappropriate.

I didn't think it was fair then and nothing has changed since. It is one of the basic problems that has been caused by inflation which by driving interest rates upward has confronted the savings and loan associations with a very massive problem of disintermediation. As Mr. Mitchell knows, one of the things that the Hunt commission focused on was that thrift institutions generally are a special type of financial institution which, as presently constituted, can be viable only in periods of significantly lesser rates of inflation.

Mr. ADAMS. Thank you, Mr. Chairman.

Mr. SMITH. Dr. Greenspan, I just want to ask a few questions on this second round. As I understand it, you say there is no short term answer to inflation. I take it you qualify that by adding to that that we will reach the goals we desire. There are short term programs that might help but nothing that will bring it down.

What percentage were you talking about?

Mr. GREENSPAN. I would consider that we want to go back to low single digit inflation at worst.

Mr. SMITH. Nine point nine?

Mr. GREENSPAN. That is not low single digit, Mr. Chairman.

Mr. SMITH. But you would agree, would you not, that if we had a long term program, it would help the short term problem?

Mr. GREENSPAN. Unquestionably, surely.

Mr. SMITH. It would help to prevent hoarding?

Mr. GREENSPAN. Yes.

Let me address myself to the whole question of the long term and short term. It is certainly true that there is no quick fix, as President Ford has said. What this basically means is that although we cannot do much which we will know will work in the short run we have to confront this problem of inflation with an effective long term policy.

However, one of the advantages of having a credible long term policy in place is that once American people believe that in fact Government is bringing this problem under control within a reasonable period of time then certain things happen to the way people behave.

One of them is certainly the issue of hoarding.

Mr. SMITH. To oversimplify it a bit, look at sugar. As soon as we lost the long term program, all they had to do was hold back 5 percent and the price went up about 400 percent.

The lack of a long term program can have a great deal to do with short term results. So for a long term program. No. 1, a very important one, is to reduce the dependency upon foreign oil.

Mr. GREENSPAN. That is certainly quite desirable.

Mr. SMITH. That is an absolute necessity. We did not talk much about restoring competitive activity. Some mention was made here about the automobile industry. But I remember when General Motors shut down 16 plants and in the same week they raised their price \$150.

I remember reading in the economics books I studied in college that that was not the way it was supposed to work. When there was a surplus of product and firms couldn't sell what they had that was supposed to lead to reduced prices. So we surely have administered prices and noncompetitive pricing in the system. We have companies affiliated with conglomerates who get priority on scarce materials without regard to their efficiency or lack of efficiency. We have an inefficient noncompetitive system that has been growing, isn't that true?

Mr. GREENSPAN. I would say that as inflation has built up, some extraordinary structural problems have emerged. It is very difficult to pinpoint them at first. When you begin to break away from the normal patterns of price change it often makes the analysis of what is causing prices to change rather difficult.

Mr. SMITH. We have been accustomed in this country to dealing with surpluses. Now suddenly we come to a place where some things are in short supply.

The economy behaves quite differently. It permits people to rake off, if you don't watch it every day—for example in the commodity markets. When something is in short supply it permits manipulation. Somebody has to watch it every day to prevent that from happening. It permits foreign governments with large amounts of credits to operate on our markets through exporters who can then hedge on our market and transfer the loss to the American people. This has to be watched daily.

We don't have a system yet where all export sales are reported within 24 or 48 hours.

MR. GREENSPAN. I understand the question you raise. This is an issue that a number of people have raised.

MR. SMITH. So the program has to include a more sensitive monitoring device to watch any material that is in short supply in order to prevent manipulation. That would be important to the success of a program against inflation, would it not?

MR. GREENSPAN. Well, it depends on what you mean basically by manipulation. If you are referring to where—

MR. SMITH. I am talking about taking a chunk of financial return out of the market without contributing some goods or services in return.

MR. GREENSPAN. I wish I knew how to measure that. It is not an easy thing to do. There is no question that we have to keep a very close eye on a number of things, including some of those things you are suggesting. I think that is essential no matter what you do to get a clear focus on the underlying day-by-day events.

MR. SMITH. I raise this because I think it is important. We saw it in the soybean market a year ago last summer. The corn and soybean markets are both in a position right now where a foreign country can buy a large amount of exports from two or three exporters.

It is probably 2 weeks before the American people know the extent to which they have purchased. In that period of time the exporters could cover those sales, hedge them and transfer the risk onto the American markets on our commodity markets, without people being aware of the change in demand. Because of these dangers we have the new commodities bill which will include commodities other than agricultural.

This same problem could also occur with steel and copper and aluminum and virtually everything else. It seems to me that we have to be especially alert to this problem.

MR. GREENSPAN. Mr. Chairman, all I can suggest to you is that the administration is very acutely aware of these issues.

MR. SMITH. I wish you would get them to agree to the 48-hour reporting. The Secretary of Agriculture very vigorously opposes it. I think it is crucial that we know within 48 hours who bought what in this kind of situation.

This gets me down to one other question I have. Just how important is \$5 billion in your judgment in reduced Government expenditures? I am not implying it is not important to control spending and we all agree we will do what we can to achieve it. But what is the impact, percentage-wise, of that amount of reduced Government expenditures on inflation?

Mr. GREENSPAN. As I said in my prepared remarks, Mr. Chairman, if it is just \$5 billion out of the fiscal 1975 budget and there is no effect in fiscal 1976 or 1977, I would say it is not worth the effort. However, what we are really trying to get at is breaking the expansion rate in Federal expenditures. \$5 billion is sort of a nucleus out of the fiscal 1975 budget. If it has counterparts in program development and the like in subsequent years, it can be a very substantial start toward bringing this inflation under control.

In fact, I would say that it is a necessary condition though not a sufficient one, meaning that if all you did was cut the budget and did not basically look at the longer term effect, I do not think it is worthwhile. But it is the implication of what that does to the budget in the next 2 or 3 years, which is very important.

Mr. SMITH. Just to get an example: in other words, we have a program that includes both grants and interest subsidies.

A dollar-grant reduction will not do anywhere near as much as a dollar reduction in interest subsidies would because interest subsidies carry with them the obligation to pay the subsidy for the next, say 30 years.

Mr. GREENSPAN. I am not quite familiar with what you are suggesting. I think I agree, but I do not know enough about it to comment on it.

Mr. SMITH. You are saying, don't just look at 1975 and cut a dollar just because you are after a dollar reduction, but look at the effects on a particular program for 1976 and 1977.

Mr. GREENSPAN. Yes, sir.

Mr. RHODES. Just as an illustration, I think probably we could go back in history and understand that had we made \$5-billion cuts in the right areas, say, in fiscal 1970, that the effect on the fiscal year budget for 1974 and 1975 would be much greater than \$5 billion. Is that a fair example?

Mr. GREENSPAN. Certainly, Mr. Rhodes, probably very substantially greater.

Mr. RHODES. So what you are saying is that although \$5 billion does not sound like much at the present time the accumulative effect and ballooning effect of certain new programs would be mitigated if we could make that \$5-billion cut now in the right areas.

Mr. GREENSPAN. Yes, sir.

Mr. SMITH. Mr. Giaimo.

Mr. GIAIMO. Most of the \$5-billion cuts you are talking about, Dr. Greenspan, would most likely be found in our income security programs; wouldn't they?

Mr. GREENSPAN. As far as I am concerned I think there is no area in the budget which should be exempt from being examined.

Mr. GIAIMO. Let's examine the \$30 billion the Government pays in interest; can we save \$5 billion there?

Mr. GREENSPAN. The only way I know of is either, one, to restructure the debt so that it comprises more items paying lower interest.

Mr. GIAIMO. But as a practical matter?

Mr. GREENSPAN. As a practical matter, no.

Mr. GIAIMO. The \$100 billion or so for defense, AID, et cetera. If we cut \$5 billion, that is not the kind of cut that is going to have the desired effect that you are talking about, is it?

Mr. GREENSPAN. I would not rule that out, sir.

Mr. GIAIMO. But as I understand it, the effect of the \$5-billion cut would be felt more minimally here than it would in other places.

Mr. GREENSPAN. Not necessarily.

Mr. GIAIMO. Is that the area where we should be cutting then?

Mr. GREENSPAN. I think we should be looking at everything at this stage.

Mr. GIAIMO. I understand, and I am. We are talking about \$30 billion where you say we cannot really, as a practical matter, find it. Can we find it in the \$100 billion for defense?

Mr. GREENSPAN. The \$5 billion?

Mr. GIAIMO. An effective type of \$5-billion reduction which is going to have a multiplier effect, as I gathered from your testimony, in future years.

Mr. GREENSPAN. I have not looked into the specific elements in the budget. As a consequence, I do not think I could address myself to that because I do not know enough about it.

Mr. GIAIMO. That leaves \$100 billion for defense. \$30 billion for interest. The next biggest item is about \$142 billion for entitlement and income security programs. That takes care of just about the totality of your Federal budget.

The rest of your \$300-billion budget is for the regular ongoing fixed costs of Government. So what you are really saying, it seems to me, is that the real chop which is going to have its impact with the multiplier effect in future years is going to be in the programs that affect the people who need assistance of one type or another from Government. You are saying that if we cut out \$5 billion in medicare, it will slow down the growth rate of medicare costs.

Mr. GREENSPAN. I have not actually focused on the individual budget items. I do not think it would be appropriate for me to do that. All I can indicate to you is what, as an economist, I think are the relevant considerations. I think one of the purposes of this budget committee and its counterpart in the Senate is to confront the types of very difficult choices which I think you have done.

Mr. SMITH. Mr. Adams.

Mr. ADAMS. Doctor, let's go to the other side of Mr. Giaimo's question now. This administration, during the past 3 years, has supported a series of programs on the tax side which have precisely the long-term effect that you might mention, only in an inverse fashion. Do you think, for example, that we should continue to have the accelerated depreciation range which will last for the indefinite future and cost us \$3 billion a year? We could pick up \$3 billion to balance the budget out of that.

Would your advice be that we do that?

Mr. GREENSPAN. I would say at this stage, no.

The reason I would say no is that with the inflation that has come about what has occurred is that the actual amount of depreciation is no longer adequate to restore the amount of moneys in the system.

Mr. ADAMS. My understanding of it is that corporate profits are at all-time highs. Therefore, you have a flow of capital going in and that the accelerated depreciation range and an overall 7-percent investment credit are now simply a manner by which we increase corporate profits. Isn't that true?

Mr. GREENSPAN. First of all, let me say that it is certainly true that the book profits reported are at an all-time high but this is one of the symptoms of the extraordinarily imbalanced economy. For example very substantial parts of the current profit figures are so-called inventory profits, profits largely reflecting the turnover of the inventories of a corporation which will have to be replaced at the new higher prices if the business is to stay in operation. Secondly, there is a substantial amount of reported profits that in effect reflects the underdepreciation of fixed assets—that is plant and equipment purchased many years ago at much lower prices. These assets when replaced at current inflated price levels will cost far more than the depreciation that has been allowed for tax purposes.

As far as I can see, I would say that these are not real profits as is often alleged, even though I think it would be a mistake to assume that they are phantom or meaningless or something of that sort. Nonetheless, I think that one of our major problems is to sustain adequate amounts of new corporate and business investment to continue jobs.

Mr. ADAMS. There is not a shortfall in productive capacity except in certain specific areas, is there? A shortfall that is producing the stagnation? We have the productive capacity. The economy is operating at less than full capacity.

I would like to discuss with you several items directed toward business. I will give you three pending before the House right now, on which we have to make a decision. Since this committee is involved in tax expenditures as well as other expenditures, I want to know what your position is on the 7-percent investment credit across the board. I am willing to be reasonable with you and say we ought to give it to commodity bottleneck areas or however you want to structure it; but across the board I don't think it is any good.

What about the accelerated depreciation range which also goes across the board and the oil depletion allowance which, God only knows, the oil companies do not need now with the profit picture they have? I want to know if eliminating these three items, which would pick us up the \$5 billion just like that tomorrow, is something that you feel that this committee should recommend to the full House to pass tomorrow.

Mr. GREENSPAN. Mr. Adams, I do not wish to be evasive but basically the Council of Economic Advisers as a rule does not comment on legislation. I do not think we should.

Mr. ADAMS. Then let's drop the legislation and comment on the policy of whether or not we ought to take tax expenditures like this and use them to balance the budget.

Mr. GREENSPAN. I think that is something that certainly should be looked at.

Mr. ADAMS. Thank you.

Mr. SMITH. Dr. Greenspan, I want to thank you for appearing this morning at this, your baptismal before this committee. We may not have the answers, but I do appreciate the give and take that we have had. I think that is evidence that there is at least an equal determination in the legislative branch to do whatever we can to get the economy back below this two-digit inflation. If we work together, hopefully we will come up with a long-term solution if not a short-term solution.

The committee will recess until 2 p.m.

[Whereupon, at 11:57 a.m., the committee was recessed to reconvene at 2 p.m. the same day.]

AFTERNOON SESSION

Chairman ULLMAN. The committee will be in order.

Mr. Chairman, we welcome you before this fourth and final session of the first set of hearings of this new Budget Committee of the House. We are looking at the 1975 budget in the broad context of economic policy. I think you will agree with us that important as fiscal policy is, and indeed I think it is at the moment the most important avenue of attack, it is only one of the ingredients necessary to put our economy back together. We know from sad experience that when we go through a period of recession, we always pay in the subsequent years both through a loss of revenue and through the increase in expenditures required to put growth back into the economy, which in turn results in further imbalances in the budgeting process and leads to larger deficits.

So, I think if we are ever going to solve the present budgeting problem, we are first going to have to get a handle on the long-term economic problem. The two go together. We on this Budget Committee, in looking at fiscal policy and budgeting, hope that we can have an input in the development of the Nation's overall economic policy.

You are Chairman of an independent agency created by the Congress. There has been some sentiment expressed to curb some of the Board's independence and legislate some controls over the exercise of monetary policy. I have mixed feelings about that. A lot of us here feel that you should be exercising your powers in a more sophisticated way through credit allocation. I'm sure you have heard all of those arguments and I won't take more of your time now. The Budget Committee is very glad to welcome you before it in open session and we look forward to hearing your presentation.

STATEMENT OF HON. ARTHUR F. BURNS, CHAIRMAN, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM

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

I welcome the opportunity to meet with this committee as it assumes its responsibilities under the Congressional Budget Act of 1974.

As you well know, our Nation is struggling with a grave inflationary problem. The economy has been damaged, and our people are deeply concerned. More determined action to curb inflation has therefore become an urgent need. The discipline that this committee—and its Senate counterpart—can impart to the Federal budget may be a decisive factor in our Nation's ability to regain control of its economic destiny.

The inflation in which we are so deeply enmeshed began to spread across the economy 10 years ago. The problem has steadily worsened, with only an occasional respite. The level of wholesale prices is now about 18 percent above a year ago, after rising almost 4 percent in August—the largest increase in more than a quarter of a century. Consumer prices advanced another 1.3 percent in August, and are 11 percent above a year ago.

Inflation has been eroding the purchasing power of both consumers and businesses. The take-home pay of the typical worker declined

materially in real terms during the past year, and so too did the real value of the public's savings, pensions, and life insurance policies accumulated over the years. Corporate profits have also suffered—a fact that is concealed by accounting techniques that have come down from inflation-free times.

As a result of the inflation, financial markets have been experiencing severe strains and stresses. Interest rates have soared, and stock prices have plummeted. Some financial and industrial firms have found it more difficult to roll over their commercial paper or to raise needed funds through other channels. Savings flows to thrift institutions have shrunk, and the flow of mortgage and construction loans has sharply diminished.

In short, as a result of the inflation, much of the planning that American business firms and households customarily do has been upset. Confidence has deteriorated and the driving force of economic expansion has been blunted.

It should not be surprising, therefore, that the physical performance of the economy has been sluggish in recent months. With consumer incomes eroding, the demand for new autos, mobile homes, household furnishings, and other durable goods has weakened. The home-building industry has been hurt not only by the shrinkage of consumer incomes, but also by rising land prices and construction costs, the high interest rates, and the shortage of mortgage funds. Industrial production is running 2 percent below the peak of November 1973, and employment in manufacturing since then has declined by almost 300,000.

Public policy is thus confronted with a most difficult problem. The forces of economic expansion have weakened to a point where, in earlier times, serious consideration would have been given to stimulative monetary and fiscal policies. In present circumstances, however, such measures would aggravate an already grave inflationary problem and plunge our economy before long into even deeper trouble.

Defeat of inflationary forces must remain the major goal of public policy. We cannot realistically expect a resurgence of economic activity until the confidence of our people in their own and the Nation's economic future is restored.

I have noted on prior occasions that a large part of the current inflationary problem is due to special factors. In most years, the economies of different nations follow divergent trends. In 1973, however, a business-cycle boom occurred simultaneously in the United States and in every other major industrial country. With production rising rapidly across the world, prices of labor, materials, and finished products were bid up everywhere.

The effects of the worldwide boom on our price level were magnified by the depreciation of the dollar in foreign exchange markets. With larger export orders adding to expanded domestic requirements, demand pressures became particularly intense in the materials-producing industries, where expansion of capacity has been slight in recent years. Severe shortages developed, and prices of basic materials shot up.

Disappointing crop harvests and the manipulation of petroleum prices by oil-exporting countries have also imparted an upward thrust to the general price level during the past year and a half. More re-

cently, prices and wages have reacted strongly to the removal of direct controls.

These special factors have played a prominent role of late, but they do not account for all of our inflation. For many years, our economy and that of most other nations has been subject to an underlying inflationary bias which has merely been magnified by special influences.

The roots of that bias lie in the rising expectations of people everywhere. Properly directed, this human drive is a powerful force for improving the general welfare. But individuals and business firms have in recent times come to depend more and more on government, and less on their own initiative, to achieve their economic objectives. In responding to the insistent demands for economic and social improvement, governments have often lost control of their budgets, and deficit spending has become a habitual practice. In many countries, monetary policy has supplied an inflationary element on its own, besides accommodating fiscal excesses.

The course of Federal expenditures over the long sweep of our Nation's history conveys both a lesson and a warning. These expenditures first reached the \$100 billion level in fiscal 1962, or nearly 200 years after the founding of the republic. By fiscal 1971, or 9 years later, spending had risen another \$100 billion and thus passed the \$200 billion mark. And the \$300 billion mark will surely be exceeded this fiscal year unless the Congress and the administration move at once to prune expenditures.

One result of the sharply rising trend of Federal expenditures is that Government has been assuming an ever larger role in the economic life of our people. Where the line can be best drawn between public and private use of resources is, of course, a matter of judgment and of social values. Nonetheless, it should be clear to everyone that Federal spending, whatever its level, needs to be financed on a sound basis.

Deficit spending by the Federal Government can be justified at a time of substantial unemployment. It becomes a source of economic instability, however, during a period of exuberant activity—such as we have experienced in recent years. The huge and persistent deficits of the past decade added enormously to aggregate demand for goods and services, but they added little to our capacity to produce. They have thus been directly responsible for a substantial part of the inflationary problem.

The current inflation began in the middle 1960's when our Government embarked on a highly expansive fiscal policy. Large tax reductions occurred in 1964 and the first half of 1965, and they were immediately followed by an explosion of Federal spending. New and substantial tax reductions occurred again in 1969 and 1971, and they too were followed by massive increases of expenditures.

Deficits have therefore mounted. In the last 5 fiscal years, that is, from 1970 through 1974, the public debt—including obligations of the Federal credit agencies—has risen by more than \$100 billion, a larger increase than in the previous 24 years.

In the fiscal year just concluded, the reported budget deficit declined to about \$3½ billion. This was a much smaller deficit than in the 3 preceding years. But when off-budget outlays and the expenditures of governmentally sponsored agencies are taken into account, as I believe they should be, the total Federal deficit reached \$21 billion last year,

which is not much lower than the corresponding deficits of the three previous fiscal years. This is a sorry record of fiscal policy during a period of sharply rising prices.

Our people have understandably become impatient, and the Congress has reacted by setting in motion revolutionary changes in its budgetary procedures. What fiscal steps and other measures will prove most constructive in current circumstances, when our Nation is threatened by increasing unemployment as well as by galloping inflation, cannot be foreseen with any precision. But the general direction for public policy seems clear to me, and in any event it is my duty to share my thinking with your committee.

First, a policy of moderate monetary restraint remains appropriate, and it will probably be required for a considerable time. As you know, the Federal Reserve has been pursuing a policy of slowing down increases of money and credit. We have tried to apply the monetary brakes firmly enough to get results, but we have also been mindful of the need to avoid a credit crunch. Thus, the supply of money and credit has continued to grow, although at a slower pace than in recent years.

The narrowly defined money supply—that is, currency plus demand deposits—has expanded so far this year at an annual rate of 5¼ percent, in contrast to 6 percent during 1973. If the time deposits of commercial banks, except for their large certificates of deposit, are also included in the money supply, the rate of growth thus far this year has been 8 percent, in contrast to 9 percent during 1973.

Clearly, the American economy—taken as a whole—has not been starved for funds. Yet, the demand for money and credit has been rising at a very much faster pace than the supply. As a result, credit markets have become strained and interest rates have risen to levels such as we have not previously known in over a century of our Nation's recorded experience.

The policy of monetary restraint pursued by the Federal Reserve has helped to cool the economy by moderating the expansion of credit and disciplining inflationary psychology. But, as you know, the incidence of monetary policy is uneven. Excessive reliance on monetary restraint leads to unwanted side effects that, of late, have been all too evident. The fabric of our financial structure has perhaps been stretched as much as it safely can.

The Federal Reserve must—and will—persevere in the fateful struggle against inflation. But I also believe, and more strongly with each passing week, that monetary policy should not carry so large a part of the burden of restraint.

The second ingredient of an effective anti-inflation program, and one that is urgently needed, is a persuasive move toward fiscal restraint on the part of the Federal Government.

Full implementation of the new budgetary procedures for which this committee is responsible will not begin for 2 more years. We dare not wait that long, however, for the fiscal discipline required in the present inflationary environment. A determined effort should be made immediately to pare budget expenditures in fiscal 1975 and to balance the budget in fiscal 1976.

I recognize that this committee is not yet in a good position to recommend where expenditure cuts would be most appropriate. Nevertheless, you can justly use your good offices to press for prompt action to restrain Federal spending.

A meaningful cut in Federal spending—say, a reduction of \$5 or even \$10 billion in this year's budget—cannot be expected to have a large, visible impact on the price level in the near future. But it is highly important to recognize that the effects of a given act of fiscal restraint on prices will cumulate as times move on; that if this year's fiscal restraint is repeated next year and the year after, the cumulative effects will swell; and that once a determination to cut the budget back is demonstrated, beneficial effects on both the stock market and interest rates can come rather promptly.

Let me turn next to a third ingredient of a program for regaining general price stability. While effective monetary and fiscal policies are absolutely essential to this objective, an incomes policy that relies on voluntary cooperation can still play a modest—but useful—contributory role. There is much good will among our citizens, and it would be wise to mobilize it in the struggle against inflation.

The newly established Council on Wage and Price Stability is a step in the right direction. Even without enforcement powers, this Agency can hold hearings on wage and price changes in pace-setting industries; it can make recommendations; it can call attention to abuses of economic power by business firms or trade unions; it can feel its way toward wage and price guidelines; and it can certainly bring the force of public opinion to bear on wage or price changes that appear detrimental to the national interest.

A labor-management committee, under the chairmanship of the President, might become another constructive force. Labor and management clearly have a mutual interest in ending inflation. If our Nation's business and labor leaders will meet frequently and reason together, practical means may yet be found to interrupt the cycle of wage, cost, and price increases that is so damaging to our economy.

As a fourth part of an anti-inflation program, our Nation needs an energy policy—as President Ford has emphasized—that will exert downward pressure on the international price of crude oil. Some success in this direction would not only help to check inflation, it would also reduce the massive diversion of purchasing power to oil-producing countries, and make the problem of recycling funds to the oil-consuming countries more manageable.

Since the end of the oil embargo, efforts to conserve fuel have diminished. Our electric lights are again blazing away needlessly; the 55 mile per hour speed law is less rigorously enforced and gasoline consumption is rising; air-conditioners hummed excessively this summer and our heating furnaces will probably soon be. Clearly, voluntary efforts to conserve fuel and broaden the use of fuel-saving devices need to be strengthened. Legislative actions should also be considered, particularly tax measures aiming to curtail the consumption of oil and gasoline.

We cannot stop, however, with conservation measures. For one thing, it is necessary to breathe life into Project Independence before it expires from inactivity. This will require, among other things, reduction of obstacles to the expansion of nuclear facilities by our electric utilities, and sufficient relaxation of antipollution regulations to encourage much more extensive use of coal. And in view of the extraordinary financial problems caused around the world by OPEC actions on oil prices, we cannot afford to lose time in exploring with other major oil-importing countries how economic, financial, and

political measures can be most effectively used to achieve an early and substantial reduction in the price of crude oil.

A fifth part of an anti-inflation program should focus on policies for enlarging our productive capacity and intensifying the forces of competition. Incentives to invest have not been adequate in recent years to keep industrial capacity expanding in step with our economy's needs, and this requires the most earnest attention of policymakers.

A strengthening of equity markets through liberalization of the capital gains tax would be helpful in providing share capital at a more reasonable cost. This could probably be accomplished without impairing tax revenues this year. Moreover, business firms themselves could gradually increase the supply of internal funds for investment by adopting more realistic and sensible accounting procedures. Many firms fail to value the inventories used up in the production process on a replacement-cost basis, with the result that earnings are overstated and taxes are paid on fictitious profits.

Our capacity to produce could be enlarged by establishing local productivity councils to increase efficiency in our Nation's workshops. It could also be enlarged by removing obstacles to supply that are sanctioned by legislation or custom. For example, building codes in many communities are badly outdated; minimum wage laws restrict access to jobs by teenagers; and barriers to entry or governmental regulation restrict output in some of our industries. Our product markets could be made more competitive by stricter enforcement of the antitrust laws, by stiffer penalties for their violation, by repeal of special-interest legislation such as the Davis-Bacon Act and the Jones Act, and by passage of the proposed Trade Reform Act. And our labor markets could function better if we developed a nationwide system of job banks, comprehensive statistics on job vacancies, and adequate manpower training programs.

Sixth, and finally, an anti-inflation program should recognize that restrictive monetary and fiscal policies have uneven effects on the economy—that some sectors are merely inconvenienced, but that others suffer hardship. Homebuilding, in particular, is highly sensitive to money market developments, as the drastic decline of housing starts has once again demonstrated. Basic reforms of home mortgage finance are essential, so that homebuilding activities may be more stable in the future. Meanwhile, another layer of governmental subsidy, for this stricken industry may be urgently needed.

It would also be wise to provide promptly for a public service employment program that would be triggered if and when the national unemployment rate averaged more than 6 percent for a 3-month period, and that could provide up to 800,000 jobs at a cost that might reach, say, \$4 billion. A contingency plan of this type would reduce fears of unemployment. It would be practical as well as compassionate; for it would enable the Federal Government to continue longer with the restrictive monetary and fiscal policies that are needed to bring inflation gradually under control.

In the interest of fiscal discipline, the funds that would be required to expand public service employment, as well as any additional housing program, would have to be found in large part, if not entirely, by cutting expenditures elsewhere or by making minor additions to tax revenues.

In sketching this six-part program, I have sought to suggest that this country needs a broad and eclectic approach to the inflation problem; that restrictive monetary and fiscal policies are basic but insufficient; that they can be usefully supplemented by incomes, energy, and supply-expanding policies; that measures are also needed to alleviate the harsh impact of a policy of monetary and fiscal restraint on some sectors of our economy; and that long-range as well as immediate considerations require attention. I hope that the Congress will recognize general price stability as a prime objective of public policy by promptly passing a concurrent resolution to that effect, and that you will then turn to exploring in detail the numerous thoughtful suggestions that are emerging from the summit meetings.

Your committee's efforts to restore order in Federal finances can make the difference between success and failure in the fight against inflation. I assure you that the Federal Reserve will do everything it can to facilitate your task.

Chairman ULLMAN. Mr. Chairman, let me commend you for expanding on your thinking in the broad arena of public policy. I, for one, have been calling for more policy built around a new national purpose—a coordinated, integrated policy, which we have not had. The administration witnesses to date have not come forth with a definitive policy recommendation, and I am glad that you have given one to us. Doubtless, there are other avenues that the committee will want to explore.

Let me next thank you for making your economists available both to me and our staff and for their helpful advice and suggestions. We will continue to call on them. This effort has to be governmentwide. We need to use the brains wherever they are, here, in the departments and in the agencies.

To begin the questioning, the Chairman of the Task Force for the 1975 Budget, Congressman Neal Smith of Iowa. Mr. Smith.

Mr. SMITH. Dr. Burns, I want to ask you one question with regard to the money supply. You indicated on page 8, "The money supply expanded so far this year at the annual rate of $5\frac{1}{4}$ percent in contrast to 6 percent in 1973."

There have been proposals that the money supply be increased in some ratio to inflation. In other words, if inflation is 10 percent, perhaps money supply ought to be three-quarters of that. What is your comment on that?

Mr. BURNS. I for one do not know how to reduce policy with regard to the rate of growth in the money supply, when related to the rate of inflation, to any mathematical rule. It is clear to me that the rate of growth of the money supply must be below the rate of growth of the dollar value of the gross national product. Unless it is below that, we have no chance to get back to anything like general price stability. A second principle that is clear to me is that, in an inflationary time, the rate of growth of the money supply must be somewhat larger than would be required for a period of general price stability.

Mr. SMITH. In effect we have had a decrease in money supply after taking into consideration the inflation of the last year, is that correct?

Mr. BURNS. You can describe it that way, but I do not see any advantage in that description.

Mr. SMITH. Is it incorrect in your judgment?

Mr. BURNS. If you mean that if you take the rate of growth of the money supply and divide that rate of growth by the rate of advance in the price level, and in the process you get a diminution, if that is what you mean, your statement is correct, yes. But there is no way of ever working our way out of the inflationary spiral if the rate of growth of the money supply were to equal the rate of growth of the price level.

Mr. SMITH. At the minisummit conferences there seems to have been a widespread opinion that there should be some loosening of the growth in the money supply. Do you subscribe to that? Has it been too tight? Is it time to loosen it a little bit or what do you say about that?

Mr. BURNS. Well, since I work on these problems, I naturally think that the money supply has been growing at an appropriate rate. If I thought otherwise, I would be bending my efforts in the direction to change it. I am not doing that. But I would call your attention to the fact that interest rates in the short-term market have declined rather appreciably since early July.

Mr. SMITH. You gave us money supply growth rates for last year. In the last 2 or 3 weeks has the money supply been increasing a little faster?

Mr. BURNS. In the last 2 or 3 weeks it has been increasing a little more slowly. But I would caution you to pay no attention to weekly figures and to pay no attention even to monthly figures, but to judge the money supply only over a period of 6 to 9 to 12 months. The figures you get from short-time units are sheer noise. They confuse rather than enlighten.

Mr. ASHLEY. Thank you for yielding. There have been reports in the Wall Street Journal that the ability of the Federal Reserve to assess accurately the increase in the credit supply is less than it might be and that you have been off by as much as 1½ percent.

Would you address yourself to that for a moment, Dr. Burns?

Mr. BURNS. Let me say first of all that our ability to forecast the rate of growth of the money supply or the rate of growth of bank credit is very limited. I wish I could say to you that our powers of prediction or forecasting are excellent. They are not.

Second, the statistics that we work with are inadequate. I could show you how we have had to revise our money supply figures because of inadequacies of current data. We do have good figures, in fact, on an average daily basis on demand deposits in member banks of the Federal Reserve System. We are in the process now, with the cooperation of the FDIC, in developing statistics for nonmember banks. But these statistics are virtually unavailable at the present time. The estimating that we do—I do not know that you would want me to burden you with the detail—would indicate the element of uncertainty in the figures that we publish.

Chairman ULLMAN. Mr. Broyhill, do you have a question?

Mr. BROYHILL of North Carolina. If I could just comment on the question of the gentleman from Iowa, I am not expert enough on this to determine what rate of growth there should be in the monetary supply, but it would seem that tying it to the rate of inflation would be dangerous. It would be just like throwing kerosene on the fire since as the rate of inflation goes up, you would be throwing more and more money into the system which would tend to feed upon itself.

Can you comment on that?

Mr. BURNS. Well, I couldn't agree more, Mr. Broyhill.

Mr. BROYHILL of North Carolina. Let me turn just for a moment to this issue of allocating credit. Credit, of course, is in tight supply in my district and I know it is all across the country. Interest rates are high as a result of this.

What about allocating credit? Do you have any ideas on this, or any suggestions that you could offer, or a plan that would call for an equitable allocation of credit?

Mr. BURNS. The Federal Advisory Council, which is a body established under the Federal Reserve Act to advise the Federal Reserve Board, recently developed some guidelines on the allocation of credit for the use or possible use of commercial banks. We at the Federal Reserve Board were very pleased by this report and its recommendations. We have circulated this report to every member bank and made it available to every nonmember bank as well. This is a voluntary effort. Actually, what the Federal Advisory Council recommended corresponds in large part to what the sounder, more responsible banks in the country, and there are many hundreds of them, are doing at present.

Mr. BROYHILL of North Carolina. Are you saying this is a voluntary program? Are you saying it could not be made a mandatory program?

Mr. BURNS. Yes; it could be made mandatory. Congress can legislate anything and everything under the sun. I would advise you not to do it. If you do, please don't give this power to the Federal Reserve Board. We are not smart enough to know how to use it.

Mr. BROYHILL of North Carolina. What would be your reaction to a mandatory down payment requirement?

Mr. BURNS. In connection with purchases of durable goods?

Mr. BROYHILL of North Carolina. In connection with commercial loans, home loans or any type of loans.

Mr. BURNS. I would think that that would serve a purpose at certain times, when consumer credit is expanding at an excessive rate.

Looking back, I wish we had a regulation like that in effect in 1972 or early 1973. But it would serve no good purpose at present. The purchase of big ticket items by consumers is down. It has been down since the spring of 1973. Consumer credit is not expanding at a very rapid rate now. Any attempt to regulate down payments in the case of purchase of consumer durable goods would only have the consequence of diminishing sales of big ticket items and would weaken the economy. I do not think this is the time to do it.

Mr. BROYHILL of North Carolina. Would such a program be easy to administer?

Mr. BURNS. It would be very difficult to administer. The Federal Reserve did have that power some years ago. I had no part in administering it. I am told that it was difficult, that it caused many headaches. But after all, members of the Federal Reserve are not appointed for the purpose of leading easy lives.

Mr. BROYHILL of North Carolina. Thank you, Mr. Chairman. I believe my time has expired.

Chairman ULLMAN. Mr. Whitten.

Mr. WHITTEN. Doctor, it is good to see you again. We welcome your appearance. We had before us this morning Dr. Greenspan. I did not get to stay but I was very pleased to see in his prepared statement

that he referred to the real GNP. As you well know, in the past I have taken strong exception to the fact that the GNP frequently used to justify expenditures included all services and all goods, even when we spent money we did not have for things we did not need or for services that were valueless. But he referred to and discussed real GNP. He further said that simply stated, fewer goods divided into more money came out to a higher price per unit. I was glad to hear that because I have heard very little about it. One of the things that I have heard from my area and what frightens me the most, is that people are withdrawing money from the banks in order to buy Federal Government notes because the Government pays more than the bank can pay. The bank has no money to lend in the area which has a depressing effect on the local economy. When you match against that the fact that we are probably sending abroad about twice as much money as we formerly did for oil and energy purposes, you wonder if that money stays abroad and whether we will have to try to borrow that money back from those countries who have accumulated far beyond their domestic needs.

I believe it was testified in the part by the Under Secretary of the Treasury for Monetary Affairs that Japan had about \$100 billion over their needs and so did the rest of Western Europe. I have a friend whose friend in Germany asked him about buying \$100,000 worth of land. That is the only specification, he said. He said, "I have the money and I just want some land for it." These all are frightening developments. But the point I keep coming back to is: Don't we need, in addition to or in connection with the things you mentioned, to begin to give some attention, not just to what the Government spends, but whether it is getting something for it. A little more selectivity in our policy in Congress as to where we provide the funds should be used. It strikes me, and I have mentioned it several times—and I am not trying to question the necessity of foreign aid—that foreign aid gives people money to buy our goods so we have fewer goods and more inflation. Defense spending needlessly amounts to the same thing.

All the things you have said in your statement are worthwhile and we need to give attention to all of them. Wouldn't you say first and foremost that when we begin to work on something with as many parts, and as complex as this is, that the first thing to do would be to go over what we are spending our money on and what we are getting for it.

Mr. BURNS. I think that is basic. I have been lecturing for a good many years now on zero-based budgeting. Some business firms have adopted it. The Federal Government as yet has not done so. It is not an easy budgetary technique, but I think eventually we will come to it.

I hope that your committee will spur effort in this direction. Under zero-based budgeting, when an agency comes before the Appropriations Committee, it would have to defend the entire expenditure that it plans, not only the increase. You know what happens normally. The committee and the agency head will focus on the increase, the change from the preceding year. They act as if somehow time has sanctified the amount that is already being spent, and that it is necessary to argue the case only for the increase. One rarely comes forward with a decrease.

Now, this kind of budgetary technique is not peculiar to government. You find it in the universities. You find it in the corporations. But to manage finances properly, I think you have to go to zero-base budgeting. We are trying to do that at the Federal Reserve. I wish I could say to you that we have developed the technique sufficiently. We have done it only in part. Indeed, it will take us another 2 or 3 years to develop that technique fully.

I would like to see the entire Federal Government move to that kind of budgeting procedure. I think before too long it will, because the demands on the Congress are so heavy. While much of the money that we spend is spent constructively and usefully, there is also some waste. Some programs are obsolete and could be dropped. An agency head ought to be required to come before the Congress and justify the full expenditure, not only the increments that he is seeking.

Mr. WHITTEN. I agree with you, Doctor. This comment is the last I will make. You might respond briefly. I have opposed through the years full funding in connection with defense. The manufacturers and producers know that you are less likely to cancel if the money has been appropriated and passed. Another defect that leaves a lot of money on account is cases where they ask the Congress to reprogram from a higher level down to a lower level. It is along the lines you are talking about. I repeat that when it gets to the Federal Government asking people to sell their insurance policies to buy Treasury bills, we have not enough to go around. The people would rather spend it than save.

Thank you.

Chairman ULLMAN. Mr. Wright.

Mr. WRIGHT. Thank you.

Dr. Burns, has it occurred to you that the policy of increasing interest rates may be the root cause of our finding ourselves in a situation where we are suffering the co-existence of economic decline and galloping inflation?

Mr. BURNS. Well, your question surprises me, Mr. Wright. There is no policy for increasing interest rates.

Mr. WRIGHT. Your answer surprises me.

Mr. BURNS. I will be glad to clarify my answer.

Mr. WRIGHT. Are you saying that the Federal Reserve lacks the power to keep interest rates down?

Mr. BURNS. I would say that the Federal Reserve has the power to influence interest rates in the short run. Over the longer run, our influence on interest rates is negligible.

Mr. WRIGHT. Who has the power to do that, Dr. Burns?

Mr. BURNS. Interest rates are determined in the market place. Our money and capital markets are among the most highly competitive markets, not only in our country, but over the entire world.

Mr. WRIGHT. We have had usury laws and laws passed by Congress designed to control the amount of interest that might be paid under certain Federal loans and things like that. The conscious policy of Government always was to come in on the side of relatively lower interest rates. Unfortunately, Government apparently has not done it very effectively during the past 3 or 4 years.

Would you consider the possibility that higher interest rates or the rising of interest rates, whether you call it a conscious policy or

not, may be the root cause of our suffering economic downturn and rising prices?

Mr. BURNS. No; I do not think that is true at all.

Mr. WRIGHT. Would you agree that increasing interest rates does cause economic decline?

Mr. BURNS. I would agree that increasing interest rates, under certain conditions, cause economic declines in some sectors of our economy.

Mr. WRIGHT. Would you say that it has a causal effect on the increase in bankruptcies and foreclosures that we have witnessed in the past 2 years?

Mr. BURNS. I would say that that, along with other factors, has had some influence, but that other factors cannot be neglected.

Mr. WRIGHT. Would you contend that increasing interest rates is an effective tool to halt rising prices?

Mr. BURNS. Increasing interest rates, I can only repeat, are not a tool of Federal Reserve policy. I said that once before and I caused surprise in the process, but I have to repeat it.

Mr. WRIGHT. I am not asking that question.

Mr. BURNS. What we do—

Mr. WRIGHT. I am asking if you could contend that increasing interest rates ever has been effective in halting the rise of prices?

Mr. BURNS. I would say that rising interest rates, to the extent that they have moderated the expansion of credit, thereby reducing the rate of growth of aggregate demand for goods and services, have been effective in moderating price increases.

Mr. WRIGHT. During the last 5 years the prime rate has increased from a bit below 6 percent to a very high level, about 12 percent, and the average rate of inflation over that same period has increased, from a bit below 5 percent to above 11 percent.

I am inclined to think that that medicine has made us sicker, Dr. Burns.

Mr. BURNS. Well, Congressman, I say this with great respect, you are confusing cause and effect.

The—

Mr. WRIGHT. Let's examine whether I am or not.

Mr. BURNS. All right.

Mr. WRIGHT. Dr. Keyserling, who was Chairman of the Council of Economic Advisers during Mr. Truman's Presidency, contends—since you referred earlier to pace-setting industries—that the cost of money is the most sensitive pace-setting factor of all and that borrowed money is used in the production of more end commodities than anything, and that therefore, rising interest rates are the most inflationary things of all. Would you quarrel with that?

Mr. BURNS. I do not see how anyone who examines economic facts can say that, because for every dollar that is paid out in interest by our business firms, \$20 to \$30 will be paid out for wages, and then there are all the other costs of production. Interest rates, by and large, are a very minor element in the cost of production, though to be sure in some industries, for example, the public utilities and other capital intensive industries, interest is an important cost element.

Mr. WRIGHT. My time has expired. Thank you very much, Dr. Burns.

Chairman ULLMAN. Mr. Ashley will inquire.

Mr. ASHLEY. Dr. Burns, I confess I was a little surprised to hear you say that increasing interest rates are not a tool of Federal Reserve policy. It is a fact, I would suppose you would agree, that the amount of credit that is allowed by the Federal Reserve is a tool of monetary policy, is it not?

Mr. BURNS. What we influence directly is the volume of reserves that commercial banks have. Now as to reserves, we have devices for expanding or diminishing reserves of commercial banks.

Mr. ASHLEY. Yes; and as you diminish reserves, the effect is to expand.

Mr. BURNS. Well, if you increase reserves, the effect is to expand loans and investments of banks.

Mr. ASHLEY. On the reserve side, if you reduce reserves, then the effect is to curb demand, is it not?

Mr. BURNS. That is right.

Mr. ASHLEY. And you curb demand because interest rates are responsive to the market forces and they are going to go up.

Mr. BURNS. Interest rates will be affected by this action.

Mr. ASHLEY. Precisely.

Mr. BURNS. Yes; but the Federal Reserve is a marginal factor in the supply of credit. Most of our lending comes from the savings of our people and of our business firms. I hope the day will come when some of our savings will come from Government, as well.

Mr. ASHLEY. In a situation such as the present, where the Federal Reserve and Congress have a dual responsibility to try to curb inflation and at the same time to prevent unacceptable recession, progress in the short term in either area is enormously difficult, is it not?

Mr. BURNS. Very difficult.

Mr. ASHLEY. In this effort we have two ways of looking at the demand: For purposes of fighting inflation, we want to dampen demand; for purposes of thwarting or averting recession, we do not want to dampen demand; we want to take the reverse approach, is that not so?

Mr. BURNS. We certainly do not want to dampen demand from the viewpoint of the Nation's real economic activity and employment.

Mr. ASHLEY. Now this takes me back to the rejection of any kind of credit allocation, because if we mean, as you suggest in your paper, to pursue a monetary policy which seeks to walk this tightwire between too much demand and too little demand, and if one consequence of this is a projected shortage of credit in the months and years ahead, then are we really prepared to say that the marketplace is the best mechanism for allocating this scarce credit?

Mr. BURNS. Let me describe in a few sentences how we have tried to function in this country.

We have left the allocation of credit to our private financial institutions, but the Congress has recognized that if credit allocation is left entirely to the free market, certain social purposes will not be met adequately. Therefore, the Congress has established special institutions to facilitate the extension of credit to our farmers, special institutions to facilitate the extension of credit to homebuyers, special institutions to facilitate the expansion of credit to small businesses.

In other words, the Congress has tried to correct for the inadequacy or imperfection in the workings of the marketplace from the view-

point of the social values that we have as a people as expressed through the Congress.

Now that, I think, is the road that we should continue to travel. If the Congress feels that credit is inadequate for certain purposes, State and local facilities, homebuilding, and so forth——

Mr. ASHLEY. I was not——

Mr. BURNS [continuing]. Congress can correct that.

I have only tried to indicate——

Mr. ASHLEY. This is a form of credit allocation, is it not?

Mr. BURNS. Oh, yes.

Mr. ASHLEY. Then we do recognize the need for a form of credit allocation. I am not suggesting that we should fasten upon the Fed the responsibility for the kind of credit allocation that causes shudders to you and Dr. Greenspan and others. You have been very helpful because what you have said is that we do have a form of credit allocation.

It is interesting to me that Mr. Simon, Dr. Greenspan, yourself, come in and you really start pointing at the need for curbing Federal expenditures, with which I agree. But at the same time, you see, many of you are saying, you really have to do it across the board or on a selective basis, you have to attack the very areas of credit allocation that you espouse.

Now we were told this morning I believe that the President is about to bail out the homebuilding industry again to the tune of \$3 or \$4 billion. We were also told this morning that we have to bite the bullet and close the deficit gap.

Now, where do we come out on this? What kind of a program really is being articulated? That is what I am trying to get at. I am not trying to do it in a caustic or acrimonious way.

Mr. BURNS. Ideally, Mr. Ashley, it would be well to have a program that spells out not only the areas in which it would be desirable to expand governmental spending, but also to indicate, very concretely, the individual areas where expenditure cuts can most usefully be made.

Now, if you mean that thus far this has not been done by the administration, you are entirely right. If you mean that I, in my statement, have not done this, you are entirely right. But if you mean that we are going to stop here, you and the administration, well, then, you would be giving up the fight and I cannot think you mean that. One way or another, the Congress and the administration must get together and work out priorities with regard to our expenditures, on a line-by-line basis.

You have not as yet received enough help in that direction, but I understand that the President will be coming forward with concrete recommendations to the Congress that will help you perform that task. Mr. Smith of your committee, I believe, is working along these lines at the congressional end. I would hope a harmonious result that, to be sure, would involve compromise, can be achieved.

Mr. ASHLEY. Thank you, Dr. Burns. You have been very helpful to me, because I think you have put into perspective the fact that we are going to be asked by the Administration to spend more money, not less, in certain areas; we are going to be asked to spend less money, not more, in certain others; we are going to be asked to do the best

that we can, working together, to bring into balance the fiscal 1975 budget, probably through some combination, I would suppose, of overall budget cuts and tax increases.

Mr. BURNS. Yes.

Mr. ASHLEY. Thank you, sir.

Chairman ULLMAN. Mr. Burke?

Mr. BURKE. Dr. Burns, I appreciate your recommendations about having the Federal budget cut. What has the Federal Reserve done about cutting its budget?

Mr. BURNS. We work on budget steadily. The Congress has given us increasing responsibilities and to fulfill various congressional mandates we have had to increase our spending. We work very hard to restrain our expenditures. I think when you see our budget for next year, you may be surprised at how little the increase will be, but there will be an increase in dollars. I see no way of avoiding it.

Mr. BURKE. Actually, you have the same problems that Congress is faced with, is that not true?

Mr. BURNS. Yes, indeed, we all do.

Mr. BURKE. Now, what influence has the money that has gone overseas had on inflation here in this country? Are the banks of this country taking advantage of the high risk money that is over there for the high interest rates? Are there any steps being taken to restrict the activity of banks, like the Franklin National and others?

What is the Federal Reserve doing in this area? What legislation are they recommending to curb this practice?

Mr. BURNS. First, as for the facts, I believe that our banks have loaned, in the first 6 months of this year, approximately \$8 billion abroad. This has been offset by deposits with our banks. That is the flow of money from abroad to our own banks, was about \$6 billion. So the net outflow has not been very large.

Mr. BURKE. How much did the Franklin National lose?

Mr. BURNS. How much did they lose?

Mr. BURKE. Yes.

Mr. BURNS. Are you referring to the loss of their deposits or to the profit and loss statement?

Mr. BURKE. To the loss as a result of their foreign operations?

Mr. BURNS. Well, they have had—

Mr. BURKE. Weren't they speculating in the neighborhood of over \$3 billion?

Mr. BURNS. They have had rather sizable losses on their foreign exchange dealings. The precise amount I do not know. It will take some time before any of us know that.

I think the reported loss, so far, is some \$50 to \$55 million.

Mr. BURKE. That appears in their profit and loss statement?

Mr. BURNS. Yes; that is in their profit and loss statement. They have had losses rather than profits, as you know, this year.

What happened was this. Starting with our suspension of gold payments in August 1971, the world moved to a regime of floating currencies. This created a new opportunity for banks and others to make money, but also, being tempted by the opportunity to make profits, some sizable losses have been sustained by German banks, Swiss banks, British banks, and some of our own.

Now, I think that some controls over the foreign exchange exposure of our banks are desirable, and the Federal Reserve Board is now considering new regulations to deal with this problem.

Mr. BURKE. How long do you think it will take to have the Board come forth with recommendations to meet this problem?

Mr. BURNS. Oh, we will be doing it within the next few months, possibly within the next few weeks; I cannot be sure. We want to be sure we know what we are doing before we put new regulations in force.

Mr. BURKE. You also want to be sure there is no repetition of the Franklin National failure and other fiascos of that type.

Mr. BURNS. I will be making a speech on that subject very soon and I will indicate Federal Reserve thinking. Our system of banking regulations leaves a great deal to be desired, and I think that some basic reforms are needed. And before too long the Federal Reserve will be making recommendations to the Congress on this subject.

Mr. BURKE. That is what we are looking forward to.

Thank you very much. My time is up.

Chairman ULLMAN. Mr. Adams will inquire.

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

Mr. Burns, you were questioned by Mr. Ashley with regard to allocation of credit. Most of us are not only aware of the Home Loan Bank and the other special segments, but also of proposals that there be a variable reserve system in order to allocate credit among the commercial banks to prevent what many of us believe is happening now. That is, through use of passthrough, major corporations simply pass on the interest charge and therefore can outbid others in the market. Or, through use of their tax advantages, they can write it off and thus pass it through. Thus, we have money drained from small business, from housing, and from certain categories which you have already described very well, in your paper, because they cannot operate in this market.

I personally have some doubts that we have a free market in banking, but you and I when we have more time, can maybe discuss that in some depth.

But we have regulation Q now which sets, under the Federal Reserve System, top payments for interest to small subscribers.

I proposed this morning to Mr. Greenspan on behalf of a number of us in Congress that we would be willing to do what you are talking about, in terms of controlling core expenditures, your so-called zero budgeting, in return for a monetary policy, that would prevent a further recession, particularly in housing. That would require in the opinion of many of us a variable reserve system.

Now Governor Brimmer recommended such a system, as you know, both in 1970 and in 1972. It also has been suggested by others. I would like to know whether or not you believe that we, the Congress, should give the Federal Reserve the power to expand regulation Q and thus control the price being paid for money by the banks. At the same time, I want to ask if you want that control done mandatorily, to exercise the power to say that interest rates will be charged on a variable rate by commercial banks based upon a variable reserve system.

Mr. BURNS. Well, you have asked a very complex question, Mr. Adams. I wish we had time to break up your question into parts and pursue each of these parts methodically.

As for regulation Q, we have powers under the law now to set ceilings.

Mr. ADAMS. Do you think they should be set across the board instead of small savers being held at a very low rate, while what I refer to as "Mickey Mouse" type commercial certificates are in variable rates? Should we not stop that and try to level out the payments to all depositors?

Take that first and then we will go to the Federal Reserve.

Mr. BURNS. Let me give you a piece of history.

We had a regulation like that, and in June 1970, I persuaded my colleagues on the Federal Reserve Board to modify that regulation. I tried to persuade them at the time to get rid of it entirely on large certificates of deposit. We worked out a compromise. Later on, the change I wanted in 1970 was carried out. Now why did I do this?

You may recall that on a certain Sunday, I believe it was June 21st—my memory is imperfect—it was a Sunday. I recall that much very vividly, Penn Central announced that it would petition the courts to go into bankruptcy.

Mr. ADAMS. It was June 21, I remember it very well.

Mr. BURNS. Penn Central had been borrowing extensively—

Mr. ADAMS. We have only 5 minutes and Penn Central you and I both know thoroughly; I have been through that case over here thoroughly.

Mr. BURNS. Yes, but—

Mr. ADAMS. I know about the \$300 million Swiss bank loan and the rest. But please just on the variable reserves—do you think we should stay across the board or not on regulation Q?

Mr. BURNS. The answer is no, and I was going to tell you why.

If that regulation had not been modified at that time, we would have had an old-fashioned panic in this country, because commercial paper became suspect. Somehow a way had to be devised to enable the banks to lend money, since business firms, many hundreds of them, were no longer able to raise money through the commercial paper market.

Now then, with the relaxation of regulation Q, banks were able to go into the market and bid for CD's. Funds that were previously going into commercial paper could be recycled into certificates of deposit and this business system of ours could function. A panic was thus prevented.

Mr. ADAMS. All right. We can control commercial paper as well as CD's, as well as the others, and the precise thing that happened in the Penn Central case is one of the things that we are trying to prevent. What is going on in business at the present time is that expansion is occurring both in the bank portfolios and in the business portfolios. It goes back to Mr. Ashley's earlier point. Precisely what happened in the Penn Central's case was that it was allowed bank credit far beyond the point where there was any justification on an income basis or otherwise.

Mr. BURNS. Well, that is something else again. If your suggestions were followed, and if you had a ceiling under which banks would have to lend at a certain rate, and if that rate were well below what market forces themselves were pointing to, we would have a credit crunch in this country. If we had recently had regulation Q applying to certificates of deposit, we would probably have a deep recession, if not a severe depression in this country by the present time.

But with the market working, banks have been able to raise money, they have been able to lend money, and credit expansion has gone forward; yes, at a higher price, it's true.

Mr. ADAMS. Dr. Burns, we have——

Mr. BURNS. But the markets have continued to function and the economy has continued to function.

Mr. ADAMS. And in a very bad fashion, which is what we on this committee and others are trying to find a way to correct. That is what I am saying to you.

What if the whole level of interest is lowered? Banks pay so much for their money and then lend it back to us at a particular rate. We have now arrived at a point where through use of the CD's and other types of commercial instruments they are paying rates that range all the way from 6 to 10 percent, and, if they are in the European market, even higher, and they are lending it at higher rates.

What I am asking of you, and this is your field, can we drop the whole level back? This is possible because we did it prior to 1952, as you know, when we had, first regulation W, regulation U, then when we had regulation Q which came in to control interest rates that were paid by banks to depositors.

Now what I am asking you is whether we can use variable credit reserves on the other end to control the amounts of interest that banks charge?

Mr. BURNS. You can do it; but I would advise you very strongly not to attempt anything of that sort. If you set a ceiling on the interest rates——

Mr. ADAMS. Tell me what will happen.

Mr. BURNS. Well, a great deal of money will go abroad.

Mr. ADAMS. All right. Now——

Mr. BURNS. You cannot compel a banker or a businessman or an individual to accept a particular rate of interest. He has options; he does not have to lend. Or he can move his money abroad. Or he can lend money under the table.

A large firm under these circumstances can still enter the public market and issue securities. But what is the small firm going to do?

Mr. ADAMS. Doctor, you and I will have another opportunity to talk I hope, but the last thing you just said is one of the problems, I think you will agree with me, in the stock market at the present time. That is, the large firms do not have to move their money into equity capital now because they can receive, in bank instruments, without risk, money at such high prices that you have a competition now for money. That competition will continue so long as the Federal Reserve System maintains, in effect, a tight-money policy or a limited supply of available money.

The Government in this country controls the amount of money available through the Federal Reserve.

Mr. BURNS. We can expand the supply of money. What do you think would happen? Within a very short time, interest rates will be very much higher than they are at the present time because everyone would be expecting, and rightly so, a quickened pace of inflation. Interest rates throughout the world and throughout history have followed the rate of inflation, and for a very good reason. If you, as a lender, have seen prices go up and up, and if you expect prices to go

still higher, you will want an inflation premium to protect yourself against the depreciation of the dollars that you are lending.

And if I as a borrower have similar expectations with regard to the price level, knowing that I will be able to pay back the loan in a depreciated currency, I will be quite ready to pay the higher interest rate; it is still a good buy for me.

Mr. ADAMS. Dr. Burns, we have had high interest rates, this type of philosophy, precede every depression in this country since its founding. What I am trying to get from you is how we break this pattern before that happens.

Now I am sorry, Mr. Chairman, that I took the time that I did. We will discuss it further and I appreciate your comments.

Mr. BURNS. I hope to have the opportunity, Mr. Adams. And I will seek you out if you do not seek me out, because I would like to pursue this conversation.

Chairman ULLMAN. Mr. Leggett will inquire.

Mr. LEGGETT. Thank you, Mr. Chairman.

Chairman Burns or Director, pursuing the line of questioning that Mr. Adams has, you have indicated inflation follows interest—or interest rates follow inflation. The concern of many of us is that interest rates lead inflation and your statement here seemed to just substantiate that, that lenders out of an abundance of caution in a spiraling market will many times demand premiums—

Mr. BURNS. That is because interest rates are following inflation, rather than leading it.

Mr. LEGGETT. They are charging the premium to guard against future inflation because they are following inflation.

Mr. BURNS. Because they have had so much inflation and this force is at work that will produce more.

Mr. LEGGETT. Exactly. So they charge a premium. Then does that not accelerate it?

Mr. BURNS. There is a grain of truth in that statement, Congressman Leggett, but only a grain of truth.

Mr. LEGGETT. Yes, but also about 5 years of fact behind that statement, is there not?

Mr. BURNS. Well, let me give you my understanding of it.

Interest is a cost like any other. And those who pay more in interest will try to recover it in prices. That is the grain of truth. But when interest rates rise, and we have plenty of evidence of this, the demand for credit tends to fall off. The demand for goods and services will no longer be expanding as rapidly. This puts downward pressure on prices. At the present time, there is evidence of such downward pressure already in the market for industrial raw materials.

Mr. LEGGETT. Let me interrupt you there because I have only a limited amount of time.

We have the highest rate of interest now in this country that has ever been experienced. Also, you have—

Mr. BURNS. And lower interest rates than practically anywhere else in the world.

Mr. LEGGETT. Well, that is beside the point.

Mr. BURNS. All right; we will ignore it.

Mr. LEGGETT. Just look at the microcosm of the United States, which happens to be the largest economy in the world. We have the

highest interest rates we have ever experienced, and I just recall that automobile prices, which are one of the basic blockstones of our GNP, happen to be rising pricewise at a greater percentage and at a greater dollar volume than ever before in history. So I find it very difficult to accept—

Mr. BURNS. Why do you attribute that to rising interest rates?

Mr. LEGGETT. Well, I do not necessarily attribute it to rising interest rates. However, you indicate that when interest rates rise they exert a downward effect on prices.

Mr. BURNS. I was talking about the most sensitive area. You see, industrial materials are the most sensitive sector in our economy from the viewpoint of prices. I was commenting on that.

Mr. LEGGETT. Let me ask you this.

Mr. BURNS. Other prices lag, and the lag is very long, indeed.

Mr. LEGGETT. Let me ask you this then: Considering that industrial raw materials are critical and the pricing thereof, and you indicated the microcosm energy to be one of the primary areas that we ought to stomp down on—did they consult with you when we raised the price of old oil in the United States at the end of last year, last December to be exact, from \$4.10 to \$5.25—

Mr. BURNS. No.

Mr. LEGGETT (continuing). Just because it happened to be a nice thing to do, but nobody really had much economic rationale to support it?

Mr. BURNS. No one consulted me on this subject and I do not see why—

Mr. LEGGETT. Do you think it was a wise move?

Mr. BURNS. I would rather not comment on that question because I would first have to examine those facts and have them in mind better than I do at the present time.

Mr. LEGGETT. But considering the fact that you have singled out energy as the area that we ought to get control of, and the fact that we have had a \$38 billion annual increase to consumers in this one sector alone, while you come before the Congress here and tell us that we have to cut Federal spending by \$5 billion to get control of the economy, do you not think you ought to have an opinion on this \$38 billion sector?

Mr. BURNS. I ought to have an informed opinion on many more subjects than I do. I do my very best, Congressman Leggett, but I cannot pretend to be an expert on every subject under the sun. I would not be serving you well if I pretended that I was.

Mr. LEGGETT. Very good. I do not mean to demean you, but I am just trying to find out if anybody is running the store here.

Mr. BURNS. I am not running the store on petroleum prices.

Mr. LEGGETT. All right. And you are not prepared to give an opinion one way or the other on petroleum prices; is that true?

Mr. BURNS. I expressed a very definite opinion on the international price of oil.

Mr. LEGGETT. That foreign oil ought to come down, but you have no opinion whatsoever on domestic oil?

Mr. BURNS. If the price of the oil that we import comes down, of course, domestic prices will follow.

Mr. LEGGETT. There are two separate pricing systems; one is—actually we have domestic oil which is old—we have domestic oil which is new, we should have a wildcat price for oil and we have foreign import oil. So we have four different sectors. They all measurably affect the price we pay for energy.

It just so happens I think at the present time, we are importing only a third of our energy and two-thirds is domestically produced. Let me ask you this: Are you allowed to comment on another major sector where we spend on the order of two-thirds of our administrative budget, to wit: national defense?

Mr. BURNS. I set my own rules as to the subjects that I comment on.

Mr. LEGGETT. Do you have any views on the defense sector as to whether or not, as Mr. Whitten indicates, that might be a soft spot for us to look at?

Mr. BURNS. I think there are soft spots everywhere in our Government. And I would be surprised if you did not find more than one soft spot in the Defense Department.

Mr. LEGGETT. Now, just one other thing.

We heard testimony this morning from Mr. Greenspan, where he gave us a chart and he indicated that his view was that inflation was essentially caused by the money supply.

Mr. BURNS. That is not my reading of his paper.

Mr. LEGGETT. Well, he gave us—he showed us a chart which shows that the GNP deflator and the unit money supply had a very close correlation.

Mr. BURNS. Yes, but he tried to explain that correlation, which you have not as yet done.

Mr. LEGGETT. Well, I did not stay here for his entire testimony.

Now, do I understand that you are satisfied with the management of the Federal money supply by the Federal Reserve System, and you are satisfied with that management during your entire tenure?

Mr. BURNS. I wish I had done it better.

Mr. LEGGETT. To what extent do you accept responsibility for not doing it better?

Mr. BURNS. I accept responsibility for whatever I do, and some things I even do well.

Mr. LEGGETT. I think that is all the questions, Mr. Chairman.

Chairman ULLMAN. Mr. Chairman, I was concerned that one of your staff economists expressed the opinion that prices—wholesale prices, industrial prices—were beginning to weaken because of sustained tight money policies. This is one of the dangers, of course, that we have in applying microeconomics; we think that the whole will follow the parts. But you pointed out in your paper what tight money does. It puts the whole economy out of kilter so that one feature goes in one direction and the other goes in another.

I was pleased you did not follow the other line of reasoning in your presentation.

At this point, after many months of tight money policy in this country, you are recommending application of a widely expanded policy. Evidently you would agree with me that continued inflation is probably the order of the day.

Mr. BURNS. That is correct, but I have also recommended a widely expanded policy for years.

Chairman ULLMAN. Yes; you have, but not, to my knowledge, quite as expansive as you have given us in this paper today.

Mr. BURNS. Oh, I think this is a very responsive, interested committee. I was in the mood and, therefore, I wrote out my thoughts. I believe every one of these thoughts has been expressed before many times.

Chairman ULLMAN. You do a good job. I commend you for it.

Now, do you or do you not believe that prices are beginning to soften and will come down?

Mr. BURNS. Well, that is a very difficult question. I see softening in the sphere of industrial materials, the more sensitive industrial material markets. Apart from that area, I as yet do not see any softening. And I—

Chairman ULLMAN. You see the opposite in many areas?

Mr. BURNS. I do, I see prices in general moving up at an accelerated pace. I see wages moving up at an accelerated pace.

Chairman ULLMAN. And you also, as you expressed in your paper, see the fabric of our financial structure stretched as much as it safely can be; right?

Mr. BURNS. Yes; and by that I meant that monetary restraint, in my judgment should not be intensified; and that the burden of restraining inflation should be borne from this point on to a much larger degree by other instruments of policy, particularly fiscal policy.

Chairman ULLMAN. Do you see any possibility of a credit crunch in the immediate future?

Mr. BURNS. I do not. That is something that the Federal Reserve can prevent and we will prevent it.

Chairman ULLMAN. Are you sure you can prevent it?

Mr. BURNS. Morally certain, which is a little different from being absolutely certain.

Chairman ULLMAN. Turning to the international picture, you have said that international inflation is proceeding at a greater rate than domestic inflation. Would you not agree that if international inflation is to be brought under control, the United States must take the lead?

Mr. BURNS. I think that in view of our role in the world, we should take the leadership. Other countries would follow our example. If we do not take the leadership, I do not know who will.

Chairman ULLMAN. Would you also agree that if we do adopt a long-range policy and implement it and begin to see a slowing down of the inflation and interest rates, that we would have to move dramatically on the international front, both to encourage the same trend abroad and also insulate our capital flows in some instances?

Mr. BURNS. Well, we certainly, first of all, should provide an example to other countries by bringing down our rate of inflation.

Next, I think we should use every reasonable weapon that we command to help the oil-producing countries see that the present high price of oil is not to their own long-run interest; that if they continue to manipulate the price of oil, as they have been doing, there may be most serious repercussions on the entire international economy, and they would suffer along with the rest. I think we should do that.

Chairman ULLMAN. Are you worried about Euro-dollars and the uncontrollable flow of that large pool of money?

Mr. BURNS. I try to follow the Euro-market movements closely. I am less worried than some people. I think there is a great deal of loose talk about Euro-dollars. After all, central banks around the world are aware of their responsibility, are able to discharge it, and are willing to discharge it. I know we would certainly come to the aid of the branches of our banks abroad, and if need be we would come to the aid of subsidiaries as well. Other central banks likewise recognize their responsibilities.

Chairman ULLMAN. Do you not think we need to consummate a new international monetary agreement, and in that agreement also lay down some rules for Euro-dollars?

Mr. BURNS. I think the Euro-dollar market, which is now an unregulated market, should be subjected to some regulation. I very definitely think that.

Chairman ULLMAN. And do you agree we should have a new international monetary agreement?

Mr. BURNS. Oh, yes, very much so. We were making good progress in that direction until the oil crisis upset all of our plans.

Chairman ULLMAN. Let me just refer to three additional problems.

First, the problem of credit allocation. I am glad to see that you are endorsing recommendations of the Federal Advisory Council, and have sent them out to member banks around the country. The Council laid down some rather interesting guidelines as to where credit should go and where it should not go, and you would not have sent it out if you did not generally agree with it; is that right?

Mr. BURNS. That is entirely correct.

Chairman ULLMAN. Now it would seem to me that when this country gets into a credit crunch situation, where we have a tremendous shortage of capital such as we have witnessed the last several months—and capital is desperately short today—that there should be some kind of triggering mechanism. If in fact this is a good set of guidelines, we could trigger them into effect.

Would you agree that might be a sound policy?

Mr. BURNS. In my judgment the banks around the country will observe the guidelines recommended by the Federal Advisory Council.

Chairman ULLMAN. We are getting now to the real crux of your position. And I know, being the conscientious, dedicated public servant you are, it must give you a great deal of cause for concern, whether in fact the Federal Reserve Board is a creature of the banking system or a creature of the Congress.

Mr. BURNS. I have no question about that.

Of course, it is a creature of the Congress. Of course, it is responsible to the Congress. Of course, it exists for one purpose only; namely, to defend the public interest. And if I may say so, it is doing just that.

Chairman ULLMAN. Well, the fact remains, though, that the Federal Reserve Banks around the country that work very closely with the Federal Reserve Board are headed, primarily, by private bankers in association with leaders of the business community; right?

Mr. BURNS. Well, there are bankers on the boards of our district banks; yes. But the power over monetary policy resides mainly in the Federal Reserve Board.

Chairman ULLMAN. Well, that is an old, old source of irritation and I am glad to hear you say what you did.

Now, you mentioned off-budget agency expenditures. I am glad you highlighted that and pointed out that if this was included in the budget, the budget would show an increase of approximately \$28 billion of additional deficit spending this year. Is that correct?

Mr. BURNS. I think the estimate for this year on the basis that I used in my statement would come to about \$25 billion. The unified budget deficit is \$6.2 billion; off-budget outlays are estimated at \$2.8 billion; and the net outlays by Government-sponsored agencies, \$16 billion. The total is about \$25 billion.

Chairman ULLMAN. I hope in the future you will help us with recommendations for bringing these off-budget agency expenditures under the direct surveillance of the Congress and advise us as to whether it would be in the best interest of the Nation to put them under the debt ceiling.

Mr. BURNS. I so advised the Congress only the other day in connection with the Export-Import Bank bill.

Chairman ULLMAN. You feel that it would be wise to put these expenditures under the national debt?

Mr. BURNS. I do.

Chairman ULLMAN. All right.

Finally, something that is causing a great deal of trouble today—disintermediation or the outflow of capital from one category of financial institutions into other kinds of investments.

It is something that is putting the economy in a serious bind at the moment. I think you agree. What have you recommended that might help resolve that problem?

Mr. BURNS. Well, this is an old story, a bit lachrymose, if I may say so.

When I took up my present post, having been a student of the construction industry for close to 50 years, I made a very simple resolution and a promise. I did it voluntarily, before the Senate Banking Committee which confirmed my appointment.

The promise was that I would bend every effort to stabilize mortgage finance, and do what I can to bring some stability to the homebuilding industry. I knew exactly what I was promising.

This industry has been subject to feast and famine throughout our Nation's history—the same is true of every industrial country and, a bit strangely perhaps, it is true also of the Socialist countries around the world.

I set a large staff to work on this problem and in March 1972, I submitted a report to the Congress, knowing full well that it was only a matter of time before homebuilding would be in a downspin once again.

I, with my colleagues on the Board, made certain recommendations to the Congress on stabilizing mortgage finance in the homebuilding industry. I had the hope that Congress would take our report seriously. By this, I do not mean that I had the hope that the Congress would adopt our recommendations—I was not sure then, nor am I now, that our recommendations were the best or the wisest in the world—but I had the hope that the report that we submitted to the Congress would become the basis for extensive congressional hearings, so that other students of this subject would come forward with their ideas, and that we would be ready before a new storm broke.

Now I am not critical of the Congress. In responding to a question of Mr. Leggett, I indicated that I do my best. I am sure you do your best. You cannot be experts on every subject, you cannot legislate on every subject, you cannot hold hearings on every subject. You are very busy; your responsibilities are so heavy. But the fact is that the Congress paid very little attention to our report.

I mention this only because we will continue to have a problem of this sort until we take time to deal with the problem before it reaches the crisis stage. We will get over the present difficulty. It may take 3 months or 6 months or longer. But down the road, unless we reform some of our institutions of finance, and some of our financial practices, we will run into this kind of disintermediation, with housing starts collapsing, once again.

Chairman ULLMAN. Well, in the long run I would agree that we do need remodeling. That does not solve our short-range problem. It is critical, you will agree?

Mr. BURNS. It certainly is.

Chairman ULLMAN. Finally, you have recommended—you may not have recommended, but you suggested—the need for a vast housing program and a vast public service employment program of \$2 billion and possibly \$4 billion.

Do you think it is going to be necessary to spend an additional \$6 billion in these areas before we get through with this recession?

Mr. BURNS. Well, I look upon public service employment as a contingency plan. I am a planner by instinct; that means that I feel it is necessary to make unfavorable assumptions, hoping that things will be better, but being prepared for any eventuality. That is why I think we need legislation on public service employment now. As for actual expenditure, I doubt very much whether we would need to spend anything like that sum.

Second, even if we spent \$4 billion, we would be saving money in other directions: on unemployment insurance, on welfare payments, on food stamps. We would also get some money back in taxes. The net expenditure would thus be a good deal less; how much, I would not know, I have not made the estimate.

Chairman ULLMAN. We always look for these savings when we build a new program, Mr. Chairman; we never find them. We expected a dividend when we got out of Vietnam, and we never got it, as Mr. Leggett well knows. This is always our problem.

Ultimately, this is why the Budget Committee has a very terrifying responsibility—to try and put it all together so that in fact you do have a quid pro quo whenever you move into a new arena.

Additional questions? Mr. Smith, do you have some?

Mr. SMITH. You said you are a planner. I am always glad to talk to planners. One of the plans that I have been advocating around here that I hope some people agree with now is the need for reserves of those kinds of materials which are going to be periodically in short supply—such as grain, for example. We almost dumped in the ocean the surplus we had in 1971; gave it away—anything to get rid of it. Now we need it. The same thing would apply to metals and a number of other materials. In these periods ahead when it looks as though we are going to have periodic shortages, we need reserves, too, don't we?

Mr. BURNS. I think reserves would help, yes.

Mr. SMITH. You mentioned in your answers and also in your statement off budget agencies such as the Federal National Mortgage Association, the Federal Home Loan Bank, and the Federal Land Bank. A number of these, not all of them, but a number of them are federally chartered but over the long run don't cost the Government any money. Now, they would not have the same kind of impact on inflation would they?

Mr. BURNS. No, not the same kind of impact. My statement on that point was not scientific because I do not know how to make it scientific. If I did, here is how I would do it. I would start with the deficit under the unified budget. Then I would take off-budget outlays plus the outlays by Government-sponsored corporations. I would not add in all of that, but a certain fraction. Next I would take the Government guarantees. I would take a certain fraction of that and the fraction would now be smaller. Then I would put these three sums together. Now, not knowing precisely what these fractions ought to be, what I did was to ignore the third category and take all of the second, trusting that I would be somewhere near the mark in the process. I think I am. But it would be very difficult to prove that conclusively.

Mr. SMITH. So on an overall basis, what you are saying is that it would be helpful to reduce the amount of credit that is being financed by Federal deficit.

\$5 billion has been thrown out as one of the figures. What effect would \$5 billion of reduction in expenditures have, in your judgment, on inflation?

Mr. BURNS. Well, I dealt with that as well as I could in my statement.

Mr. SMITH. Not measurable, is that it?

Mr. BURNS. I will answer that in a moment. I did not refer to measurements in my statement. I indicated that the effect in the short run would be very small but with the passage of time the effect would cumulate.

If you did it this year and then did it again next year, and did it again the year after, these cumulations would in turn accumulate at a higher order. Therefore, looking to the future the effect could be very large.

Calculations that have been made by economists suggest that a cut in the Federal budget of \$5 billion would reduce the inflation rate anywhere from one-tenth to two-tenths of 1 percent. This would be the effect according to these calculations after 1 year. The effect after 2 years would be larger, et cetera. But there are two other points of some importance to be kept in mind.

First, these calculations are based on experience on the average. But we are dealing with a concrete situation, a situation that is unique, where we have by far the fastest rate of inflation under peacetime conditions in our history. Average past experience hardly gives us a reliable rule for judging the current situation. That is one point to bear in mind. Another point to bear in mind is that a cut in the Federal budget could have very prompt effects on interest rates and on the stock exchanges even if we at the Federal Reserve did not change our policy in the slightest.

Mr. SMITH. Now, of course, one of the ways to help reduce the deficit is to increase taxes and at the same time cut expenditures. You indicated in your statement, I believe, and in response to a question by

Mr. Ashley, that you would support some kind of increase in taxes as part of the program and the gas tax was singled out as one possibility.

Is that correct?

Mr. BURNS. I did not elaborate but I think some tax adjustments might be advisable, yes.

Mr. SMITH. Do you have any suggestions on tax adjustments other than gas tax increases?

Mr. BURNS. Well, in the field of energy, I would consider very seriously a horsepower tax, that is a tax based on the power of the engines that we install in our automobiles.

Mr. SMITH. Are you talking about trucks or pleasure vehicles?

Mr. BURNS. I am thinking of pleasure vehicles, where the tax would be negligible or there would be no tax at all on the lowest priced cars, but the tax would become very steep on the high powered luxury cars.

Another change that I would consider seriously is increasing the minimum tax. I think it is too low. We have a 10-percent tax covering preferential income, so-called, at the present time. I think that tax should be raised to something like 20 or 25 percent. Such an increase would not yield a great deal of revenue, but it would have another beneficial effect. It would make many of our people feel that there is greater justice in our tax system. A fiscal policy by the Congress, to be successful, must convey to the people that the Congress is mindful of considerations of equity.

Mr. SMITH. If there were to be a temporary surtax would you have an exemption or what kind of a surtax would you propose?

Mr. BURNS. Well, I would have grave doubts about increasing the level of taxation generally at the present time. I think that might injure our economy at the present time.

Mr. SMITH. It would be too difficult to select a category for a surtax.

Mr. BURNS. Well, I thought you had in mind a surtax on personal and perhaps also corporate incomes.

Mr. SMITH. One of the suggestions that was made at some of the pre-summit conferences was that there be a surtax with a \$10,000 or \$15,000 exemption.

Mr. BURNS. Yes. I would question the wisdom of doing that at the present time.

Chairman ULLMAN. Mr. Leggett.

Mr. LEGGETT. Thank you.

Just a few more questions.

A number of things I think we are in general agreement on: No. 1. I think that most of the members of this committee believe we should have a balanced budget. What we are probing for many times is to find out the extent that that balancing is directly related to inflationary policy and to what extent it is perhaps indirectly related to psychological factors. I think your answer to Mr. Smith indicating that a \$5 billion reduction equates to one-tenth or two-tenths in cost escalation the first year when we are faced with a 4 percent escalation in 1 month of wholesale prices indicates that in large part we are dealing with psychology. In that respect, whatever it is, I think it is probably worth doing.

Mr. BURNS. We are dealing in large part with psychology but we are dealing with real economic forces as well, I, for one, think of budgetary restraint as being a continuing policy. Therefore, let's say

a \$5 billion cut would be the first installment, so to speak, of a policy that will be continued next year and the year after and the year after that.

Mr. LEGGETT. Of course, the problem comes when Presidents submit budgets that are essentially out of balance at the outset. Traditionally up to the last half dozen years budgets were generally submitted in balance and we did not have these massive trust funds that we were swiping for general funding purposes. I think for fiscal 1974 we are taking in the order of \$13.5 billion, for 1975 I think it is more like \$8.4 billion, out of the trust funds. I think that is a very regressive method of financing Government activities.

I believe if Presidents are not going to submit budgets which are in balance to begin with, they put the Congress in a rather hopeless position because it would be just a surplus appendage, rubber stamping act if we have no discretion.

Mr. BURNS. That is the way it has been for too many years. Now, under the Budget Reform Act we can have, and I hope we will have, a legislative budget for the first time.

Mr. LEGGETT. I hope we can legislate perhaps even further and require that Presidents submit budgets in balance at the outset or at least submit an alternative budget for our consideration which is in balance and I mean in total balance. I hope we can arrive at that.

Mr. BURNS. That is a very interesting suggestion; namely, to ask the President to submit the budget that he thinks is appropriate at a given time and, second, to submit simultaneously a budget that he may not prefer, that he may think is undesirable, but which is still a budget in balance. You could thereby provide better guidance to the Congress. This is the first time I have heard that suggestion put forward, and I think I like it.

Mr. LEGGETT. Your suggestions on energy control, I think, are appropriate. You are not the first obviously to suggest horsepower control. I think Senator Jackson was talking about something of that nature the other day. I fully believe that we need to get control of our energy utilization and we need to legislate it because it is not going to come about through natural supply-demand because the American public has shown they are prepared to pay 35 cents, 45 cents, 55 cents, 65 cents, whatever it costs for a gallon of gas. They will buy it and use it. I think our utilization right now is within a percent or two of what it was a year ago when prices were considerably different.

Your suggestions that we abort the Jones Act and the Davis-Bacon Act, I think are in the realm of idealism. In the Congress of the United States we are not about to abort the Jones Act. The President of course experimented with aborting Davis-Bacon—the previous President, that is. He did that for 30 days and then summarily reversed himself. I doubt if they are going to get into that kind of experiment again. That is just a way of saying there are certain things you can do and certain things you cannot do. You have to be in the realm of the possible.

Mr. BURNS. I don't believe that. May I tell you a story?

Mr. LEGGETT. Please do.

Mr. BURNS. I had a talk with Ben Gurion, then Prime Minister of Israel, back in 1958. I asked him if he was getting any help from his economists. He said, "No, I am not." I said, "That is too bad. You

should be calling on them. They are very able people. They are dedicated and highly respected in this country and Europe. They can be of great assistance to you." Then Ben Gurion answered, "Well, you know, Professor Burns, I used to call on the economists and whenever I put up a problem to them, they would say, 'Oh, this is too difficult to handle,' or 'This is impractical,' or 'This is impossible.' Well, "Ben Gurion went on, "that was my experience with economists but we in Israel had to do the impossible and therefore we have learned how to get along without the economists."

You in the Congress, Mr. Leggett, may have to do the impossible if we are to get this country straightened out.

Mr. LEGGETT. Well, as I recall, collectively the Congress and the Executive here a few years ago had a pretty good compromise worked out. We had suggested in the Congress a thing called wage-price controls. The Executive thought that that was an anathema. Certainly, given in your position, for you even to talk about it would perhaps stimulate the adrenalin of the market and perhaps would be inappropriate. But it seems to me that we did have a couple of phases of wage-price controls that did work. It also appears to me that we centered originally on the construction industry, which you have been reported to be expert on, and I am sure you are—

Mr. BURNS. I used to be.

Mr. LEGGETT. I am sure it has exactly the same problems today as it had when you started attacking the problems. Now I am getting people saying as they did a few years ago, "Let's control the escalation of wages in the construction industry." Many of us in Congress have not been prepared to control wages and prices unless we did it for industry reasonably across the board—and do a little more than just jawboning. I notice your third recommendation is jawboning; that we should cooperate together. That is merely a nice way of saying we should talk together to restrain ourselves. It appears to me that the old laws of economics do not apply. We can have very high unemployment in California and still have the highest wage rates in the United States.

A lot of that is because of organized labor's bargaining power but corporate pricing power is just as powerful. It seems to me in order to get control of this that we should adopt some kind of a comprehensive program of controls. We have seen where inflation can go in Chile and Brazil; that is in the hundreds percent over a several-year period. We are not that bad yet, but we are escalating geometrically from where we were a few years ago.

It appears that it is concurrent with escalation of the prices of raw materials, primarily raw agricultural and energy prices. If it is worthwhile to control the price of energy, to wit, oil, I think it is worthwhile to consider a number of other commodities also. You don't need to reply to that.

Mr. BURNS. Well, I just want to say one word. I would have liked the recent legislation by the Congress better if the law had given the Council authority to suspend price or wage increases for a period of 30 to 45 days, during which time hearings would be held and then recommendations made.

Mr. LEGGETT. Thank you.

Chairman ULLMAN. Mr. Chairman, again I want to express the appreciation of the committee for your appearance here, your patience, and your willingness to exchange ideas with us and to give us the benefit of your very wide experience and knowledge in this field. Thank you very much.

Mr. BURNS. Thank you.

Chairman ULLMAN. The committee will stand adjourned.

[Whereupon, at 4:17 p.m., the committee adjourned, to reconvene subject to the call of the Chair.]

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