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# REGIONAL IMPACT OF CURRENT RECESSION

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## HEARING

BEFORE THE

SUBCOMMITTEE ON FISCAL AND  
INTERGOVERNMENTAL POLICY

OF THE

JOINT ECONOMIC COMMITTEE

CONGRESS OF THE UNITED STATES

NINETY-SIXTH CONGRESS

FIRST SESSION

OCTOBER 16, 1979

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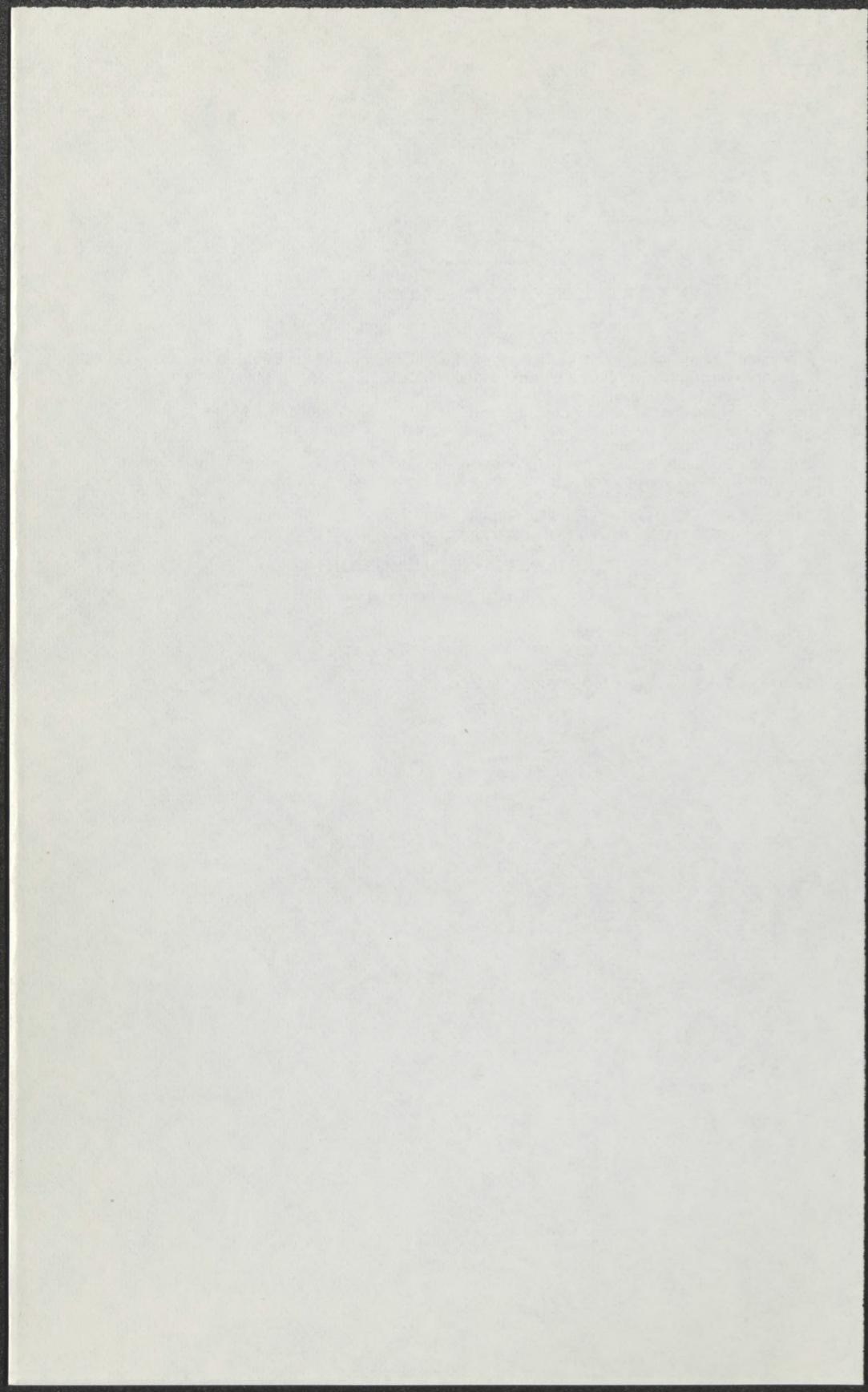
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## REGIONAL IMPACT OF CURRENT RECESSION

TUESDAY, OCTOBER 16, 1979

CONGRESS OF THE UNITED STATES,  
SUBCOMMITTEE ON FISCAL AND  
INTERGOVERNMENTAL POLICY  
OF THE JOINT ECONOMIC COMMITTEE,  
*Washington, D.C.*

The subcommittee met, pursuant to notice, at 10 a.m., in room 340, Cannon House Office Building, Hon. William S. Moorhead (chairman of the subcommittee) presiding.

Present: Representatives Moorhead, Bolling, Wylie, and Heckler.

Also present: John M. Albertine, executive director; Louis C. Krauthoff II, assistant director-director, SSEC (Special Study on Economic Change); William R. Buechner and Deborah Norelli Matz, professional staff members; Carol A. Corcoran, minority professional staff member; Mark Borchelt, administrative assistant; and Katie MacArthur, press assistant.

### OPENING STATEMENT OF REPRESENTATIVE MOORHEAD, CHAIRMAN

Representative MOORHEAD. The Subcommittee on Fiscal and Intergovernmental Policy of the Joint Economic Committee will please come to order.

Good morning. It gives me great pleasure to welcome our distinguished witnesses to discuss the regional impact of the current recession, particularly its effect on State and local finances. We are particularly pleased to welcome to the subcommittee the vice chairman of the Joint Economic Committee, the gentleman from Missouri, Representative Bolling; and, of course, the Secretary of the Treasury. I believe this is the first time that you have appeared before the Joint Economic Committee in your new capacity.

Secretary MILLER. My new incarnation.

Representative MOORHEAD. Yes, but you not only come from a distinguished background but also with the experience as having served as Chairman of the Federal Reserve Board and now as chief fiscal officer of the United States, Secretary of the Treasury, and we are particularly pleased to have you.

Mr. Secretary, since this hearing of the Subcommittee on Fiscal and Intergovernmental Policy was arranged, the Federal Reserve Board—of which you were the Chairman until recently—has announced a major change in its monetary policy and the technique for implementing it. I notice that one prominent banker has labeled this the most important change in U.S. economic policy in 30 years, and I think he may be right. What is more, it comes at a time of profound concern, even fear, among our citizenry—particularly over the seeming impossibility of getting the inflation problem under control.

Mr. Secretary, I would like to begin this hearing with some reflections on the new Federal Reserve policy, reflections which will lead into the precise subject of this hearing. I will be asking you questions along these lines later on.

Let me say first, and unequivocally, that I approve of what the Federal Reserve has done, though I recognize that the new policy contains some real risks. The new effort to control closely, for the first time, the growth of the money supply gives us the chance to slowly reduce, and eventually eliminate, this source of inflation. I am not sure it can work without a credit crunch of some kind, but I believe that this is a risk that should be taken. The new policy might do a great deal to wring inflation out of the economy, but only if the Fed sticks to it.

That brings me to the next point. If the Fed is to stick with this policy, it means that we must accept the risk of a serious shortage of credit and therefore the possibility of a deeper recession in the economy than is now generally foreseen. Just as important, it means that we should not rely on monetary policy for stimulus if the recession does develop. A steady Fed policy means controls of money growth through thick and thin, and no reversion to runaway money growth as soon as business turns sour and unemployment rises.

While I am willing to accept these consequences of the new policy, I am not willing to inflict major hardship on the sizable portion of the American people that will suffer the consequences of a deep recession. These victims, incidentally, include the State and local governments which are the principal subject of this hearing.

This leads me to the third point. If we are to have a steady, anti-inflationary monetary policy, our discretionary response to a serious recession must come through fiscal policy—spending policy and tax policy. I recognize the theoretical advantages of tax reduction over expenditure increases for countercyclical purposes, but I have great concern over the politics of tax reduction, particularly next year, an election year. I fear that we may find ourselves bidding tax reduction upward to massive and unsound levels, with the consequence of a budget deficit so large that it could be an inflationary force of its own and, in any case, would put great strains on the ability of the Federal Reserve to carry out its new policy.

And, thus, I think we ought to be thinking seriously about using pin-pointed, targeted, and temporary expenditure policy as the means of both countering the recession and mitigating its impact on particular groups of people. One such device, successful in the past, is extended unemployment compensation benefits. There may be a case for expanded countercyclical public service jobs. And one of the most obvious devices is connected with this hearing—countercyclical aid to State and local governments.

Let me summarize. If we are to conduct the new promising monetary policy on a steady basis, we risk a deeper slump than is now generally forecast. If that happens, we don't want to reverse monetary policy, or we will throw away the potential gains on the inflation front. But we do want to be ready with fiscal measures. Rather than tax cuts, which might get out of hand, we ought to be thinking about pin-pointed, limited spending measures. I hope you will ponder these thoughts, Secretary Miller.

Several Joint Economic Committee studies have documented the negative effect which recessions have on State and local finances. It seems that as a result of a downturn in the national economy, many State and local governments are forced to reduce services and employment and raise tax rates. Particularly hard hit are the older central cities which seem to go deeper into the recession and recover more slowly than other cities. A severe recession, combined with the double-digit inflation we are experiencing, could create chaos for local governments.

Not only does the national economy affect State and local governments, but State and local government impact on the national economy as well. State and local governments spend about \$300 billion a year for goods and services or more than 13 percent of the gross national product. Any substantial holddown or reduction, therefore, is bound to have a restrictive effect on the national economy. If State and local governments play a procyclical role by being forced to cut or hold down spending for essential services and construction outlays, it seems to me the national recession could deepen rather than lessen in the coming months.

Unfortunately, we in public policy do not always learn from our past mistakes. It wasn't until we were almost out of the last recession that the Congress enacted a countercyclical revenue sharing bill to provide assistance to State and local governments suffering from the effects of the recession. This legislation, which expired last year, was not reenacted, and as a result, local governments are not protected against a recession by a standby countercyclical program.

I feel strongly that we should have a standby program on the books. Since we do not, I feel a responsibility for providing our local officials with as much information as possible on the anticipated length and severity of the current recession as well as its likely regional impact. In this way, I am hopeful our local officials will be able to plan and budget accordingly so as to avert local crises. I am also hopeful that this hearing will prove useful to my colleagues in the House and urge their deliberation of a countercyclical bill.

I am most interested in the assessments of the national economy and its likely effect on State and local governments which our witnesses will be discussing.

I would now like to call upon G. William Miller, whom I am very pleased to have with us today.

Mr. Secretary, I read your prepared statement. It is excellent. We would like to hear it from you personally, but now I would like to yield to the vice chairman of the Joint Economic Committee, Congressman Bolling. Do you have any comments?

Representative BOLLING. No, I have no comments at this time.

Representative MOORHEAD. Mr. Secretary, will you proceed.

#### STATEMENT OF HON. G. WILLIAM MILLER, SECRETARY OF THE TREASURY

Secretary MILLER. Mr. Chairman, thank you very much. I appreciate your welcome. I have appeared before various sessions of the Joint Economic Committee previously in my role as Chairman of the Federal Reserve and I certainly appreciate this opportunity to appear here in my new capacity.

The statement has been submitted for the record, Mr. Chairman, and in order to allow more time for us to discuss the issues, it might be more appropriate for me to submit that for the record and perhaps make a few introductory comments that would lead into your questions.

Representative MOORHEAD. Without objection, the entire statement will be made part of the record, but I hope that you will verbalize a good portion of it, Mr. Secretary.

Secretary MILLER. I will certainly be glad to.

Of course, we are here to talk about the countercyclical measures which you mentioned, but I think I should first comment on the economic outlook. The economy was under a mode of restraint earlier this year from economic policy. Then in the second quarter with the large increase in oil prices we had a particularly severe impact on the economy and with disruptions from strikes, and from the impact of the oil price increases we had an economic slowdown resulting in a negative growth rate in the real GNP in that quarter.

We have now just completed the third quarter and the economy has behaved a little stronger than might have been expected. I would like to suggest to the committee that, all things considered, it appears that the economy is in a recessionary mode and we should not be misled by the special characteristics that have led to slightly stronger performance in the third quarter than had been anticipated earlier. Retail sales recently have shown good gains. On the other hand, we have noted just in the immediate past that automobile sales have weakened, part of which may be a seasonal transition to the new model, but I would recognize the underlying trend of the economy to go through an adjustment process that will be in the nature of a modest recession.

Other signs of performance in the economy can be looked at in terms of another barometer, that is unemployment. Unemployment has actually gone back down to 5.8 percent from 6 percent in August, and as I mentioned retail sales have shown somewhat better tone. The economy is fairly well balanced, but the main evil, the main distress, the main concern is that these events have been coupled with a marled acceleration of inflation. A good deal of this is associated with the 60-percent increase in oil prices as it works its way through the economy but, of course, what we must guard against is the possibility of that kind of shock increase in inflation working its way into the permanent structure of wages and prices and saddling us with higher, underlying rates for a long period of time.

As you point out, in the face of these conditions, toward a slowing in the economy, and toward our efforts to grapple in a comprehensive way with the threat of inflation, the Federal Reserve did on Saturday, October 6, introduce some new policies. These included an increase in the discount rate and an associated increase in other interest rates that go with that. It also included the imposition of margin requirements on the increases in new managed liabilities of banks over a base period, making it less attractive for banks to accumulate those managed liabilities as a basis for loans; and third, it announced a change of emphasis in the method of carrying out monetary policy, putting more emphasis on maintaining the growth of the monetary aggregates within the established ranges. And, finally, it called upon banks to

moderate their loans for nonproductive uses such as the holding of commodities, or gold, or foreign exchange.

In my view, as you have indicated, Mr. Chairman, these are appropriate actions under the circumstances that we were facing and they do give us the prospects of gaining a better control on inflation. I think they have the prospects of dampening not only inflationary forces but inflationary expectations, and this will speed the time when we can wring out inflationary expectations and see a more promising outlook for balanced growth in the future.

My view would be that these actions by the Federal Reserve do not indicate a deeper or sharper recession. The recession that is underway is in a context of a well balanced economy, and the actions of the Federal Reserve, to the extent that they make it clear to all segments of the economy that there is not going to be funds available for non-productive purposes but there will be an adequate growth of money supply to maintain productive business activities—to the extent that that is understood, we can see conditions in which we avoid expediting the commodity boom that would have aggravated inflation and after a brief burst of activity would have resulted in a more serious recession. So actually, I look upon this action as nipping in the bud a kind of response in the markets that could unsettle our economy and lead to more difficulties later.

Now the main objective of all of our economic policies has to be to wring out inflation and restore a condition for balanced growth and the levels of employment opportunity that are the essential elements of our Nation's economic goals.

I want to turn from that brief outlook at the economy to mention the impact of this recession, or any recession, on regional areas in the country. Different regions are sensitive in different ways to recession, depending upon a number of factors. Perhaps among the most important factors are the economic structure of the region, and second, its rate of growth, the rate of growth of the economy at large and the rate of growth within that area. Regions that are more dependent upon manufacturing are more subject to the cyclical forces of recession, and to the extent that regions are older areas of manufacturing dependence, they are likely to be more sensitive. Areas that have been developed more recently and, therefore, are experiencing a greater than national average of growth rate tend to have more resilience to adjust to recession, and areas that depend more on agriculture are really subject to different cyclical forces and are not as impacted by a normal recession.

During the postwar period, the east north-central area, New England and the Mid-Atlantic States have shown the greatest sensitivity to national economic slowdowns. The Mountain States, the west south central, the west north central, and the South Atlantic States have shown the least sensitivity. I think these are well known area characteristics and if we look through them one by one I think we find the general relationship that I mentioned.

In the Northeast, and east north-central regions where you have a higher percentage of activity in manufacturing than in other parts of the country, there tends to be more of an effect from a recession. In areas like the Southeast where there's been a new industrialization and less dependence upon manufacturing, there has been less impact.

The Pacific States generally are more dependent upon services and other activities so that, except for the great recession of 1974-75, they have been somewhat free from the effects of recession.

All of the areas of the country, of course, suffered in the recession of 1974-75 because it was the deepest recession we have seen. But in terms of the more moderate recession that we expect now, the more normal pattern should repeat itself.

This particular observation leads me to note that the administration itself does not have official economic forecasts for individual States or local areas or regions. There are a number of private forecasts and, on the basis of those private forecasts rather than any official forecasts, we would expect this particular recession to follow the patterns that have been seen in similar mild recessions in the past.

New England, the Mid-Atlantic, and the east north-central regions could be expected to bear the brunt of this recession. The Mountain States are expected to suffer very little. The Pacific, the South Atlantic, the East South-Central, the North Central, and the West South States are expected to suffer very little. The Pacific, the South Atlantic, Central States are apt to have mild employment declines.

Part of this, of course, is based upon historical analysis so these private forecasts, while they are good guides for us, I think do have the imperfection that they are using the history of the past as a guide and they may not reflect changes that we have not yet perceived.

Mr. Chairman, now let us turn to the question of countercyclical aid and how it fits in with the general program.

There's been a good deal of comment about rather large State and local budget surpluses in recent years. I think that's been perhaps misunderstood to a degree because the surpluses have existed in a relatively few States and some of these surpluses, in fact a good many of them, consisted of contributions to various social insurance funds such as retirement funds, workmen's compensation and temporary disability insurance funds which aren't available in general for other purposes. So, those kinds of set-asides to pay for social insurance do not help a State or locality meet its current operating needs. Thus we have to be careful not to overgeneralize and assume that because there are surpluses around the country that there's no need for countercyclical aid in times of recession.

For example, in the second quarter of this year, State and local governments actually ran a \$6.3 billion deficit after allowances are made for contributions to social insurance funds. I think that's evidence that we do not have a case where there's a great surplus and we need not worry. Further reductions in the rate of growth in State and local revenues can be anticipated in this recession and we could see the deterioration in the fiscal positions of States and the curtailment in public spending that would be procyclical and would exacerbate the recession.

So one reason to look at countercyclical action is to avoid a condition where the shrinking of State and local revenues at a time of recession will cause those States and localities to reduce their own spending and add to and contribute to the downward trend of the economy. We expect this, of course, in older cities and in the regions that are particularly impacted by the type of employment patterns that I have already mentioned.

The administration considered the prospects for various regions when it made its fiscal assistance proposal last March. Let me pause just for a moment to relate the basic justification for countercyclical programs that provide varying payments region by region during a recession.

In time of economic prosperity, most States and local governments accumulate fund balances and that allows them to keep spending for a period of time, perhaps up to a year, after a recession begins. About the time economic recovery begins, those fund balances have been substantially reduced so that localities and States find themselves cutting back on spending. Therefore, they are unable to sustain activity at a time when the economy needs support for its recovery. This pattern is observable in all the recessions since World War II.

The lesson we can learn from this is that there is momentum in spending by State and localities as a recession begins and the best time to come to the aid of these governments is well after the economy has turned down and when their fund balances are depleted, so that Federal aid is important to sustain State and local spending.

The choice among available countercyclical options requires a balancing of the relative job-creating effectiveness per dollar of Federal deficit against the potential inflationary side effects of any given policy. These countercyclical policies we're talking about will target spending to areas that have slack in their utilization of human or capital resources so that additional spending will have the least inflationary impact.

I think you made this point in your opening statement. We are looking at ways to have a countercyclical program that doesn't contribute to inflation. To do this we must avoid adding funds to areas that have not felt the impact of a recession or are still growing at fairly high levels. Instead we should direct funds to the areas that have slack in employment and capital utilization and thereby help the total economy with the least inflationary impact.

The proposal that we are talking about triggers on at a national unemployment rate of 6.5 percent. In effect there would then be made available countercyclical funds targeted to localities that have the higher rates of unemployment, and, based on a formula that would provide an equitable distribution of such funds.

The administration's particular proposal that was submitted has been somewhat modified by the Senate and I think it might be best for the purpose of this discussion to focus on the Senate bill which is generally consistent with the administration's view. That one, I think, would be better to work from than to start over and have two proposals before us.

The first part of the Senate bill—there are two tiers, as you know—would involve the payment of \$85 million per quarter in targeted fiscal assistance in fiscal year 1980. Funds would flow in this quarter if the law is approved in a timely fashion and would continue to be disbursed through the 1980 fiscal year, unless the standby program is triggered on.

The second tier of aid would be the countercyclical assistance, which I mentioned before and here this would mean that if the national unemployment rate reaches 6.5 percent for one full quarter, the program would be triggered and, two quarters later, there would be

a payment to those States and localities with at least a 6-percent unemployment rate. When the second tier triggers, the first tier would be turned off so there would not be an overlap. The result of this would be to assure that the allocation would go into the targeted areas.

The last forecast officially presented by the administration contemplated a 6.6-percent unemployment rate in the fourth quarter of this year which is the first quarter of fiscal year 1980. If this were the actual result, then that means starting in the third and fourth quarters of fiscal year 1980 countercyclical fiscal assistance payments would be made. The amount of payments would be \$125 million per quarter plus an additional \$30 million for each one-tenth of 1 percent by which the national unemployment rate exceeds 6.5 percent.

Mr. Chairman, we believe this to be a balanced and reasonable approach to preparing ourselves. This is not the only policy that needs to be considered in terms of the recession, but it is a particular one, a focused one, and a targeted one, and I think it's consistent with the general philosophical view that in these inflationary times all of our economic responses need to be more targeted toward the pain, suffering and distress and not broadcast over an economy that may have parts of it operating well and does not need to be federally stimulated for fear that there will be increased inflation.

I hope this rather brief summary will be helpful to you and I thank you for your attention for this rather detailed subject.

Representative MOORHEAD. Thank you very much, Mr. Secretary, for a statement that is, I would say, very well targeted on the issue which is facing us in a legislative subcommittee on which I serve.

[The prepared statement of Secretary Miller follows:]

#### PREPARED STATEMENT OF HON. G. WILLIAM MILLER

Mr. Chairman and Members of this distinguished Subcommittee:

Thank you for this opportunity to discuss the economic outlook, its regional impact, and what might be done to mitigate the effects of a recession on our State and local governments. I am pleased that the Subcommittee is giving its attention to this important subject.

#### ECONOMIC OUTLOOK

Let me begin by summarizing briefly my assessment of the current economic outlook. In recent weeks the economy has shown more strength than earlier anticipated. Indeed GNP growth in the third quarter of this year is likely to show some recovery from the depressed levels of the second quarter. The September unemployment rate fell back to 5.8 percent after rising to 6.0 percent in August. Retail sales for August and September were up 5 percent in nominal terms, and almost 3 percent in real terms, from second quarter levels. However, this strengthening of economic activity has been coupled with an acceleration of inflation, a heightening of inflationary expectations, an expansion in credit flows and increasing evidence of speculative activity in commodity and financial markets.

In September, the rate of inflation, as measured by producers' finished goods prices, accelerated. The monthly increase of 1.4 percent was the largest single monthly advance since late 1974.

In recognition of accelerating inflationary pressures and developments in the domestic and international financial markets, on Saturday, October 6 the Federal Reserve Board acted to slow the growth in money and credit expansion.

The recent policy actions by the Federal Reserve—actions which are appropriate and necessary—will help us get a better handle on inflation, the dominant economic problem of our time. If we are to preserve the economic advances that have been made since the end of the last recession, we have no reasonable alternative but to mount a strong and broad attack on inflation and inflationary expectations.

We must recognize, however, that the underlying factors have now changed somewhat and we cannot be as certain as previously about the depth and severity

of the economic slowdown. However, there are few signs that we are facing a deep downturn of the 1973-75-type, and with economic policies focused on curbing inflationary expectations, the outlook continues to indicate a moderate recession.

The Administration intends to continue its comprehensive fiscal discipline, monetary restraint, responsible pay-price policy, an overall energy program, reduction of regulatory burden and other measures. This will contribute to a slowing of price increases during the coming months. By doing so, we can avoid an acceleration of wage and price increases and a new inflationary spiral.

By acting to slow the rate of inflation, we will be able to shore-up real incomes, reduce uncertainty, reverse expectations of future inflation, strengthen consumer and business confidence, and reduce significantly the chances for a deeper recession.

The steps that have been taken to reduce inflation are necessary to restore economic stability and balanced growth. We must prove to ourselves and demonstrate to others that we have the conviction, the courage, and the fortitude to stick with the policies that are needed to bring inflation under control.

#### REGIONAL IMPACT OF RECESSION

With this brief background on the economic outlook, let me now address the question of the regional impact of a recession.

The sensitivity of regions to a national economic recession varies widely and is dependent upon a number of factors, including industrial composition and growth rates. Historically, during periods of declining economic activity, manufacturing industries (particularly durable goods manufacturing) have tended to experience relatively wider fluctuations in output and employment than other industries. Purchases of consumer durables (such as automobiles and large household appliances) and capital goods are more readily postponed during economic slowdowns than purchases of non-durables (such as clothing and food) and many services. Thus regions which are heavily dependent upon manufacturing activity as a source of income and employment are generally more severely impacted by national recessions.

Regions that have been experiencing rapid increases in economic growth due to increased capital investment, immigration of labor, favorable climate, relatively cheap resources, or any number of other factors may be less severely affected by national economic recession than regions with slower growth rates and regions that have a relatively older, less-efficient capital base. Regions heavily engaged in agriculture are not usually affected by recession to the same degree as regions heavily dependent upon industry.

During the post-war period, 1948-1975, the East North Central, New England, and Mid-Atlantic States have displayed the greatest sensitivity to national economic slowdowns in terms of employment declines relative to the national average. On the other hand, the Mountain, West South Central, West North Central and South Atlantic States have shown the least sensitivity. The degree of sensitivity is explainable basically in terms of the make-up of the economic base of the various regions.

Using the latest data then available, a 1978 Boston Federal Reserve Bank study indicates that:

(1) During the six business cycle episodes of the post-war period, employment in the East North Central, New England and Middle Atlantic States has almost always shown percentage declines far in excess of the national average. In the 1973-1975 recession for example, total U.S. employment declined 2.9 percent from its peak-to-trough. Employment declined 4.7 percent, however, in the East North Central States, 4.3 percent in the New England States and 3.8 percent in the Middle Atlantic States. Although employment declines in other regions occasionally exceeded the national average, this has been the exception rather than the rule.

In the three regions where employment declines are more severe than the nationwide average, manufacturing is the predominant source of labor and proprietor's income. Manufacturing is also more important to these three regions than to any other region in the Nation and durable manufacturing is substantially more important than nondurable manufacturing.

(2) Except for the 1969-1970 recession, when employment losses in the Pacific States were aggravated by the winding down of the Vietnam War and its impact on the aerospace industry, employment declines in this region have been less than the national average. During the last recession, the Pacific States suffered employment declines of only 1.3 percent, less than half of the national average. Although manufacturing accounts for about 25 percent of the region's total labor and proprietor's income, the relative importance of income from government, services,

trade, and other nonmanufacturing sectors is greater in the Pacific region than in the Nation as a whole. Thus, the Pacific region is more diversified than many of the other regions and is less sensitive to recessions.

(3) In each of the six post-war recessions, employment declines in the Mountain States have also been substantially less than the national average. During the severe 1973-1975 recession, for example, this region experienced an employment decline only half that of the national average; and in the two preceding recessions these States suffered *no* declines in nonagricultural employment. The Mountain States receive a smaller share of their income (less than 15 percent) from manufacturing than any other region. This fact and the fact that government and services account for larger income shares than in any other region probably assures this region of only a minimal adverse impact from recessions.

A region's industrial mix also has implications for the timing of the recession's impact. Since manufacturing activity is most sensitive to a recession, those States or regions most heavily dependent upon manufacturing (particularly durable manufacturing) generally should feel the effects of a recession first. Those States or regions also would probably be among the first to qualify for fiscal assistance from the Federal Government under the Administration's proposed Intergovernmental Fiscal Assistance program that I will discuss shortly. Private forecasts of the regional impacts of the current recession seem to bear out this point.

Not all regions will be affected to the same extent by the current recession. Only those regions relatively heavily engaged in manufacturing (particularly durable goods manufacturing) or experiencing slow growth are likely to be seriously affected. In the mild 1969-1970 recession, for instance, the South Atlantic, East South Central, and Mountain States experienced no declines in employment while the West South Central States showed only minimal declines. In contrast, the New England, East North Central, and Mid-Atlantic regions endured employment declines far above the national average. (Regional employment data for past recessions is presented in Table 1 and regional definitions are shown in Table 2.)

During the 1973-1975 recession, the most severe economic downturn since the Great Depression, no region escaped unscathed. All suffered employment losses. Even the East South Central and South Atlantic States, which experienced no employment declines during the mild 1969-1970 recession, showed large declines. At the same time, however, three regions—the West South Central, Pacific and the West North Central States—experienced milder relative declines in employment during the last recession than they had during the mild 1969-1970 recession, highlighting the fact that the regional impacts of recession differ from recession to recession.

#### STUDIES OF THE REGIONAL IMPACTS OF THE CURRENT RECESSION

The Administration has no official economic forecasts of individual States, local areas, or regions. However, there have been a number of private forecasts of the regional impacts of the expected current recession. Those forecasts were undertaken several months ago and are predicated upon the assumption of a modest recession for the national economy.

The private forecasts indicate that the recession's regional impact pattern will not differ greatly from that experienced during the mild 1969-1970 recession.

The New England, Middle Atlantic, and East North Central regions are expected to bear the brunt of the recession. As noted previously, all three of these regions rely heavily upon durable manufacturing for jobs and income.

The Mountain States are expected to suffer little or no employment losses—only a slowdown in employment growth. As also noted earlier, of all the regions of the country, this one is least dependent upon manufacturing.

The Pacific, South Atlantic, East South Central, West North Central and West South Central States all are predicted to experience mild employment declines. Except for the Pacific region, where specific factors were operative, none of these areas experienced marked employment declines during the mild 1969-1970 recession.

Of course, these studies of the regional impacts of the current recession are largely based upon historical regional impact patterns. To the extent that the weaknesses and causes underlying the current recession differ significantly from previous recessions and to the extent that structural changes in communications and transportation have taken place, the regional impact of the current recession could differ from the past.

## CURRENT FISCAL POSITION OF STATE AND LOCAL GOVERNMENTS

There has been considerable attention directed to the "huge" budget surpluses enjoyed by States. However, only a few States account for most of these surpluses. More importantly, virtually all of these surpluses consist of contributions to various social insurance funds (such as retirement funds, workmen compensation, and temporary disability insurance funds) which are not generally available for other purposes. During the second quarter of this year, State and local governments actually ran a \$6.3 billion deficit (based on national income and product accounts data) after allowances are made for contributions to social insurance funds (See Table 3). This was the first such deficit since the second quarter of 1976. With the anticipated declines in the growth of employment, personal income, and retail sales due to the recession, further reductions in the rate of growth in State and local government revenues can be expected. If it were to continue for some time, such a development could jeopardize the fiscal posture of many State and local governments.

The spread of public sentiment for Proposition 13-type tax reductions could result in a further deterioration of the fiscal position of States and localities unless public spending is also curtailed. Curtailed public spending, however, could exacerbate the recession. A countercyclical fiscal assistance program for State and local governments would help avoid such pro-cyclical actions.

Many of the regions that will be most affected by the recession have older cities that are experiencing secularly declining economic growth rates. These cities may be particularly hard-pressed to maintain service levels in the face of the current slowdown.

The Administration considered the prospects for regional variation in the effects of a recession in preparing its fiscal assistance proposal, which was submitted to the Congress last March. Let me first relate the basic justification for a countercyclical program to the evidence on varying regional effects from a recession. Then, I will summarize the provisions of the bill recently passed by the Senate, which is very similar to the Administration's March proposal.

## THE RATIONALE FOR COUNTERCYCLICAL FISCAL ASSISTANCE

During periods of economic prosperity, most States and local governments accumulate fund balances that allow them to sustain spending for as much as a year after a recession begins. At such a point, typically about the time recovery begins, fund balances have been reduced to the point where the normal spending trend can no longer be sustained, and outlays in real terms may actually begin to decline. This pattern is observable in the record of every recession and recovery since World War II, including the 1973-77 period. Although the continued growth in spending during the decline helps to reduce the seriousness of the recession, the fall-off in spending tends to slow the pace of the early phase of the recovery. Thus, from the perspective of macroeconomic policy, countercyclical fiscal assistance should be triggered well after the economy has turned down. However, payments should cease after the recovery is well under way, in order to minimize potential inflationary effects.

In the current economic environment, decisions on macroeconomic policy must take serious account of the potential inflationary side-effects of any anti-recession fiscal policy option under consideration. The choice among the available policy options should be based upon a careful balancing of relative job-creation effectiveness per dollar of federal deficit against potential inflationary side-effects.

Other things equal, a policy that targets the first-round economic stimulus to areas with significant concentrations of unemployed or underutilized human and capital resources is likely to have the least inflationary effect on prices. Such targeting cannot be achieved by traditional forms of antirecession tax cuts, which must apply uniformly throughout the nation. However, a geographically differentiated spending program can be targeted to areas with high levels of unemployed resources.

Studies of the recent experience suggest that a countercyclical fiscal assistance program—such as Antirecession Fiscal Assistance (ARFA) adopted in 1976 and extended in 1977, or the similar countercyclical tier of the Targeted Fiscal Assistance Program currently before the House—can be very effective in terms of job creation with minimal inflationary side-effects.

Logic and the evidence on the experience with ARFA suggest that local governments with high unemployment rates are most likely to commit such grants quickly and for job-creating purposes. This is a major reason why the targeting

mechanism in the proposed program is based on local unemployment rates, rather than on such alternatives as the change in real wages and salaries.

While the recession facing the nation is expected to be moderate, the current economic outlook remains volatile, particularly in light of the uncertainties about energy prices and availability. It therefore seems prudent to put in place a stand-by countercyclical fiscal assistance program, such as the countercyclical tier of the Senate-approved bill that is now pending before the House Subcommittee on Intergovernmental Relations and Human Resources.

As in the Administration's March proposal, there are two tiers in the Senate bill. The first involves the payment of \$85 million per quarter in targeted fiscal assistance payments in FY 1980 to a very small number of particularly distressed local governments.

The second tier, which is germane to this discussion today, involves a stand-by countercyclical fiscal assistance program which would trigger on during periods of high national unemployment rates.

#### STAND-BY COUNTERCYCLICAL FISCAL ASSISTANCE PROGRAM

Let me indicate briefly how this countercyclical tier would work. By comparison with the 1976-78 ARFA program, the proposed program is much more highly targeted. It would only operate when the national unemployment rate reaches 6.5 percent or more for a full quarter, instead of 6 percent as under ARFA. Once the program is triggered, a recipient government would be eligible for payment under the Senate-passed bill only if its quarterly unemployment rate is at least 6 percent, instead of the 4.5 percent under ARFA. This additional targeting, in the present inflationary context, is highly desirable. It would ensure that countercyclical funds go only to areas with substantial amounts of unemployed human and physical capital, and thus are less likely to fuel inflation. Moreover, governments in areas with high unemployment rates are more likely to be experiencing significant fiscal stress, and such governments are most likely to use the payments for purposes that involve maximum job-creation effects.

The Administration's mid-session economic forecast anticipated that national unemployment rates would have reached 6.5 percent or more by the last calendar quarter of 1979. This would have triggered payments under the proposed stand-by program. The apparent strength of the economy in the third quarter, and the events of the last few weeks, have caused us to reconsider the economic forecast, but a new one is not yet available. If the national unemployment rate reaches 6.5 percent by the first calendar quarter of 1980, this would trigger payments under the countercyclical tier, which would be distributed in the last quarter of fiscal year 1980. Given the lags in State and local budgetary processes and the spend-down of balances accumulated during the past few years, this is approximately the time when recession induced revenue losses raise the prospect of serious budgetary disruption. This disruption will then threaten to require fiscal behavior by State and local governments that will tend to impede the early stage of the recovery from the recession.

When the program provided for in the Senate bill is triggered, it would distribute \$125 million per quarter plus an additional \$30 million for each one-tenth of one percent by which national unemployment exceeds 6.5 percent. One-third of the funds would be distributed to the States, the balance to eligible local governments.

#### CONCLUSIONS

The proposed fiscal assistance program is an important element of the President's domestic program. It is a balanced, two-tiered program that would address the immediate needs of a limited number of fiscally strained local communities, as well as the prospective needs of State and local governments as they strive to deal with substantial economic uncertainty. In particular, the stand-by tier of the program is a sensible fiscal insurance program for State and local governments in the event of future excessive unemployment.

I appreciate the opportunity to discuss the pending proposals for countercyclical fiscal assistance in the context of regional variation in the economic effects of a recession. I look forward to working with you and other members of Congress toward enactment and implementation of the program.

TABLE 1.—PERCENTAGE DROP IN NONAGRICULTURAL EMPLOYMENT DURING 6 POSTWAR RECESSIONS

	United States	New England	Middle Atlantic	East north-central	West north-central	South Atlantic	East south-central	West south-central	Mountain	Pacific <sup>1</sup>
1948-49-----	5.0	5.6	6.8	6.7	1.8	4.8	7.4	2.3	1.8	4.5
1953-54-----	3.5	3.9	4.5	6.2	2.3	3.0	3.6	2.2	2.7	1.9
1957-58-----	4.4	5.0	4.5	8.5	2.3	2.0	2.5	1.8	1.4	3.1
1960-61-----	2.3	1.1	2.5	4.9	1.2	1.3	(2)	1.6	(2)	.4
1969-70-----	1.4	3.1	2.1	4.3	1.7	(2)	(2)	.5	(2)	2.6
1973-75-----	2.9	4.3	3.8	4.7	2.8	4.5	4.3	.7	1.5	1.3

<sup>1</sup> Data for the 1st 3 expansion periods calculated using California and Oregon employment only; data for final 3 periods calculated using employment figures for the entire region.

<sup>2</sup> No decline in absolute level of employment during the recession.

Source: Federal Reserve Bank of Boston, "New England Economic Review" (November/December 1978).

TABLE 2.—CENSUS BUREAU'S REGIONS OF THE UNITED STATES

New England	East north-central	West south-central
Connecticut	Illinois	Arkansas
Maine	Indiana	Louisiana
Massachusetts	Michigan	Oklahoma
New Hampshire	Ohio	Texas
Rhode Island	Wisconsin	
Vermont		
Middle Atlantic	East south-central	Mountain
New Jersey	Alabama	Arizona
New York	Kentucky	Colorado
Pennsylvania	Mississippi	Idaho
	Tennessee	Montana
		Nevada
		New Mexico
		Utah
		Wyoming
South Atlantic	West north-central	Pacific
Delaware	Iowa	Alaska
District of Columbia	Kansas	California
Florida	Minnesota	Hawaii
Georgia	Missouri	Oregon
Maryland	Nebraska	Washington
North Carolina	North Dakota	
South Carolina	South Dakota	
Virginia		
West Virginia		

TABLE 3.—STATE AND LOCAL GOVERNMENT RECEIPTS AND EXPENDITURES

[Billions of dollars; annual rates]

	1975	1976	1977	1978	1979	
					I	II
Receipts-----	236.9	268.0	298.8	331.0	343.9	345.9
Expenditures-----	230.6	250.1	271.9	303.6	316.3	326.1
Surplus or deficit (-) National income and product accounts-----	6.2	17.9	22.8	27.4	27.6	19.7
Social insurance funds-----	12.4	15.7	19.6	23.2	25.0	26.0
Other funds-----	-6.2	2.3	7.3	4.2	2.6	-6.3

Note: Figures may not add due to rounding.

Source: Bureau of Economic Analysis, U.S. Department of Commerce.

Representative MOORHEAD. Mr. Secretary, as a result of the Federal Reserve Board's action last week, many forecasters are now predicting a more serious recession, some say with unemployment up as high as 9 percent. You have been quoted as saying that the recession is half over.

You say, at one point in your prepared statement, that the Federal Reserve action does not indicate a deepening recession. At another point you say we cannot be as certain as previously about the depth and severity of the economic slowdown and at yet another point you say the apparent strength of the economy in the third quarter and the events of the last few weeks have caused us to reconsider the economic forecasts.

It seems to me—and I don't blame you for feeling that way—that there's a bit of uncertainty in your position as to the prospects of the recession getting worse.

Secretary MILLER. Mr. Chairman, let me try to straighten that out. I think that it would not be correct, first, to attribute to me the proposition that the recession is half over. I felt prior to some of the recent events that following the oil price shock that we were moving into a recession. I still believe we are in a recession. The recession appeared to be one in historical measurement that would be moderate in depth and duration and would probably run over four quarters or so.

The trouble with trying to decide when you're halfway through a recession is that calendarwise you may be halfway along, but more than half of the effects of the recession come in the latter part of it. As you can see, if this is a recession, as I claim that it is, unemployment is still quite consistent with levels when we're doing much better in the economy. The general trend is that the unemployment impact comes later. So much of the distress in the economy comes later and I think the implication that that means a lot of our worries are over would be incorrect. I think we have ahead of us the strains and dislocations and disturbances of the recession to deal with.

Now one has to analyze the effect of the Federal Reserve actions in terms of prior expectations about a recession and while the quarterly data may be harder to gage right now because these things impact in a particular way, I think the general context of the outlook is very much the same, that is, one of which is there would be a moderate recession relatively consistent with past moderate recessions.

Now, why is this so? It's so because we must remember back to 1973-74 when inflation psychology led to a severe speculation in commodities and in manufactured inventories. Businesses were ordering materials three times their needs and components three times their needs because the economy was so overheated that deliveries were stretched and businesses were really out of control in trying to cover their needs, and their double and triple ordering led to massive speculation with a massive over accumulation of inventories and a massive liquidation that led to the worst recession we have ever seen.

So far in current economic pattern, the economy has maintained a greater balance. We do not have, for example, the dislocations in housing that we had in 1972-73. On the other hand, in the period of August to September, there appeared some evidence of speculation in commodities, and had that been allowed to build I think one would have seen a complete change in the outlook in which this overaccumulation would have resulted in some major impacts on marketplaces

as people would scramble and businesses would scramble to cover their needs, and that would lead to another high-amplitude cyclical downturn.

What I'm saying is that the Federal Reserve, by curbing that speculation, has contributed to maintaining conditions where we won't see that bubble; we won't see that overaccumulation; we will maintain the balance and, consequently, have a greater probability that the recession will be moderate in depth and duration. Uncertainty, yes; but I think that is the probable outcome.

Representative MOORHEAD. Mr. Secretary, did Mr. Volcker consult with you before taking this action; and if he didn't, should he have?

Secretary MILLER. Well, yes; he did. We have always had close consultations between the Federal Reserve and the administration. The Federal Reserve is independent. When I was Chairman, we were independent; but economic policies cannot operate in a vacuum and, as you have said and I have said and everybody has said, monetary policy cannot do the job alone. Therefore, to do it in isolation, as distinguished from independently, is not wise.

Mr. Wylie was with us on a trip to the IMF annual meetings and he was conscious throughout that we were continuing our consultations about various economic policies. The Federal Reserve then makes the decision in the context of all of our views of what the circumstances are and what should be done. We certainly support these actions.

Representative MOORHEAD. One quick question before my time expires. When you were Chairman of the Federal Reserve, you were reluctant to make predictions about interest rates because you said it would influence them. You're not under those constraints now as Secretary of the Treasury.

Could you give us any prediction as to what we can look forward to in interest rates partly as a result of the new Federal Reserve policy?

Secretary MILLER. Mr. Chairman, I feel under constraint as Secretary of the Treasury because markets seem to react to what we say. It is very important that markets be allowed to act freely and that our policies be ones of actions and decision and not of forecasting because that is disruptive. I think it would be inappropriate for me to make a forecast.

I join with Paul Volcker in saying that, to the extent that we are able to curb inflation, we will have different interest rate structures; or to put it another way, as I have often said, interest rates are the byproduct of inflation and byproducts of our efforts to control inflation. As we dampen inflationary forces and inflationary expectations, we can expect to hasten the day when interest rates will abate.

Representative MOORHEAD. Thank you, Mr. Secretary. Congressman Bolling.

Representative BOLLING. Thank you, Mr. Chairman.

Mr. Secretary, the first question I would like to ask is almost technical. Last year we had a very great deal of difficulty in dealing with countercyclical legislation. It was bitterly opposed by some. One of the reasons for opposition had something to do with the trigger mechanism. One of the problems that bothers me and has for some time—perhaps because I spent a long time being the chairman of the Subcommittee on Statistics of the Joint Economic Committee a long time ago—is that we do not have statistics that derive from our

own efforts at the level of Government to deal with the trigger mechanisms in all situations. That's one of the questions that bothers me, but I'd like to link it with another question. At least last year I was under the impression that the trigger mechanism was so fine in terms of its size that it was well within anybody's judgment as to the possible statistical error in the statistics themselves, and I would like your comment on the advisability of our doing a little bit better in terms of the fundamental forces that set off the trigger, set off the gun, in light of those facts—if indeed they are facts.

Secretary MILLER. Congressman Bolling, I think you are correct. Our statistical base is imperfect and undoubtedly we will make efforts in the Government—this is not a Treasury function, but I certainly agree that we should make efforts in the Government—to improve it. While we may have statistically a very good measure, a fairly accurate measure, with error in the method of sampling, in the national figures, we are not so good—in fact, often imperfect—in the local and State figures. I believe the Congress, recognizing this, allows some 30 standard metropolitan areas to use an alternate system of determining the unemployment rate based on a methodology developed by the Bureau of Labor Statistics. That is one way of dealing with the problem, giving an option to a locality where the figures were imprecise and could perhaps not measure the local distress.

I have no solution to making an allocation system based on such statistical imperfection except to provide the necessary resources, and I believe, if I'm correct, such a program is underway. It was recommended and I guess it's waiting for funding in order for it to be done and if it's funded I believe it would take a couple of years to develop a better technique, and I certainly would support it.

It's hard for the Congress to make decisions on handing out money when the data have error in them.

Representative BOLLING. Right. Thank you, Mr. Secretary.

Now, on the broader issue, first, I take it that you feel confident that the administration and the Federal Reserve are going to pursue persistently the policy of dealing with inflation on this occasion.

Secretary MILLER. Congressman Bolling, I'm sure of it. I just cannot see this administration, which has shown the courage and determination to make inflation the No. 1 issue, suddenly backing off from that at a time when it's critical that we maintain our determination, our will, and our perseverance in fighting this deadly disease. I don't believe the American people will be forgiving for those who are lighthearted in this war, and I think we have to show ourselves strong enough to continue it. There are those who question this based upon their observation of politics. I am not a politician, but let me give you my view as someone who's been in Washington for 1 year and 7 months. I have seen an enormous growth of strength in the attitude of the Congress about fiscal discipline, about the acceptance of monetary discipline, about the willingness for us to take the steps to assure a stable dollar to curb inflation, and about coming to grips with the most difficult problem this Nation has faced, and that is energy policy.

A year ago the Congress passed the natural gas bill and Congresswoman Heckler will tell you that in New England now homes are being connected to gaslines to get away from expensive oil. I believe

Congress will enact the President's other energy proposals as well. So I think Congress has shown its determination in its budget resolutions, and I think the policy of the Nation has been well reinforced. It shows up in the attitude of the American people.

From the administration's point of view, I cannot see the political circumstances which would make it attractive to relent in this battle. In my mind, the measure of the electorate on the merits of this administration will be on its effectiveness in dealing with problems that were largely inherited. The Nation's inflation problem built up over 15 years. Prior to this administration, only the symptoms of this problem were addressed—never its causes. For the first time, a comprehensive strategy to impose a new direction in fiscal discipline has been laid out. The Federal deficit has been reduced from 3 percent of GNP to 1 percent and we are determined to move it lower; moving Federal expenditures from 22.6 percent of GNP to 21.5 percent. We are determined to reduce them even lower. The willingness of this administration to impose restraint and accept and support tight monetary policies, at least in my experience in Washington, is unprecedented. It has shown a willingness to engage in overcoming the 30-year debate in this country that favored subsidizing energy, and moving to replacement costs to provide incentives to conserve and produce, as well as to deal with removing the regulatory burden upon our system which adds costs. All of these things are courageous. These measures have been undertaken and I can see no way in which we would relent from pursuing them.

Representative BOLLING. Thank you. That's a very eloquent statement in support of a very important decision on the part of people. I think the greatest threat to the success of this effort probably comes from some things that are not predicted but could occur so quickly that timing would be crucial; such as in the case of a more severe recession which led to a higher rate of unemployment, and which did not come at a time when we had succeeded in putting in place all of the programs that the administration had suggested, perhaps even including this countercyclical one which has been very hard fought and will be very hard fought again in a timely fashion.

Now if that were to happen there would be a very strong possibility in a political year, not of the administration panicking, but of the Congress panicking and undoing most of the good that had been begun simply on the grounds that they could not face an election with as many unemployed; and the thing that I'm curious about is that, without in any way suggesting that the administration give up on its effort to pass its own first line program, is there being given very serious consideration to alternative or supplementary programs which—in the unhappy event that we are unsuccessful in dealing with the first line programs, if I may call them that—we will not then face the alternative of just collapsing and ending up with a substantial and unwise tax cut that the President would have to face, the alternative of really not being able to deal with the problem of unemployment or of signing or letting into law a bill that he did not approve on the one hand, and on the other hand, having to veto a bill that would be disruptive in a variety of ways; and the thing that I'm concerned about is—and I know the Congress is always moving without an alternative and I just hope that this time the administration is not.

Secretary MILLER. Congressman Bolling, the efforts of the Congress have been impressive to me. I think I have seen a major shift of attitude in my experience in Washington and the recent bipartisan support for disciplined fiscal policy in the second budget resolution is evidence of that. But you're correct. Conditions could worsen and we could find new pressures.

Let me say that we are all human and that in forecasting an economy we are not only subject to the error of the behavioral patterns of a new regime for which we have no data bank—we have no experience of what happens in a whole decade of high inflation in peacetime—but more than that, we do not have control over external events. We do not have control over crop failures or the ability of those who own resources to jack up prices or the fall of a country that reduces its production of oil and therefore impacts on world prices. So we also have not only the imperfections of our own knowledge, but the external events we might have to cope with.

We have recognized and have said that we will be prepared in case of a deeper recession to look at alternatives, but we will do so with great caution because circumstances require that we make the war against inflation our No. 1 priority, not because we desire to cause harm to any individual or any sector or any part of the economy, but because we can do the most good for the most people if we wring out inflation. If we come to it and find a deepening recession, we will be prepared to offer to Congress alternatives that we believe will be properly disciplined, properly targeted, and to the extent that they cushion a recession, anti-inflationary in their impact. I believe there has been building in the Congress over my experience some bipartisan views on the kinds of targeted efforts that could do that, and I believe those efforts that stimulate investment and those that reduce costs are the ones that we would approach. I believe that such measures could be used in a deeper recession without exacerbating inflation, without departing from our disciplines, and without upsetting our long and determined warfare against inflation.

Representative BOLLING. Thank you very much, Mr. Secretary.

I'd like to conclude with just one point. You say that you're not a politician. I have seldom seen anybody that stayed in town as long as a year who did not take on some of the skills and attributes, as well as some of the difficulties, of a politician, and I think it's safe to say that the key element that determines whether a person is a successful politician or not is a sense of timing. I would suggest that in this particular problem the question of timing is going to be crucial because the difficulty of determining what's going to happen in the economy is as nothing—one to a thousand—to the difficulty of determining when the Congress is going to panic. Thank you, Mr. Secretary. [Laughter.]

Representative MOORHEAD. Do you want to be recognized after that, Congressman Wylie?

Representative WYLIE. I would like very much to be recognized.

Mr. Secretary, it's a real pleasure to see you again and may I congratulate you publicly for your excellent statement at the International Monetary Fund meeting. I said so privately. There have been some very positive vibrations from that statement and I might say, though, in our discussion in coming back on the plane I did not get the 12-percent discount vibrations.

Secretary MILLER. As we do consult, we do keep our little secrets.

Representative WYLIE. As you know, I think we may be putting too much pressure on Mr. Volcker and monetary policy and maybe some of it should be shifted to fiscal policy, but I have talked to you about that.

Now Congressman Moorhead mentioned interest rates and are they going higher, and I want to take a little different approach. I might say that at the airport in Columbus yesterday morning I was practically attacked by mover and shaker businessmen who asked me the question: "Are interest rates going higher or have they leveled off?" And I can understand your reluctance to try to state publicly your position because of the impact it might have. So I would like to approach it from a little different standpoint.

Treasury bill rates climbed to over 11.8 percent this week, which is reportedly the first time in the history that they have been that high or have been over 11 percent. That has an effect, of course, of crowding out money for capital improvements in the business sector, but that isn't the thrust of my question.

The inflation rate is now over 13 percent so far for 1979 and many economists are drawing attention to the fact that an 11-percent rate of return on funds for savers is actually a net loss of 2 percent to the saver if the inflation rate is 13 percent. So the savers are going to want higher interest rates. Most borrowers, on the other hand, have to pay 15.5 percent or more for their money at the present time and with inflation at 13 percent and the prime rate at 14.5 percent there isn't much spread between the cost of money and the rate of inflation. That just encourages more borrowing and more inflation.

Do you think it's fair for us in Congress, or a fair statement for me as a Member of Congress, to tell our constituents that interest rates won't come down until inflation comes down?

Secretary MILLER. I think that, in general, is an accurate statement. I might just take a moment to try to shed a little more light on the interaction of interest rates and what the Federal Reserve is now doing.

You will recall—and particularly, Congressman Wylie, you will recall because as a member of the Banking Committee you have been closely associated with the work of the Federal Reserve—but you will recall that in our January hearings of the Banking Committee, the Federal Reserve when I was Chairman laid out the ranges of growth for monetary aggregates over this year which we believe were consistent with moderation in the rate of growth of the economy and a dampening of inflationary pressures.

During the first 7 months of the year we ran in the very low part of those ranges or below them because we had a very tight control on the growth of money. When the oil price shock came and all of the aftermath of that, there was a breakout in the growth of the monetary aggregates and they moved up to the top of the ranges and at least M-1 went temporarily through the top—not seriously, but through. What the Federal Reserve has now done in the face of all of these uncertainties is not to become mechanical and mechanistic, but has merely said we are going to give more emphasis to bringing those monetary growth rates back into the preestablished ranges which are consistent with an economy we are talking about and do not envisage a credit crunch. They envisage no credit for noneconomic purposes

but adequate, if expensive, credit where there's a payoff and an economic consequence.

Now interest rates will fluctuate under that emphasis more than they did before, but they will not be completely uncontrolled. The Federal Reserve will make a judgment as the monetary aggregates come back into the ranges as to just how rapidly they want to bring them into the ranges, whether they want to move toward the lower part, the midpart, or whatever. So they will have some latitude and, therefore, this will be something for us to learn together.

But the main thing is that as soon as there is clear evidence that this is a determined program that will be pursued and that the administration will continue to pursue an anti-inflation priority, then inflationary expectations will dampen and you will begin to see a behavior that will lessen the demand for credit and that will take the pressure off these things. But that's because inflationary expectations are built into interest rates as well as current day inflation. If things go without a new external shock, we could expect in the next few months to see inflation come down because we will absorb this one-time shock and if that happens and there is continued discipline, I think we will see a regime in which there could be some abatement.

Representative WYLIE. Are we at the top of the inflation rate cycle?

Secretary MILLER. Absent a new external shock, I believe we are. You can't judge week to week, but I think we have been absorbing this 2 percent additional inflation that was introduced by the oil price increase of 60 percent. That first shows up as products are bought, new and old products are worked off, and the cost of new oil and oil-based products and all things made with energy continue to escalate and after it works its way through the economy and when it's finished working its way through, then you don't have a new shock to absorb. Fortunately, the underlying rates of inflation in our economy have not been allowed to ratchet up in this period. If we can just wring out this one shock and get back to the terrible levels of 8 or 9 percent, then we can work from there, but I think that's our first task.

Representative WYLIE. Yes. Congressman Bolling touched on that ancillaryly but I think it was Mr. Volcker who said when he made the discount rate 12 percent that recession isn't the worst thing that can happen to the United States right now. Increasing inflation is worse. And I would say that unemployment does hurt a lot of people and the rate might increase some, but at the present time inflation is hurting 220 million Americans and hurting them very severely. Unemployment, on the other hand, will hurt some and, of course, we don't want unemployed families, but is it a good tradeoff or are we talking about a legitimate tradeoff here when we say we need to cool inflation by perhaps some recession?

Secretary MILLER. Congressman Wylie, let me say that last March our economy ended 4 years of economic upswing. By any historical measure, that is a long upswing and we are in the fifth year since we had a recession. So regardless of any other factor, you would have an economy that would begin to be tiring. It would have come near its output capacity and its markets would have begun to consolidate. There would be some slowing just by the natural process by which business cycles buildup.

The events that have taken place, of course, make it more probable that we will have a slowdown. Nobody—Mr. Volcker nor anybody

else—involved in the management of the economy likes to be in the position of receiving suggestions that he or anybody else has caused unemployment. Unemployment is very painful for those who suffer from it, but periods with slackened employment opportunities are natural in the very organic life of our economy.

What we want to do is dampen the rate of growth of the economy so we don't push up against our physical output limits and we have time to build up the supply side and, therefore, restore the balance between supply and demand and make possible the production of goods and services Americans want and need, but at more stable prices. So it is a natural phenomenon that will contribute to better outlook for jobs and a better outlook for general welfare for every American.

The consequences of a responsible management of the economy to dampen inflation, to counter any distress in the economy through the programs we are talking about today, to give aid to those who may be disadvantaged during this process, ends up in sheltering those who bear the brunt. But in ending up this way it also is providing better job opportunities, a better outlook for balanced growth, and certainly a better outlook for every American in terms of real incomes, real values, and real prospects for the future.

Representative WYLIE. I think that's a very responsible and thoughtful statement there, Secretary Miller.

Thank you very much, Mr. Chairman.

Representative MOORHEAD. Congressman Heckler.

Representative HECKLER. Thank you, Mr. Chairman.

I'd like to welcome the Secretary wearing a new hat. Your career is becoming reminiscent of that of another New Englander who we both know, Elliot Richardson.

Secretary MILLER. I haven't had that many hats yet.

Representative HECKLER. They said of Elliot that he could never hold a single job in Washington. So you will be vulnerable to the same charge should you continue on this same course. Hopefully, however, you will find your current challenge satisfying and also it will be satisfying to the economic needs of the country and to the Congress.

I am concerned with the current economic condition, whether one characterizes it as a recession or a slowdown. The fact is that, as you have said in your statement, the regional impact can clearly be identified and we both know that New England will bear the brunt of a heavy part of the burden as has happened in the past.

In that context, since you have mentioned targeting the assistance to various areas, in view of the fact that the New England economy is so oriented toward small business and the development of small business, with the discount rate at its present high that obviously will have a very negative impact on small business more than large companies.

I'm wondering—I'm told that even today the Peoples Bank at Providence, R.I., has a two-tier interest rate and smaller companies are getting a lower interest rate and having to pay that which is allowing them to expand and not bear an unreasonable share of a burden of an economic slowdown.

Could you foresee a possibility that some kind of a two-tier system could be established for interest rates so that the small companies

that are struggling to survive in New England or elsewhere would not be so severely impacted by the higher inflation, that they would by that very act be snuffed out of existence? We have discussed that before, Mr. Secretary, in this committee before this same committee. I wonder now that we are dealing with very high interest rates, would there be a possibility of a two-tier rate which would benefit the smaller companies?

Secretary MILLER. Congresswoman Heckler, in the past I have favored this kind of approach by banks and it sounds peculiar and let me give you a reason why I think it makes sense, because it sounds peculiar to bankers and businessmen to say they should have two kinds of interest rates, one for large enterprises and one for smaller. There are some very sound business reasons in the self-interest of banks and many banks do that.

In the first place, no small business should be immune to what all businesses are subject to and no bank should be lending money to a small business to speculate on commodities. But assuming it's lending money and carrying on its business and keeping itself going, every bank I know of, and in New England this is certainly true, has a business interest in developing those clients and making them healthy and grow because that's the future of New England. If you starve them off by denying them credit in a tough time, then in good times you don't have any business; you don't have any employment; you don't have any business customers or you don't have the incomes and mortgage payments and deposits of the people who work in those enterprises.

So banks who have looked at this and said, well, in times of low interest rates we charge a premium to small business because it's harder to service them; in times of higher interest rates we will give them a preferred rate in order to keep them going, and the average over 5 years will be good for the bank and it will keep our customers and build our clientele and in terms of today's banks earnings they can absorb that to the degree they want to build it up, and I think it makes good sense and I think many good thinking banks are taking advantage of this to strengthen their ties with the companies who will be the Digital Equipments of the future. The Digital Co. started as a tiny little company in Woodmill, Mass., in an old textile mill and today it's one of the giants with a billion and a half sales, and one of the biggest employers in the State. If somebody hadn't helped that company when it was small, they wouldn't have that account now.

Representative HECKLER. So you would favor a two-tiered system which would allow the smaller companies to have some sort of relief in terms of the impact of a tight credit policy?

Secretary MILLER. I think it's wise, but I would do it for good business reasons, not because they demand subsidy. I would persuade my banker friends that's the way to build their future, by building enterprises, by building the new youthful spirit that renews an area; and New England is moving more to technologically based companies to get away from the old industrial base that is becoming somewhat obsolete.

Representative HECKLER. I'm relieved to hear that because the survival of small businesses is really the only hope for New England and for many areas of the country and it's terribly important that the

tight credit policy not impact unfairly on smaller enterprises which would easily happen without some special redress.

Secretary MILLER. Congresswoman Heckler, there's also those in the administration who would like to help New England by making it more attractive to buy wood stoves made up there.

Representative HECKLER. Well, we'll advertise all New England products of course.

Mr. Secretary, I would like to get into the area of your feeling about the timing of a potential change in policy. You have assessed the current situation in your statement and consulted with Chairman Volcker and you have discussed the inability that you would have or anybody would have of protecting the future, but there are very important aspects to the timing of what might happen should the recession deepen. I'm concerned because I think my area is extremely vulnerable to a deepening economic slowdown and as my colleague, Congressman Dick Bolling, said, the timing of congressional agenda is also of significance.

Now this Congress intends, as the Speaker has circulated, the Congress will wind down in November. What kind of information could you have by the middle of November which would allow for a shift or are you looking toward a longer, several months test of the current policy before applying any other finetuning targeted assistance programs?

Secretary MILLER. Congresswoman Heckler, I feel and the administration feels we will monitor this on a much tighter timetable, that we will do it weekly. We are watching the data we can get weekly. We will watch it monthly and we will not be so deleterious as to let disaster strike before we respond. So, we are not thinking of waiting a few quarters and see what happens, but we also are determined to be objective, disciplined, and cautious in our approach. We will act upon facts and realities rather than upon hopes and myths, because I think we do have to realize that the economy behaves far differently now than people would have told you 3 or 6 months ago. I have been one to say let's wait and see and then be prepared to move quickly. We are geared to move quickly, so why move prematurely on the basis of uncertain information? The last thing we need to do now is to make the wrong move and generate another round of inflationary pressures and be back in the soup for 5 more years. We need to play this with all the skills and wisdoms and cooperation with the Congress and administration that we possibly can have to make the soundest determination and to move forcefully, but only when we are sure that what we are doing is the right medicine.

Representative HECKLER. Well, then, is it safe to assume that you feel that if further or different steps are necessary and must be taken that the Congress would be called back to do that? Because obviously some of the moves that you might consider would not only apply to Executive order or to the Federal Reserve but also to a tax policy, and so forth.

Secretary MILLER. They certainly could, and I would not foreclose that in an emergency, but my guess is that the way the schedule looks Congress will be here past Thanksgiving I think, but I may be wrong, and in any case, I think Congress is ready to respond if necessary and I think would be willing to stay if we had some reason to move in the Nation's interest as I understand it.

Representative HECKLER. Mr. Secretary, one of the tools that's being discussed in Congress and has gained a great deal of support in terms of developing productivity and increasing—well, increasing our productivity and providing new incentives for industry is the accelerated depreciation allowance and that has gained a great deal of—I think over 200 congressional cosponsors and so forth.

Now, in your statement you refer in a general sense to other initiatives. Is this one of the initiatives that you would consider possible, likely, or preferable?

Secretary MILLER. I think it's one of the high priority possibilities for several reasons. In the first place, I think we have focused too much on consumption for too long a period and neglected to modernize our industrial base from which all of our wealth will derive. We have underinvested as a nation. In Germany, fixed capital investment is 15 percent of GNP; in Japan, over 20 percent; and we have been investing 10 or 11 percent at most, and if you back out our requirements for environment and safety, we have been underinvesting in real productive capacity even to a greater degree, and we cannot continue that without losing our technological edge.

So I think as we look not only at the short term but the long term that we are going to, as part of our anti-inflationary strategy, be giving high priority to working on the supply side by providing incentives for investment. We are going to do this regardless of business cycles, but we must time it to the condition of the budget and to the condition of our responsibility to bring down the deficit. And as that begins to be fulfilled I think we will move forward with initiatives and if the recession should deepen I would suspect this would be a initiative we would accelerate.

Now as to the exact form of a preferred technique of providing incentives for direct investment, I would rest judgment on it. There are some interesting proposals in Congress, some I have made myself, but I will continue my study of those, and before we come forward we want the best possible proposal that will hit right where we want to hit and we will not waste our ammunition on targets that are not beneficial.

Representative HECKLER. My time is up. Thank you, Mr. Secretary. I know that fine tuning of the economy is considered an almost impossible task, but you have to have very narrow targets and you seem to know the mechanisms available and I think hopefully you will succeed with this because while this current situation is difficult with tight money starting to create a toll in the economy, nonetheless, any deeper recession would be extremely unsatisfactory and unfortunate for the American people and I think the fine tuning with the careful monitoring week by week might be the only answer and I certainly would want to let you know that I would be very supportive of any move to create a redress in this total economy whether the Congress is in session or not. I don't think most Members would want to come back but I am concerned that the situation will get out of hand before the palliatives or cures are applied and then we will get into that catch-up situation with inflation and recession at one time.

Secretary MILLER. We would certainly avoid that and with your help and with hearings like this I think we can keep on top of that and be ready to enforce that. Thank you.

Representative MOORHEAD. Mr. Secretary, I want to thank you very much for being with us and giving us the benefit of your wisdom in these extremely difficult economic times when all of us, on a bipartisan basis, are trying to solve the economic problems of this Nation. You also give us a very confident look into the future and I think this is helpful also. Thank you, Mr. Secretary.

Secretary MILLER. Thank you, Mr. Chairman.

Representative MOORHEAD. The subcommittee would now like to hear from Mr. Roy Bahl, professor of economics and director, metropolitan studies program, The Maxwell School, Syracuse University; Bernard Weinstein, director, Southwest Center for Economic and Community Development, University of Texas at Dallas; and John Zamzow, vice president for regional economics, Chase Econometric Associates. If you gentlemen will please come forward we will hear from each of you in the order called and then the membership of the subcommittee will ask questions. We'll start with you, Mr. Bahl.

Mr. Bahl, you may proceed as you choose. If you wish to summarize your prepared statement, then without objection, your entire statement will be made a part of the hearing record.

**STATEMENT OF ROY BAHL, PROFESSOR OF ECONOMICS AND DIRECTOR, METROPOLITAN STUDIES PROGRAM, THE MAXWELL SCHOOL OF CITIZENSHIP AND PUBLIC AFFAIRS, SYRACUSE UNIVERSITY, SYRACUSE, N.Y.**

Mr. BAHL. I have a prepared statement which I will summarize briefly and then get on to questions.

I would like to suggest three propositions. First, I'd like to give you my view of the current situation in the State and local sector. Then, I will suggest what a recession means, first for the older declining States, and that's pretty much an old story; and second, for the newer growing States; and I think that's a bit of the new story in terms of what lies ahead. And finally, I'd like to suggest another criterion needed in evaluating programs like countercyclical aid.

First, the current situation. As the Secretary pointed out earlier, there's a lot of confusion about the use of the State and local government surplus measure. I agree with most people who have looked at it that it's not a useful measure on which to base short-term policy and it does not clearly indicate fiscal health in the State and local sector.

The only thing I could add by way of footnote to what's already known is that the surplus in the State and local sector has been running around 5 to 10 percent of revenues raised from all sources during the recovery, and by most rules of thumb that's about the kind of precautionary balance we ought to expect. So really, what's happened during the recovery is that some State governments have gotten quite well; some local governments have not gotten very well at all; but in any case, what's happened has really not been all that unusual.

Some local governments, however, were very hard hit during the recession and they haven't fully recovered thus far. At the end of 1978, their revenue position was down, their expenditures had been bid up by a higher rate of inflation, they had shown lower growth in

spending because of overly cautious policies on the part of their financial managers, revenue projections had been low, unions had not demanded excessive compensation increases and by all accounts there have been deferrals in maintenance and replacement of capital stock.

To give you an idea on the possibility of program cutbacks of the 20 largest cities in the United States, 11 reduced their employment level between 1970 and 1975. Three of the remaining nine had increases of less than 1 percent. So the growth in activity at the city level has been very slow. Where that puts them, I think, by the end of 1978, is that some of these cities are not at all healthy, that they haven't built the capital stock on which they are going to be able to draw in the event of a recession.

Now I would offer three propositions about a current recession. The first is not new news at all: That the older parts of the country—those that have been declining and are poorer—are going to be hurt most. These are the old northeastern and industrial midwestern cities. Their taxes will grow more slowly. They will be reduced most in a recession because they will lose most in terms of economic activity, but also these are the States that are more local government dominated, where cities are much more dependent on State aid and they will suffer because State aid will grow more slowly. As a matter of fact, for the decade ending in 1975, for every 10-percent increase in personal income, State aid went up about 16 percent, but for the period after 1975—the period of the recovery—for every 10-percent increase in personal income, we find State aid rising about 6 to 8 percent. So the recession also affects local governments by affecting States.

It is not just recession. It is also inflation. These cities are relying on the property tax which does not respond to inflation, but their budgets are heavily oriented toward labor costs which do respond to inflation. Estimates made by our metropolitan studies program a few years ago, based on the 1972-74 period where the inflation rate was not unlike what we are looking at now, suggested that a conservative estimate might be a 10-percent loss in purchasing power during that 2-year period. For cities that were relying heavily on the property tax, that estimate may be conservative.

So what lies in store for these kinds of cities are likely more deferrals, more program cutbacks, and a slower growth in the public sector activity. I guess one thing to be looked at is that they have gone through a period of adjustment in the last few years—maybe it becomes less painful to retrench once you have begun the process of retrenchment.

For the Northeast, one would have to add something about suburban jurisdictions, because the disparities are enormous. The suburban jurisdictions facing the same kind of recession won't fear so badly. First, they have a bit more breathing room on the tax side, and second, their budgets are much more heavily devoted to education. With enrollments going down in suburbs all over that region, there should be some breathing space. So even within the region that will be hurt the most, the central cities will be hurt decidedly more than the suburbs.

Now that's pretty much old news. What is going to be different about the coming recession is what's going to happen to State-local finances in the States of the growing regions, particularly those in

the Southeast and the Southwest. They really did not feel the last recession all that much because their economies were benefiting from the regional shifts out of the Northeast and industrial Midwest. But, because there has been very rapid in-migration of people and jobs and because these States have public service levels which are thought to be relatively low, it creates an enormous backlog of investment requirements and a need to bid up the level of public services. What we are going to see now is a period when the rate of national economic growth is going to slow down and when there will be resistance to further tax increases.

Do you have my prepared statement in front of you?

Representative MOORHEAD. Yes.

Mr. BAHL. Look at table 1 and let me refer to a couple States in terms of some State government revenue projections that we made with the simplest kind of model.

What I'm trying to show here is the kinds of adjustment problems that different States are going to have to face. They key assumption here is slower national growth. I use the Department of Commerce projections of regional shifts to continue in the future and no tax level changes relative to income. So the effective tax rate remains the same.

Look at a State like New York, which is a depressed State, and you will see that 1973 to 1977 revenues grew at 8.2 percent a year, but my projection shows they will grow at 8.7 percent per year. The reason why is because the 8.2 already represents a pretty substantial retrenchment on the part of the State and it represents a time when tax rates were being cut rather than increased, whereas the 1979-82 projections assume no further cuts. Please note this is really an illustration rather than a projection.

Look at Pennsylvania and Massachusetts, and you see pretty much the same kind of thing. But in the growing States like California, there is a substantial reduction in rate of growth in revenues. The same is true in Texas and Louisiana, and the reason is that we have assumed that taxpayers in those States, as in the rest of the country, won't accept rate and base increases as easily as they have in the past and because national income is growing slower and the share of the pie that they can gain just isn't that much.

Now, if you add to those possible adjustment problems the possibility of unions moving south where public employee wages are considerably lower, where State and local governments have a great number more employees per capita than in the Northeast, and where we are told that the inflation rate may be greater, then we may have some very serious kinds of adjustment problems over the next 2 or 3 years in the growing regions. What it suggests, among other things, is that the battle for the share of Federal grant money in the past may be nothing compared to what we will see in the next few years.

The last thing I would say is simply to try to add something to the dialog over how to evaluate a proper kind of Federal role in dealing with the recession and its effect on State and local finances. It seems to me that there are two contradictory trends going on and they center around State government, which may play the pivotal role.

The first trend is that with slower growth in the national economy, there have been increasing city-suburb disparities. Some would see this as an abrogation of responsibility by States. There is an imposing list of charges. In the Northeast and in the industrial Midwest, it's

pretty clear that the boundary issue has never been dealt with. They have central cities that are stereotyped poor and the stereotype fits too often, and they have suburbs that are relatively wealthy. Yet you don't have the same kind of thing in the Jacksonville or Nashville area. At least they have solved the boundary part of their problem. That problem in the North could be laid at the door of State legislatures.

Other kinds of issues include California's growing local tax burdens and growing State surpluses, and whose responsibility is Cleveland and New York? Are these cities' problems first the responsibility of New York State and Ohio or first the responsibility of the Federal Government? All that aside, what has happened over the last decade is that the share of State and local financing at the State level has increased and it's increased substantially—between 1965 and 1977 from 50.7 percent to 57.5 percent, and the State's share of direct expenditure increased from 34.9 to 37.9 percent. I suggest that's a pretty substantial increase for a decade. The level of State aid over the decade ending in 1975 also increased—for every 1 percent increase in personal income State aid went up by 1.6 percent. That suggests more State involvement.

On the other hand, Federal policy seems to be acting in the last few years implicitly or explicitly as though State governments ought to be increasingly bypassed and ought to be a less important partner in this Federal-State-local system.

Two examples of Federal action might be cited. First is the large increase in the direct flow of Federal aid to local governments. This flow bypassed the State.

The other is not really a Federal action but a discussion of the possibility of removing the State share from general revenue sharing. If policy went in that direction, toward more direct involvement of local and Federal relations, then it would imply the following Federal objectives; not to resolve the boundary problem, to slow the rate of aid flow from State to local governments—which in fact happened between 1975 and 1977, to slow the rate of direct assumption by State Government—which is what you would expect if the rate of Federal money slowed down to States; and to slow this process of lifting the financing of State and local services off the property tax. I just suggest that those may be byproducts of the Federal aid programs that were intended to do other things, but they certainly seem to me to be byproducts.

Representative MOORHEAD. Thank you very much, Mr. Bahl.  
[The prepared statement of Mr. Bahl follows:]

PREPARED STATEMENT OF ROY BAHL

*State and Local Finances and the National Economy: The Near Term Outlook*

I would like to address this important topic by offering three propositions to the Committee. The first is well known and needs little justification here: a combination of recession and inflation will have severe fiscal effects on some state governments and some central city governments in the declining regions of the country. The second is less well known: that inflation and a slower rate of economic growth will cause some significant fiscal adjustment problems for the growing states. The third is that an ambivalence—at the Federal level—about the "proper" role of state government in state-local government finances may exacerbate some of the problems created by inflation and a slower growing economy, and may not be in the best interest of the country.

## THE NATIONAL ECONOMY AND THE DECLINING REGIONS

State and local governments in the declining region suffered most in the last recession and their recession-induced revenue losses were greatest—e.g., various estimates place the loss at between 10 and 12 percent of own-source revenues in a state such as New York as compared to about half that percent for the nation.<sup>1</sup> In some of the growing states, the fiscal effects of recession were virtually nil. To some extent, high inflation rates offset this revenue loss by boosting receipts in states that are more reliant on personal income taxes (typically Northern states) and sales taxes (typically Southern states). But inflation does least for states in which local government financing is more important and which are more heavily reliant on the property tax (typically Northern and Midwestern States). Hence, recession and inflation, together, have the net effect of lowering revenue yield most in the older cities of the Northeastern and industrial Midwestern states.

Recession and inflation influence both sides of the budget. Declining states, hardest hit by recession, are more likely to postpone new projects, defer maintenance, or defer compensation. Hence, many of the expenditure effects of recession go unseen. The expenditure effects of inflation, however, are more obvious in the form of increased compensation rates for public employees and rising prices for state-local government purchases. Greytak and Jump estimated that inflation alone bid up state and local government expenditures by 25 percent between 1972 and 1974.<sup>2</sup>

Occurring simultaneously, recession and inflation have reduced the amount of revenues available to state-local governments and have further lowered the purchasing power of what was left. The effect has been most severe in the older regions which are declining or growing slowly, and particularly severe for central cities. A repeat of the 1973–1975 combination of high unemployment rates, a differentially more severe recession effect in the industrialized Northern States, and double-digit inflation could wreak havoc on state-local government budgets. A 5 to 10 percent decline in the purchasing power of revenues and a 5 to 10 percent shortfall in potential revenues would not be an unrealistic expectation even for the state-local government sector in aggregate. For these states where taxes are already relatively high and where local governments stand to lose most from Federal aid reductions, compensation and maintenance deferrals and program cutbacks are virtually certain.

## ADJUSTMENT PROBLEMS IN THE GROWING REGION

A slowdown in the national economy and a continued high inflation rate will also bring problems to the growing regions. To illustrate these problems, we have developed—for Hamilton-Robinovitz, Inc.—a projection model for state government revenues through 1983.<sup>3</sup> To demonstrate the revenue implications of slower national economic growth, we have used the following OMB projections of GNP and the CPI:

	1979		1980		1981		1982
GNP (in billions of current dollars).....	\$2,289		\$2,506		\$2,759		\$3,025
Percent increase.....		9.5		10.1		9.6	
Percent increase in Consumer Price Index.....		8.2		6.7		5.7	4.5

Indeed, these projections may well be optimistic. Each state's share of this income growth, and population growth, are taken from U.S. Department of Commerce Projections.<sup>4</sup> The projections show a continuation of regional shifts away from the older regions of the Northeast and industrial Midwest.

<sup>1</sup> Advisory Commission on Intergovernmental Relations, "State-Local Finances in Recession and Influence" (Washington, D.C.: May 1979); and, the Comptroller General of the United States, report to Congress, "Antirecession Assistance is Helping but Distribution Formula Needs Reassessment" (Washington, D.C.: U.S. General Accounting Office, July 20, 1977).

<sup>2</sup> David Greytak and Bernard Jump, Jr., "The Impact of Inflation on the Expenditures and Revenues of Six Local Governments, 1971–79," Monograph No. 4, Metropolitan Studies Program, The Maxwell School (Syracuse, N.Y.: Syracuse University, December 1975).

<sup>3</sup> Roy Bahl, Marvin Johnson and Lawrence P. DeBoer, Jr., "The Fiscal Outlook for State Governments," a report prepared for Hamilton-Rabinovitz, Inc., under a grant from the Aetna Foundation (July 1979).

<sup>4</sup> Bureau of Economic Analysis, Regional Economic Analysis Division, "Population, Personal Income and Earnings by State: Projections to 2000," U.S. Department of Commerce, October 1977.

The projection assumptions are straightforward. Federal grants are assumed to remain at their 1977 level of 15.6 percent of Federal Budget Current Services Outlays. We assume that each state's share of total Federal grants to state and local governments will remain constant at its 1977 level, and that there will be a continuation of the 1977 state government share of total Federal grants to state and local governments. For tax and nontax revenues raised from own sources, we have assumed that states hold their tax (revenue) effort constant at its 1977 level.<sup>5</sup> In sum, a state's per capita revenue growth will be forecast higher, *ce. par.* if the growth in national income is higher, if the Federal budget is larger, if the state's income share is increasing or if its population share is decreasing. Because of these assumptions, and because of the GNP and growth and inflation rates assumed, these projections ought to be viewed as primarily illustrative.

TABLE 1.—AVERAGE ANNUAL PERCENT INCREASE IN PER CAPITA RESOURCES AVAILABLE: 1973-77 AND 1979-82  
LOW PATH, OMB PROJECTIONS

State	November	1973-77	1979-82
Alabama	1	12.6	9.7
Alaska	2	34.8	8.7
Arizona	3	12.1	8.8
Arkansas	4	11.0	8.6
California	5	13.4	8.6
Colorado	6	11.6	8.2
Connecticut	7	8.5	8.9
Delaware	8	12.5	7.7
Florida	9	6.5	8.4
Georgia	10	7.9	9.3
Hawaii	11	13.3	8.5
Idaho	12	11.6	8.0
Illinois	13	9.8	8.9
Indiana	14	16.9	8.9
Iowa	15	14.9	9.0
Kansas	16	12.7	9.0
Kentucky	17	10.9	9.2
Louisiana	18	11.2	8.2
Maine	19	12.8	9.2
Maryland	20	12.3	8.7
Massachusetts	21	11.9	8.9
Michigan	22	10.4	8.6
Minnesota	23	12.4	8.8
Mississippi	24	10.1	9.9
Missouri	25	9.6	8.8
Montana	26	14.0	9.3
Nebraska	27	14.0	8.9
Nevada	28	8.3	7.1
New Hampshire	29	8.5	7.6
New Jersey	30	15.1	8.6
New Mexico	31	12.2	9.3
New York	32	8.2	8.7
North Carolina	33	12.1	9.2
North Dakota	34	17.2	8.4
Ohio	35	11.2	8.7
Oklahoma	36	11.5	9.2
Oregon	37	13.8	8.5
Pennsylvania	38	9.2	9.1
Rhode Island	39	13.6	9.2
South Carolina	40	12.1	9.7
South Dakota	41	9.9	9.4
Tennessee	42	11.3	9.3
Texas	43	13.2	8.6
Utah	44	9.2	8.8
Vermont	45	8.9	8.0
Virginia	46	11.8	8.9
Washington	47	11.0	8.8
West Virginia	48	9.9	9.4
Wisconsin	49	11.6	8.9
Wyoming	50	18.4	7.9

The projected average annual growth rates in per capita resources are shown in Table 1. One result stands out. Under any of the three assumptions about the growth rate in GNP, most states will face a slower revenue growth in the next 3-5 years than they did in the last 3-5 years. This generally slower growth in per capita resources available may be attributable to any one or some combination of several factors: (a) a slower rate of GNP growth; (b) a declining Federal budget share and, hence, a declining amount of Federal grants; (c) declining state

<sup>5</sup> Tax effort is defined as the ratio of taxes to state personal income.

shares in total personal income growth; (d) increasing population; and (e) the assumption of a ceiling or floor (at the 1977 level) on the ratio of taxes to personal income.

What is a bit surprising is that these projections are for resource growth to slow most in some of the growing states where tax effort has been rising and where benefits from a more rapid GNP growth have been greater. For example, the illustration in Table 1 shows that the per capita revenue growth in Texas and California will be a third lower between 1979 and 1982 than between 1973 and 1977. (Under more optimistic CBO projections, the gap is about one fourth below the 1973-77 growth rate. Of course, this pattern doesn't hold for every growing state, but it appears to be roughly correct. The opposite is true of the declining states—revenue growth in New York and Pennsylvania is as high or higher during the projection period as during the 1973-77 period. Delaware, another declining state, is an exception to this rule. As a check on these crude projections, we have examined the revenue projections made by individual states. As may be seen from table 2, most of the state's projections are even more conservative than those resulting from this model.

#### IMPLICATIONS

Some important implications for the future may be drawn out of these results. The first is that fiscal adjustment problems may be as severe for the growing as for the declining states. The slower rate of growth in resources available coupled with a higher rate of inflation and, therefore expenditure pressure may force some tough budgetary decisions in growing states. Since these states do have relatively low tax efforts and may face the most rapid price level growth in the nation, substantial increases in effective tax rates might be expected.

A second implication is that state governments in the declining regions will have to continue their retrenchment programs. Slower growing revenues and inflation will lead to budgetary pressures which cannot likely be solved by tax rate increases because tax levels are already thought to be uncompetitive in most of these states. It would seem to follow that these pressures on state resources might at least slow the process of fiscal centralization to the state government level.

TABLE 2.—COMPARISON OF AVERAGE ANNUAL GROWTH IN RESOURCES AVAILABLE UNDER ALTERNATE GNP GROWTH RATE ASSUMPTIONS: SELECTED STATES FOR 1979-82

State	GNP growth assumption			State projections
	OMB	CBO	Pessimistic	
Colorado.....	10.6	12.2	11.4	7.8
Hawaii.....	10.6	12.2	11.4	9.8
Minnesota.....	9.7	11.2	10.3	11.2
New York.....	8.9	10.4	9.7	6.1
Pennsylvania.....	9.3	10.8	10.1	8.3
Tennessee.....	11.0	12.6	11.8	8.9
Utah.....	10.4	12.0	11.3	13.5
Virginia.....	10.4	12.0	11.1	11.7
Wyoming.....	9.7	11.3	10.6	11.8

Source: Roy Bahl, Marvin Johnson, and Lawrence P. DeBoer, Jr., "The Fiscal Outlook for State Governments," a report prepared for Hamilton-Rabinovitz, Inc., under a grant from the Aetna Foundation (July, 1979).

#### *The Future Role of State Governments*

State governments raise 58 percent of all state and local government taxes, made 38 percent of direct expenditures and accounted for 73 percent of Federal aid in FY 1977. Yet state government is approaching a new crossroads—a redefinition of its fiscal role. The past decade has seen two important, but contradictory, influences on state government financing and service delivery. The first is in respect of its relationship with the Federal government and its place in the intergovernmental system. Total grants-in-aid have quadrupled since 1970, but much of this growth has been in direct Federal-local grants, with the states being bypassed. In 1977, local governments were directly receiving 27 percent of total Federal aid to state and local governments, as compared with 13 percent in 1970. This policy of direct Federal-local relations is not inconsistent with the view from some state capitols (e.g., New York and Ohio) that city financial emergencies are as much Federal as state government responsibilities. Now, as the end of the

General Revenue Sharing authorization approaches, there is even talk of eliminating the state share.<sup>6</sup> Whether or not state governments have brought this change on themselves by abrogating their responsibility toward urban governments is debatable, but the drift toward reducing the importance of state government in the intergovernmental process seems real enough.

The second way in which the state role is changing is in the continuing shift of financial responsibility from local to state governments. The state government's share of total state and local government taxes collected rose from 50.7 percent to 57.5 percent between 1965 and 1977, and the state's share of direct expenditure increased from 34.9 to 37.9 percent. The state aid share of total state expenses remained about constant between 1965 and 1977, but the state government share of health, education and welfare direct spending increased markedly. States may not have done all that they should to lift the financing burden off the local property tax, and too little may have been done about city/suburb fiscal disparities, but the trend toward more state fiscal responsibility has continued. A combination of local government tax or expenditure limitations, a more elastic state government tax structure and high rates of inflation could accentuate this trend.

In fact, the increased Federal-local aid flow may have slowed the trend toward state financial assumption. Before 1975, state aid had behaved as though it were a highly elastic tax, i.e., for every 1 percent increase in personal income, there was a 1.6 percent increase in state aid to local governments. That responsiveness fell to 0.96 percent in 1976 and 0.69 in 1977.

Representative MOORHEAD. The subcommittee would now like to hear from Mr. Bernard Weinstein.

**STATEMENT OF BERNARD L. WEINSTEIN, DIRECTOR, SOUTHWEST CENTER FOR ECONOMIC AND COMMUNITY DEVELOPMENT, UNIVERSITY OF TEXAS AT DALLAS, AND PRESIDENT, WEINSTEIN & ASSOCIATES, WASHINGTON, D.C.**

Mr. WEINSTEIN. Thank you. Let me say at the outset that I applaud the new direction the Fed seems to be taking. The rising discount rate and the higher reserve requirements strike me as entirely appropriate responses to a seemingly intractable inflation rate. As we know, producer prices posted their sharpest rise in 5 years last month and this increase will soon be reflected in even higher consumer prices. Inflation is by far America's No. 1 problem, and until the inflation rate is brought down our energy problems, balance of trade, and other pressing policy concerns cannot be dealt with effectively.

I have several areas of disagreement with Mr. Miller and Mr. Bahl. I expect this recession to be a severe one. Only twice before since World War II has the Federal Reserve raised interest rates after a recession was underway and in each case the subsequent decline in economic activity turned out to be worse than average. I expect the national economy to report flat or negative real growth at least through the third quarter of 1980. Unemployment will be above 8 percent. Manufacturing activity will nosedive over the next two quarters and we will also see a pronounced decline in both commercial and residential construction.

The downturn in the construction sector may lag by a quarter or two. Secretary Miller and Mr. Bahl both intimated that the Northeast would bear the brunt of this recession as the Northeast allegedly did in the last recession. It's true that some southern regions escaped most of the ravages of the last downturn in the 1973-75 period. For example, when the unemployment rate was over 9 percent nationally,

<sup>6</sup> Joint Economic Committee, Congress of United States, Joint Economic Report 1979, Washington, D.C., 1979.

it was under 6 percent in Texas. There are lots of reasons why this was the case—migration patterns Mr. Bahl referred to, import substitution, new household formation in many parts of the South and the Southwest in particular helped to insulate the region from the vicissitudes of business cycle and possessing much of the Nation's oil and gas didn't hurt. But this time around I don't think the South will be so fortunate and there's a very simple explanation.

The southern economy is more complex than it was 6 years ago. It is more heavily industrialized. It is more closely integrated with the national economy. The South is more like the rest of the Nation and this integration of the South into the economic mainstream has been a major factor in the region's strong employment and income growth over the past decade, but just as it's been a source of strength, it's a source of vulnerability. This growth has made the South more susceptible to the ripple effects from a national economic downturn.

Take the following example: Usually in periods of recession branch plant operations are the first to be cut back or shut down. Much of the South's industrial growth in the recent years has been accounted for by the establishment of branch plants of national corporations. Thus, I would predict the South will feel the brunt of these cutbacks as the recession worsens.

Another reason the South will participate in the current recession relates to energy supply. During the last recession interstate prices were held below market levels. Higher prices in the uncontrolled intrastate market assured an ample supply of energy to the region's industrial and individual consumers. In the future, energy producers will be indifferent between selling to the intrastate or interstate markets because of price uniformities. Because the region as a whole consumes more Btu's than it produces, some energy intensive industries may find themselves short of feedstocks. The result could be a further decline in the region's value-added in manufacturing.

There is already strong evidence that the recession is taking hold in the South. The Federal Reserve Bank of Atlanta recently reported that district bank loan growth dropped 50 percent during the first half of 1979. The slowdown is even more striking when contrasted with a strong performance nationally. Furthermore, the drop in loan demand was spread across the consumer, real estate, and business sectors.

Texas, in many ways the bellwether State of the South, has recorded sluggish economic activity for over a year. In the 12-month period ending June 30, 1979, industrial production in Texas was up a mere 0.9 percent compared with a 4.5 percent increase nationally. Total State construction activity was down 11.2 percent compared with a year ago; residential construction was down 16.4 percent. And in July the Federal Reserve Bank of Dallas reported a downturn in business loans for the first time in a year.

Mr. Bahl has already addressed himself to the State and local fiscal outlook. He and Secretary Miller both mentioned that the accumulated surpluses of State and local governments have evaporated. By one account we shifted from a surplus of \$8.4 billion in the first quarter of 1978 to a deficit of \$6.1 billion in the second quarter. I think this has serious implications for States in all regions.

Some energy-rich Southern States, such as Texas and Oklahoma, are in a strong position to ride out the recession, but other States in the region will find themselves hard pressed. As the current recession

deepens and real growth turns negative, tax receipts can be expected to drop.

Mr. Bahl talked about the backlog of demands in the South in the fast growing areas for both infrastructure and public services. I don't think the recession will dampen these demands.

Let me turn finally to the Federal response in terms of State and local government problems in the coming years.

Over the next few months the Congress will no doubt consider several targeted and antirecession fiscal assistance proposals for State and local governments. Certainly, the public interest groups representing State and local governments will lobby hard for such a program. But while the fiscal outlook for State and local governments is far from rosy in the near term, I do not believe present circumstances warrant the reenactment of countercyclical fiscal assistance. I base my conclusion on the following evidence:

One. Though the State/local surplus has dwindled dramatically this year, much of the decline is explained by rampant tax cutting. Since proposition 13 was approved in California 16 months ago, some three dozen States have reduced taxes. According to the Advisory Commission on Intergovernmental Relations, 19 States have cut their personal income taxes this year while 14 have pared sales taxes. As a consequence, many States and localities have underutilized tax capacity. This is especially true for Southern States where the relative State/local tax burdens have been dropping for over two decades.

Two. Financial management in most cities and States has improved markedly in recent years. As a result, these governments are better equipped to cope with revenue shortfalls.

Three. Many existing Federal programs—such as CETA, community development block grants, and general revenue sharing—are already targeting funds to cities alleged to have the greatest needs for fiscal assistance. If I had more time I'd like to debate Mr. Bahl about definitions of urban need. He made a casual reference to the Northern cities being poor. This is something that has become standard to the journalistic lexicon. I would suggest it's not the Northern cities that are poor but the Southern cities that are poor, if you look at poverty rates and per capita incomes.

Four. The efficacy of previous countercyclical grant programs has been marginal at best. According to a study by Robert D. Reischauer of the Congressional Budget Office, aggregate State and local expenditure data for 1976 and 1977 indicated no surge in overall spending that might be linked to the significant increase in Federal grants during that period. Instead, States and localities built up tremendous surpluses. Reischauer concludes that the spending supported by the grant moneys replaced spending or tax cuts that would have occurred in the absence of the countercyclical programs; thus the objective of stimulating the economy was at least partially subverted.

Five. My final reservation about countercyclical fiscal assistance is a philosophical one. If hard times lie ahead, I believe all sectors of the economy—and all levels of government—should be forced to tighten their belts. The inflation rate must be reduced. If private spending is to be restrained as an anti-inflationary measure, public spending should be restrained as well.

Thank you.

Representative MOORHEAD. Thank you.

[The prepared statement of Mr. Weinstein follows:]

## PREPARED STATEMENT OF BERNARD L. WEINSTEIN

*The Current Recession and Its Impact on the South*

## THE LENGTH AND DEPTH OF THE RECESSION

The Federal Reserve's moves last week to restrain the growth of the money supply have made a moderate to severe recession all but inevitable. Only twice before since World War II has the Federal Reserve raised interest rates after a recession was underway. In each case, the subsequent decline in economic activity turned out to be worse than average. I expect the national economy to record flat or negative real growth at least through the 3rd quarter of 1980. Unemployment will most likely reach 8 percent, and I expect manufacturing activity to nosedive over the next two quarters. A pronounced decline in both commercial and residential construction also seems likely, though the downturn may lag by a quarter or two.

Let me state that I applaud the new direction the Fed seems to be taking. The rise in the discount rate and the higher reserve requirements strike me as entirely appropriate responses to a seemingly intractable inflation rate. Last month, for example, producer prices posted their sharpest rise in 5 years, and this increase will soon be reflected in even higher consumer prices. Inflation is by far America's number one problem. Until the inflation rate is brought down, our energy problems, balance of trade, and other pressing policy concerns cannot be dealt with effectively.

## IMPACT OF THE RECESSION ON THE SOUTHERN STATES

The southern region escaped most of the ravages of the last downturn in 1973-75. For example, when the national unemployment rate was over 9 percent it was under 6 percent in Texas. Interregional migration patterns, import substitution, and new household formation all conspired to insulate many parts of the South—and the Southwest in particular—from the vicissitudes of the business cycle. And possessing much of the nation's oil and gas didn't hurt.

But this time around I don't think the South will be so fortunate. The southern economy is more complex than it was six years ago. It is also more heavily industrialized and more closely integrated with the national economy. This "integration" of the South into the economic mainstream has been a major factor in the region's strong employment and income growth over the past decade. But it has also made the South more susceptible to the ripple effects from a national economic downturn. The following example will serve to illustrate this point.

Usually, in periods of recession, branch plant operations are the first to be cut back or shut down. Much of the South's industrial expansion in recent years has been accounted for by the establishment of branch plants by national corporations. Thus the South will likely feel the brunt of these cutbacks as the recession worsens.

Another reason the South will participate in the current recession relates to energy supply. While oil and gas deregulation should encourage new exploration and drilling, higher energy prices in the interstate market will generate additional demands for the region's energy output. During the last recession, when interstate prices were still held below market levels, higher prices in the uncontrolled intrastate market assured an ample supply of energy to the region's industrial and individual consumers. In the future, energy producers will be indifferent between selling to the intrastate or interstate markets because of price uniformities. Because the region as a whole consumes more BTU's than it produces, some "energy intensive" industries may find themselves short of feedstocks. The result could be a further decline in the region's value-added in manufacturing.

There is already strong evidence that the recession is taking hold in the South. The Federal Reserve Bank of Atlanta recently reported that district bank loan growth dropped 50 percent during the first half of 1979. The slowdown is even more striking when contrasted with a strong performance nationally. Furthermore, the drop in loan demand was spread across the consumer, real estate, and business sectors.

Texas, in many ways the bellwether state of the South, has recorded sluggish economic activity for over a year. In the 12 month period ending June 30, 1979 industrial production in Texas was up a mere 0.9 percent compared with a 4.5 percent increase nationally. Total state construction activity was down 11.2 percent compared with a year ago; residential construction was down 16.4 percent. And in July the Federal Reserve Bank of Dallas reported a downturn in business loans for the first time in a year.

## THE STATE-LOCAL FISCAL OUTLOOK

While difficult to gauge, it seems probable that the recession will constrain the growth of state and local tax receipts. Already, much of the accumulated surpluses of state and local governments has evaporated, and by one measure—the National Income and Product Accounts compiled by the Department of Commerce—the combined budget balances of states and localities plunged from a surplus of \$8.4 billion in the first quarter of 1978 to a deficit of \$6.1 billion in the second quarter of 1979.

Some energy-rich southern states, such as Texas and Oklahoma, are in a strong position to ride out the recession; but other states in the region will find themselves hard pressed. I would offer two explanations. Southern states tend to have more state-dominated fiscal systems than is the case in other regions, a feature that is reflected by a heavier reliance on non-property taxation, especially the sales tax. This difference is of considerable importance to the potential response of the fisc to growth or decline in the economic base. Over the past decade, real economic growth and inflation combined to keep most southern states and local coffers full. But as the current recession deepens, and real growth turns negative, tax receipts can be expected to drop.

Though receipts are dropping, demand for greater expenditures by state and local governments in the South will not abate. To a large extent, the state/local public sector in the South remains "underdeveloped." That is, state and local governments in the South generally provide a narrower range (and perhaps lower quality) of public and social services than is the case elsewhere. But ten years of unparalleled growth have resulted in a backlog of demands for new public infrastructure as well as better public services. Higher per capita income levels, expanded metropolitan populations, and higher population growth rates across the South will also generate pressures for increased state and local fiscal activity. The recession will not likely dampen these demands.

## THE FEDERAL RESPONSE

Over the next few months the Congress will no doubt consider several targeted and antirecession fiscal assistance proposals for state and local governments. Certainly, the public interest groups representing state and local governments will lobby hard for such a program. But while the fiscal outlook for state and local governments is far from rosy in the near term, I do not believe present circumstances warrant the re-enactment of countercyclical fiscal assistance. I base my conclusion on the following evidence:

1. Though the state/local surplus has dwindled dramatically this year, much of the decline is explained by rampant tax cutting. Since Proposition 13 was approved in California sixteen months ago some three dozen states have reduced taxes. According to the Advisory Commission on Intergovernmental Relations, 19 states have cut their personal income taxes this year while 14 have pared sales taxes. As a consequence, many states and localities have underutilized tax capacity. This is especially true for southern states where the relative state/local tax burdens have been dropping for over two decades (see Table 1).

2. Financial management in most cities and states has improved markedly in recent years. As a result, these governments are better equipped to cope with revenue shortfalls.

3. Many existing federal programs—such as CETA, Community Development Block Grants, and General Revenue Sharing—are already targeting funds to cities alleged to have the greatest needs for fiscal assistance.

4. The efficacy of previous countercyclical grant programs has been marginal at best. According to a study by Robert D. Reischauer of the Congressional Budget Office, aggregate state and local expenditure data for 1976 and 1977 indicated no surge in overall spending that might be linked to the significant increase in federal grants during that period. Instead, states and localities built up tremendous surpluses. Reischauer concludes that the spending supported by the grant monies replaced spending or tax cuts that would have occurred in the absence of the countercyclical programs; thus the objective of stimulating the economy was at least partially subverted.

5. My final reservation about countercyclical fiscal assistance is a philosophical one. If hard times lie ahead, I believe all sectors of the economy—and all levels of government—should be forced to tighten their belts. The inflation rate must be reduced. If private spending is to be restrained as an anti-inflationary measure, public spending should be restrained as well.

TABLE 1.—RELATIVE CHANGES IN STATE-LOCAL TAX BURDENS, 1953-77

Region and State	Tax revenue as percent of personal income			State percent related to U.S. average (United States=100)			Percent change in per capita income, 1950-77
	1977	1953	Percent increase	1977	1953	Percent increase or decrease	
<b>Northern tier:</b>							
Delaware.....	11.80	4.21	180.3	92.2	55.5	66.1	261
Maryland.....	12.95	6.33	104.6	101.2	83.5	21.2	373
New Jersey.....	12.61	6.59	91.4	98.5	86.9	13.4	336
New York.....	17.68	8.79	101.1	138.1	116.0	19.0	302
Pennsylvania.....	11.88	6.17	92.5	92.8	81.4	14.0	355
Illinois.....	11.73	6.37	84.1	91.6	84.0	9.0	326
Indiana.....	10.54	7.08	48.9	82.3	93.4	-11.9	358
Ohio.....	10.00	5.87	70.4	78.1	77.4	1.0	337
<b>Southeast:</b>							
Alabama.....	10.00	7.00	42.9	78.1	92.3	-15.4	539
Arkansas.....	10.18	7.92	28.5	79.5	104.5	-23.9	572
Florida.....	10.47	9.20	13.8	81.8	121.4	-32.6	422
Georgia.....	11.15	7.67	45.4	87.1	101.2	-13.9	482
Kentucky.....	11.28	6.47	74.3	88.1	85.4	3.2	506
Louisiana.....	12.01	10.43	15.2	93.8	137.6	-31.8	428
Mississippi.....	11.82	9.37	26.2	92.3	123.6	-25.3	566
North Carolina.....	10.98	8.25	33.1	85.8	108.8	-21.1	472
South Carolina.....	10.77	8.61	25.1	84.1	113.6	-26.0	530
Tennessee.....	10.73	7.32	46.6	83.8	96.6	-13.2	482
Virginia.....	10.87	6.09	78.5	84.9	80.3	5.7	459
West Virginia.....	11.64	6.81	70.9	90.9	89.8	1.2	462
United States.....							369

Sources: Advisory Commission on Intergovernmental Relations, "Significant Features of Fiscal Federalism, 1978-79" and "Survey of Current Business," August 1978.

Representative MOORHEAD. Now we would like to hear from Mr. John Zamzow, vice president for regional programs, Chase Econometric Associates.

**STATEMENT OF JOHN C. ZAMZOW, VICE PRESIDENT, REGIONAL ECONOMICS, CHASE ECONOMETRIC ASSOCIATES, INC., BALA CYNWYD, PA.**

Mr. ZAMZOW. Thank you. I knew there was a reason I didn't like my name to begin with a "Z". Being the last speaker is one of them.

Regardless of how the third quarter gross national product turns out, and it may, in fact, be slightly positive, we believe that the United States indeed is in the midst of a recession. We expect this recession to last through the yearend and into early 1980, showing a peak to trough decline in real GNP of almost 3 percent and unemployment rising to above 8 percent. This will make this recession worse than the 1970-71 recession but very much less severe than the 1975 recession.

The basic forces creating this downturn; namely, inflation, declining real income, high debt repayments and debt burdens, and high interest rates, have still not rendered their full effects. In addition, liquidation of the excessive inventories which we believe are being built up in the economy will further exacerbate the recession, leading to lower employment and still more weakness in household spending.

It will take about three more quarters before all of this works through the economy. By the spring of 1980 a modest recovery will begin. It will be modest primarily because inflation even at the "low 8-percent rate" we forecast for 1980 would prevent sharp gains in purchasing power. Furthermore, because of the problems of inflation and the dollar, both fiscal and monetary policy will be a lot more stimulative

than is normally the case during a recession and early in a recovery output will rise at approximately a 3.5-percent rate throughout 1980 and 1981.

Now as Secretary Miller alluded to in his remarks, unemployment will not peak until the late 1980's; that is, after the recovery begins. This is typical of economic recessions and recovery, and it will occur in this one as well. Countercyclical funds which begin to be spent in the 1980 period will continue in 1981 and 1982. In fact, with the 6.5-percent trigger, they will continue all the way until mid-1984.

If we look at State and local finances, as Secretary Miller mentioned, the State and local governments are already at a \$6 billion deficit. We think this deficit will increase to \$13 billion by 1980. In fact, real expenditures by State and local governments—that is, net of inflation—are going to fall almost 3 percent this year and will not rise in the succeeding next 2 years. Many of them will be held down by spending ceilings.

If we look at the various regions, I guess where we fall is somewhere halfway between the other two witnesses. We do indeed believe that the Northeast, in particular the Middle Atlantic States, will bear the brunt of the recession. We think that the Mountain and Southwest States will be affected the least and show continued growth all through the upcoming 1980 recession. While employment in the Northeast should fall by an average of 1.7 percent, in the Mountain and Southwest States it should continue to increase by 1 to 2 percent. This occurs right through the recession.

Growth in the Pacific, Southeast, and Farm Belt States will slow significantly, but no large declines in employment are expected in these areas.

Having said this, however, please note that the performance that we're talking about really composes relatively small differences. The very large regional variations, which characterized business cycles response in previous periods, are not expected to be nearly so severe during the upcoming recession.

If we look at the proposals for distributing countercyclical funds to the various areas, I have made a calculation based on the proposed Senate version with a 6.5-percent unemployment rate trigger. These are summarized in table X in my prepared statement. You can see that the total funds distributed by Census Division add up to about \$8 billion for the United States as a whole over the entire 1979 to 1984 period. Expenditures at the U.S. level in any 1 year will be about \$2 billion. These funds continue to be expended in 1981, 1982, 1983, and part of 1984 because we do not expect unemployment to drop nearly as rapidly after this recession as it has in previous recessions.

In terms of the distribution, the trigger is reasonably well designed; that is, the areas of the lowest growth tend to have the highest proportion of funds. The single exception is the Pacific coast which historically has had high unemployment rates because everyone supposedly finds this area attractive. Consequently, a very high unemployment rate is required in that area to keep people out.

That concludes my remarks.

Representative MOORHEAD. Thank you, Mr. Zamzow.

[The prepared statement of Mr. Zamzow follows:]

## PREPARED STATEMENT OF JOHN C. ZAMZOW

*The Current Recession: Its Regional Impact*

## SUMMARY CONCLUSIONS

The nation is indeed in a recession, and unemployment should reach 8 percent nationally in 1980. A modest recovery will begin next spring.

The relatively good third quarter 1979 performance will only worsen the decline in the fourth quarter and in the first quarter, 1980.

The Northeast and industrialized Mid-West states will bear the brunt of the recession.

The Mountain and Southwest states will be affected the least and show continued growth through the recession.

Growth in the Pacific, Southeast and Farm Belt states will slow significantly, but no decline is expected.

However, the regions will perform much more uniformly than in the 1975 recession. The very large regional variations experienced in the 1975 recession are not expected to reoccur.

Proposals for countercyclical funds will require a maximum of \$2 billion per year and be activated until mid-1984. Total disbursements over the 5-year period would be about \$8-\$10 billion.

## U.S. MACROECONOMIC OUTLOOK

Regardless of the final third quarter GNP figure—and it should be slightly positive—the United States is in the midst of a recession. We continue to expect the recession to last through year-end and into early 1980, with a peak-to-trough decline in real GNP of about 2.8 percent and unemployment rising to above 8 percent. That would make this recession worse than the 1970 recession but far less severe than the 1975 recession.

The basic forces producing the downturn, namely inflation with declining real incomes, high debt repayments, and high interest rates, have still not rendered their full effects. In addition, liquidation of the excessive inventories that have piled up in recent months will further exacerbate the recession, and in the process will lead to lower employment and more weakness in household spending. It will take about three more quarters before all of this works through the economy.

By next spring, a modest recovery will begin. It will be modest primarily because inflation, even at a slower 8 percent annual rate, will prevent sharp gains in purchasing power. Furthermore, both fiscal policy and monetary policy will be far less stimulative than is normally the case late in recessions and early in recovery periods. Real output will rise at about a 3½ percent annual rate through the remainder of 1980 and 1981.

Table I on the next page summarizes the key economic statistics for the U.S. economy over the next 3 years. These are the assumptions underlying the regional forecast discussed later in this report.

Most of the key indicators support our conclusion that a recession is coming. Quickly summarizing these:

Inflation continues at very high rates.

Housing starts and construction contracts are declining, albeit slowly.

TABLE I.—U.S. ECONOMIC ASSUMPTIONS

	1977	1978	1979	1980	1981
Real GNP (percent change).....	5.3	4.4	1.4	-0.9	3.6
CPI (percent change).....	6.5	7.7	11.1	9.6	7.6
Unemployment rate (percent).....	7.0	6.0	6.1	8.0	7.9
Real personal income (\$72).....	1,081	1,130	1,158	1,163	1,188
Total employment (millions).....	82.2	85.8	88.5	88.2	89.8
Housing starts (millions).....	1.96	2.01	1.68	1.52	1.84
New car sales (millions).....	11.2	11.3	10.6	9.3	10.3
Capacity utilization (percent).....	84.2	85.8	84.3	79.1	81.1

New durable orders are down from early this year.

Consumer credit growth has slowed.

Retail sales are down in real terms despite the recent recovery.

Business inventories are up sharply.

Consumer confidence is at recession levels.

Interest rates are at record levels as the Federal Reserve fights inflation and a weakening dollar.

Despite this evidence, there is still skepticism in some circles that a recession is underway. Additional support for this theory will come from the third quarter GNP figures, which should show slightly positive real growth. A slight rise in third quarter real GNP, however, will not indicate that a recession can be avoided. What it will mean, in fact, is that the fourth quarter and the first quarter of 1980 will be even worse than otherwise.

Several factors are coinciding in July and August which have supported final demand: (1) Social security payments were increased on July 1 to compensate for inflation, (2) gasoline lines in most parts of the country ended in June/early July, (3) auto manufacturers were giving hefty rebates and dealer incentive programs to stimulate lagging auto sales, (4) the foreign trade deficit narrowed considerably, and (5) inventories continued to accumulate. Almost all of these factors are temporary and they are, in fact, causing the Federal Reserve to push interest rates even higher. Worse, auto sales are being borrowed from the future, inflation is being given greater strength and duration by the continued demand and inventories will have to be liquidated. All of these factors point to a bad fourth quarter and a poor first quarter in 1980.

As was the case in 1974, the 1979-80 recession is a consumer-led recession, caused by falling purchasing power for most families as a result of a sharp acceleration in inflation. Even the sources of the buildup in inflation are similar to those which preceded the last recession—a large OPEC price hike and substantial food price increases. A mounting debt burden also is holding down consumer spending currently. Finally, as in 1974-75, high nominal interest rates are also playing a role in this recession, although their impact is lessened by high inflation rates and by the availability of new financial instruments in recent years.

#### REGIONAL OUTLOOK

The topic today, however, is the regional impact of this recession and the possible need for counter-cyclical funds for the hardest hit areas. In the following pages, I will outline the following:

1. The expected regional impact of the recession.
2. The reasons for the different regional impacts.
3. The potential amount and distribution of countercyclical funds under current proposed legislation.

#### *Regional Impact of the Recession*

The 1979-1980 recession, like past recessions, will impact the Northeastern section of the U.S. harder than the South or West. This is clearly illustrated in Tables II through IV, where employment growth, unemployment rates and real personal income growth are compared by region. Table II, for example, shows that total (non-agricultural) employment will decline an average of 1.3 percent in 1980 in the New England, Middle Atlantic, and East North Central regions.

Note: A definition of the states included in each region is in Appendix A. While employment in these Northeastern regions is declining during the recession, it is climbing in the remainder of the U.S. by almost 0.4 percent. The Mountain states and the Southwest show the strongest performance, with lower, but continued growth in the Farm Belt, Southeast and Pacific Coast regions.

TABLE II.—PROJECTED REGIONAL PERFORMANCE: TOTAL EMPLOYMENT GROWTH BY CENSUS DIVISION

	Percent change				
	1977	1978	1979	1980	1981
New England.....	3.8	4.8	3.0	-1.4	2.0
Middle Atlantic.....	1.5	2.6	1.6	-1.2	.8
East north-central.....	3.5	3.3	2.4	-1.3	1.7
South Atlantic.....	4.1	4.5	3.0	-.4	3.0
East south-central.....	4.8	5.0	2.7	-.3	3.3
West south-central.....	4.6	5.9	4.2	1.0	3.6
West north-central.....	4.2	3.6	3.2	.2	2.3
Mountain.....	6.7	7.8	6.5	2.3	4.1
Pacific.....	5.4	7.4	4.7	.5	3.1
U.S. total.....	3.6	4.3	3.2	-.3	1.8

TABLE III.—PROJECTED REGIONAL PERFORMANCE: UNEMPLOYMENT RATES BY CENSUS DIVISION

	Percent				
	1977	1978	1979	1980	1981
New England.....	7.7	5.7	6.1	8.5	8.4
Middle Atlantic.....	8.7	7.3	7.3	9.8	10.0
East north-central.....	6.5	5.9	6.4	8.5	8.3
South Atlantic.....	6.6	5.6	5.8	7.6	7.4
East south-central.....	6.3	6.0	6.2	7.5	7.0
West south-central.....	5.7	5.2	5.0	6.3	6.1
West north-central.....	4.8	4.0	4.0	5.3	5.3
Mountain.....	6.6	5.4	5.4	6.8	6.6
Pacific.....	8.2	7.0	6.9	8.8	8.7
U.S. total.....	7.0	6.0	6.1	8.0	7.9

TABLE IV.—PROJECTED REGIONAL PERFORMANCE: GROWTH IN REAL PERSONAL INCOME BY CENSUS DIVISION

	Percent change (\$72)				
	1977	1978	1979	1980	1981
New England.....	3.7	3.4	1.6	-0.7	2.2
Middle Atlantic.....	2.5	2.0	.5	-.2	1.1
East north-central.....	4.9	3.3	1.8	-1.0	2.2
South Atlantic.....	3.9	4.3	2.2	.5	3.1
East south-central.....	5.2	5.1	2.1	1.1	3.4
West south-central.....	6.4	6.3	3.8	1.9	4.0
West north-central.....	6.4	5.1	1.5	.4	2.6
Mountain.....	5.8	7.8	5.3	3.3	4.0
Pacific.....	5.1	6.0	4.4	.6	2.7
U.S. total.....	4.6	4.3	2.5	.4	2.1

This pattern is reflected in unemployment rates, as shown in Table III. Unemployment in the Northeastern regions will average almost 9 percent, while averaging only 7.3 percent in the rest of the U.S. The only other region with unemployment rates nearing those in the Northeast is the Pacific region, led by California and Alaska. On the West Coast, however, the unemployment rate is high due to a large in-migration of population and despite high employment growth: a high unemployment rate is almost guaranteed because of the perceived attractiveness of the area. Thus, in 1978 the Pacific unemployment rate was a full point over the U.S. average even though employment grew faster there than almost anywhere in the nation. In the Northeast, the high unemployment rate comes despite net out-migration because employment growth is low or negative.

Real personal income, whose growth through the recession is shown in Table IV, reflects the relative employment performance shown earlier. Personal income is the "GNP" of state economic performance. It is the best all around measure of a state economy which is available, capturing wages and salaries, farm income, property/business income, transfer payments, etc. Table IV shows the same pattern of decline in the Northeast and slower, but continuing growth in the rest of the nation all through the recession. Real personal income declines an average of 0.6 percent in 1980, in the Northeast, while rising 0.3 percent in the other regions. Again, the Mountain and Southwest states show the strongest relative performance, well exceeding the national averages.

#### *The Reasons for Differential Growth*

The reasons for the relatively stronger performance of the South and West during the recession revolve around near-term costs, industrial mix and resource advantages. First, in regard to costs, the plant and equipment of the Northeastern states is relatively old and inefficient. The Northeast has a much higher concentration of very old industrial plant which is relatively inefficient and, therefore, costly to operate. In addition, utility costs, taxes and wages are generally much higher in the Northeast. Thus, it costs much more to operate industrial plants in this area and any fall-off in national demand is reflected in disproportionate cutbacks in the Northeast.

These cost factors are illustrated in Tables V through VII, where relative tax loads, labor costs and energy costs are shown for each region of the country. Unit energy costs are notoriously high in the Northeast, and long winters make the burden even higher. Taxes in relationship to the income available to support them are also generally high, particularly in the Middle Atlantic states. Wages are very high in the industrialized Mid-West.

A second major factor affecting the Northeast is industrial mix. The East North Central and Middle Atlantic states in particular have a high concentration of manufacturing, and especially manufacturing of durables and primary metals. Since durable sales are always hit the worst in a recession, these industries are cut back proportionately more. This cutback ripples through the whole regional economy.

This dependence on manufacturing is shown in Table VIII, with the highest levels in the industrialized Mid-West and New England. The seemingly high proportion shown for the south Atlantic region is centered in the Northern states of Delaware, Maryland, West Virginia, etc., while states like Florida and Georgia are quite low. The East South Central also has a high proportion of manufacturing, which helps to account for its mediocre performance during the recession despite being located in the Southern portion of the U.S. Manufacturing employment in the West North Central (the Farm Belt) is surprisingly high, but naturally this is concentrated in food products, which is less susceptible to recessions.

The third, and final, factor is what I call resource advantages, particularly energy. The development of energy is helping to fuel the performance of the Mountain and Southwest states, including oil, gas, shale and coal. The South and West also have the advantage of generally lower taxes, lower living costs, better weather, and other such "resources" which attract investment and migration. Thus, the long-term pattern of higher growth continues even in a recession, cushioning the impact of a national slowdown. As previously shown in Tables II and IV, for example, the areas least affected by the recession are also those with the highest growth rates throughout the seventies. Because of the advantages discussed above, they will continue as high growth areas in the eighties.

TABLE V.—RELATIVE COST POSITION: RELATIVE TAX LOAD<sup>1</sup> BY CENSUS DIVISION

[U.S. average=100]

	1978 average (percent)	Low to high range (percent)
New England .....	103	81-122
Middle Atlantic .....	111	94-143
East north-central .....	93	76-111
South Atlantic .....	89	82-99
East south-central .....	86	80-92
West south-central .....	87	81-98
West north-central .....	94	85-109
Mountain .....	103	95-119
Pacific .....	97	96-110

<sup>1</sup> "Tax load" includes all major State and local tax revenues divided by the total personal income of the State. This ratio is then compared to the average for all States.

TABLE VI.—RELATIVE COST POSITION: RELATIVE MANUFACTURING WAGES BY CENSUS DIVISION

[U.S. average=100]

	1978 average (percent)	Low to high range (percent)
New England .....	89	83-94
Middle Atlantic .....	100	97-101
East north-central .....	107	103-115
South Atlantic .....	92	83-108
East south-central .....	88	73-99
West south-central .....	89	79-96
West north-central .....	95	86-112
Mountain .....	101	81-134
Pacific .....	115	102-164

TABLE VII.—RELATIVE COST POSITION: RELATIVE ENERGY COSTS BY CENSUS DIVISION

[U.S. average=100]

	In percent		
	Electricity	Motor gasoline	Natural gas
New England.....	135	100	130
Middle Atlantic.....	137	103	130
East north-central.....	107	103	103
South Atlantic.....	110	98	102
East south-central.....	90	98	83
West south-central.....	88	93	88
West north-central.....	108	101	78
Mountain.....	81	98	81
Pacific.....	62	103	120

TABLE VIII.—Regional comparison—manufacturing as a percent of total employment

	1978 average
New England.....	28.3
Middle Atlantic.....	24.8
East north-central.....	30.2
South Atlantic.....	21.9
East south-central.....	27.8
West south-central.....	18.4
West north-central.....	20.7
Mountain.....	12.3
Pacific.....	19.6
United States total.....	23.5

*Comparison to Other Recessions*

Despite the fact that the Northeast will fare worse than the nation as a whole during the coming recession, the gap will not be nearly as large as in previous recessions. New England, for example, is attracting high technology industries to its area due to the highly educated labor force and relatively low wage costs. Certain states, such as New Hampshire, also have low tax rates. Since the industries have relatively low energy usage, high energy costs are generally not a problem. In addition, the transportation equipment companies in New England have full order books and should continue to thrive. However, the apparel, wood-related and other industries will go through their typical recessionary cycle. Thus, on balance New England will be somewhat more affected by the recession than the nation as a whole but nowhere near the disaster of 1975.

This same pattern is true throughout the Northeast: each region will be worse off than the nation as a whole, but not nearly as much so as in the 1975 recession. This is clear in Table IX, which compares the performance of each region during the three recessions of the seventies. The difference between the "best" and the "worst" performance will narrow significantly in this recession, with much more uniform regional outlooks. No region is disastrously affected, although unemployment rates will become fairly high in the Middle Atlantic and East North Central states.

*Countercyclical Funding*

There have been several recent proposals for countercyclical funding to be distributed to the states to offset the recession. The Senate version calls for funds to be disbursed only in quarters when the U.S. unemployment rate exceeds 6.5 percent. In each of these quarters, the total funds to be disbursed is equal to \$125 million plus \$30 million for each 0.1 percent that the U.S. unemployment rate exceeds 6.5 percent. An Administration version is similar except that only \$25 million is added to the \$125 million base for each 0.1 percent that the U.S. unemployment rate exceeds 6.0 percent.

TABLE IX.—COMPARATIVE RECESSION PERFORMANCE BY CENSUS DIVISION

	Peak to trough		
	1970-71	1974-75	1979-80
<b>Real personal income (percent change):</b>			
New England.....	-1.1	-3.6	-0.9
Middle Atlantic.....	-0.7	-3.2	-1.3
East north-central.....	-1.3	-5.0	-1.0
West north-central.....	-0.5	-9.6	-1.0
South Atlantic.....	-0.2	-3.3	-0.3
East south-central.....	+4.3	-4.2	-0.7
West south-central.....	+3.7	-1.4	+2.6
Mountain.....	+5.0	-2.6	+4.4
Pacific.....	-0.9	-1.0	-0.3
United States.....	-0.5	-3.3	-0.3
<b>Unemployment rate (maximum percent):</b>			
New England.....	7.2	11.0	8.7
Middle Atlantic.....	6.2	9.6	10.1
East north-central.....	6.4	9.6	8.5
West north-central.....	4.1	5.6	5.3
South Atlantic.....	4.5	8.8	7.6
East south-central.....	5.4	8.2	7.5
West south-central.....	5.4	6.7	6.3
Mountain.....	5.7	8.7	6.8
Pacific.....	9.1	10.0	8.9
United States.....	6.0	8.9	8.2
<b>Total employment (percent change):</b>			
New England.....	-2.7	-4.2	-1.8
Middle Atlantic.....	-2.3	-3.7	-1.6
East north-central.....	-3.4	-4.5	-1.6
West north-central.....	-1.6	-2.0	-0.4
South Atlantic.....	+1.3	-3.8	-1.0
East south-central.....	+1.4	-3.9	-1.6
West south-central.....	-0.4	-0.4	+0.9
Mountain.....	+3.0	-0.9	+2.4
Pacific.....	-2.1	-1.0	-0.4
United States.....	-1.2	-2.8	-0.9

The total funds disbursed under these two programs would be as follows:

	Annual disbursements (millions)						Total
	1979	1980	1981	1982	1983	1984	
Senate version.....	\$185	\$1,910	\$1,880	\$1,820	\$1,340	\$620	\$7,755
Administration version.....	300	2,175	2,150	2,100	1,700	1,100	9,525

Thus, the Senate bill would total \$7.8 billion, with a maximum annual expenditure of \$1.9 billion, while the Administration proposal would total \$9.5 billion with a maximum annual expenditure of \$2.2 billion.

Table X shows how the funds under the Senate version would be distributed to the various regions. A breakdown by individual states is shown in Table XI. In calculating this allocation, it was assumed that the allocation would be based on the absolute number of unemployed in an area above the level of 6.0 percent unemployment relative to the national number of unemployed above the level of 6.0 percent.

It is clear from the table that:

1. The Middle Atlantic (33 percent) and Pacific (21 percent) regions get over half the total funds.
2. Generally, the slowest growing areas get the largest fraction of the funds, which was the intent.
3. The Pacific and South Atlantic regions, however, have an above average growth in employment and a large allocation of countercyclical funds.

TABLE X.—COUNTERCYCLICAL FUNDS: SENATE VERSION, BY CENSUS DIVISION

	Total funds distributed, 1979-84	Total employment growth, 1979-84 (percent)	Percent of U.S. total
New England.....	\$564	5.8	7.3
Middle Atlantic.....	2,574	1.9	33.2
East north-central.....	1,634	5.3	21.0
South Atlantic.....	898	10.0	11.6
East south-central.....	204	12.2	2.6
West south-central.....	116	14.3	1.5
West north-central.....	6	8.9	.1
Mountain.....	144	18.3	1.9
Pacific.....	1,615	11.1	20.8
U.S. total.....	7,755	8.5	100.0

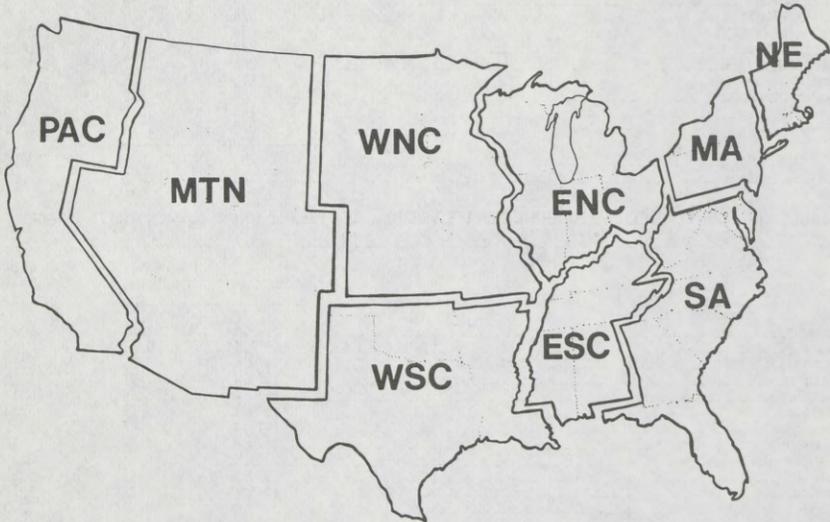
TABLE XI.—COUNTERCYCLICAL FUNDING: SENATE VERSION, 6.5-PERCENT UNEMPLOYMENT RATE TRIGGER

	Starting date	Total funding (millions)	Percent of U.S. total
Alabama.....	1979.4	\$102.26	1.32
Alaska.....	1979.4	29.03	.37
Arizona.....	1979.4	69.94	.90
Arkansas.....	1979.4	77.37	1.00
California.....	1979.4	1171.65	15.11
Colorado.....	1980.1	26.15	.34
Connecticut.....	1979.4	142.47	1.84
Delaware.....	1979.4	37.69	.49
District of Columbia.....		0	0
Florida.....	1979.4	357.45	4.61
Georgia.....	1979.4	132.72	1.71
Hawaii.....	1979.4	56.34	.73
Idaho.....	1979.4	7.47	.10
Illinois.....	1979.4	194.03	2.50
Indiana.....	1979.4	226.03	2.91
Iowa.....		0	0
Kansas.....		0	0
Kentucky.....	1980.1	13.31	.17
Louisiana.....	1979.4	38.09	.49
Maine.....	1979.4	47.53	.61
Maryland.....	1979.4	82.60	1.07
Massachusetts.....	1979.4	308.11	3.97
Michigan.....	1979.4	787.90	10.16
Minnesota.....		0	0
Mississippi.....	1979.4	56.16	.72
Missouri.....	1980.3	6.18	.08
Montana.....		0	0
Nebraska.....		0	0
Nevada.....	1979.4	14.59	.19
New Hampshire.....	1980.1	9.12	.12
New Jersey.....	1979.4	535.85	6.91
New Mexico.....	1979.4	25.80	.33
New York.....	1979.4	1526.20	19.68
North Carolina.....	1979.4	119.85	1.55
North Dakota.....		0	0
Ohio.....	1979.4	408.39	5.27
Oklahoma.....		0	0
Oregon.....	1979.4	166.46	2.15
Pennsylvania.....	1979.4	511.73	6.60
Rhode Island.....	1979.4	45.01	.58
South Carolina.....	1979.4	70.40	.91
South Dakota.....		0	0
Tennessee.....	1979.4	32.50	.42
Texas.....		0	0
Utah.....		0	0
Vermont.....	1979.4	11.71	.15
Virginia.....	1980.1	44.70	.58
Washington.....	1979.4	191.29	2.47
West Virginia.....	1979.4	52.67	.68
Wisconsin.....	1980.2	18.33	.24
Wyoming.....		0	0

## APPENDIX

1. Definition of Census Division
2. Unemployment Rates by Census Division (Graphs)

## THE CENSUS DIVISIONS



Pacific: Washington; Oregon; California; Alaska; Hawaii.

Mountain: Montana; Idaho; Wyoming; Colorado; New Mexico; Arizona; Utah; Nevada.

West North Central: Minnesota; Iowa; Missouri; North Dakota; South Dakota; Nebraska; Kansas.

New England: Maine; New Hampshire; Vermont; Massachusetts; Rhode Island; Connecticut.

East North Central: Ohio; Indiana; Illinois; Michigan; Wisconsin.

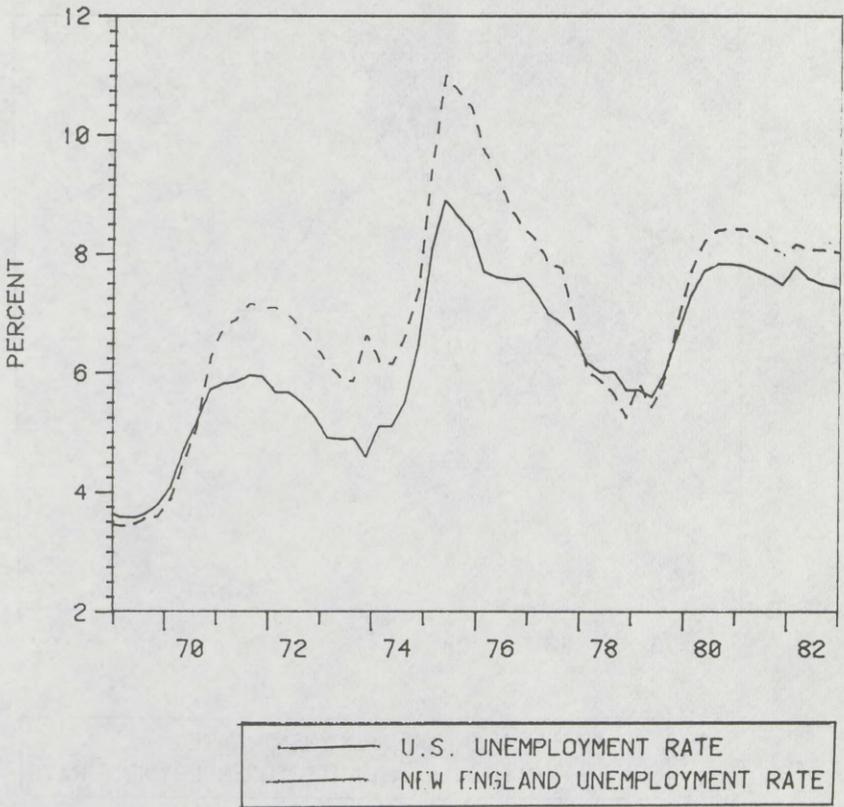
Middle Atlantic: New York; New Jersey; Pennsylvania.

West South Central: Arkansas; Louisiana; Oklahoma; Texas.

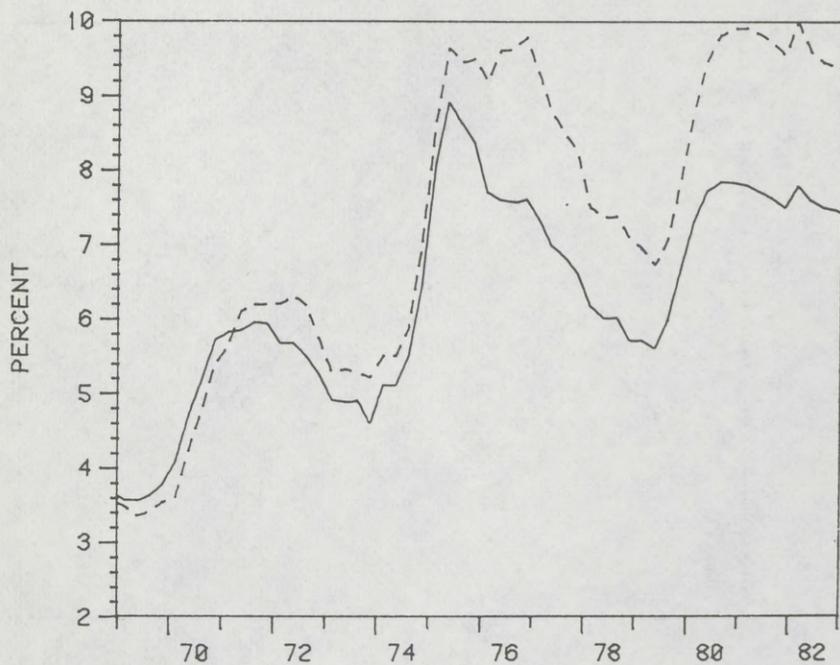
East South Central: Kentucky; Tennessee; Alabama; Mississippi.

South Atlantic: Delaware; Maryland; District of Columbia; Virginia; West Virginia; North Carolina; South Carolina; Georgia; Florida.

## NEW ENGLAND UNEMPLOYMENT RATE

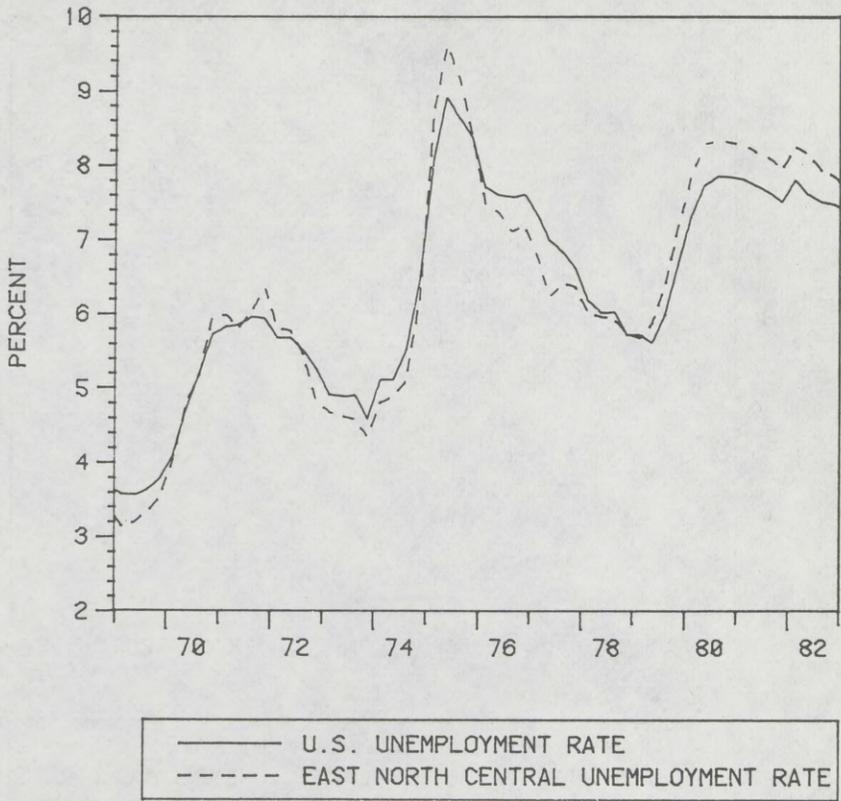


## MIDDLE ATLANTIC UNEMPLOYMENT RATE

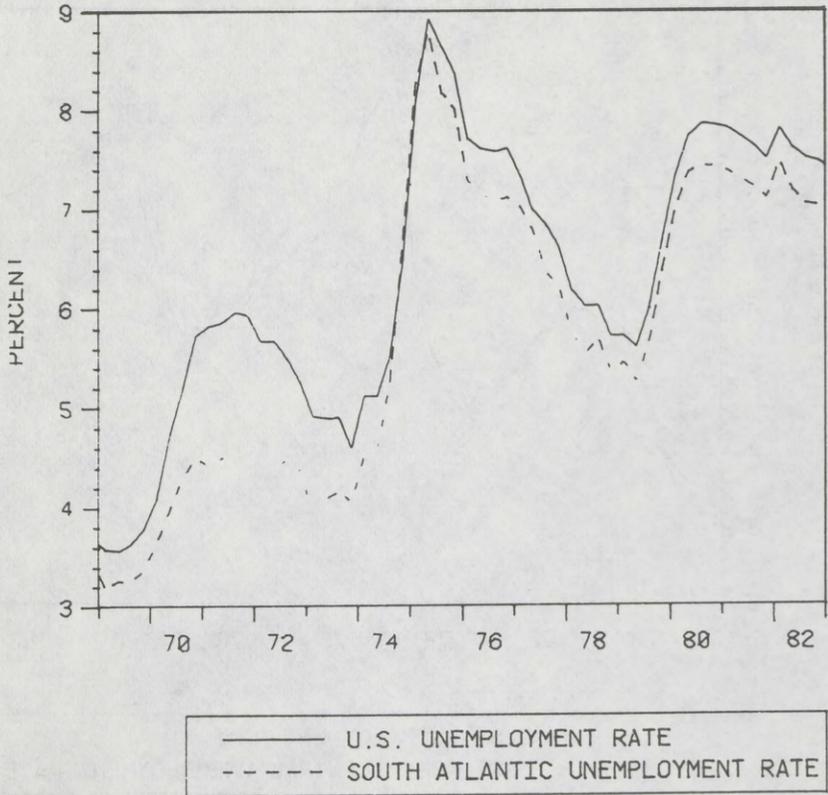


— U.S. UNEMPLOYMENT RATE  
- - - MIDDLE ATLANTIC UNEMPLOYMENT RATE

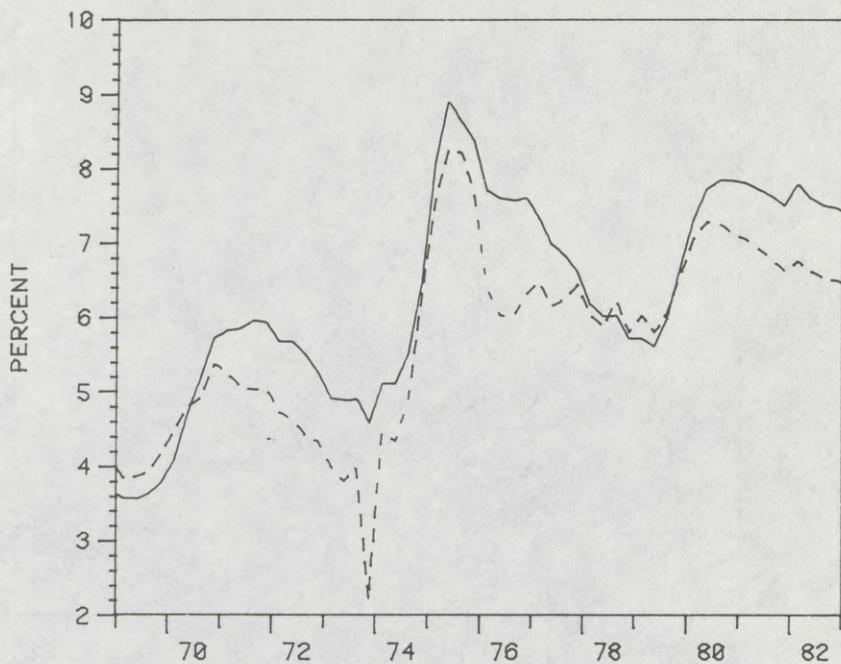
## EAST NORTH CENTRAL UNEMPLOYMENT RATE



## SOUTH ATLANTIC UNEMPLOYMENT RATE



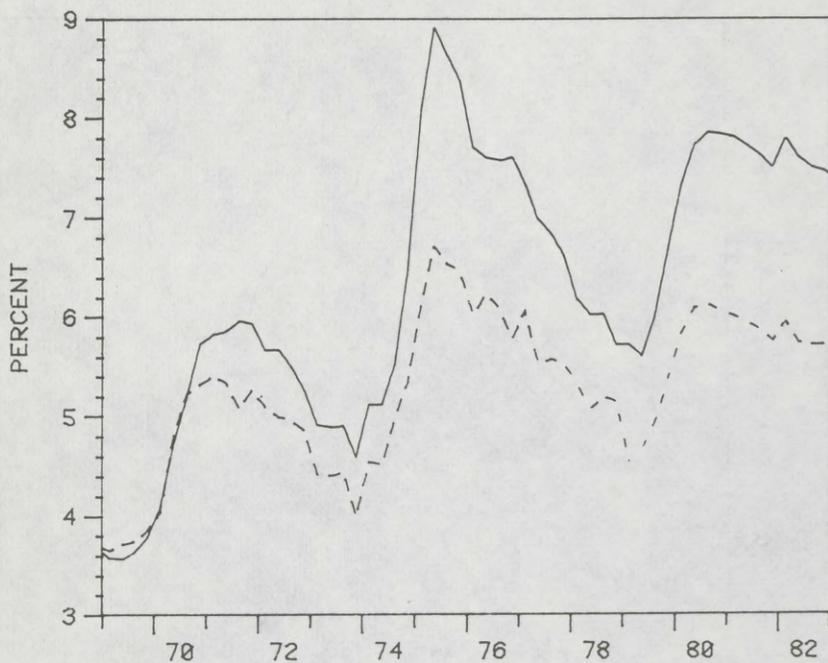
## EAST SOUTH CENTRAL UNEMPLOYMENT RATE



—— U.S. UNEMPLOYMENT RATE

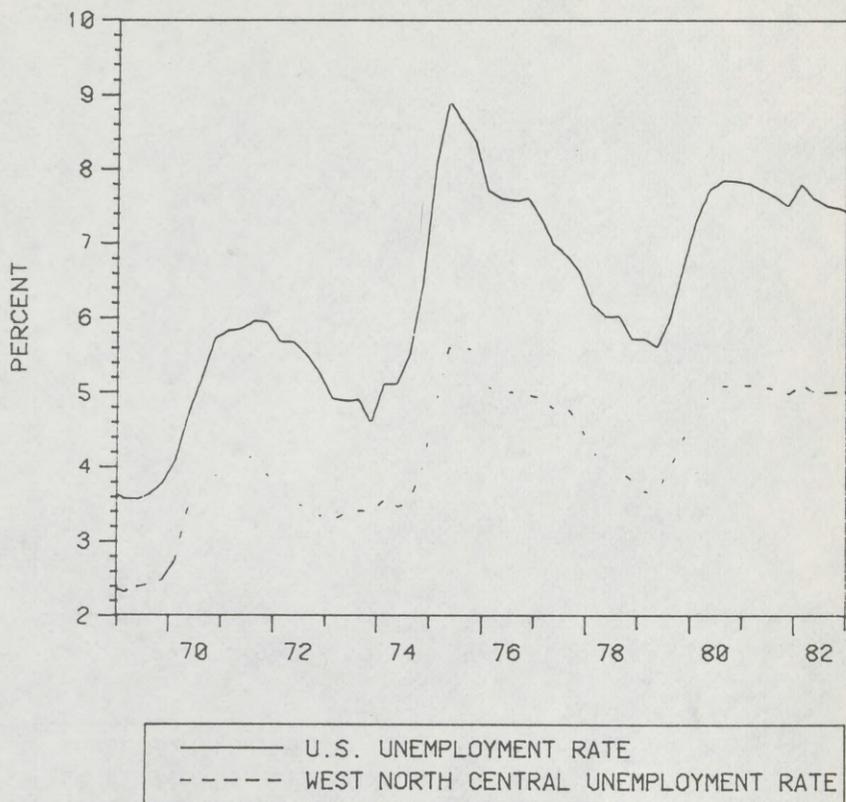
- - - - EAST SOUTH CENTRAL UNEMPLOYMENT RATE

## WEST SOUTH CENTRAL UNEMPLOYMENT RATE

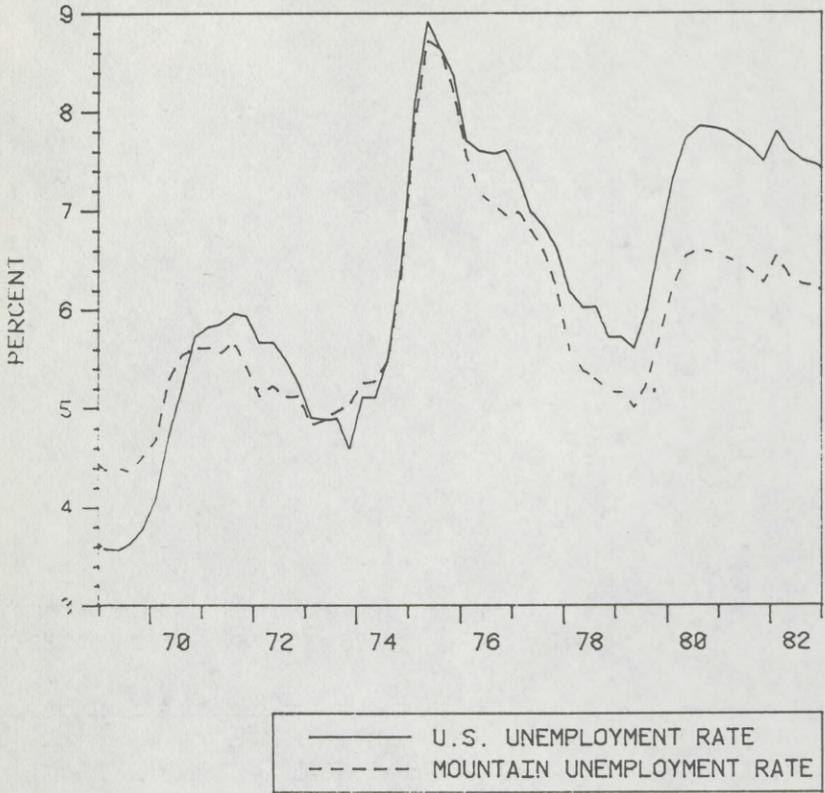


—— U.S. UNEMPLOYMENT RATE  
----- WEST SOUTH CENTRAL UNEMPLOYMENT RATE

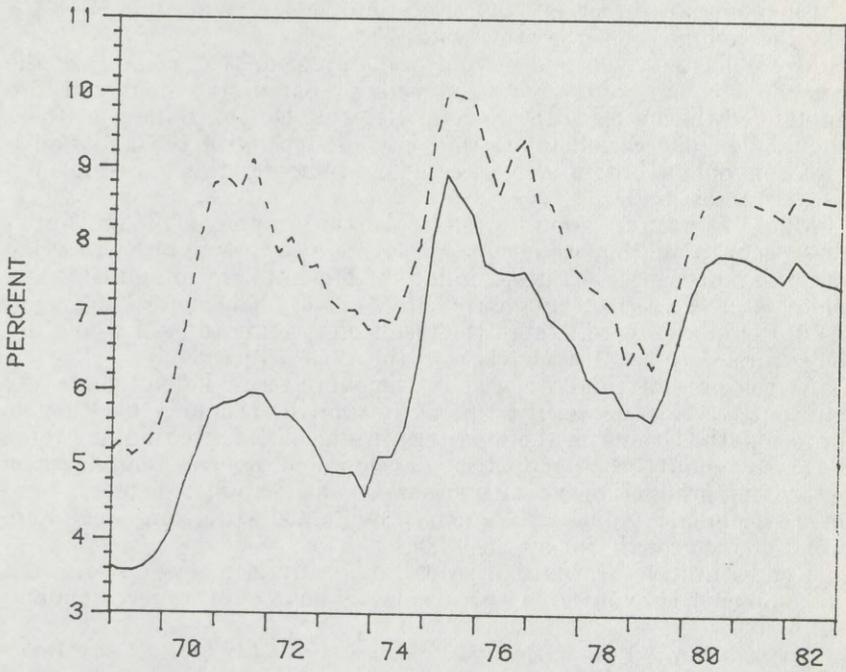
## WEST NORTH CENTRAL UNEMPLOYMENT RATE



## MOUNTAIN UNEMPLOYMENT RATE



## PACIFIC UNEMPLOYMENT RATE



— U.S. UNEMPLOYMENT RATE  
- - - PACIFIC UNEMPLOYMENT RATE

Representative MOORHEAD. Thank all of you very much. I never understood that Pacific Coast phenomena until you explained it, Mr. Zamzow.

I'm going to direct my first question to Mr. Weinstein, but I'd like the comments of the other witnesses.

Mr. Weinstein, you said in your oral statement that you expect the recession to be severe and yet in your prepared statement you also applauded the action of the Federal Reserve. Do you think that there should be some action taken that is consistent with the Fed's anti-inflation policy but is also directed at relieving the hardship of a "severe recession"?

Mr. WEINSTEIN. I don't want to be the prophet of doom, but it does seem to me that we need some severe measures in order to wring out this unacceptable rate of inflation. I believe my prepared statement used the terms "moderate" to "severe." The more I hear and read, the more severe I think the recession is going to be. I would not be surprised to see it come close to the 1973-75 period.

At the present time, at least in the short term, I don't have any alternatives to propose in terms of getting the economy back on its proper path. I think in the long term we need to start thinking more seriously about broad industrial development policies, emphasis on improving productive capacity, other so-called supply side macro- and micro-economic policies that can provide us with some real non-inflationary growth during the 1980's.

Representative MOORHEAD. Mr. Bahl or Mr. Zamzow, do you want to comment? Do you agree we are going to have a severe recession and so forth?

Mr. ZAMZOW. Yes, basically, although probably not as severe as was just testified to. In terms of near-term palliatives, we also are at a loss as to what can be done to prevent the recession. In fact, the recession may be very good for the U.S. economy at this time.

In the long term, we think that investment incentives and incentives for savings are the kinds of things that are needed to stimulate the economy, increase productivity, and get the Nation rolling again.

The very, very high oil prices that we have already experienced plus those that are coming, including the decontrol of oil prices in the United States, and probable high agricultural prices, are going to keep inflation at a very high rate through 1980 and 1981. These are relatively "exogenous" factors which we cannot control.

Representative MOORHEAD. Mr. Bahl, I would take it from your testimony that you would believe that if we do enact countercyclical revenue sharing, States should be recipients; is that correct?

Mr. BAHL. I think as a practical matter it's probably late to re-define a whole program like that, and I think probably if there is a countercyclical program, it is going to be as it was before. All I was doing was suggesting that to do that is to move against the pattern of increased State assumption and probably will induce States to cut back what they do for local governments. The implication of that to me is that States are being let off fairly easy with respect to their responsibilities toward cities.

Representative MOORHEAD. Mr. Zamzow, in your testimony you indicate that the recession should end by the second quarter of 1980, but that if we enact countercyclical, at least along the Senate lines,

that the program would continue and not be phased out until 1984. Am I correct that this is because of the lag of unemployment after the recession? Is that the way you explained it?

Mr. ZAMZOW. Right. Unemployment rates rise late in the recessionary period and actually almost always hit their peak after the recovery has actually begun. This was true in the 1975 recession and the 1970 recession, and because we expect the recovery to be relatively modest, those unemployment rates are going to be hard to bring down. You are starting from a higher level. They are going to rise and they are going to stay at a higher level for a longer period than previously.

Representative MOORHEAD. Well, if countercyclical assistance is wise, should it continue until 1984 or should the law be amended so it would not continue as long as 1984? Does that make good economic sense, is really what I'm asking?

Mr. ZAMZOW. I would recommend that you do have a cutoff date, in other words, that the States not be dependent upon the Federal Government for their financing because they will use it to solve their near-term problems but not as a long-term existing ongoing type of supplement.

Representative MOORHEAD. Before I yield to Mr. Wylie, I find it interesting politically that one of our problems in passing this legislation will be, and has been in the past, the Southern-Southwestern States. If these witnesses are correct that those regions will not be spared from this recession, we may get more support from Members from those areas.

Representative WYLIE. We might or might not, depending on whether you think CETA and countercyclical programs are best for the Nation as a whole.

Mr. Weinstein, would you care to comment on that? As I took it from your statement—and I hope this is a fair appraisal of it—you're not too much in favor of CETA and countercyclical programs as a stimulative to the economy.

Mr. WEINSTEIN. Certainly not countercyclical. The point I was making about CETA and general revenue sharing is that these programs, while not necessarily designed to target funds to areas of the greater perceived needs, do in fact operate in that fashion. So that by many accepted definitions of needy places, adequate funds are already being targeted with existing programs. That's the point I was trying to make.

Representative WYLIE. Mr. Zamzow indicated that at best it should be only short term, the countercyclical. Is that a fair statement?

Mr. ZAMZOW. Through 1981 let's say.

Representative WYLIE. With a phasedown of countercyclical programs during 1981?

Mr. ZAMZOW. Right.

Representative WYLIE. Do you agree with that, Mr. Bahl?

Mr. BAHL. Yes. I guess it depends on what happens to the rate of unemployment after 1980, but in principle I agree with what Mr. Zamzow said, that it's a short-term program of assistance designed to get State and local governments through a period of recession.

Representative WYLIE. It depends on what happens to unemployment. In other words, if the unemployment rate stays up, that means countercyclical isn't working, so you would continue more of it?

Mr. BAHL. Well, the unemployment rate can stay up for a couple of reasons. One is that the national economy is growing slowly and it's not recovering, and the other is that you get these continued regional movements which tended to be accelerated during the last recession. That's the second reason why it could stay high.

Representative WYLIE. There may be another factor in all of this. I want to be the devil's advocate for a moment. What do we do about the Arabs? What if they don't respond to our efforts to attempt to help our own economy? Have we any options then as far as our macro-economic policy is concerned? Maybe monetary and fiscal policy are helpless if the Arabs continue to increase the price of oil. What do we do about that? Have you thought about that?

Mr. BAHL. I hope you're not looking at me.

Representative WYLIE. I'm looking at the panel. I think it's something that we need to think about as a Congress.

Mr. WEINSTEIN. Again, this is your short-term view and long-term view. Presumably, a marked slowdown in economic activity combined with conservation measures will reduce our demand for imported oil. If that demand weakens sufficiently, this at least would help to moderate any price increases. Of course, that would also depend on whether other countries are doing the same.

In the long term, we haven't begun to fight in terms of developing alternative energy sources and I think the Congress should probably be focusing on long-term energy supply rather than short term.

Representative WYLIE. The point I'm making—you're all experts in economic policy and that sort of thing. Does the focus switch if the Arabs don't respond to our efforts to bring our inflation under control with macro- and micro-economic policy and instead want only to increase the price of oil? Macroeconomic and micro-economic policy would then be helpless to slow inflation.

Mr. ZAMZOW. Well, one problem is that we have seen a very definite shift in what I will call the way Arabs are pricing and supplying oil. After the very large increases in 1973-74 of oil, prices basically stabilized and in fact they fell in real terms in 1977 and 1978, basically because of an oversupply of oil.

The payments deficit of the OPEC nations was falling dramatically. In fact, they were well over \$10 billion in 1978. Now in 1979 we have had a new round of increases. What's happened now is that we are going into another recessionary period. We have had large oil price increases. Indeed, conservation, the economic slowdown, additional production in the non-OPEC nations, is going to hold down the demand for OPEC oil. But this time we are not going to see prices stabilize and fall in real terms from the OPEC nations.

What they have learned is the lesson of what happened last time. Already they are embarking on a program to cut back production of oil. We have had announced production cuts from Venezuela, Libya, Nigeria, Saudi Arabia, probably Kuwait. In fact, the surplus of oil which would normally occur in the 1980 period is not going to. Consequently, we are going to see continuing pressure and probably continuing increases in oil prices, and there's nothing that I know of that we can do about that in the short term.

Representative WYLIE. So that sounds as if you feel we're almost helpless if the Arabs want to put us in that posture.

Mr. ZAMZOW. Yes, sir.

Representative WYLIE. Do you feel that way, Mr. Weinstein?

Mr. WEINSTEIN. In the short term. I don't know that I'd use the term "helpless." So much of it depends on our response and our ability to bring down the inflation rate so that the price of oil does not decrease in real terms. Presumably this is what the Arabs are hedging against. I think a stable dollar and lower rate of inflation helps us to reach that goal.

Representative WYLIE. What if they do like Mr. Zamzow says and simply reduce the supply of oil that's coming to us?

Mr. WEINSTEIN. Again, it is not just the supply or just the demand, but how the two interact and at what level some equilibrium price is determined. It's really a question of how much we can conserve and reduce our dependence—or I should say the amount we conserve. Reducing our dependence on imported oil has got to have an effect on the output of the OPEC nations.

Representative WYLIE. So we may have to put more emphasis on an energy policy even in the short term than we have in the past and maybe not quite so much emphasis on fiscal and monetary policy?

Mr. WEINSTEIN. I think so.

Representative WYLIE. Mr. Bahl, would you think so?

Mr. BAHL. I think so, and I also agree with Mr. Zamzow that there's very little that can be done in the short run. Certainly not much can be done on the demand side in the near-term future. So if in fact supply is restricted—and that's an argument that's not without some foundation—it may be that energy policy will make a lot of things subservient that we have been talking about.

Representative WYLIE. How are you advising your clients? Are interest rates going up?

Mr. ZAMZOW. I wish I was Secretary of the Treasury or something and could say we didn't have an opinion.

Representative WYLIE. I couldn't get an answer out of him.

Mr. ZAMZOW. We do think they are going to peak probably not much higher than their current levels, and come down reasonably quickly. In other words, we believe that they are there to stop the "speculative binge" and that if economic activity falls off they will come back down.

Representative WYLIE. Mr. Weinstein.

Mr. WEINSTEIN. I'm sorry. Did you want me to respond to that?

Representative WYLIE. If you will.

Mr. ZAMZOW. You're not Secretary of the Treasury either.

Representative WYLIE. I figure three heads are better than one.

Mr. WEINSTEIN. I think long-term interest rates will probably peak in the next 2 or 3 months. I wouldn't care to predict what that range will be. I would think that the long-term rate structure would fall before the short-term rate structure.

Representative WYLIE. Mr. Bahl.

Mr. BAHL. I have no clients to advise, but I would guess they are going to peak in the next 6 months.

Representative WYLIE. Thank you very much, Mr. Chairman.

Representative MOORHEAD. Congresswoman Heckler.

Representative HECKLER. Thank you, Mr. Chairman.

Mr. Weinstein, you seem to have the most negative forecast of all and you said you differed very strongly with Secretary Miller and you see the country as being in a severe recession at this time.

Mr. WEINSTEIN. Not at this time. Moderate to severe recession with unemployment at or above 8 percent, and my other point of disagreement is I think this is going to be a fairly widespread recession. I don't think any region of the country is going to be insulated from it.

Representative HECKLER. You're saying it's going to be a moderate to severe recession?

Mr. WEINSTEIN. Yes.

Representative HECKLER. Do you differ with him in terms of length? Do you see this as a recession of any special duration?

Mr. WEINSTEIN. Well, I would expect negative growth at least through the third quarter of 1980, which is another four quarters.

Representative HECKLER. So 1 more year. What factors lead you to believe that we are going to have a deeper recession than the Secretary of the Treasury suggests? What factors are you reading differently, internal factors, external factors, or international or domestic or whatever?

Mr. WEINSTEIN. That's a question—

Representative HECKLER. What are the indicators that give you this?

Mr. WEINSTEIN. First of all, the highest interest rates in history. Second of all, an extremely high inflation rate and a consensus that seems to be developing in the administration, in the Congress, and even at the State and local levels that we've got to bring this inflation under control even at the cost of foregoing some things we might like to have. State and local governments, and Federal Government as well, have all got fiscal religion. Usually we would hear a clamor for tax cutting at this stage of the business cycle, but we don't hear that. What we hear is most of our leaders saying we'll just soft pedal for a while, let's keep the budget in balance or close to balance because we do have that inflation rate, and that really is the problem, and if it takes four or six quarters to wring out 4 or 5 percent from that rate, then that's what we need to do.

Representative HECKLER. Do you believe that as Secretary Miller suggested the major shock can be absorbed within the next say three quarters and a good measure of the inflationary spiral can be curtailed within that time by the tight monetary policy of the Fed?

Mr. WEINSTEIN. I hope so. In a sense, we are in uncharted waters, but I hope so.

Representative HECKLER. You stated earlier I believe that this is the only recession in which the money policy had been tightened during the recession.

Mr. WEINSTEIN. No. I said this was—there are only two times before, since the Second World War, when the Federal Reserve raised interest rates after a recession was underway. Usually at this stage interest rates are coming down. Interest rates went up when we were already into the recession and subsequent declines in economic activity turned out to be worse than what was anticipated.

Representative HECKLER. All three of you agree that the Northeast will be very hard hit and to use what is becoming a cliché, will bear the brunt of the recession.

Mr. WEINSTEIN. I don't.

Representative HECKLER. Mr. Weinstein, you do not agree with that? I know you stated that the South will be harder hit than in the past, but—

Mr. WEINSTEIN. Again, the Northeast encompasses a large region—you're talking about New England and the Mid-Atlantic States. I think there are several States in the Northeast that have some long-term structural problems to which they have not yet fully adjusted. I don't think New England is going to suffer as much as the Mid-Atlantic States because over the last decade New England has succeeded in upgrading its economic base. It has much more high technology industry which is a kind of corollary to the argument that the South may be more vulnerable than in the past is because it's more closely integrated with the national economy.

I would agree with Mr. Zamzow that the interregional variation in terms of growth in the unemployment rate during the downturn will not be that significant. But to say the Northeast is going to bear the brunt of this recession implies that nobody else is going to bear the brunt, and I don't think that's true.

Representative HECKLER. It implies that others will not suffer as much, that the Northeast will bear the heaviest burden. You think that New England is not going to be as hard hit, but we in Massachusetts have great concerns that we will be very hard hit and I also wondered what we could do about—there was a response earlier of a sense of hopelessness about our dependence on OPEC oil. Certainly we are at the mercy of the Arab States right now in terms of the price hikes and their policies as they wish to set them. Do you see anything that the Northeast or the other States can do to insulate their own economy or their regional economy from an unbalanced economic shock due to a recession? Is there anything they can do in the short run?

Mr. WEINSTEIN. I don't think so. I will defer to Mr. Bahl and Mr. Zamzow.

Mr. ZAMZOW. No. The conventional palliatives take longer to work than just 1 year through the next recessionary period. Massachusetts is—just to address your own State—as you know, it is a relatively high-tax State. I think it's growing less than perhaps New Hampshire, basically, because of those tax differences. I think in the long run that your State needs to do something to bring itself more into balance with the other States at least in its area. But again, that takes time and nothing that you do in the immediate next year or so is going to be able to weaken your vulnerability or lessen your vulnerability.

Representative HECKLER. All of you heard the Secretary of the Treasury discuss his monitoring of the economy on a week-by-week basis and the potential use of other options should the recession deepen. Now there were a number of options that are being discussed in Congress. One is the accelerated or liberalized depreciation rate which is a proposal that in its present version has been costed out at \$5 billion a year, and that will certainly be a factor in terms of the budget deficit, et cetera.

Another proposal, if the depreciation rate is accelerated with tax changes, then it's very likely that the total tax package will also include some measure of relief for the taxpayer. That too, will create a greater deficit.

How would each of you respond to the desirability of any of these answers and how deep would you want the recession to go if you were fine tuning the economy in the Treasury Department—how deep would you allow unemployment to go, or a contraction of the economy

to reach, before we desired these politics be put in place? What would you be looking at and how would you handle these issues and which option is most desirable, Mr. Zamzow?

Mr. ZAMZOW. That's a string of tough questions. I thought I was the last in the alphabet. Don't they have to answer first?

The thing that you have to be very careful of is the impact on inflation. I agree that our utmost priority ought to be put on reducing the rate of inflation. Obviously you can't do that indiscriminately when the unemployment reaches 10 percent, 12 percent—you obviously have to stop somewhere. But I think we should devote all of our energy to getting the inflation rate down, getting it down to reasonable levels such that we get the inflationary psychology out of the economy. If it takes rising unemployment rates to get up to 8 percent or above, I think that's perfectly justified and I would not take actions until the light at the end of the tunnel is clearly visible as far as inflation goes.

Representative HECKLER. Regardless of how deep the unemployment or how great unemployment became, you would not take action?

Mr. ZAMZOW. No. What I say is you would have to balance that. If unemployment—I don't think we should stop the battle against inflation just because unemployment gets up to 7.5 or 8 percent. If it gets a lot higher than that, we may say the battle is not worth it; but up to that point I would definitely put the priority on wringing out inflation.

Mr. WEINSTEIN. Congresswoman Heckler, I would argue that in the long term, in terms of setting the stage for renewed growth during the 1980's, we do need some basic changes in our tax structure in the incentive system, and the way we treat depreciation. We've got to do something to encourage capital formation. We've got to do something to encourage savings to change the balance between consumption and savings. As Mr. Zamzow said, if we can't bring down the inflation rate, if we can't deal with these inflationary expectations, those policies will not be efficacious.

Let me add finally, I think the long-term outlook for the Northeast is quite rosy. If you look at where foreign investment has situated in the last couple years, if you look at the narrowing of the business cost differentials between regions, the Northeast is going to find itself in a much stronger competitive situation in the 1980's than was the case in the 1970's.

Representative HECKLER. That's encouraging, but I have to say the Northeast is finding itself in great difficulty facing this cold weather and the survival into those happy future days is going to be a more difficult struggle for many people in the Northeast with the short-range perspective which definitely impacts strongly in our consciousness, but I do agree with you that the long-range future will certainly be brighter.

Mr. BAHL. I guess I was just going to say that I really disagree with what Bernard Weinstein has to say about that. I guess I now disagree with you as well, because I don't really see the long-range outlook being rosy.

Let me comment on a couple things—and my data are no better than anybody else's because nobody really knows the right answers, but one could make this kind of a case: That a good reason for the rapid decline and a good reason for why the Northeast and the industrial Midwest felt the last recession more than the rest of the country

had to do with the obsolescent and older capital plant, and when firms had to make choices about where to close down they chose on the basis of where the plant was least efficient, and that tended to be in this region.

Now there's no reason to expect that that's changed a great deal. What data we have also suggest that another major contributor to the loss in economic activity in our region of the country was that the incubation effect wasn't there, that new firms simply weren't being born at as fast a rate as they were elsewhere, and that has a lot to do with the fact that wealth and population has been moving out of that region and a farsighted businessman looking ahead would locate where the activity was.

The last point I think has to do with your question about Federal policy. I would add, if the unemployment rate goes high and is allowed to go very high, that all regions of the country won't feel it the same way, that the unemployment rate may go much higher in the Northeast and the Midwest, and if we talk about tax policy to stimulate investment it may be that all we do is accelerate the movement out of our region of the country because if reinvestment plans are on the board by a firm they likely involve reinvestment outside of our region. So things like investment tax credits may, if anything, accelerate the movement away.

Representative HECKLER. Than you would be opposed to them?

Mr. BAHL. No, I wouldn't be opposed to them because I don't think that shrinkage in the Northeast and Midwest is necessarily bad. I think it's inevitable and policy really ought to worry about how you compensate States to get through a transition period rather than to deal with how you might return New York to what it was 10 years ago.

Representative HECKLER. Well, I'd just like to say that there is considerable movement in the direction of setting policies in place that will restore the vital economic climate that's necessary for private investment in, say, Massachusetts, and that's a current political attitude that's gaining acceptance. Nonetheless, I don't minimize the problems for today and tomorrow, but I would like to go on, Mr. Chairman, but I have been informed that my time has expired.

Representative MOORHEAD. Mr. Wylie had a question.

Representative WYLIE. I wonder if I might follow up on that. I think I noticed a little pulling of the cork there by Mr. Zamzow in response to one of your questions on the point that the problems of Massachusetts may in large part be the fault of Massachusetts and not the Federal Government, and maybe the problems are in part local in nature.

For instance, I have a feeling that the problems in Cleveland are in Cleveland. We have been very fortunate in Columbus, Ohio, I might say.

But are there any so-called recession-proof cities or areas or what might those characteristics be if there are such cities and States?

Mr. ZAMZOW. Well, basically, the higher growth areas of the country in 1977 and 1978, during this current recovery will be the same areas which will be the least impacted by the economic recession of 1979 and 1980. Those areas are areas which have lower energy costs; they have lower tax loads in general; they have lower wage rates; and that is part of the stimulation that is causing them to grow faster than the Nation as a whole.

New England and the Middle Atlantic States have energy costs that are 30 to 40 percent above the national average. The Middle Atlantic States have tax loads that are 10 to 40 percent above the national average. Those are the kinds of things that do hold back and do tend to restrain economic development.

So, the areas that are "immune" or less subject to the economic recession and continue to grow are those that have local policies oriented to promote growth. A lot of it is not just tax or cost considerations. A lot of it is local political environment; that is, are you encouraging through whatever local governmental programs are available, business to come into your area? Just a good, friendly environment is worth a lot to many corporations.

Representative WYLIE. I tend to agree with you. Did you want to expand on that, Mr. Weinstein? It's a matter of diversification that enters the picture some I suppose. For instance, in Detroit—

Mr. WEINSTEIN. It's so hard to say. People point to Houston and Dallas as examples of recession-proof cities because the unemployment rate remained relatively low during the last recession. Interestingly, population growth in those cities slowed down somewhat during the last recession and I expect that to continue during the current recession. There's some initial evidence that migration rates to the South and West are slowing down, that population growth in those States has slowed down as well.

Recession-proof cities—I think they probably don't exist. Some think the city of San Jose is so heavily tied into electronics and defense that there's no way San Jose is going to feel a recession, but I think all cities are going to feel this recession to some degree.

Mr. BAHL. I think that there are cities that are more prone to feel a recession than others and we can think of certain cities that are more or less one-industry towns where we would expect a much greater effect.

Representative WYLIE. Like Detroit, for example?

Mr. BAHL. Or Flint. But I think it doesn't work so much the other way. To put the question the other way: Are there places that will get an increasing share of the pie, no matter how small it is, and in growing areas that's what we can expect? I guess the conditions that are necessary—I don't know if I would buy energy, taxes, and wage rates. Energy costs as a share of value added, if you look at the cost structure of a firm, are small, even for an energy intensive firm. If you look at direct business taxes as a share of cost to a firm, they are relatively small. What may not be is your personal taxes on executives, and in New York this has been cited for a reason for decisions to move out of the State or not move into the State. I think, wherever it started, one of the reasons is that New York had 12 percent of the Nation's income 15 years ago and now it has about 8 percent of the Nation's income. That explains in small part why it has a smaller share of jobs.

Representative WYLIE. You mentioned energy cost and that made me think of an example. Ohio has many refineries as you know. We had refinery capacity all during the gasoline crisis, whereas in New England they have had a policy of discouraging refinery development, which leads to higher gasoline costs and higher fuel oil costs, et cetera, and maybe that contributes to their economic malaise.

Representative HECKLER. If you would yield, I'd like the gentleman to know that I invite any oil company to establish a refinery in my district. We have an ideal location and a supportive political attitude, and lest the good name of Massachusetts be tarnished by the exchanges today, I would like the record to show that we have had definite technological growth. We are a center of high technology and remain so. We have certain assets in our environment which make Massachusetts the envy of many other States. Many Members of Congress with teenage children seek to send their children to college in Massachusetts and there is a sticker which characterizes the desirability of that State or that whole region which says, "I will take New England any day," and that's the way I feel about it.

Representative WYLIE. What's the problem then?

Representative HECKLER. The problem is age. The problem is that this is a segment of the economy where the Revolution began with the Boston Tea Party and many of the delightful structures that have emerged from that era to this have withstood the years of growth, development and maturation and now have to be replaced, and policies have not been put in place because of the high cost to do that. There is a change of attitude and economically I think there's a new mood, but I will say, for the quality of life, it's hard to find the equal in the United States.

Representative WYLIE. I think a change in attitude may indeed improve the quality of life in the North, in New England, and the State of Massachusetts.

Thank you very much, Mr. Chairman.

Representative MOORHEAD. Do you have any further questions?

Representative HECKLER. No further questions.

Representative MOORHEAD. Gentlemen, thank you very much for this illuminating testimony and particularly these tables and additions that I want to study. I think you have given us a lot of food for thought not only in your oral statements but also in your prepared statements, which without objection, will of course be made a part of the record in their entirety.

The subcommittee will now stand adjourned, subject to the call of the Chair.

[Whereupon, at 12:30 p.m., the subcommittee adjourned, subject to the call of the Chair.]

