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94TH CONGRESS
2d Session

SENATE

REPORT
No. 94–000

THE 1976 JOINT ECONOMIC REPORT

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REPORT

OF THE

JOINT ECONOMIC COMMITTEE CONGRESS OF THE UNITED STATES

ON THE

FEBRUARY 1976 ECONOMIC REPORT OF THE PRESIDENT

TOGETHER WITH

AN INTERNATIONAL SECTION IN WHICH MAJORITY AND MINORITY CONCUR, AND MINORITY, SUPPLEMENTAL AND ADDITIONAL VIEWS

MARCH —, 1976

Printed for the use of the Joint Economic Committee

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

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1976 JOINT ECONOMIC REPORT

CONTENTS

I. Introduction and Summary 5
Main Recommendation 13

II. Economic Situation and Outlook 24
Outlook for 1976 26
Will the Recovery Be Sustained? . . . 28
Energy 35
Longer-Run Growth Prospects 38

III. Fiscal, Monetary and Price-Incomes Policies 41
Goals of Economic Policy 41
Fiscal Policy 48
Price-Incomes POlicy 63
Monetary Policy 68
Coordination of Economic Policy . . . 72

IV. Special Policies to Achieve Full Employment 78
The High Cost of Extended Unemployment 78
The Proper Role for Unemployment Compensation 82
A Program of Job Creation 87
Economic Planning 99

V. Federal Budget Priorities 102
Expenditures 102
Income Security 114
Housing 119
Energy 124
Agriculture 125
Defense Spending 131
Tax Reform 139
Small Business 146

VI. Investment Requirements and Capital Sufficiency 150
Investment Needs 151
Availability of Funds 155
Can Business Finance Needed Investment? 165
Broadening the Ownership of Capital 170

VII. Economic Problems of Regions, States, and Cities 174
Operating Budgets 174
Sustaining State Unemployment Funds 184
The Municipal Bond Market 185
Chronically Depressed Regional Economics 192
The Need for Regional Economic Information 199

VIII. International Economic Issues 201
Monetary Reform 201
Coping With Oil Deficits 217
Commitment to Concessional Aid 220
Consumer-Producer Conference 223
International Energy Policy 226
Achieving World Food Security 228

Supplemental Views of Vice Chairman Wright Patman 231
Supplemental Views of Senator William Proxmire 237
Supplemental Views of Senator Abraham Ribicoff 240
Supplemental Views of Senator Lloyd Bentsen 241
Supplemental Views of Senator Edward M. Kennedy 245
Supplemental Views of Representative William S. Moorhead 264
Supplemental Views of Representative Gillis Long 266

Minority Views 271

I. Introduction. 275
II. Economic Outlook. 277
III. Monetary Policy 281
IV. Fiscal Policy 285
V. Employment. 289
VI. Energy. 293
VII. Capital Formation 297
VIII. State and Local Governments 304
Supplemental Views of
Senator Jacob K. Javits. 314
Additional Views of
Senator Charles H. Percy 334
Additional Views of
Representative Garry Brown 335
Additional Views of
Representative John H. Rousselot 339

Committee Activities 345

94th Congress
2nd Session

SENATE

Report
No. 94-

REPORT ON THE FEBRUARY 1976 ECONOMIC REPORT OF THE PRESIDENT

March 1976. -- Ordered to be printed
with illustrations

Mr. Humphrey, from the Joint Economic Committee,
submitted the following

REPORT

together with

AN INTERNATIONAL SECTION IN WHICH
MAJORITY AND MINORITY CONCUR,
AND MINORITY, SUPPLEMENTAL, AND
ADDITIONAL VIEWS

(Pursuant to sec. 5(a) of
Public Law 304, 79th Congress)

This report is submitted in accordance with the requirement of the Employment Act of 1946 that the Joint Economic Committee file a report each year with the Senate and the House of Representatives containing its findings and recommendations with respect to each of the main recommendations made by the President in the Economic Report. This report is to serve as a guide to the several committees of Congress dealing with legislation relating to economic issues.

Report of the

Joint Economic Committee

on the

February 1976

Economic Report of the President

(3)

I. INTRODUCTION AND SUMMARY

The condition of the United States economy continues to be a matter of distress to Members of this Committee. Despite recent signs of improvement, seven million people remain out of work by official count. If discouraged and underemployed workers are included, the figure exceeds 10 million. An estimated 60 to 75 million people in 1975 were members of families in which someone was unemployed. No one can be complacent about the recent gains when full employment is still years away.

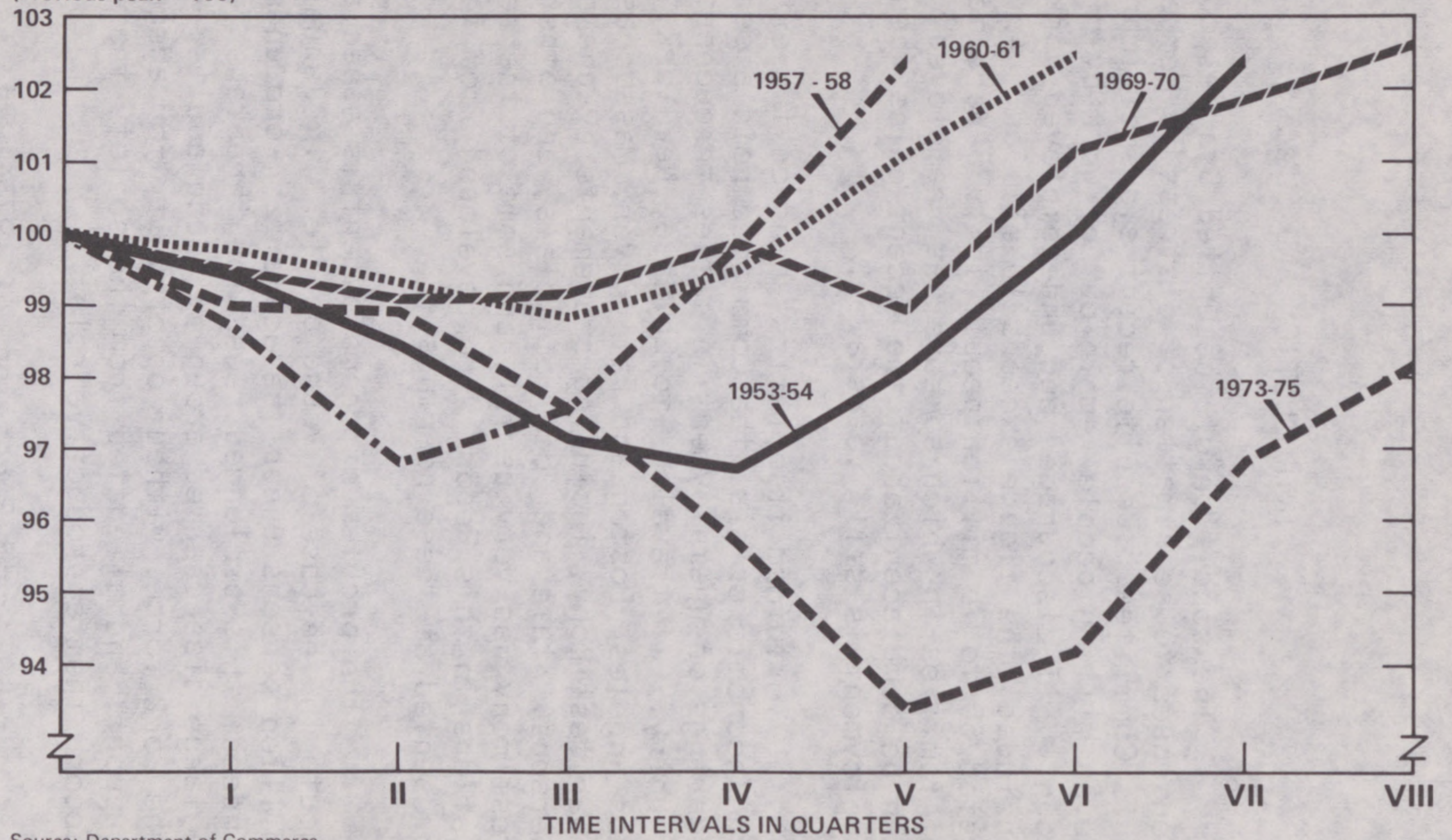
To inform itself first hand on the extent of the economic crisis, the Committee held a series of hearings on unemployment in cities throughout the country. It traveled to Chicago, New York, Atlanta, Los Angeles, Boston and Fall River, Massachusetts to hear testimony, including statements by unemployed persons, State and local officials, and others. This testimony was very useful, and some of the recommendations in this Report were developed from ideas presented at these hearings.

The problem of unemployment is especially acute in the case of young people. In January, 3.7 million persons under the age of 25 were unemployed. Indeed, this prolonged recession threatens to spawn a large disenchanted group of young adults -- out of the work force, without opportunity for adequate self-support, and alienated from the society that fails to accord them a productive role.

The Great Recession of 1973-1975, as Chart 1/1 starkly shows, dwarfs all previous postwar recessions in depth and duration. Two and one half years after this recession began, the economy has not yet returned to its 1973 income levels. Meanwhile, the

Chart I/1

POSTWAR RECESSION AND RECOVERY PATHS



Source: Department of Commerce

Nation's economic potential has grown faster since 1973 than during most previous downturns. Lost income and production since the start of the recession now totals some $400 billion in constant dollars, and further losses by 1980 will run in the range of $600 to $900 billion depending on the speed of recovery. In either case, this unnecessarily severe recession continues to involve a monumental waste of national resources.

It is in this light that the recommendations of our Report must be viewed. It is true that the economy has made good strides toward recovery in recent months. But no one should forget that it still has very far to go before its resources will be fully utilized and before inflationary shortages could recur on any significant scale. Stimulative economic policies at a time like this create jobs, productivity and income; not inflation.

The President's Economic Report is a blueprint for recession-level unemployment and high inflation for several years ahead.

The President's 1977 budget is so restrictive that it does not serve as a useful starting point for budget policy deliberations. His proposals to cut spending by $25 to $30 billion below the level needed to maintain current government services would mean a very sharp shift toward recession while the economy remains underutilized and unemployment remains above 7 percent. Compared with this irresponsible proposal, our recommendations may look quite stimulative. Compared to the projected needs of the economy, however, our recommendations are moderate.

The President's estimate of the budget deficit based on his policies, moreover, is so optimistic that it cannot be taken seriously. After correcting for this overoptimism, this Committee estimates that the

President's deficit would be nearly $60 billion -- not $43 billion, as he states. The Committee's recommendations, after counting additional tax revenues from higher income and employment, would not materially enlarge the deficit, yet more than 1-1/2 million more jobs would be available under the Committee's program, real output would be 4 percent higher and the inflation rate 2 percentage points lower.

The long-awaited recovery from recession is less assured than the President and his economic advisers would have us believe. Although an important element of confidence is returning, capital investment still is languishing; housing construction is far below what it should be with a record number of young people forming new households; and consumer intentions remain uncertain. We expect improvement in economic performance in the next several months, but we are very concerned that the President's restrictive 1977 budget, if accepted, would remove the supports from beneath the recovery at a critical time. Unless economic policies are substantially more stimulative than the Administration proposes, the recovery could founder in 1977. It is distressing to realize how long and slow that recovery will be even if more stimulative fiscal and monetary policies are adopted.

The severe recession of the past two and a half years need not have been so drastic. Its severity is a direct result of economic misunderstanding and mismanagement by the Administration and the Federal Reserve. The Nation is a victim of misguided policies.

Administration officials would have us believe that such a recession was the unavoidable consequence of an inflation which stemmed from profligate government spending. This myth has been repeated so often from such high pedestals that many otherwise well informed people believe it. The truth is that the inflation of 1973-1974 derived not from

government profligacy but largely from factors such as grain, oil, and dollar devaluations that did not reflect generalized excess demand.1/ The recession has been gravely prolonged by failure to understand this in the Administration and the Federal Reserve. Eagerness to believe their own preconceptions has blinded them to reality.

In spite of warnings from many economists and from this Committee, the Administration and the Federal Reserve continued in 1974 to apply restrictive fiscal and monetary policies to an already collapsing economy. As late as November of 1974, the President and his advisers referred to inflation as "public enemy number one" without mention of rising unemployment. In December, the President still was calling for a tax increase (surcharge) when a tax cut clearly was needed to bolster the economy against collapse. Congress fortunately rejected this request.

The bitter results of overly restrictive policies are still with us. This is the cause of today's enormous budget deficits, occasioned by recession-induced outlays and revenue shortfalls. Every percentage point in unemployment costs the U.S. Treasury an estimated $17 billion -- $12 billion in lost tax revenues and $5 billion in food stamps, unemployment insurance, and other support programs. The recession also is the main cause of the persistent decline in real capital formation.

The Nation has failed consistently to meet the objectives of the Employment Act of 1946 under which this Committee was established. After 30 years, it is evident that we must improve our

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1/ See Joint Economic Committee, Achieving Price Stability Through Economic Growth, December 1974, Chapter II.

capacity to manage the economy to achieve full employment. To attempt less would be an inexcusable failure to use our ingenuity to build a more rational and humane society.

This objective will require nothing less than fundamental reform of the institutions and policies we employ for making national economic policy. Among the new initiatives needed to achieve full employment are the following:

- A national commitment to all adult Americans able, willing, and seeking to work, to provide opportunities for useful paid employment at fair rates of compensation;

- The establishment of annual economic goals jointly by the President, the Congress, and the Federal Reserve to achieve full employment, production, and purchasing power;

- The use of fiscal and monetary policy to meet the annual economic goals with provisions to encourage the Federal Reserve to pursue monetary policies that support these goals and that achieve full employment as promptly as possible;

- The establishment of a process of long-range economic planning to analyze developing trends and economic conditions; to recommend long-term goals for full employment, production, and purchasing power; and to propose policies and programs to achieve such goals; 2/

- The establishment of supplementary employment policies to close the gap, if one should exist, between employment levels achieved

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2/ See Representative Long's comments, p. 18, footnote.

through aggregate monetary and fiscal policy and the goals adopted to achieve full employment as promptly as possible. Supplementary employment programs should be designed to reduce unemployment due to recessions and to structural barriers within regions and among particular labor force groups; and

- The establishment of comprehensive anti-inflation policies that directly moderate price increases in noncompetitive industries which threaten to undermine national progress toward price stability.

In submitting its recommendations on economic policy to the Congress, the Joint Economic Committee must deplore the continual statements of Administration officials that purvey ignorance and misinformation to the public on matters of economic policy. Despite its deficiencies, economics has become a highly developed discipline. Administration officials often speak as though they had heard nothing of its progress in the past 40 years. To illustrate:

- In dealing with the large deficits of recent years, the Administration ignores the fact that they result directly from recession and not vice versa. When unemployment mounts, tax revenues decline and spending on unemployment compensation, among other things, rises. This process is one of the so-called "automatic stabilizers" of the economy. Each percentage point of unemployment, as noted above, increases the Federal deficit by about $17 billion. If unemployment in fiscal year 1976 had been at 4 percent instead of its

67-480 O - 76 - 2

projected level of about 8 percent, the deficit would have been very largely eliminated. Yet the Administration spreads the erroneous notion that the deficit is caused by "wasteful spending."

- Another distortion of fact lies in constant allusions to massive growth in Federal spending. The Federal Government is not gobbling up the national pie. As a proportion of gross national product (GNP), in fact, the Federal budget has maintained a roughly constant 20-percent share from 1953 to 1973. Federal employment has fallen steadily over the same period as a share of the civilian labor force, from 4 percent to 3 percent.

- Inflation cannot be talked down by castigating the Congress for its budget decisions. Congress now has a rigorous process for regulating the budget. Dealing with inflation responsibly requires public action to ease supply shortages, to curb excessive wage and price increases, and to cushion the domestic effect of world price fluctuations.

- It is time to stop misleading statements on the significance of the national debt. The facts are that the debt has dropped sharply from 82 percent of annual GNP in 1950 to 26 percent in 1974.

There are other illustrations of poor economic analysis by the Administration, such as warnings that Federal borrowing will "crowd" private investors out of the credit markets at a time when credit is overly abundant; and such as unnecessary alarms about social security financing and proposals to raise social security taxes needlessly while the economy remains weak.

Constant reiterations of archaic and erroneous notions mislead the public. They are divisive and harmful to the formulation of reasoned economic policy. We call on the Administration to cease these proclamations and to elevate the discussion of economic policy to a more informed and productive level.

Main Recommendations

For the immediate future, the Committee recommends a number of essential policy initiatives:

• Current services budget estimates prepared by the Congressional Budget Office, rather than the President's budget, should serve as a starting point for congressional decisions on the 1977 budget. Congress should make reductions from current services outlay levels wherever such reductions are consistent with efficient maintenance of necessary government services. Because of the high unemployment which will still persist in 1977, a large part of the savings achieved in this way should temporarily be invested in programs to deal with unemployment.3/ Adoption of our recommendations would result in an estimated outlay total of $412 to $418 billion.4/5/6/

• Action should be taken prior to July 1 to provide for continuation at least through the end of 1977 of the personal income tax reduction which has been in effect during 1975 and the first half of 1976.

3/ Senator Proxmire states: "I object to using the current services levels -- that is, last year's programs increased for population and price levels -- as a starting point. This is a mindless method. It legitimizes all those programs and expenditures -- good and bad -- now in the budget. I advocate zero-based budgeting, strict benefit-cost analyses,

(Footnotes continued)

(Footnote 3/ continued)

determining the economic costs of alternative programs, and cutting back or ending inefficient and useless agencies and outlays."

4/ Senator Sparkman states: "It is most disturbing to see continuing increases in Federal spending. I believe that the Congress and the Administration must make greater efforts to limit this spending growth. For that reason, I would place particular emphasis on the proposal in the Report that immediate efforts be made to reduce spending for programs that do not have high priority. I believe we should do this with even greater efforts than stated in the Report.

"Also, I would hope that the strength of our recovery and the wise use of monetary and tax policy could speed up the recovery and thereby reduce the deficit. An economic recovery will automatically increase incomes, which in turn leads to higher revenues. Likewise, it should greatly reduce the need for spending on such programs as unemployment, welfare, food stamps and emergency employment. In this way, there would be a healthy force working to reduce public spending. It must be remembered that the recession has been very costly to the Federal Government as well as to the other sectors of our economy."

5/ Senator Proxmire states: "I strongly oppose such a high budget outlay. See my supplemental views on p. 237."

6/ Representative Hamilton states: "Although I favor a more stimulative program for the economy than the President has proposed in order to sustain and quicken the recovery now underway, I am concerned with the magnitude of the stimulus proposed by this Report. I am hopeful that the recovery will be vigorous enough to avoid reaching the spending target recommended in this Report. For that reason, I will reserve judgment at this moment on the specific

(Footnotes continued)

(Footnote 6/ continued)

expenditure figure recommended herein.

"The report also recommends the enactment of a large number of legislative proposals. While I subscribe to the objectives of these proposals, and may very well support them when they come before the Congress for consideration, I do not want my general approval of the Majority Report be be construed as an unreserved endorsement of each such proposal."

• The strength of the recovery should be carefully monitored during the next few months. Should output growth appear to be dropping below the 7-percent rate needed to bring unemployment down appreciably, an additional tax cut should be enacted for 1977. This additional reduction should be of a type which will act directly to reduce costs and prices. An income tax credit against some part of social security taxes paid would meet this requirement.

• No increase in the social security tax rate is necessary or desirable in 1977, nor should the Federal unemployment insurance tax rate be increased at that time.

• The President should establish and vigorously support a voluntary program designed to ensure that price increases are held to a necessary minimum during 1976 and that real wage increases are in line with productivity gains, taking into account the expected rate of price increase. The Council on Wage and Price Stability should be given full Presidential support in the use of its authority, including its subpoena authority, to investigate price increases and to seek compliance with price and income standards. Tax policy should also be used to contribute to the achievement of a satisfactory rate of increase in workers' real disposable incomes. We believe such a program can succeed in reducing the inflation rate to 5 percent this year and 4 percent by the end of the next year. This goal can be achieved without resort to comprehensive price or wage controls, to which we are opposed.

• During the remainder of 1975, monetary policy should be conducted so as to avoid any substantial rise in short-term interest rates and to encourage reductions in longer-term rates. Temporary fluctuations in the rate of growth of the monetary aggregates should not precipitate monetary policy changes so long as the pattern of interest rates is

satisfactory. Over the longer run, however, growth of the monetary aggregates must be in line with potential growth of real output.

• The costs to the Nation of prolonged unemployment are unacceptable. The goal of economic policy should be to reduce the unemployment rate to 6 percent by the end of 1977 and eventually to achieve an unemployment rate no higher than 3 percent of the adult labor force.

• A comprehensive strategy for dealing with unemployment is essential to overall economic recovery. An antirecession program should place primary emphasis on providing jobs -- in the private sector to the extent possible, but supplemented by emergency public works jobs and public service jobs as necessary. Unemployment compensation should be used to assist workers who are jobless for relatively short periods of time. Until enough jobs are provided, however, unemployment compensation or other income support must be extended. Federal supplemental unemployment benefits should be phased out with the implementation of an adequate jobs program.7/

• Emergency job programs should be expanded to provide additional jobs for the cyclically unemployed -- those who normally could find jobs when the economy is operating near capacity. The additional jobs

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7/ Senator Proxmire states: "This could become a very costly program unless done right. I advocate that the Government become the employer of last resort by providing useful work at the unemployment compensation rates of those laid off (plus the cost of getting to work) and at the minimum wage for those with no unemployment compensation eligibility who are entering the labor force. In this way useful work can be performed for the society at little added cost."

created by this program expansion should be in special projects lasting from one to two years and having a useful and identifiable output. The jobs should be clearly temporary and should make use of skills which the participants already have. This emergency program should be in addition to the existing CETA job training and public service employment programs. Appropriations should be provided to create a total of one million jobs during 1977, including the 600,000 jobs which would be provided under legislation recently passed by the House of Representatives extending and enlarging Title VI of CETA.

• Congress should quickly reenact and the President should sign legislation providing for

(a) countercyclical aid to State and local governments, and

(b) an emergency public works program designed to fund high-priority local work projects.

• Nearly one-half of the total unemployed are persons under 25 years of age. Extended idleness for young people with little past work experience will result in severe social and economic costs. Congress should give high priority to developing a comprehensive program targeted specifically at the unemployment needs of young people.

• Congress should enact legislation establishing Federal planning procedures to develop long-range policies for balanced economic growth and full employment. These procedures should provide roles for Congress and the Executive Branch as equal partners in the planning process and should provide for full participation by the private sector and by State and local governments. The goals of full employment

and price stability should be high priorities in any system of economic planning.8/

• The Social Security Trust fund is in basically sound condition. The single most important thing that can be done to ensure the continued soundness of the social insurance system is to restore health to the overall economy. Even so, some changes will be necessary to avert problems in 1980 or after, but Congress has time to give careful consideration to the full ramifications of these changes.

• Congress should enact policies designed to increase the rate of housing starts to levels that are consistent with a national goal of 2.3 million units annually. This level of production is sufficient to meet the demand created by net new household formation and replacement of the existing housing stock. Top priority should be given to programs designed to make new and existing housing affordable to more families. As a first step toward implementing this recommendation, the $2 billion available for use in the Government National Mortgage Association tandem plan should be released immediately.

• Congress should give energy conservation higher priority, moving promptly to consider economic incentives and assistance to realize energy efficiency in residential and commercial buildings, industrial processes, transportation, and electric power generation. While pursuing promising technology development based on nuclear and fossil fuels and the development and production of synthetic fuels

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8/ Representative Long, La., states: "I believe that the thrust of this recommendation is to coordinate the activities of the Federal Government so that the private sector will have a better idea of exactly what Federal policy is and what the intentions of the Federal Government are."

from nonpetroleum feedstocks, Congress should provide adequate funding for research and development on energy conservation and the use of renewable energy sources. 9/

• To gain control of the tax expenditure budget and to ensure that each provision serves a useful purpose equitably and effectively, Congress should direct its tax-writing committees to report on all tax expenditures within five years. After critical examination, each item should either be reauthorized with or without modification for a period not to exceed five years, or else eliminated. A regular five-year review cycle should be established.

• Tax reform should be given high priority on the legislative agenda in 1976. Actions should be carefully considered which would provide a more effective and equitable tax system. Any revenue-raising changes should be offset by general tax reductions.

• Congress should review the Federal laws, agencies, and regulations affecting small business. This review should develop a National Small Business Policy that will foster a dynamic small business sector.

• Small firms, which need high retained earnings to finance operations, pay far more of their earnings in taxes than big businesses. The Treasury Department, Federal Trade Commission, and Securities and Exchange Commission together should review the reasons for this phenomenon and make recommendations for tax code revisions to make the effective rates more equitable.

9/ Representative Moorhead, Pa., states: "To provide for added emphasis to conservation R&D is good as far as it goes, but much of the answer to the Nation's energy needs rests with commercialization of already existing synthetic fuels technology. See my supplemental views on p. 264."

• Business investment may need to be proportionately greater in the next several years than in the past decade. The most serious obstacle to the achievement of needed investment is the underutilization of existing capacity and the lack of promising markets for the output of new factories. A shift in demand growth from basic materials toward less capital-intensive sectors could reduce total capital needs significantly.

• Private saving augmented by shifts in international capital flows should remain adequate to fund desired investments at reasonable interest rates at least well into the year 1977, given proper monetary policy. If congestion appears in credit markets later in the recovery, new savings incentives or an adjustment of the Federal budget toward surplus would become desirable.

• Effectively designed proposals to stimulate capital formation should be given careful consideration. There are a number of tax preferences in today's corporate tax code, however, that are poorly designed or outmoded and do not serve this purpose effectively. In view of the redistribution of the tax burden that already has occurred from corporations to individuals, the revenue loss from any new corporate tax incentive should be offset by closing these ineffective loopholes. Any corporate tax reduction should emphasize reductions at the small-business end of the spectrum.10/

10/ Senator Proxmire states: "The corporate income tax is not a progressive tax. Its incidence falls on consumers and employees far more than on stockholders. It inhibits investment. It should be reduced as the President has requested. I would favor an even greater reduction."

• To provide a realistic opportunity for more U.S. citizens to become owners of capital, and to provide an expanded source of equity financing for corporations, it should be made national policy to pursue the goal of broadened capital ownership. Congress also should request from the Administration a quadrennial report on the ownership of wealth in this country which would assist in evaluating how successfully the base of wealth was being broadened over time.

• As long as the economy operates significantly below capacity, the real value of Federal assistance to State and local governments should not be allowed to decline. Congress should reject changes in Federal policies that significantly increase the costs and responsibilities of State and local governments.

• The countercyclical grant-in-aid program should be reenacted by Congress and signed by the President. It should remain in effect as long as the national unemployment rate remains above 5-1/2 percent.

• The General Revenue Sharing Program should be extended for three years so that State and local governments are assured of receiving this source of Federal assistance to meet current services needs without substantially increasing taxes.11/

• State and local governments should be offered the option of issuing taxable securities accompanied by a Federal subsidy of about 40 percent of the interest payment. The option of issuing a taxable bond with an interest subsidy should be

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11/ Senator Proxmire states: "I disagree. Revenue sharing should be ended forthwith and Federal tax sources should be shifted to the States instead. Revenue sharing severs the ability and the advantage of spending from the discipline and pain of raising the taxes."

available to all general purpose units of government but should not affect existing provisions of law that permit these governments to issue tax-exempt securities.

• As an initial effort to encourage the development of private sector job opportunities in chronically depressed areas, Congress should consider establishment of a regional economic development bank. The bank should be designed to make low-interest loans to businesses and State and local governments for the purpose of encouraging investment in chronically despressed regions or areas.

• The Congress should enact promptly in 1976 the legislation required to amend the IMF Articles so as to permit early full implementation of the agreement on monetary reform announced in Kingston, Jamaica, on January 8. This legislation should include provisions requiring congressional approval of any proposal to dispose of the remaining 100 million ounces of Fund gold or of a proposed return to a par value for the dollar. It should also include instructions to the Secretary of the Treasury indicating that any intervention in exchange markets conducted by or cooperatively participated in by U.S. monetary authorities should be short term, for the exclusive purpose of combating disorderly conditions in exchange markets, and should under no circumstances attempt to alter the trend of exchange rates.

II. ECONOMIC SITUATION AND OUTLOOK

In the second half of 1975, the United States economy began a recovery from the worst recession in the postwar period. Federal tax reductions and spending increases set in motion during 1975 will sustain that recovery throughout 1976, although its pace could slow in the second half. The support which these fiscal measures provided to real income will boost consumer spending and, combined with greater availability of credit, should help to maintain the modest recovery in housing which began at the end of 1975. These improved prospects, aided by returning confidence, may provide the impetus for business investment increases later in 1976. The budget policy decisions that must be made in 1976 will determine whether the recovery will maintain its momentum in 1977 or whether growth will slow, causing inflation and unemployment to persist at high rates.

The 1973-75 recession was not only the most severe in the postwar period, but the economy's rebound from this sharp decline could leave some productive labor and capital idle for the rest of this decade. In the final quarter of 1975, real output was still below the levels which prevailed in late 1973. This is the only postwar recovery in which the economy did not reach its prerecession levels within the first nine months of recovery. As Table II/1 indicates, output dropped twice as far in the 1973-75 recession as in any other postwar decline. In the early stages of the four previous postwar recoveries, furthermore, the economy's growth rate was twice or three times as high as the rate of decline in the recession. In 1975, this has not been true.

The loss in gross national product (GNP) from underemployed capacity from the start of the recession to the end of 1975 sums to nearly $400 billion -- a monumental total of wasted opportunity. Even if the economy experiences a sustained recovery, another $600 billion to $900 billion in output could be lost be 1980, depending on the speed of recovery.

In judging the present situation and policies to deal with it, one must be fully aware of how far the economy remains from the limits of its capacity.

Table II/1

Changes in Real Gross National Product in Postwar Recessions and Recoveries[a/]
(Percentage)

Period	Recession Decline	Recovery in First Nine Months
1953-54	-3.3	5.9
1957-58	-3.2	5.8
1960-61	-1.2	3.7
1969-70	-1.1	3.7
1973-75	-6.6	5.1

Source: Department of Commerce.
a/ See Chart I/1, p. 6.

The unemployment which accompanied the 1973-1975 declines in output was more severe than at any time since the Great Depression. The official unemployment rate rose to a peak of 8.9 percent in May and declined to just under 8.0 percent at the beginning of 1976. However, when one includes discouraged workers who have dropped out of the labor force and part-time workers who want full-time jobs, the unemployment rate climbed to nearly 12 percent and still remains in early 1976 over 9-1/2 percent. Recent improvements in the overall unemployment rate, moreover, mask the hardship suffered by several labor force groups: in January, the unemployment rate for blacks was over 13 percent; for teenagers it was almost 20 percent; for black teenagers, it was 35 percent; among construction workers was still above 15 percent. As pointed out in the Committee's recent regional hearings, unemployment rates in cities and in certain regions of the country are sharply higher than the

national average. The Committee's program to accelerate the return to full employment is outlined in Chapter III and IV.

The Outlook in 1976

In our judgment, real output may be expected to grow by about 6 percent in 1976, if the Administration's proposed policies are followed. Other forecasts of real output growth range from 5 to 7 percent, with the average a bit more pessimistic than our own. Those predicting growth rates approaching 7 percent generally assume a somewhat more expansive policy course than the Administration has recommended.

During the first half of this year, economic events will be determined largely by decisions which already have been taken. Important tax decisions yet to be taken could affect the economy beginning in the third quarter, and by the fourth quarter decisions relating to the fiscal 1977 budget will begin to have their effect. A sharp shift toward a restrictive budget policy such as the Administration recommends could materially weaken the prospects for continued economic recovery late this year and in 1977. By contrast, the supportive budget policy and other recommendations contained in this report would, we believe, raise the output growth rate for 1976 as a whole to about 7 percent and would provide for the continuation of a strong recovery in 1977.

Consumer spending in real terms is expected to rise by 5 to 6 percent this year, led by a strong increase in purchases of durable goods. Extension of the 1975 income tax reduction plus an historically high savings rate and the deferral of many major purchases during the past two years are factors contributing to a rebound in consumer spending. While the consumer sector should provide the bulk of the real growth in the economy this year, a renewal of inflationary expectations would weaken the still fragile improvement in consumer confidence.

The outlook for private investment -- which includes plant and equipment spending, residential construction, and inventory investment -- is less certain. A modest rise in housing starts to a level above 1.5 million by the end of 1976 will contribute to higher investment. This recovery will be hastened if the Federal Reserve pursues monetary policies which lower long-term rates throughout the year. The rebuilding of inventories also will contribute to GNP growth during the year. At the present time, however, business plans for investment in plant and equipment remain weak. The latest Commerce Department survey of spending plans indicates a decline of 4 percent in real investment in 1976. While these plans may be revised upward as the year progresses, investment in plant and equipment cannot be expected to make any significant contribution to the growth in real output during the first half of 1976.

Although the sharp drop in unemployment to 7.8 percent in January was welcome, it was so large that there may be a tendency in succeeding months for the rate to remain at this level or even to rise slightly. It is not uncommon for the unemployment rate to move in step-like fashion; that is, to drop sharply and then remain on a plateau for several months. It is possible that the drop in unemployment during January will be the major improvement that we will see this year.

A recovery path which increases output by only 5 to 6 percent in 1976 is unlikely to reduce the unemployment rate below 7.5 percent by year's end. In 1975 unemployment averaged 8.5 percent. Normally, a 4-percent growth in output is required to maintain the current unemployment rate; and for every additional three percentage points of real GNP growth, the unemployment rate drops about one percentage point. By this rule of thumb, growth in real GNP of 6 percent in 1976 would reduce the unemployment rate by about two-thirds of one percentage point from last year's average, or to an average of about 7.8 percent in 1976.

67-480 O - 76 - 3

Will The Recovery Be Sustained?

The continuation of a strong recovery into 1977 is in doubt at this time. According to the majority of forecasters, the adoption of a 1977 budget that cuts the level of real government services, such as the budget proposed by the President, will reduce the 1977 growth rate in real GNP to well below the 5 to 6-percent rate projected by the Administration. If the President's budget of $395 billion is adopted a growth rate of only 3 to 4 percent in 1977 appears probable. Those forecasters who predict 1977 growth rates close to the Administration's 5 to 6-percent projection uniformly assume that more stimulative budget policies will be adopted.

A growth rate of 3 to 4 percent would lead to an increase in the gap between actual and potential GNP and to a continuation of an unemployment rate well above 7 percent -- and probably above 7-1/2 percent -- throughout 1977.

Several of the sectors that are expected to lead the increase in GNP during 1976 will not be as strong in 1977. The rebuilding of business inventories in the early stages of recovery will be largely complete by the end of this year. The strong rate of increase in residential construction expected in 1976 is unlikely to be maintained in 1977 both because this year's spurt in homebuilding can hardly be repeated and because the high price of housing seriously limits demand. Real outlays at the Federal level and grants to State and local governments would be sharply reduced under the Administration's budget. Thus the government sector would be a source of weakness in 1977 if this budget were adopted.

This would leave consumer spending and business investment to lead any growth of output. But the strong stimulus given by the 1975 tax cuts and rebates to 1976 consumer spending will not be repeated in 1977. The income tax cuts recommended by the

Administration for 1977 would be substantially offset by recommended increases in social security taxes. The reduction in transfer programs implied by a $395-billion budget would further reduce the gains in consumer income. If inflation continues at the 6-percent rate expected by the Administration, this too would cut real incomes and also would mean that the personal savings rate,which is expected to decline somewhat in 1976 from its present very high level, would be unlikely to decline further in 1977. The combination of high inflation and the threat of unemployment, which has buffeted American families for the last three years, is likely to preclude a swift return to personal savings rates in the prerecession range of 6 percent of disposable personal income unless strong evidence emerges that both inflation and unemployment are being permanently reduced. All these restraining factors suggest a decline in the growth rate of consumer purchases to the 3 to 4-percent range in 1977 from the 5-percent growth we anticipate in 1976.

The outlook for investment in plant and equipment in 1977 remains relatively strong. Sharp increases in corporate profits during this year will provide the impetus for gains in business spending. Because of the time lags involved in actually executing increased investments, the influence of higher profits will be realized primarily in 1977. However, even an assumption of 10-percent growth in business investment, given the expected slowdown of the other major sectors, would be insufficient to raise the overall growth rate in real GNP above 3 to 4 percent.

Although it does not appear probable at this time, there is a possibility, which should not be excluded, that a restrictive budget policy combined with tighter monetary policy could halt the growth in output in 1977.

In sum, the continuation of a satisfactory pace of recovery in 1977 requires a set of economic policies which both provide support to the economy and instill confidence in consumers and businessmen that neither

inflation nor recession threatens again. We recommend such a set of policies in this report. We want to stress that policies operate with a time lag. Action in 1976 is needed to support continued recovery in 1977.

Prices. Prices at both wholesale and retail levels rose considerably more slowly in 1975 than in 1974. Consumer prices rose by 7 percent, compared to 12.2 percent in 1974. Wholesale prices rose only 4.2 percent, down from 20.9 percent in 1974.

As Table II/2 shows, the components of the consumer price index rose at similar rates in 1975. The 6.5 percent rise in food prices during the year was primarily due to sharply higher prices for meats, while other food items generally rose by less. The other two items causing the largest increases in consumers' budgets were fuels and medical care, which rose 11 percent and 10 percent, respectively.

In spite of the overall improvement in wholesale price behavior, there were increases among individual sectors that are cause for concern. As Table II/3 shows, the wholesale prices indexes for industrial commodities accelerated from the second quarter of 1975 to the end of the year. Price increases were greatest in lumber products (10.7 percent during the year), machinery and equipment (7.7 percent), mineral products (8.3 percent), and fuels (12.7 percent). The acceleration in many wholesale prices during this period of slack demand and low capacity utilization suggests strong market power on the part of a number of basic materials industries. A major factor contributing to the improved performance of wholesale prices was the modest increase in farm product prices and the 3.8-percent decline in processed food and feed prices during the year.

The Administration's forecast of 6 percent inflation in 1976 and 1977 is plausible if one assumes sluggish growth and the complete absence of any anti-inflation policy. Several factors will contribute to

Table II/2

Percent Change in Price Measures, 1973-1975

	Year			1975, by Quarters[1/]			
	73	74	75	I	II	III	IV
Consumer Price Index							
All items	8.8	12.2	7.0	6.6	7.0	7.4	7.3
Food	20.1	12.2	6.5	0.5	9.7	8.0	8.3
Energy (gasoline, motor oil, fuel oil and coal, gas and electricity)	16.8	21.6	11.6	1.4	17.0	23.6	6.0
All items less food	5.6	12.2	7.1	7.1	7.2	7.6	6.7
All items less food and energy	4.7	11.3	6.7	9.4	5.1	5.8	7.1
Wholesale Price Index							
All commodities	15.4	20.9	4.2	-6.3	7.2	11.1	5.6
Farm products, processed foods and feeds	26.7	11.0	-0.3	-27.6	17.0	26.8	-7.9
Industrial commodities	10.7	25.6	6.0	4.2	2.6	7.3	10.1
Fuels, related products and power	24.3	51.2	12.7	0.3	16.0	25.5	10.2

a/ Quarterly changes at seasonally adjusted annual rates.

Table II/3

Percent Change in Wholesale Industrial Prices
(seasonally adjusted annual rates)

	1974	1975	
	2nd half	1st half	2nd half
All industrials	19.5	3.4	8.7
By stage of processing:			
Crude materials, excluding foods and feeds	6.7	1.5	7.6
Intermediate materials, excluding foods and feeds	21.5	2.2	8.8
Producer finished goods	24.5	8.4	7.9
Consumer nonfood finished goods	15.6	3.9	9.6
Textile products and apparel	- 3.2	- 5.0	13.9
Fuels, related products and power	23.5	7.9	17.6
Chemicals and allied products	50.9	6.8	4.0
Lumber and wood products	-18.9	9.4	12.0
Pulp, paper and allied products	31.4	0.8	6.2
Metals and metal Products	16.3	-3.3	6.2
Machinery and equipment	26.5	8.7	6.6
Motor vehicles and equipment	21.4	6.0	8.7
Other industrial products a/	15.1	5.4	5.2

a/ Not seasonally adjusted; includes hides, skins, leather, rubber and plastic products, nonmetallic mineral products, furniture and household durables and miscellaneous products.

Source: Department of Labor, Bureau of Labor Statistics.

slightly better price performance this year than last. Food prices are not expected to rise more than 4 to 5 percent according to the latest Department of Agriculture forecast, although the current drought in the grain belt or other unfavorable weather developments could change this outlook substantially. Average crude oil prices should not rise and may decline somewhat as a result of the domestic price rollback. The gains in productivity which usually accompany the early stages of recovery should hold down unit costs of output in most sectors.

Private forecasters and several witnesses before this Committee have emphasized the possibility of reducing the inflation rate below the Administration's 6-percent forecast. Stronger GNP growth in the second half of 1976 and early 1977 would hold down unit costs through greater increases in productivity. A stronger government role in restraining prices in concentrated industries, where prices rose even at the bottom of the recession, could hold price increases to 5 percent this year and improve the possibility for an inflation rate in the 4-percent range by the end of 1977.

Wages. Wage settlements over the life of union contracts rose by 7.8 percent in 1975 compared to 7.3 percent in 1974. These increases in wages and in wages combined with benefits were more modest, however, than one would have expected considering the declines in real income which workers have suffered. Real hourly earnings -- that is, earnings adjusted for inflation -- declined 1.1 percent in 1973 and 3.4 percent in 1974. A high unemployment rate combined with falling corporate profits in 1975 limited the size of settlements during the year. As Table II/4 shows, increases in overall compensation for the entire economy in 1975 averaged 9 percent compared to 9.7 percent in 1974.

This year the collective bargaining calendar is especially heavy with 4.4 million workers affected by contract expirations, compared to 2.5 million in 1975. Major industries facing contract negotiations include

Table II/4

Annual Rates of Change in Compensation, 1973 - 1975

(percent)

Measure of Compensation	1973	1974	1975
I. Wages (1,000 workers or more)			
First year adjustment	5.8	9.8	10.2
Average over life of contract	5.1	7.3	7.8
II. Wages & Benefits Combined			
First year adjustment	7.1	10.7	11.2
Average over life of contract	6.1	7.8	8.0
III. Aggregate Compensation Measures			
Total compensation per hour, all employees, private nonfarm economy	7.9	9.7	9.0
Average hourly earnings, production or nonsupervisory workers, private nonfarm economy	7.0	8.3	7.0
Real adjusted hourly earnings	-1.1	-3.4	2.2

Source: Bureau of Labor Statistics.

automobiles, trucking, construction, electrical machinery, meat packing, rubber, farming, and construction machinery. Rising corporate profits and an attempt to catch up with past price increases, especially by unions without cost-of-living escalators in their existing contracts, will put strong upward pressure on wage settlements. Continued high levels of unemployment will exert some pressure in the opposite direction, but the factor which could have the greatest effect in encouraging moderation in wage settlements would be confidence that the rate of increase in consumer prices will continue to decline. A price-incomes policy designed to provide that assurance is discussed in Chapter III.

Energy

The 1975 Joint Economic Committee Report focused on the potential economic impact of the oil pricing proposals announced by the President in January 1975. These included heavy new tariffs and excise taxes on oil and removal of price controls from oil and gas. The Administration claimed that these steps would reduce oil imports by one million barrels per day by the end of 1975 and by two million barrels per day by January 1977.

The Committee pointed out the arbitrary nature of the proposed oil import reductions. To this day no justification of these objectives has been presented. It also emphasized the damaging economic effects of adopting the Administration's energy program. It was calculated that the President's package would have added between 3 and 4 percent to the inflation rate in 1975 and would have diverted up to $55 billion in purchasing power annually from the consumption spending stream to the Government and sellers of oil. Given the depth of the recession one year ago and the persistence of unacceptably high inflation, enactment of the President's energy program would have dealt a catastrophic blow to the economy.

A congressional energy program provided an alternative to the President's proposals and laid out

the framework for the Energy Policy and Conservation Act that was passed in December.1/ A number of important provisions, many of them recommended in the Committee's annual report, were incorporated in the final version of this Act. These included automotive fuel efficiency standards, requiring doubled fuel efficiency by 1985; mandatory energy efficiency labeling for major home appliances; energy efficiency targets for the 10 energy-intensive industries; conservation standards for Federal agencies; standby presidential authority for national emergencies; provisions to expand coal production and its use in electric power generation; and authorization for a strategic petroleum reserve. Despite persistent Administration opposition to the oil pricing provisions during most of the year, the President's reluctant decision to sign this measure enacted legislation that shields the economy from unwise energy price increases and also sets in place essential pieces of a balanced and comprehensive long-term energy strategy.2/

1/ The Congressional Program of Economic Recovery and Energy Sufficiency, first published in February 1975.

2/ Representative Gillis Long states: "While I generally agree with this analysis, I am concerned with several aspects of the oil price mechanism, and I was very disappointed when the President signed the bill. For one thing, the $7.55 composite price does not provide enough incentive for increased domestic production, especially for the independent producers who found 94 percent of all new domestic oil fields in 1974. When the House of Representatives passed its version of the Energy Policy and Conservation Act, I was able to pass an amendment that would have encouraged increased domestic production so that we would be less dependent on foreign oil, which is so expensive and unreliable. Unfortunately, the final bill did not contain the necessary provisions to achieve these goals, and I could not support the bill."

The Senate and House next must resolve differences over the prices of natural gas in both interstate and intrastate markets. It is inappropriate for this Committee to suggest the components of an acceptable compromise prior to action by the Senate-House Conference Committee. At a minimum, however, the average price approved for natural gas should not exceed the average price per Btu for oil under the compromise agreed to in the Energy Policy and Conservation Act. The natural gas pricing provision should cover both intrastate and interstate gas. Protection against exorbitant price increases, combined with fair incentives for producers to expand supply, should continue to be the objective. 3/

Despite settlement of some of the contentious energy policy issues of the past two years, much remains to be accomplished. There is no presently apparent way at any reasonable cost to reduce U.S. dependence on Arab oil greatly by 1985. 4/ We may be doing well to hold imports to a constant fraction of consumption. Many of the energy production options that were viewed with enthusiasm in the initial response to higher energy prices -- especially the technology development projects for synthetic fuels, shale oil, and nuclear power -- now are seen to involve much more time and far higher costs than were anticipated. 5/

3/ Representative Gillis Long states: "I strongly support the Pearson-Bentsen and Krueger bills, which would deregulate natural gas over a 5-year period. I believe that deregulation of natural gas will ultimately result in assuring the American people a steady supply of natural gas at reasonable prices."

4/ Representative Gillis Long states: "I believe significant gains can be made to reduce U.S. dependence on foreign oil by increasing domestic production, as I indicated in a previous note."

5/ Representative Moorhead, Pa., states: "I believe significant advantages can be gained through the commercialization of existing synthetic fuels technology, involving much less time and expense than predicted, as noted in my supplemental views on p. 264."

Creation of a strategic petroleum reserve, authorized by the Energy Policy and Conservation Act, will provide more prompt and economical insurance against threats of supply interruptions than an array of crash programs to develop advanced technologies. While these options should be pursued, their cost effectiveness should now be reassessed against that of more prosaic but eventually high-payoff possibilities such as conservation, coal, and solar heating and cooling. Given the present production-oriented Federal energy policy, we believe that some shift in the emphasis, which will be described more fully in Chapter V, is appropriate.

Longer-Run Growth Prospects

One of the fundamental questions for economic policy is whether the economy can and should continue in the longer term to grow at the rates of the past two decades. The desirability and the possibility of continuing rapid growth has been questioned in recent years far more than in the past. Most people until recently supported rapid growth while only a few analyzed its costs. Now, however, these questions have become very widespread. Recognizing the need for a fair distribution of employment and income, many people have begun to doubt that continuing growth brings overall increases in the quality of life. In addition to the ultimate physical limits imposed by nature, moral, social, and cultural limits to growth are coming to the forefront of the argument.

For the medium term, trends in economic activity are determined largely by the development of the Nation's maximum productive potential based on the growth of the labor force, the number of hours worked, and labor productivity, which reflects the rate of investment and the development of technology. Since the end of 1968, potential output has been growing at about 4 percent per year. As we move toward the 1980s, however, the growth of this potential is expected to decline, primarily because the large number of people born in the decade after World War II will have entered the labor force, and the flow of new manpower will then drop off. In the 1980-85 period,

therefore, growth of potential output should decline to to 3 to 3-1/2 percent.6/

The potential growth rate also could be affected in the medium term by other factors: (1) Lower rates of investment, foreseen by some, and correspondingly lower productivity advances; (2) a possible decline in dramatic technological innovations; (3) saturation of markets for certain products, particularly consumer durables; (4) a potentially limited capacity of service industries to employ an ever larger share of the labor force; and (5) higher prices of raw materials, largely from less developed countries.

In the long run, limits to growth in the world at large may be posed by the availability of raw materials and energy, by the limits to environmental tolerance of pollution, or by the rise of a conservation ethic replacing the traditional growth ethic. Whether or not this will occur depends on a large number of unforeseeable variables, primary among which are the course of future technological progress and the ability of policymakers to foresee and adopt to the evolution of circumstances.

At the very least, a basic consensus, stated at a recent Committee hearing by Louis Lundborg, retired Chairman of the Bank of America, seems to be emerging. Mr. Lundborg testified that "Our present exponential rate of industrial growth, based on nonrenewable natural resources, simply cannot be sustained." This view was supported by other witnesses at the hearing.

Although recognizing that serious impediments to maintaining recent growth rates may be on the horizon, the Committee still believes, as reflected throughout this Report, that healthy U.S. economic growth is necessary over the medium-term future. This

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6/ More detailed projections are to be published in the Monthly Labor Review in the spring of 1976. These projections will update a similar study published in the same Review in December 1973.

statement does not imply, however, that future growth patterns should be the same as growth patterns of the past. Rather, the Committee supports the idea that the qualitative dimension of economic growth -- the way we grow -- must become an integral part of economic analysis and policymaking.

If an adjustment must be made to a slower growing economy or to a different kind of growth, this adjustment may be one of the most profound since the industrial revolution began. In this case, the question of the timespan over which such an adjustment must happen and what forms it may take becomes one of the most important for scientists and social thinkers to address.

In this spirit, the Committee has launched an extensive study series entitled U.S. Economic Growth, 1975-1985: Prospects, Problems, and Patterns. This series will present the research results of more than 50 authors from diverse disciplines in both the social and physical sciences. Many issues will be examined from both traditional and new perspectives. These papers will be published by the Committee beginning in the spring of 1976.

III. FISCAL, MONETARY, AND PRICE-INCOMES POLICIES

In 1976 and 1977 the opportunity will be present to make significant progress toward both lower unemployment and less inflation. This desirable progression of events will not occur spontaneously, however. Federal policies must be consciously directed toward specific targets for output, employment, and prices. This chapter describes the targets which we believe to be appropriate for 1976 and 1977 as well as the fiscal, monetary, and price-incomes policies needed to achieve those targets. Subsequent chapters describe the direct labor market policies and other supplemental policies which are also necessary for achieving the recommended goals.

The Goals of Economic Policy

The 1975 Annual Report of the Joint Economic Committee recommended that policy in 1975 be directed toward an output target for the fourth quarter of 1975 which would be consistent with an unemployment rate of 7.8 to 8.1 percent. Actual output in the fourth quarter of last year was very close to the recommended target, and the unemployment rate, although it remained above target in the fourth quarter, has subsequently fallen to 7.8 percent in January. This time lag between output changes and changes in the unemployment rate is to be expected in the early stages of an economic recovery.

Targets for 1976. Last year we also recommended that policy be directed toward achieving real output growth of 8 to 9 percent from the fourth quarter of 1975 to the fourth quarter of 1976. We continue to believe that such rapid growth of output would be desirable. It would pose no threat of

accelerating inflation.1/ Indeed, the productivity gains associated with rapid growth would help reduce the rate of price increase.

It does not presently appear, however, that 8 to 9 percent output growth is at all likely in 1976. It would be a disservice to advocate short-term policy targets which have such slim hope of realization. The maximum output growth which it seems reasonable to expect during 1976 is about 7 percent. We recommend this as an appropriate policy goal for this year.

• Employment Targets. Achievement of this output target would still imply an unemployment rate of 7.2 to 7.3 percent at the end of this year. This we do not regard as satisfactory. Our short-run goal should be to bring the unemployment rate below 7 percent by the end of this year. To do so will require supplementing monetary and fiscal policy with special emergency job programs. These programs are discussed in Chapter IV.

• Price Targets. Measured by the deflator for gross national product, prices rose 6.5 percent from the fourth quarter of 1974 to the fourth quarter of 1975. The Administration projects further price increases of 5.9 percent in 1976 and 6.3 percent in 1977; in other words, no further dimunition of inflation either this year or next.

We believe that both tax policy and price-incomes policy can be utilized in ways which will significantly increase prospects for regaining price stability. The setting of specific price targets is

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1/ Representative Gillis Long states: "Generally, I support increased output as an essential element of economic recovery; however, I am concerned about a resurgence of inflation which could possibly result from this. I would not go so far as to say that increased output poses no threat of accelerating inflation, but I recognize fully the need for increasing output."

necessary to provide the guidance which business and labor need in order to join in a cooperative voluntary effort to further reduce inflation. With proper policies, the rate of inflation should not exceed 5-1/2 percent for 1976 as a whole. By the fourth quarter the inflation rate should be no higher than 5 percent.

In recommending specific price targets, we wish to stress, however, that some causes of inflation lie essentially outside the control of economic policy. Our recommended targets assume an adequate harvest and the absence of new external price shocks. Should some major unanticipated event, such as the world oil price increases of 1973-74, occur in 1976, these price targets will require amendment.

Goals for 1977. Policies adopted now will have more influence in 1977 than in 1976. As discussed in the previous chapter, the present outlook is for output growth to slow significantly in 1977 and for unemployment essentially to remain stuck at a rate above 7 percent. Obviously, this is not a satisfactory outlook. Policy actions are needed now to support a stronger economy in 1977.

Policies should be directed toward continuation of a 7 percent rate of growth of real output in 1977. Policy should also aim to reduce the rate of unemployment to 6 percent or less by the fourth quarter of 1977. As in 1976, this will require augmentation of fiscal and monetary policy with a temporary program of direct job creation.

Neither labor nor capital resources can be expected to approach full utilization in 1977. Hence continued rapid output growth poses no danger of worsened inflation. Rather, rapid growth coupled with appropriate tax policy and voluntary price-incomes policy can reduce the inflation rate to no more than 4 percent by the end of 1977. Again, this inflation goal assumes adequate harvests and the absence of major external price shocks.

67-480 O - 76 - 4

Table III/1 summarizes our suggested policy goals for 1976 and 1977. These targets are ambitious, but they are not unattainable. With unemployment still well above the levels of past recessions and with prices still rising at a rate which prior to the 1970s would have been regarded as intolerable, there is no room for complacency about the economy. To aim at targets which represent anything less than the maximum progress which can be achieved would be to turn our backs on the Employment Act mandate to promote "maximum employment, production and purchasing power."

The benefits of achieving these targets are well worth the effort. By the end of 1977, more than 1-1/2 million more jobs would be available than would be the case if the Administration's policies are followed. The unemployment rate would be 1.7 percentage points lower, real output 4 percent higher, and the rate of price increase 2 percentage points lower. The Administration's program would keep unemployment stuck very close to its present 7.8 percent rate. Our proposals would bring unemployment down steadily and fairly rapidly.

Returning to Potential Output: Goals for 1980. Chart III/1 compares potential output through 1982 with expected actual output under two different assumptions. The output path labeled "desired recovery path" assumes that our recommended output targets for 1976 and 1977 are achieved. From 1978 through 1982, it is assumed that the rate of growth of real output is gradually reduced from the 7 percent of 1977 toward the 3-1/2 percent which will approximate the growth of potential in the early 1980s.2/ In

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2/ The potential growth rate is defined as the rate of real output growth necessary to keep the economy operating at a constant level of resource utilization. It is determined by growth of the labor force, changes in average hours worked, and growth of output per hour (productivity). The potential growth rate is presently about 4 percent per year but, because of slower growth of the working age population, it is expected to drop gradually to about 3-1/2 percent by 1980.

Table III/1

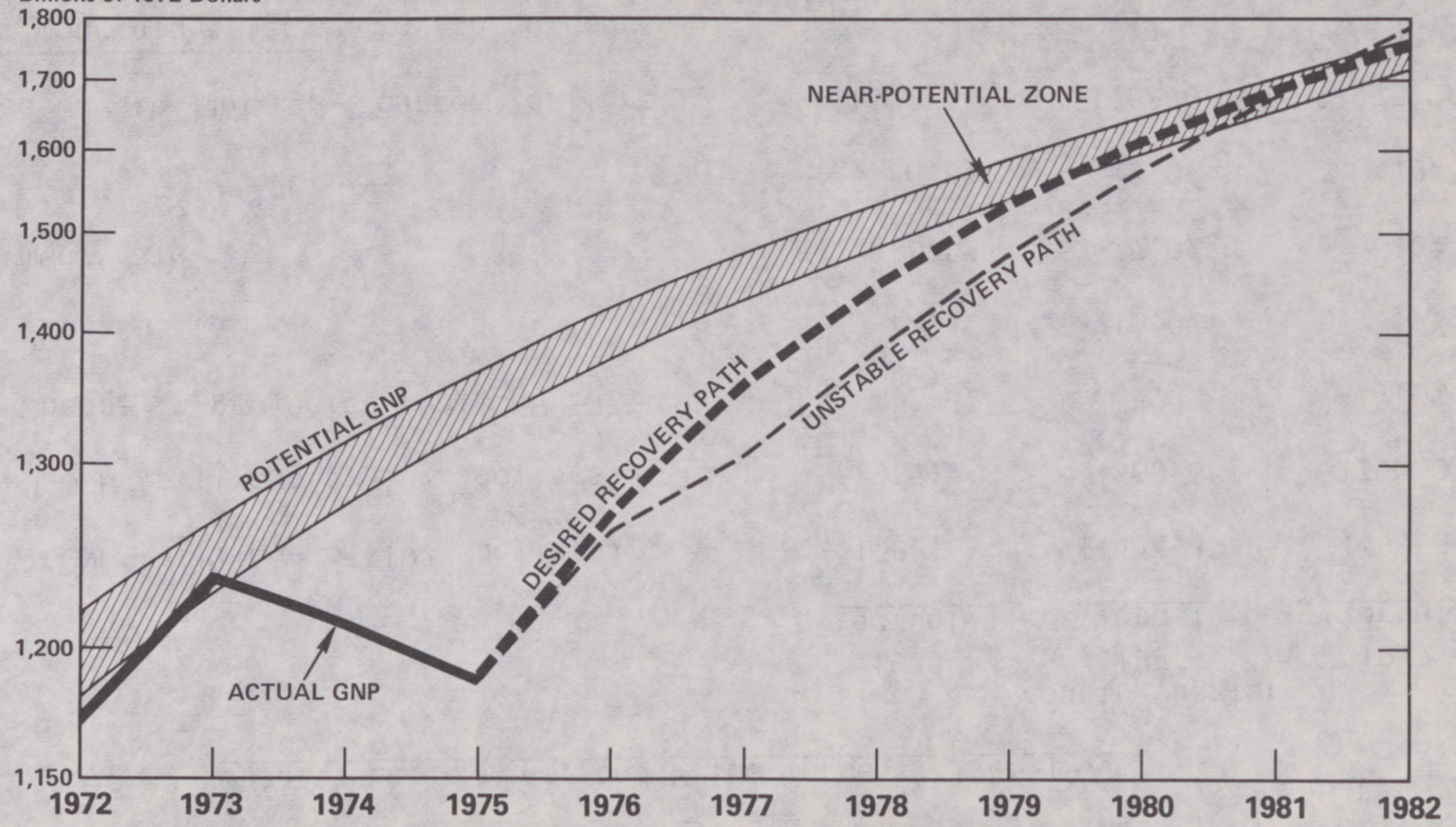
Output, Employment, and Price Targets, 1976-1977

	1975 (actual)	Fourth Quarter 1976 (target)	1977 (target)
Potential GNP (billions of 1972 dollars)	$1388.8	$1444.4	$1498.6
Projected GNP (billions of 1972 dollars)	1215.9	1300.0	1390.0
Percent Change in projected real GNP a/	2.5%	7.0%	7.0%
GNP Gap b/	12.4%	10.0%	7.2%
Unemployment rate	8.5%	7.0%	6.0%
Inflation rate c/	6.8%	5.0%	4.0%
Projected GNP (billions of current dollars)	$1572.5	$1768.0	$1970.0

a/ From fourth quarter to fourth quarter.
b/ Difference between actual and potential GNP as a percent of potential.
c/ GNP deflator, percent change during quarter, seasonally adjusted annual rate.
Sources: Department of Commerce, Council of Economic Advisers, and Joint Economic Committee.

Chart III-1

ALTERNATIVE RECOVERY PATHS



Sources: Council of Economic Advisers, Joint Economic Committee

this way the economy enters its potential zone growing at a rate sufficiently moderate that sudden demands are not imposed on scarce resources. With a growth pattern of this type, inflationary bottlenecks can be avoided, and continuing operation of the economy within the zone of its potential should be compatible with reasonable price stability.

The output path labeled "unstable recovery" does not bring the economy to its potential zone until 1981. Furthermore, potential would be reached in a way which would both increase the cumulative loss of output prior to 1980 and greatly enlarge inflationary risks. This path assumes that output growth will drop below 4 percent in 1977, a pattern which in our judgment must be expected if Administration policies are adopted. It is then assumed that, beginning in 1978, the economy grows steadily at 6.5 percent per year until the zone of potential output is reached. This is the type of path which is assumed for planning purposes in the Administration's five-year budget projections. Judging from historical experience, such a pattern is extremely unlikely to be achieved. If it were to occur, it would cause output to come up against its potential while still growing rapidly, creating inflationary pressures which would prevent the maintenance of a stable full employment growth pattern.

Even based on the path labeled "desired," the cumulative loss of output resulting from the recent recession will approach $1 trillion through 1980 (measured in 1975 prices). This enormous loss is all the more tragic because much of it could have been avoided if wiser and more foresighted policies had been adopted in time to head off or minimize the recession. If the alternative path labeled "unstable recovery" is followed, the cumulative loss of output would be increased a further $300 billion.

Fiscal Policy

Present expectations are that real output will grow about 6 percent this year, that unemployment will still be above 7 percent at year-end, and prices still rising at about a 6-percent rate. Policy changes adopted at this time cannot achieve dramatic departures from this path within the remaining nine months of this year. As discussed in the previous section, however, proper policies can raise the growth of real output to about 7 percent while at the same time gradually setting in motion further reductions in the inflation rate. Even more important, policies adopted at this time can lay the foundation for continued rapid growth and greater price stability in 1977.

The Fiscal 1976 Budget. The Second Concurrent Resolution on the 1976 Budget embodies congressional decisions on the proper levels of outlays and receipts. These decisions are appropriate to the needs of the economy. Tax and spending decisions made by Congress during the past year, sometimes in the face of determined opposition by the Administration, have served to halt the worst recession in 40 years and initiate a recovery.

Two vital pieces of legislation remain necessary to achieve the budget policy established in the Second Resolution. The first of these is the extension and expansion of the Emergency Public Jobs Program. Legislation providing for this has now passed the House and is pending in the Senate. The second legislative need is for the provision of special antirecession aid to State and local governments. Legislation containing provision for such aid was recently passed by Congress but was vetoed by the President. As discussed more fully in Chapter IV, this assistance to State and local governments is a vital part of an overall strategy for economic recovery. We urge the Congress to again enact and the President to sign legislation providing for this program.

Provision for fiscal 1976 outlays for both these programs was contained in the Budget Resolution. Thus enactment will represent a carrying out of previously determined policy, not a new addition to planned outlays. It will also represent adoption of essential components of a program to reach our recommended goals for economic performance this year.

The Fiscal 1977 Budget. As discussed above, present expectations are that the economy will weaken in 1977. If Administration policies are adopted, output growth can be expected to drop to 4 percent or less. To achieve instead the 7-percent growth which we recommend will require supportive policies. Much can be accomplished through a monetary policy which accommodates private investment and through a price-incomes policy which reduces inflationary expectations. Fiscal policy too must play a supportive role.

Administration Recommendations. The Administration has proposed a highly restrictive budget for 1977. Examination of the recommended quarterly pattern of outlays and receipts is instructive. As can be determined from Table III/2, the Administration recommends that expenditures rise only 4 percent from the first half of 1976 to the first half of 1977. With prices expected to rise about 6 percent under Administration policy, this implies an actual decline of about 2 percent in the real level of government services. Such a decline, coming at the very time when the economy most needs support in order to add vigor to the recovery, represents extremely poor timing of fiscal policy.

It is also helpful to look at the budget as it would be at "full employment," that is as it would be if the unemployment rate could be kept constantly at 4 percent. The estimates shown in Table III/2, which have been prepared by the

Table III/2

Federal Receipts and Expenditures, Actual and Full Employment,
Assuming Administration Budget
(NIA basis, billions of dollars, seasonally adjusted annual rates)

Calendar Years	Actual			Full Employment		
	Receipts	Expenditures	Surplus (+) Deficit (-)	Receipts	Expenditures	Surplus (+) Deficit (-)
1976: I	311.1	384.6	-73.5	365.5	375.4	- 9.9
II	322.3	391.4	-69.1	375.2	382.4	- 7.2
III	328.9	391.8	-62.9	379.6	383.3	- 3.7
IV	342.5	394.5	-52.0	390.3	386.6	+ 3.7
1977: I	359.4	401.5	-42.1	403.3	393.7	+ 9.6
II	372.4	406.3	-33.9	414.7	398.8	+15.9
III	388.9	415.1	-26.2	426.5	407.8	+18.7
IV	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Sources: Office of Management and Budget, Joint Economic Committee.

Committee staff, indicate a swing of almost $30 billion in the full employment surplus over the seven quarters shown in the table. 3/ The most recent past experience of a large swing in the full employment budget is found in 1972-1974, when the full employment surplus rose by over $40 billion during the six-quarter period from the fourth quarter of 1972 to the second quarter of 1974, helping to precipitate the severe recession of 1974-75. The tragic experience of this recent recession provides persuasive evidence that sudden swings in fiscal policy can have devastating economic effects and must be avoided.

The Administration's budget recommendations are inadequate both as regards total receipt and expenditure levels and with respect to the composition of spending. The Budget contains individual recommendations which deserve serious consideration, but taken as a whole it does not constitute a helpful guide to the Congress in setting budget policy.

The Current Services Budget. Congress has available this year two estimates of the Current Services Budget, one prepared by the Congressional Budget Office (CBO) and the other by the Office of Management and Budget (OMB) under the provisions of the Congressional Budget Act of 1974. These provide estimates of the cost of maintaining the present real level of government services, making allowance for expected changes in economic conditions and for case-load changes under entitlement programs. The two estimates differ slightly in concept. Of the two, the CBO estimates are somewhat more satis-

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3/ Estimates supplied by the Council of Economic Advisers imply an even larger swing in the Full Employment Budget during 1976. The Council has supplied the following estimates of the full employment surplus(+) or deficit(-) by quarter (in billions of dollars): 1976-I, -16.5; 1976-II, -12.9; 1976-III, -7.7; and 1976-IV, +3.2. No estimates were supplied for 1977.

factory for use as a baseline budget since they have been recently updated and since they make consistent inflation adjustment for all programs, rather than limiting the adjustment, as OMB did, to those programs where such adjustment is required by law.

Current services budget estimates prepared by the Congressional Budget Office, rather than the President's budget, should serve as a starting point for congressional decisions on the 1977 budget.4/ Congress should make reductions from current services outlay levels wherever such reductions are consistent with efficient maintenance of necessary government services. Because of the high unemployment which will still persist in 1977, a large part of the savings achieved in this way should temporarily be invested in programs to deal with unemployment. These programs should include:

- Antirecession grants to State and local governments, 5/ and

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4/ Senator Proxmire states: "I object to using the current services levels, that is, last year's programs increased for population and price levels, as a starting point. This is a mindless method. It legitimizes all those programs and expenditures -- good and bad -- now in the budget. I advocate zero-based budgeting, strict benefit-cost analyses, determining the economic costs of alternative programs, and cutting back or ending inefficient and useless agencies and outlays."

5/ Senator Proxmire states: "The States and localities now get $6 billion in revenue sharing funds and $3 billion in community development funds. Nine billion is enough. The proposed antirecession grants would violate the sound fiscal principle that those who spend money should be required to raise the money.

• An emergency jobs program designed to provide about one million temporary jobs in 1977. 6/

As recently estimated by the CBO, the spending level needed to maintain current services in fiscal 1977 would be about $425 billion. We believe program cuts of at least $4 billion and possibly as much as $10 billion from this total are possible. Examples of cuts which would total about $4 billion are described Chapter V. It is important to note that these program reductions, if enacted promptly, could lead to budget savings of as much as $25 billion by 1981. The examples we cite are by no means an exhaustive list of possible program reductions. We anticipate that scrutiny by the Budget Committees and others will lead to identification of many other needed reforms and reductions, as well as some areas where increases are needed. A net reduction in permanent programs of at least $4 to $10 billion below current services levels appears to be a desirable and appropriate objective.

In addition to the savings which can be made in 1977 through program reductions, the lower inflation rate which would result from our recommended policies would reduce budget outlays by $7 to $8 billion.

6/ Senator Proxmire states: "I am against a job program of this size which is accomplished through public works, which is wasteful and too slow, or through public service jobs where there is a big substitution effect if it gets too large. Instead, I believe we should provide for jobs through a shallow housing subsidy where one job can be created for about $500, instead of $8,000 per public service job, and as high as $25,000 for a public works job."

At expected levels of unemployment, continuation of antirecession aid to State and local governments will cost about $1 billion in fiscal 1977. An emergency jobs program for close to 1 million persons would have a gross cost of $8 to $9 billion. Some allowance for these temporary antirecession programs is already contained in the current services budget. Our recommendation for an expanded program would add about $6 billion to the amount already assumed. As shown in Table III/3 below, the net result of the outlay changes which we suggest would be a spending total of about $418 billion. 7/8/

Tax Policy. The personal income tax rates presently in effect expire on July 1 and without new legislative action, taxes will revert at that time to the higher rates which prevailed in 1974.

7/ Senator Sparkman states: "It is most disturbing to see continuing increases in Federal spending. I believe that the Congress and the Administration must make greater efforts to limit this spending growth. For that reason, I would place particular emphasis on the proposal in the Report that immediate efforts be made to reduce spending for programs that do not have high priority. I blieve we should do this with even greater efforts than stated in the Report.

"Also, I would hope that the strength of our recovery and the wise use of monetary and tax policy could speed up the recovery and thereby reduce the deficit. An economic recovery will automatically increase incomes, which in turn leads to higher revenues. Likewise, it should greatly reduce the need for spending on such programs as unemployment, welfare, food stamps and emergency employment. In this way, there would be a healthy force working to reduce public spending. It must be remembered that the recession has been very costly to the Federal Government as well as to the other sectors of our economy."

8/ Senator Proxmire states: "I strongly oppose such a high budget outlay. See my supplemental view on page 237."

Table III/3

Derivation of Joint Economic Committee Outlay Recommendation for Fiscal 1977
(billions of dollars)

CBO Current Services estimate (Path B):	$425.0
Savings through program reductions	-4.0 to -10.0
Savings due to less inflation	-7.5
Savings due to lower unemployment:	-1.5
Additional cost of jobs programs:	+6.0
JEC recommended outlay level:	$412 to $418

Sources: Congressional Budget Office, and the Joint Economic Committee.

Action should be taken prior to July 1 to provide for continuation at least through the end of 1977 of the personal income tax reductions which have been in effect during 1975 and the first half of 1976.

- The strength of the recovery should be carefully monitored during the next few months. Should output growth appear to be dropping below the 7 percent rate needed to bring unemployment down appreciably, an additional tax cut should be enacted for 1977. This additional reduction should be of a type which will act directly to reduce costs and prices. An income tax credit against some part of social security taxes paid would meet this requirement.

- No increase in the social security tax rate is necessary or desirable in 1977, nor should the Federal unemployment insurance tax rate be increased at that time.

The above tax actions are needed both to provide support to the economic recovery and to help in achieving further progress toward price stability. Care must be taken that restrictive fiscal actions do not weaken or interrupt the moderately strong recovery now underway. Failure to extend the tax reductions presently in effect would be very damaging to the recovery. We urge prompt action to extend present tax rates at least through the end of 1977.

When taken in conjunction with an outlay level of $418 billion, an additional tax cut of approximately $10 billion will be necessary in 1977 simply to prevent fiscal policy from moving in a restrictive direction. Should outlays be held to $412 billion, a correspondingly larger tax cut would be required to sustain a neutral fiscal policy. The precise state of the economy in 1977 is impossible to predict at this time. It may be that the recovery will gather such

strength that a modest move toward restriction will be appropriate. However, history tells us that in the past growth of output at the 7-percent rate we feel is needed has been only rarely maintained over a period as long as 2-1/2 years.

Should output growth appear to be dropping below the 7-percent target rate, an additional tax cut should be enacted in order to keep fiscal policy on a neutral path which will not exert a drag on the private economy. Any such tax cut should be of a type which contributes to greater price stability as well as to stronger growth. Discussion of possible further tax reduction for 1977 should begin now so that Congress will be prepared to act quickly when and if the need for such action becomes clear. In the past, fiscal policy has often responded far too slowly to changing circumstances With the new congressional budget process now in place, continuous monitoring of the economy and prompt response to changing policy needs should be more readily achievable.

Anti-inflationary Impact of Tax Reduction. The stimulative effect of tax reductions is well understood. Tax reductions result in more after-tax income available to individuals. Most of this increase in disposable income is spent on additional purchases of goods and services. This in turn leads to increases in production and employment.

The use of tax reductions as an anti-inflationary tool is less well understood. Indeed, conventional economic theory has maintained that inflation can be controlled through tax increases which, by reducing consumer spending, ease demand for goods and services in inadequate supply. This traditional theory is not applicable, however, to a situation in which inflation is primarily due to cost pressures and is continuing in the face of obvious insufficiency of demand. Tax reductions can be designed to make an important contribution to price stability. Similarly, poorly designed tax increases can worsen inflation.

In considering changes in tax policy, the effect on the real level of economic activity is normally thoroughly discussed. So too are the distributional effects and the potential effects on business incentives. Except at times when a tax increase is thought to be needed to restrict excess demand, as in 1968, the impact of a tax change on changes in price levels seldom receives the same attention.

There are at least two major ways in which tax reductions could be used as part of an anti-inflation policy. First, some taxes -- such as sales taxes and payroll taxes -- enter directly into costs and pricing decisions. Reductions in these taxes have direct and important effects on prices. Second, reductions in taxes imposed on workers -- either income or payroll taxes -- would have the effect of raising after-tax income and thereby reducing the need for money wage increases to sustain real disposable incomes. No serious recent effort has been made in the United States to use tax policy as an integral component of price-incomes policy. However, a number of imaginative suggestions have been made. These suggestions deserve serious study and exploration during consideration of possible tax reductions for next year.

Among the possibilities which deserve consideration is the use of an income tax credit against social security taxes. We have discussed this possibility in several past reports. The economic impact of this type of tax reduction would be identical to that of a reduction in the social security tax itself. However, use of the income tax credit avoids any reduction in Social Security Trust Fund receipts. Maximum anti-inflation impact of this type of tax change would be achieved if it were made an integral part of a voluntary price-incomes policy which also established wage and price standards designed to preserve real after-tax income gains consistent with productivity trends.

An imaginative variant of the income tax credit against social security taxes has recently been suggested. This proposal would make eligibility for the credit dependent on the individual firm's success in adhering to agreed upon price and wage targets. Participation in the plan would be voluntary, but the economic incentive to participate would make it attractive to both labor and management. This proposal deserves serious consideration and discussion.

The Social Security Tax. The Administration's request for a social security tax increase in 1977 is an example of a tax change which could only worsen inflation. The employer share of the social security tax is a cost of production. Increasing this cost would both force prices up and discourage growth of employment.

Additional financing of the social security system may well become necessary in the future. No evidence has been presented, however, that this need is so urgent as to justify economically damaging tax increases in 1977. The current imbalance between trust fund receipts and outlays is a direct result of recent high unemployment and high inflation. The Secretary of the Treasury has informed the Committee that under conditions of full employment social security trust fund receipts in fiscal 1977 would be nearly $10.4 billion higher than the actual estimated level of $96.2 billion. This is substantially more than the $4.4 billion per year which the proposed tax increase would produce. Surely the most desirable way to increase the surplus in the trust funds is through higher employment and reduced inflation.

Chapter V (pages 114 to 118) discusses the status of the social security trust funds in greater detail. As shown in that chapter, it was only with the high unemployment of fiscal 1976 that trust fund outlays exceeded receipts so that the balance began to decline instead of rise. A return

to full employment would have a dramatic impact on future trust fund receipts.

Similar arguments apply to the proposed increase in the unemployment insurance tax. It, too, would raise labor costs and thus both worsen inflation and discourage increased employment. As discussed in more detail in Chapter IV, there is no compelling reason why this tax must be increased at this time.

Budget Totals. Table III/4 compares the Joint Economic Committee's economic assumptions and estimated budget totals with the official Administration recommendations and with our own estimate of the results of following the Administration's recommended policies.

The Administration has projected a deficit of $43 billion. As we have discussed elsewhere in this report, however, the Administration's unemployment assumption for 1977 is optimistic relative to the restrictive policies which are proposed. Our own estimate is that if Administration policies are followed, unemployment will average 7.8 percent in 1976 and 7.9 percent in 1977. This would reduce receipts and increase outlays for unemployment compensation. In addition, the President's budget assumes receipts of $6 billion from off-shore oil rents and royalties, whereas the CBO projection on which our estimates are based assumes only $1.9 billion. Off-shore oil receipts defy accurate estimation To facilitate accurate comparison of different budget policies, however, columns 2 and 3 of Table III/4 assume $1.9 billion of off-shore oil receipts. When this adjustment and the adjustment for what we consider more reasonable economic assumptions are made in the Administration's budget, the deficit rises from the $43 billion shown in the budget document to almost $60 billion.

The estimated defict which results if the JEC's proposed targets for economic performance are achieved is also in the neighborhood of $60 billion. Outlays are substantially higher than the Administration has

Table III/4

Economic Assumptions and Budget Totals

Economic Assumptions (Calendar years)	Official Administration Estimate	JEC Estimate of Impact of Administration Policies	JEC Policies
Average unemployment rate:			
1976	7.7%	7.8%	7.5%
1977	6.9%	7.9%	6.4%
Percent change in GNP deflator:			
1976	5.9%	5.9%	5.3%
1977	6.3%	6.3%	4.3
Unified Budget totals (FY 1977) (billions of dollars)			
Receipts	$351.3	$341.2	$352.0 to $357.0
Outlays	394.2	400.8	412.0 to 418.0
Deficit	-43.0	-59.6	-60.0 to -61.0

Sources: Office of Management and Budget, Congressional Budget Office, Joint Economic Committee.

proposed, but so too are the receipts produced by a more prosperous economy. The estimates presented in Table III/4 assumes an outlay range of $412 to $418 billion. The receipt estimates assume a tax cut of $10 billion (annual rate) if outlays are assumed to be $418 billion and a correspondingly larger tax cut if outlays are lower. Should the private economy develop more strongly than is assumed in the table, a tax cut of this size would not be needed and the deficit would be smaller.

The projected deficit is about $15 billion less than the $75 billion deficit expected for fiscal 1976. Ironically, a major reason the defict does not drop further is the slower growth of receipts due to a falling rate of inflation.

The virtually identical deficit which result from the Administration's policies and from our proposals is instructive. The immediate choice. facing the Nation is not the size of the deficit but the degree of progress which can be made toward full employment and price stability. That choice not only has far reaching consequences for the personal well being of individuals and families but important future consequences for the Federal budget. With a healthy, growing economy the deficit will diminish rapidly in future years. With the high unemployment and near stagnation which would result from Administration policies, the deficit could be expected to remain extremely large indefinitely.

Estimated as it would be at full employment, the budget which results from our policy assumptions moves from a deficit of $7-1/2 billion in the first half of calendar 1976 to an approximate balance in the second half of calendar 1977. However the fiscal restriction which this swing would norally imply is largely offset by the recommended expansion of emergency job creation programs (which do not enter into the full employment budget estimate, because they automatically phase out as unemployment is reduced). Thus, the policies we are recommending satisfy the need need for supportive fiscal policy at this time but do so in a way which does not jeopardize progress toward

a balanced budget as the economy moves toward full employment.

Price-Incomes Policy

Continuing studies of inflation which this Committee has conducted over several years have provided convincing evidence that inflation has a multiplicity of causes. Anti-inflation policy must take into account the particular causes of inflation at any particular time. When inflation stems from an excess of consumer demand relative to the immediately available supply of goods and services, policy must be directed toward restricting demand until supply can be adequately expanded. When inflation is coming from such special factors as poor harvests or sudden increases in world prices of other important commodities, the options for dealing with it may be quite limited.

At the present time, inflation is not resulting from any excess of consumer demand. Nor is it deriving from excessive government spending. Nor are special supply problems in particular markets creating unusual inflationary pressure.

Nor can inflation presently be explained in terms of rapidly rising unit labor costs. Unit labor costs in the private nonfarm economy rose at a rate of less than 2 percent during the last three quarters of 1975, dramatically illustrating the point that recovery brings productivity gains which hold costs under control and make greater

price stability possible. The puzzling and disturbing factor in the experience of this recovery to date is that, while productivity and unit labor costs have responded as expected, the rate of increase of many industrial prices accelerated late in 1975.

It is difficult to find an explanation for this price behavior. It may result from widespread expectations of future inflation. It may result from anticipation of possible future price controls. It may stem from a desire to boost profits or recover past cost increases. Certainly it appears doubtful that prices in recent months have been rising at a rate which has a good economic justification. This in itself indicates that an active but voluntary price-incomes policy would be of great benefit at this particular time. Such a policy should have two elements -- first, an investigation of the extent to which price and compensation increases are justifiable, and second, a program for voluntary cooperation in holding such increases to the necessary minimum.

Two additional factors strengthen the case for such a policy. First, profits are expected to rise rapidly this year. The Council of Economic Advisers expects at least a 25-percent increase in operating profits. Second, a large number of workers will be involved in major union contract negotiations this year. Stronger profit positions will both weaken employer incentives to resist union wage demands and increase union incentives to seek generous contract settlements. Yet neither labor nor business will benefit if both prices and wages continue to rise rapidly.

Important progress toward price stability is possible this year and next if proper policies are adopted. The proper policy is not, however, restriction of aggregate demand. Demand is not

excessive and is not about to become so. Restrictive policies can only do more harm than good.

The proper approach to reducing inflation at this particular time lies in the enunciation of specific targets for wage and price adjustments, followed by vigorous efforts to achieve voluntary compliance with these standards. It is clearly in the interest of all major elements in the economy that the rate of inflation be further reduced. Statesmanlike leadership by the President could achieve a high degree of compliance with a voluntary price-incomes policy.

Comprehensive price or wage controls are neither necessary nor desirable. We oppose both. However, should voluntary compliance with reasonable price and wage standards prove impossible to achieve, the provision of selective authority to delay price increases in instances of signal importance to the economy would be preferable to the indefinite toleration of inflation at rates of 6 percent or greater. The Chairman of the Federal Reserve Board of Governors expressed his support for such a policy in recent testimony before this Committee, stating:

> . . . a policy that would permit modest delay in key wage or price increases, thus creating opportunity for quiet governmental intervention or for public hearings and the mobilization of public opinion, may yet be of significant benefit in reducing abuses of private economic power and moving our Nation towards the goal of full employment and a stable price level.

Typical forecasts assume an increase in average hourly compensation of about 8 percent this year. However, this expectation is reasonable only if the rate of price increase declines. Given an expected rate of productivity gain of more than 3 percent,

if wage increases average around 8 percent in 1975, there would appear to be no justifiable reason for the average rate of price increase to exceed 5 percent . Put another way, if the rate of price increase can be held to 5 percent this year, both real wage gains in line with productivity trends and important progress toward price stability can be achieved. As discussed earlier, tax policy can also be used to further contribute to the maintenance of workers' real disposable incomes.

During the second half of 1975 price development did not accord with expectations as to a reasonable rate of price increase. As shown in the Tables in Chapter II (pages 31 - 32), consumer prices rose at a rate in excess of 7 percent in the second half of last year, and the rate of increase for wholesale industrial prices rose to 10 percent in the fourth quarter. The January price data were more encouraging, with the consumer and wholesale industrial price indexes each rising only 0.4 percent (or at an annual rate of about 5 percent). Only limited significance can be attached to any one months's data. Our analysis of the underlying causes of inflation leads us to conclude, however, that the chances of holding the inflation rate to about 5 percent this year are quite good, provided an effective price-incomes policy is adopted.

The President should establish and vigorously support a voluntary program designed to insure that price increases are held to a necessary minimum during 1976 and that real wage increases are in line with productivity gains, taking into account the expected rate of price increase. The Council on Wage and Price Stability should be given full Presidential support in the use of its authority, including its subpoena authority, to investigate price increases and to seek compliance with price and income standards. As discussed in the previous section,

tax policy should also be used to contribute to the achievement of a satisfactory rate of increase in workers' real disposable incomes. We believe such a program can succeed in reducing the inflation rate to 5 percent this year and 4 percent by the end of next year. This goal can be achieved without resort to comprehensive price or wage controls, to which we are opposed.

The Council on Wage and Price Stability has conducted several useful investigations and published some thorough and critical studies of industry pricing practices. It could be much more effective, however, in establishing a comprehensive price-incomes policy and achieving cooperation with such a policy if it had the firm and unequivocal backing of the President and other high government officials, and if adequate staffing and resources were placed at its disposal.

Given the avowed concern of this Administration with the problem of inflation and given the major contribution which we believe an active price-incomes policy can make, it is both a surprise and a disappointment that neither the President's Economic Report nor the accompanying Report of the Council of Economic Advisers contains any discussion whatsoever of price-incomes policy. Several inflationary actions and proposals by the Administration are also puzzling. The proposal for payroll tax increases next year and the recent veto of legislation which would have facilitated reasonable wage settlements in the construction industry are examples.

The complacency exhibited by the Administration with regard to its own forecast that the inflation rate will remain at approximately 6 percent throughout the coming two years is remarkable. It comes very close to representing an open invitation to business and labor to engage in competitive

escalation of prices and wages. Nothing could be more damaging to the economy at this time. The Administration is correct in its contention that high inflation rates pose a threat to the continuation of economic recovery. Yet the Administration is content to leave untested the policy which in our judgment represents the most promising approach to bringing inflation down.

Monetary Policy

The crucial importance of monetary policy in sustaining a strong economic recovery can scarcely be overstated. The Federal budget can provide extra temporary support in a time of recession, but steady and continuing growth of output and employment must rest with a strong private sector and especially with the business investment sector. This is all the more true now that we have entered a period in which State and local governments can no longer be looked to as a strong growth sector.

The single policy tool of greatest importance in encouraging private investment is monetary policy. Tax changes can also affect investment, but their importance is dwarfed by the far greater importance of an adequate supply of money and credit. A monetary policy which accommodates investment demands will be of key importance not only this year but through the remainder of this decade.

Recent Financial Development. The behavior of the credit markets in recent months has surprised most observers. During the second half of 1975, bank loans to business grew scarcely at all, interest rates were virtually unchanged, and the money supply grew at a less than 3-percent rate. In January both the money supply and business loans actually fell and, as shown in Table III/5, short-term rates

Table III/ 5

Money Supply, Bank Lending, and Interest Rates

Percent Change (Seasonally adjusted annual rate)	Dec.1974-June 1975	June-Dec. 1975
Money Supply (M_1) a/	5.7%	2.8%
Money Supply plus net time deposits (M_2) b/	10.0%	6.6%
Business Loans c/	-6.8%	1.6%

Selected Interest Rates	June 1975	Dec. 1975	Jan. 1976
3-month treasruy bill	5.2%	5.5%	5.0%
Prime bank rate	7.0%	7.25%	6.75%
Aaa Corp. bonds d/	8.8%	8.8%	8.6%
Home Mortgage Yields e/	9.2%	9.4%	9.3%

a/ Currency plus demand deposits
b/ Currency, demand deposits, and time deposits at commercial banks other than large CD's
c/ Commercial and industrial loans by commercial banks
d/ Moody's
e/ FHA, new homes
Sources: Federal Reserve Board of Governors, Treasury Department, Moody's Investor's Service, Department of Housing and Urban Development.

dropped noticeably. While this combination of developments might be expected at the trough of a recession, it is a puzzling development six months into a recovery.

Several special factors offer a partial explanation of these events: bank lending policies have been unusually selective, business financing has undergone a shift toward longer term instruments, changes in Federal Reserve regulations have produced shifts from demand deposits to savings deposits. Even after taking these special factors into account, however, loan demand still appears surprisingly weak for a recovery period. This weakness underscores the need for a monetary policy which encourages private investment.

Of particular concern is the fact that the money supply, however measured, grew only very sluggishly in the second half of last year, and not at all in December and January. This does not necessarily represent a tightening of monetary policy, but more probably the surprising weakness in the demand for credit.

Monetary Policy for 1976. The unusual behavior of the money supply poses a dilemma for monetary policy during the remainder of this year. Output cannot continue indefinitely to grow at a rapid pace while the money supply grows so slowly. If the recovery continues at the desired pace, the demand for money will increase, perhaps quite suddenly. If so, this demand should be accommodated, and accommodated at short-term interest rates little if any higher than at present. Long-term interest rates should be permitted and encouraged to decline. If accommodative monetary policy causes the money supply to grow for a time at a rate exceeding the Federal Reserve's targets, this should not be a cause of concern. As shown in Table III/6, the

Table III/6

Monetary Aggregates: Federal Reserve Targets and Actual Performance

Date Target Announced	Base Period	Percent Changes in Monetary Aggregates: Target Ranges M_1	M_2	M_3	Actual Performance to Date (seasonally adjusted annual rate) M_1	M_2	M_3
May, 1975	March 1975 - March 1976	5 - 7 1/2	8 1/2 - 10	10 - 12	4.8	8.9	11.9
July, 1975	2nd Quarter 1975 to 2nd Quarter 1976	5 - 7 1/2	8 1/2 - 10	10 - 12	4.9	8.3	11.7
November, 1975	3rd Quarter 1975 to 3rd Quarter 1976	5 - 7 1/2	7 1/2-10 1/2	9 - 12	2.5	6.2	9.5
February, 1976	4th Quarter 1975 to 4th quarter 1976	4 1/2-7 1/2	7 1/2-10 1/2	9 - 12	n.a	n.a	n.a

Definitions: M_1: Currency plus demand deposits
M_2: M_1 plus time deposits at commercial banks other than large CD's
M_3: M_2 plus deposits at nonbank thrift institutions

Source: Federal Reserve Board of Governors

Federal Reserve has recently demonstrated its willingness to revise its targets downward when money supply growth fell below expectations. The same flexibility should be available with respect to the upper end of the range.

At times during 1976, money supply growth may be both rapid and erratic. This should not be a cause for concern so long as interest rates conform to a pattern which encourages the credit flows necessary to economic recovery. This is not to say, however, that we have no concern about the rate of growth of the monetary aggregates. As the economy returns toward full employment, money supply growth must be brought into line with the economy's growth of potential.

<u>During the remainder of 1976, monetary policy should be conducted so as to avoid any substantial rise in short-term interest rates and to encourage reductions in longer term rates. Temporary fluctuations in the rate of growth of the monetary aggregates should not precipitate monetary policy changes so long as the pattern of interest rates is satisfactory. Over the longer run, however, growth of the monetary aggregates must be in line with potential growth of real output.</u>

Coordination of Economic Policy

Careful coordination of the three basic elements of aggregate economic policy -- fiscal, monetary, and price-incomes policy -- is essential if the difficult and delicate task of restoring and maintaining full employment with reasonable price stability is to be accomplished. In the past, the absence of systematic procedures for coordination has sometimes permitted monetary policy established by the independent Federal Reserve Board

to work at cross purposes with the fiscal policies established by the President and Congress.

Last year Congress acted to require Federal Reserve authorities to appear periodically before the Banking Committees to discuss their monetary growth targets for the year ahead. These appearances have been very useful in informing the Congress of the intentions of the Federal Reserve and providing opportunity for discussion. The question of what further action to take if the Federal Reserve's proposed policies conflict with congressionally determined fiscal policy remains unresolved, however, we repeat here the recommendations we made in our 1975 Midyear Report last October.

The following steps should be taken to help establish the proper degree of congressional control over monetary policy:

- Congress should adopt systematic procedures for establishing output, employment, and purchasing power targets.

- The Administration should be required to present specific monetary policy recommendations to the Congress. 9/

9/ Senator Proxmire states: "I object. Under Article I, Section 8, of the Constitution, Congress, not the Executive, has the power to coin money and regulate the value thereof. It has established the Federal Reserve Board as its creature to carry that out. This is a congressional responsibility, not that of the Executive. The Federal Reserve Board is independent of the Executive under the Constitution."

• The Federal Reserve should be required to present targets for the monetary aggregates which are consistent with congressionally determined output, employment, and purchasing power targets. 10/

Proper congressional supervision of economic policy must begin with a clear enunciation of specific short-run targets for the economy. The Employment Act of 1946 requires the President to recommend policies necessary to "promote maximum employment, production, and purchasing power" and the Joint Economic Committee to report to the Congress on the adequacy of these recommendations. In its Annual Reports, the Joint Economic Committee has typically presented the output and employment targets which it concludes to be realistic and desirable. The Employment Act does not require Congress to take any specific formal action on the Joint Economic Committee's Annual Report. Hence, these output and employment targets, while they may have the support of many individual Members of Congress, do not have the formal endorsement of the Congress as a whole.

The fiscal policy adopted by Congress in the First Concurrent Resolution on the Budget in May 1975 was estimated by the Budget Committees at the time to imply an unemployment rate of about 7-1/2 percent at the end of 1976, and this might be regarded as at least an indirect endorsement by the Congress of an employment target. It could surely be argued, however, that it would be preferable to

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10/ Senator Proxmire states: "This recommendation, in practice, is meaningless. The range of monetary aggregates 'consistent with' any output targets is so great as to be meaningless."

agree upon the output, employment, and purchasing power targets first and then to adopt a budget policy -- and also monetary and price-incomes policies -- designed to reach the agreed objectives. Establishment of these basic economic policy targets could be achieved through congressional debate on the adoption of the Joint Economic Committee's Annual Report, through a planning process such as that provided for in S.2794, The Balanced Growth and Economic Planning Act of 1975, or through other mechanisms.

Another obstacle to proper coordination of policy is the veil of silence maintained by the Administration regarding monetary policy. The original intention of the Employment Act was that the President would incorporate monetary policy recommendations into his annual Economic Report. In practice, these recommendations have been either extremely vague or missing entirely. This is again the case in this year's Economic Report. In carrying out its oversight responsibility for monetary policy, Congress should have the benefit of a detailed presentation of the Administration's analysis and conclusions in this area. The President's Economic Report should contain recommendations on monetary policy, and these should be couched in terms of specific rates of growth of the monetary aggregates, specific interest rate targets, and/or such other specific dimensions of policy as the Administration judges to be appropriate.

The responsibility for the detailed design and execution of monetary policy has wisely been entrusted to the Federal Reserve. The Committee would oppose any effort by the Congress to legislate or otherwise impose specific targets for growth of the money supply or any other monetary variable. Congress should insist, however, that the Federal Reserve periodically present a "plan of action" which is consistent with congressionally enunciated targets for output, employment, and purchasing power.

67-480 O - 76 - 6

These action plans should be accompanied by documentation based on the best available information demonstrating why and how these monetary policies will contribute to the basic objectives sought by Congress. At present Congress is considerably handicapped in evaluating monetary policy by the refusal of the Federal Reserve Board to make staff economic forecasts and other similar material available to Congress. The Federal Reserve has declined to make staff forecasts available on the grounds that they are continually subject to revision. However, the Congress regularly receives Administration and private forecasts of which this is equally true. It is difficult for the Congress to evaluate testimony when that testimony is not supported by any detailed evidence or analysis.

Changes in Federal Reserve Structure. Coordination of economic policy would also be improved if Federal Reserve procedures were revised to make continuing consultation with Congress and the Executive Branch an integral part of the process of determining monetary policy. In addition, the membership of the Federal Reserve Board of Governors should be more broadly representative of the major elements in the economy.

Changes in the structure of the Federal Reserve System are needed in order to achieve closer coordination of monetary policy with other aspects of overall economic policy. Legislation is needed which would provide for the following:

- inclusion of the Secretary of the Treasury and the Chairman of the Council of Economic Advisers in the membership of the Federal Open Market Committee;

- reduction in the term of office of Members of the Federal Reserve Board from the present 14 years to 7 years;

- broadened composition of the Membership of the Federal Reserve Board to better reflect the views of various sectors of the economy, including labor, small business, consumers, and agriculture, and

- submission of the Federal Reserve budget to the regular congressional appropriation process and periodic congressional audit of the Federal Reserve. 11/ 12/

11/ Senator Sparkman states: "It is my opinion that the Federal Reserve and its Board Members have, since the system was put into operation in 1914, served this country well because it has been independent and not subject to political pressures. I am not opposed to the tenure of the Federal Reserve Board's members being reduced from 14 years to 7 years; however, I would like for a provision to be made that members could serve a second term. As to the Secretary of the Treasury and the Chairman of the Council of Economic Advisers being made members of the Open Market Committee, I am not sure that this would serve any more meaningful purpose than under the present operation of this committee. My objection to the provision of the Federal Reserve coming to Congress for its appropriations and being subject to periodic audit is again my fear of the Federal Reserve being unable to work independently and perhaps being subjected to more political pressures, especially to the pressures of the Administration (be it Republican or Democrat) that may be in office."

12/ Representative Long, La., states: "I think these recommended changes in the Federal Reserve system will preserve the independence and integrity of the Board and at the same time increase opportunities for public input into this extremely important agency. Better coordination of policy, coupled with increased accountability to Congress and the American people, will make our Federal Reserve system more responsive to our Nation's monetary needs and more in keeping with our democratic principles."

IV. SPECIAL POLICIES TO ACHIEVE FULL EMPLOYMENT

As Chart IV/1 shows, the official unemployment rate reported by the Bureau of Labor Statistics reached a peak of 8.9 percent in May 1975 and has declined since then to 7.8 percent in January. The comprehensive unemployment rate, including allowance for discouraged workers and persons limited to part-time work by poor economic conditions, reached nearly 12 percent. If the President's proposals for a more restrictive fiscal policy in 1977 are adopted, however, we can expect little, if any, further decline in unemployment this year or next. The human and economic costs of continuing high unemployment need not and should not be accepted. Not only would such unemployment seriously threaten the welfare of millions of American families -- and leave in want hundreds of thousands who will exhaust their unemployment compensation in 1976 -- it also would do major long-run damage to the economy as productive capacity stands unused, national needs go unmet, and prolonged idleness erodes workers' skills.

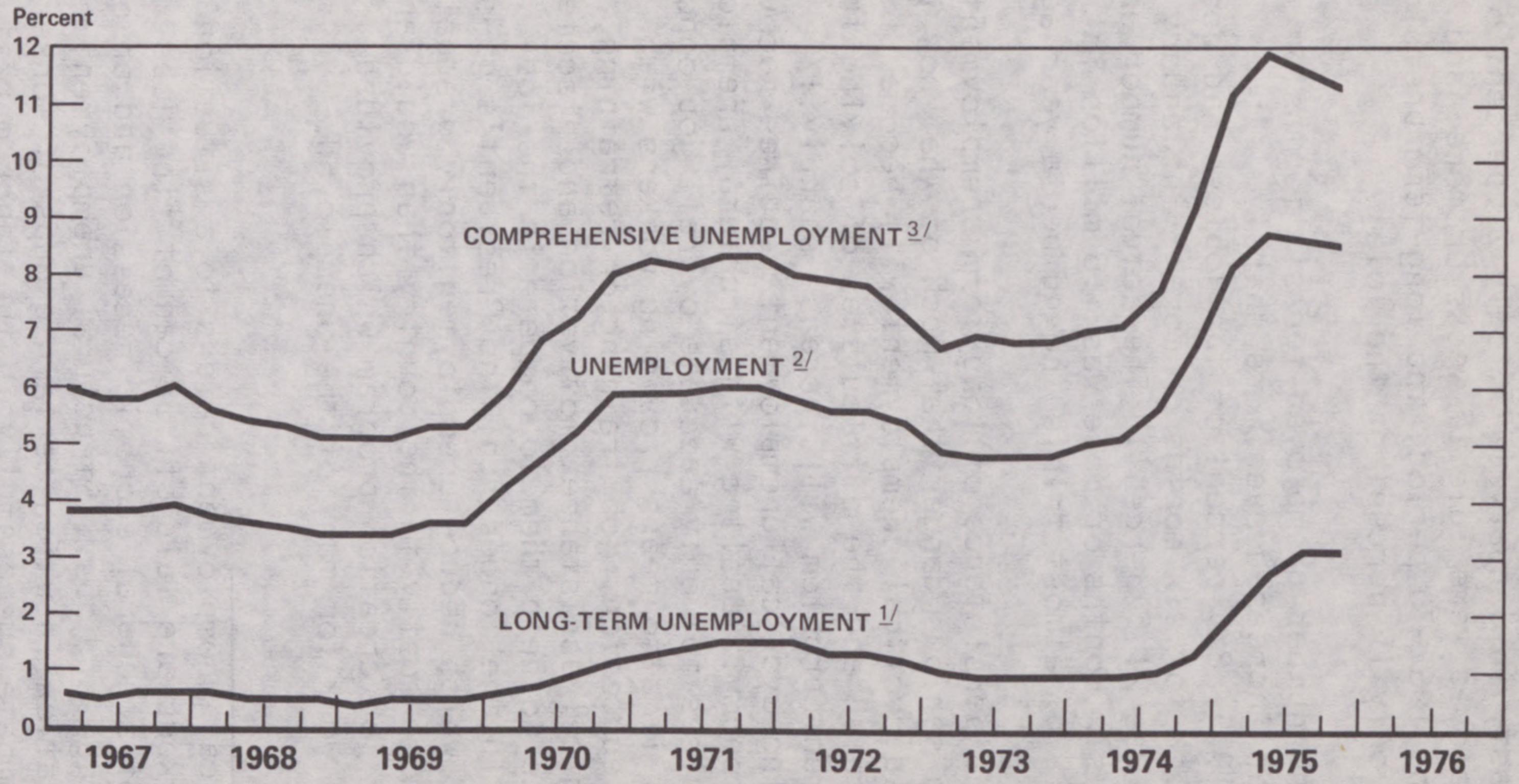
The policies described in this Chapter, together with the fiscal, monetary, and price-incomes policies described in Chapter III, should succeed in reducing unemployment steadily, bringing the jobless rate down to 6 percent or less by the end of 1977. Equally important, these policies can lay the foundation for continued progress toward full employment and price stability during the remainder of this decade.

The High Cost of Extended Unemployment

A critical and often ignored effect of the 1973-75 recession is the sharp rise in the duration of unemployment during the past year. In January 1976, almost 2.8 million (36 percent) of the 7.3 million jobless had been idle for 15 weeks or more.

Chart IV/1

UNEMPLOYMENT INDICATORS



Selected Quarterly Unemployment Rates

1/ Fifteen weeks or longer as percent of civilian labor force.

2/ Unemployed as percent of civilian labor force as reported monthly by BLS.

3/ Full-time job seekers plus one-half part-time job-seekers plus half of those working part-time for economic reasons plus discouraged workers.

Source: Bureau of Labor Statistics

By contrast, in January 1975, only 21 percent of the unemployed were idle 15 weeks or more, and during the 1967-70 period, the long-term unemployed averaged only 15 percent of the total.

The number unemployed for six months or longer has increased even more sharply. In January 1975, 8.5 percent of the jobless had been out of work for six months or more; in January 1976, it was 21.5 percent. The actual number unemployed six months or more was 1.6 million in January 1976, almost triple the number a year ago.

The persistence of long-term unemployment creates a serious danger that much of what now is considered cyclical unemployment will become "structural," and the difficulties of solving the unemployment problem will increase sharply.1/ Eliminating cyclical unemployment requires recovery of the economy. Dealing with structural unemployment requires not only adequate overall job opportunities, it also means providing workers with remedial education, job training or retraining, psychological assistance, motivation, and placement assistance to help them to compete in the job market. In the longer run, the President's go-slow policies, which reduce unemployment only gradually, will be more costly to the country than would an emergency job creation program which provided immediate work for many of the unemployed.

1/ Cyclical unemployment refers to a situation in which workers are laid off or cannot find jobs because of a general economic recession and an overall shortage of jobs. Structural unemployment refers to a situation in which certain groups of workers cannot compete successfully in the labor market because of a deficiency of skills or education, a depressed regional economy, or discriminatory hiring practices. Such workers have difficulty finding satisfactory jobs even during periods of high overall employment.

There are several ways in which cyclical unemployment can become a more serious and lasting unemployment problem. For instance, during a protracted period of idleness, experienced workers lose job skills. In addition, the psychological impact of enforced joblessness and dependence is demoralizing and affects attitudes toward work. The experience affects workers' fitness for work and creates problems for some in getting and keeping regular jobs.

Second, many young workers entering the labor force for the first time will not obtain needed work skills and experience. Often, the first three or four years of full-time employment are used to experiment with different kinds of jobs and to become accustomed to the demands of full-time work. Because of the high unemployment rates expected for the next several years, many young people may reach age 25 without ever holding a full-time job.

Third, although most firms can endure short periods of underutilization without impairment of their ability to recover, a longer period of poor business may prove fatal to firms in tenuous financial condition. If such firms employ specialized skilled workers or are located in cities or towns with few alternative employers, workers may then need retraining, placement, and relocation assistance to regain productive jobs.

<u>The costs to the Nation of prolonged unemployment are unacceptable. The goal of economic policy should be to reduce the unemployment rate to 6 percent by the end of 1977 and eventually to achieve an unemployment rate no higher than 3 percent of the adult labor force</u>.

The Proper Role for Unemployment Compensation

Until recently, the Administration's policy toward high unemployment has been (1) to extend unemployment benefits to cushion financial hardship while waiting for the private sector to begin rehiring, and (2) to accept reluctantly a modest program of public job creation through emergency funding and diversion of funds from training and other programs intended to deal with structural unemployment.

The regular State unemployment insurance programs pay up to 26 weeks in benefits, plus an additional 13 weeks during periods of high unemployment. The severity of the 1973-1975 recession, however, made extending unemployment compensation imperative.

Early in 1975, Special Unemployment Assistance was enacted to provide Federally funded compensation to some 12 million workers not covered by State programs -- mainly local government, farm, and household workers. In addition, the maximum duration of benefits for persons covered by State programs was extended from 39 to 65 weeks through the Federal Supplemental Benefits Program. Both of these programs will expire in March 1977, unless they are extended by Congress.

More than 24.5 million workers received unemployment benefits at some time during 1975. The average weekly number receiving benefits rose from less than 1.8 million in 1973 to almost 5.9 million at the March 1975 peak, and it still exceeds 4 million. During 1975, however, almost 1 million workers exhausted their 65 weeks of unemployment compensation provided under the Federal Supplemental Benefits Program.

In December 1974, Congress provided some 300,000 public service jobs under Title VI of the

Comprehensive Employment and Training Act, a new title added by Congress, in the Emergency Jobs and Unemployment Assistance Act.

In his 1977 budget, however, the President proposes to cut both public jobs and unemployment benefits at a time when both are still badly needed. The Report of the President's economic advisers states that "unemployment will almost surely remain distressingly high this year" and that "the social hardships and economic waste associated with the current level of unemployment should not be underestimated."2/ But the budget seems designed to prolong the unemployment and to exacerbate the hardship.

The President proposes cutting almost every program assisting the unemployed. Some 260,000 public service jobs out of a current total of 310,000 jobs would be cut by September 1977. The Federal contribution to the wages for these jobs would be slashed from $10,000 to $7,000 per year. In addition, federally funded summer jobs for youths would be cut by 100,000 in 1976 and by 70,000 more in 1977. Finally, the President recently vetoed the $6.1 billion Local Public Works Capital and Development Act, designed to create several hundred thousand new jobs and to use unemployed resources to improve public facilities.

Unemployment compensation also would be cut. The emergency, federally funded benefits described above would be allowed to expire. This would make some 450,000 jobless persons ineligible for further payments.

We cannot accept this callous approach to the needs of the unemployed. While the Committee believes strongly that primary reliance in treating unemployment should be shifted from benefit payments

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2/ Economic Report of the President, 1976, p. 19.

to job creation, as will be outlined in the next section of this chapter, it believes that unemployment benefits must continue to be provided until an adequate jobs program is in place. It believes, moreover, that some reforms in the unemployment insurance system are needed to raise the ceiling on benefits and to create more uniformity in payments among States.

The amount of benefits paid under current law is 50 percent of the worker's average weekly earnings, up to a maximum that varies by State. Because of the maximum, over 40 percent of all claimants in fiscal year 1975 received less than 50 percent of the average earnings from their previous employment. In previous years this figure has been higher (52 percent in 1970 and 1971).

A greater number of workers should be receiving 50 percent of their average weekly wage. To achieve this goal, the States should be required by Federal law to raise the maximum weekly benefit to two-thirds of the statewide average weekly wage in each State. The Federal Government should provide interim financing for two years to give States time to change their laws. The cost of such a program would be approximately $1 billion in fiscal 1977.

After a period of widespread use of unemployment claims, however, it also is time for a basic review of the standards and operations of these programs to assure that eligibility requirements are appropriate and well enforced and to assess the future financial soundness of the unemployment insurance system.

The maximum weekly unemployment benefit should be increased to two-thirds of the statewide wage in each State. Individuals should receive at least 50 percent of their previous weekly wage up to the maximum. After this extended period of high unemployment it is time for an

in-depth review of unemployment insurance programs, including eligibility requirements.

The Committee believes, however, that a policy based on extending unemployment insurance is totally inadequate as a primary response to a deep, prolonged period of high unemployment such as the present one. In this situation, jobs are needed. It is indefensible to pay people for such an extended period and to keep them idle.

First, unemployment compensation is a very expensive way to deal with long-term unemployment. Its cost will be over $18 billion in fiscal year 1976, or $14 billion more than at full employment. The cost including food stamps, aid for dependent children, and other income maintenance programs affected by the economic slump will be over $19 billion more than at full employment.3/ The President's go-slow policies would guarantee continuing high outlays for these purposes for the rest of this decade.

Second, society receives no useful product from those on unemployment insurance. Reliance on this form of relief as the primary response to long-term unemployment constitutes a terrible waste of manpower resources in view of the Nation's many unmet needs. The 300,000 jobs provided under the Emergency Jobs and Unemployment Assistance Act are a great improvement over unemployment compensation, but this is a small program relative to the size of the problem and leaves more than 7 million Americans still unemployed.

Moreover, the diversion into countercyclical public service jobs of funds intended for job training and work experience under Titles I and II of the Comprehensive Employment and Training Act (CETA)

3/ Congressional Budget Office.

thwarts the intent of that legislation, which was to provide jobs and training to persons handicapped by poor education or other deficiencies. Although the CETA legislation contains safeguards against such diversion of funds, data on program participants clearly indicate that Title II funds, which were specifically allocated to train disadvantaged workers for regular public employment, have gone recently to employ persons not in this category. This policy reduces the funds available to help structurally disadvantaged workers become self-supporting.

> A comprehensive strategy for dealing with unemployment is essential to overall economic recovery. An antirecession program, however, should place primary emphasis on providing jobs -- in the private sector to the extent possible, but supplemented by emergency public works jobs and public service jobs as necessary. Unemployment compensation should be used to assist workers who are jobless for relatively short periods of time. Until enough jobs are provided, however, unemployment compensation or other income support must be extended. Federal supplemental unemployment benefits should be phased out with the implementation of an adequate jobs program.4/

4/ Senator Proxmire states: "This could become a very costly program unless done right. I advocate that the Government become the employer of last resort by providing useful work at the unemployment compensation rates of those laid off (plus the cost of getting to work) and at the minimum wage for those with no unemployment compensation eligibility who are entering the labor force. In this way useful work can be performed for the society at little added cost."

A Program of Job Creation

The pessimistic unemployment projections for the rest of this decade make job creation the vital issue facing Congress this year. Right now, there are over 7 million Americans unemployed. In addition, about 2-1/2 million more workers can be expected to enter the labor force this year. In light of this, we believe that it is important for economic policy to aim to expand employment by about 3-1/2 million jobs during 1976. Almost as large a growth of employment will again be needed in 1977 if unemployment is to continue rapidly declining.

In addition to the fiscal and monetary policies described in Chapter III, achievement of this job goal will require an enlargement of government job creation programs to about one million jobs in 1977. Such programs should be accompanied by new incentives to step up private sector hiring.

Public Job Creation. Direct public job creation, according to a number of studies including one recently issued by the Congressional Budget Office,5/ is the quickest and surest form of job stimulus the Federal Government can undertake. An antirecession jobs program, according to these studies, reduces unemployment more sharply than any other spending measure.

Currently, some 300,000 public service jobs are being funded under Title VI of the Comprehensive Employment and Training Act. If pending legislation is enacted, the funding level for this program through fiscal 1977 will be $5.9 billion, or enough to enlarge the public service employment to 600,000 jobs. Provision for fiscal 1976 outlays under this program was included in the Second Concurrent

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5/ Temporary Measures to Stimulate Employment, Congressional Budget Office, September 2, 1975.

Resolution on the 1976 Budget. In fiscal 1977 we believe that it should be increased to about one million jobs.

Two objections often are raised against temporary government job creation programs. One is that, although described as temporary, they may be allowed to continue after the need for them has passed. For this reason, we recommend again, as we have in the past, that countercyclical programs be tied explicitly to the unemployment rate. Then the spending authority for these programs will expire automatically when unemployment returns to more satisfactory levels.

As a formula to provide this link, we have suggested in past reports that a temporary jobs program be funded to create 250,000 jobs for each 1/2 percentage point by which the unemployment rate exceeds 5 percent in the absence of the program. With the unemployment rate now expected to average close to 7.0 percent in fiscal 1977, this formula suggests a need for one million emergency jobs. With such a program and with an overall economic policy which supports recovery, the unemployment rate can be reduced to 6 percent or less by the end of calendar year 1977.

A second objection to emergency jobs programs is that these programs create public rather than private jobs. We share this concern and have no desire to create public jobs at the expense of private jobs. Both monetary and fiscal policy should be designed to encourage the maximum feasible growth of private employment this year and next. At the same time, we must face the fact that, even with the strongest growth of private employment that is reasonable to anticipate, unemployment will remain much too high through the end of 1977. Temporary work opportunities in the public sector are far preferable to continued reliance on income support for idle workers.

A third objection which has recently been raised against a public jobs program is that its net contribution to new job creation is small, because most of the jobs paid by the program existed anyway. For instance, substitution of Federally funded employees for regular State and local government personnel has been a problem in some places in the past. However, the contention of the Council of Economic Advisers that only one job may be added for every ten jobs funded is grossly exaggerated. To the extent that funding substitution has been a problem, it can be greatly reduced by the adoption of antirecession grants to State and local governments to avert the need for layoffs and the use of the locally initiated work-projects approach to temporary job creation, which is described below.

To assert, as the Council of Economic Advisers has done, that it is impossible to design an effective emergency jobs program is a counsel of despair. The fact that unemployment is going to remain unacceptably high this year and next must be faced. Effective programs must be adopted to provide temporary employment opportunities until an adequate number of jobs become available in the private sector.

Nonetheless, to accommodate criticisms described above, the structure of the emergency jobs program should be modified as it is expanded. Simply increasing the funding for CETA's Title VI without modifying the program has several disadvantages.

First, a further large expansion of the program, which is administered by the State and local governments, would strain the capacity of many of these governments by confronting them with a large influx of temporary workers. To some extent, this has already happened. According to one

study prepared for this Committee,6/ the need to establish public service jobs quickly under CETA's Title VI early in 1975 led some local governments to develop make-work jobs for newly available employees. Most local governments made good use of these funds, but any make-work job creation resulting from a further expansion of the program could discredit a good method of creating jobs during a recession.

Second, the existing program tends to create expectations of permanent government employment among persons hired for countercyclical purposes. Since some CETA jobs -- those under Title II -- are intended to lead to regular government employment, and since many employees paid under CETA's Title VI are placed in jobs of a permanent nature involving continuing governmental functions, both employer and employee come to expect that these arrangements may continue indefinitely.

A detailed description of program modifications to avoid these problems and to minimize funding substitution was presented in the Committee's Midyear Report. Briefly, local or State governments, nonprofit organizations, Federal agencies, and even private businesses could propose projects and apply to specially constituted regional administrative boards for project funds. Private business would be expected to undertake nonprofit projects. The work projects would have to be activities which would not otherwise be undertaken, which could be completed in one to two years, and which would provide socially valuable goods or services to the community. Such projects might include rehabilitation of housing occupied by

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6/ Thomas A. Barocci, "The Canadian Job Creation Model and Its Applicability to the United States," Joint Economic Committee, 1976.

low-income persons, construction of bycle parts, care of parklands and public spaces, construction of recreational facilities, and provision of care for the chronically ill.

The distribution of funds should be based on local unemployment rates, as is currently the case under CETA. Once a project is begun, however, its funding should not be interrupted if the local unemployment rate falls. There should be a clear understanding from the beginning that employment will end with the completion of the project. No individual should be employed under this program for more than two years. Financial incentives should be provided to encourage individuals to find regular private or public employment whenever jobs become available. Employees under this program should be eligible for regular unemployment benefits on completion of a project.

Clearly, not everyone currently seeking work could be employed under this program. It therefore should be directed primarily at those who have been unemployed for some time and who lack alternative means of support.

During the past year, the Joint Economic Committee has conducted regional hearings in six cities (Chicago, New York, Atlanta, Los Angeles, Fall River, and Boston). In the course of these hearings, much was learned about the operation of Federal training and employment programs in different areas. The following conclusions emerged:

- The need for a continued and expanded emergency jobs program is keenly felt in all areas visited.

- The existing CETA Title VI program is working reasonably well in most places. It is succeeding in providing jobs for persons who would otherwise be unemployed. In most cases, these persons are performing highly useful work.

67-480 O - 76 - 7

• The program can be improved and made even more successful. The program design described above stems in part from the evidence gathered at regional hearings and from studies commissioned by the Committee during the past year.

We are pleased to note that legislation which has recently passed the House and is currently pending in the Senate would continue the Title VI emergency jobs program and would expand it by providing for locally initiated work projects of the kind we have suggested. Enactment of this legislation should receive high priority.

> Emergency job programs should be expanded to provide additional jobs for the cyclically unemployed -- those who normally could find jobs when the economy is operating near capacity. The additional jobs created by this program expansion should be in special projects lasting from one to two years and having a useful and identifiable output. The jobs should be clearly temporary and should make use of skills which the participants already have. This emergency program should be in addition to the existing CETA job training and public service employment programs. Appropriations should be provided to create a total of one million jobs during 1977, including the 600,000 jobs which would be provided under legislation recently passed by the House of Representatives extending and enlarging Title VI of CETA. 7/

7/ Senator Proxmire states: "I am against a job program of this size which is accomplised through public works, which are wasteful and too slow, or through public service jobs where there is a big substitution effect if it gets too large. Instead, I believe we should provide for jobs through a shallow housing subsidy where one job can be created for about $500 instead of $8,000 per public service job and as high as $25,000 for a public works job."

While no public jobs program can be entirely free from criticism, the approach outlined above would overcome many of the defects inherent in the existing program. Without a substantial and innovative program similar to the one described, the United States will continue to suffer high unemployment through the end of this decade. The resulting loss in income and human dignity is unconscionable, as is the erosion in the productive capacity of the labor force.

The emergency one million job program recommended above is only one element of an overall strategy to reduce unemployment rapidly. Countercyclical aid to State and local governments and an accelerated public works program are two other equally essential ingredients. Provision for both of these programs was included in the Second Concurrent Resolution on the fiscal 1976 budget, and both programs would have been authorized by a bill which Congress passed and sent to the President in January. The President's veto of this bill has torn a gaping hole in the comprehensive recovery program that Congress had developed.

The proposed emergency public works program has been criticized on the grounds that the projects would get underway too slowly to be of real benefit in dealing with recession-induced unemployment. If the 1974-75 recession had been as mild as other recessions experienced in the postwar period, this criticism might be valid. However, the recent recession has left an aftermath of high unemployment which will remain throughout the remainder of this decade. Unemployment in the construction industry is especially severe and appears likely to remain so for quite some time. A program of high-priority local work projects which can be initiated quickly and completed during the present period of high unemployment is thoroughly justified and badly needed.

Congress should quickly reenact and the President should sign legislation providing for:

- countercyclical aid to State and local governments, and

- an emergency public works program designed to fund high-priority local work projects.

Providing Jobs for Young People. Teenagers and young adults have always experienced higher unemployment rates than adults. While the unemployment rate among adults 25 years old and older was 5.4 percent in January 1976, that among persons 20 to 24 years old was 12.7 percent, and among teenagers of 16 to 19 it was 19.9 percent. For black teenagers, the unemployment situation was much worse. In January, 34.6 percent of 16 to 19-year-old blacks could not find a job; in many inner city ghettoes, the unemployment rate for teenagers exceeded 50 percent.

The total number of teenagers and young adults who were jobless in January 1976 was 3.7 million -- almost half the total number of Americans unemployed. In addition, there are about 400,000 youths who would be looking for work if it were available -- discouraged workers -- who are not counted in the unemployment statistics. One of the most tragic consequences of the 1975 recession and the severe unemployment projected through 1980 is the economic, social,and psychological impact it will have on many young people.

First, as noted above, many young people will lose the opportunity to develop job skills and work experience, to experiment with different kinds of jobs, and to adjust to the demands of the labor market -- a healthy process which normally precedes entry into a career job.

Second, many youths already have financial responsibilities without having the savings to sustain them during a period of prolonged unemployment. This problem is underscored by the fact that, among young adults (ages 20 to 24), 500,000 household heads are unemployed. In addition, there are also teenagers with family responsibilities. Among unemployed teenagers about 66,000 are household heads.

Third, younger workers are much less likely to be eligible for unemployment compensation. During 1975, only 30 percent of those under 25 were eligible for benefits, compared to more than 75 percent of those over 25.

Finally, prolonged unemployment increases the incidence of crime, drug abuse, and other forms of behavior that can ruin a person's chance of achieving a productive life in the future and that seriously increase the social costs of continued high unemployment.

High unemployment rates among youth result from many factors, including lack of work experience, inadequate job skills, poor job counseling, the weak work attachment of many students, and the rapid influx into the labor market in the past few years of those born during the postwar baby boom.

Data show that over 70 percent of the teenaged unemployed are searching for a first job or are reentering the labor force after a period in school or traveling. By contrast, almost two-thirds of 20 to 24-year-old men are unemployed by the loss of their previous jobs. Among 20 to 24-year-old women, reasons for unemployment were equally attributable to job loss and labor force entry.

About two-thirds of unemployed youths are seeking full-time work. Among teenagers, roughly half are seeking full-time work; among 20 to 24-year-olds, about 85 percent.

Although young workers are to be included in the general countercyclical job creation program described above, a separate program is needed in recognition of the special employment problems faced by youth.

Nearly one-half of the total unemployed are persons under 25 years of age. Extended idleness for young people with little past work experience will result in severe social and economic costs. Congress should give high priority to developing a comprehensive program targeted specifically at the employment needs of young people.

Included in such a comprehensive youth employment program, Congress should consider:

• Continued funding for summer jobs for youth and improvement in the administration of this program. In the summer of 1975, 840,000 jobs for teenagers were funded. The President proposes to eliminate 170,000 of these jobs by the summer of 1977. The serious unemployment problem among teenagers requires, to the contrary, that summer jobs be expanded or, at the very least, maintained at the 1975 level.

• Establishment of a youth employment service within the United States Employment Service to bring professional job placement and job counseling services to youths while they are still in school or when they are first entering the labor force. Assistance should be provided to facilitate the transition from school to work and to expand the availability of job apprenticeships in the private sector.

• Creation of a permanent jobs program directed specifically at young people. A project-type approach to public employment suggested earlier as a countercyclical measure could be adapted into a permanent youth employment program. Such an approach would lend itself more easily to the part-time or temporary employment needs of teenagers

and young adults. The need for such a program is greatest in the next five years when the influx of young people will be greatest. After 1980, teenagers will constitute a diminishing percentage of the labor force.

Stimulating Private Sector Employment. Almost 85 percent of American workers depend on the private sector for jobs and income. Of the persons who are currently unemployed because they lost their jobs, almost 90 percent worked in the private sector. Even with the large-scale public job program recommended above, most of these unemployed will depend on recovery in the private sector for renewed job opportunities. In addition to expansionary fiscal policy, we also must examine more direct methods of stimulating employment in the private sector during the next few years.

There are several reasons for providing incentives for job creation and training in the private sector. First, a well-designed subsidy or tax credit for hiring new workers, if effective, could entail a much lower Treasury cost per job than providing comparable public sector jobs. Second, the output of private jobs expands the supply of goods and services available in the private market and helps to dampen inflationary pressures. Finally, it is generally recognized that on-the-job training is the most effective means for upgrading workers' skills; and this training can be carried on by the trainee's future employer.

While Congress continues to pursue traditional means of improving employment opportunities in the private sector, including expansionary fiscal policies and incentives to business investment, new measures to stimulate additional private job creation and training should be explored.

In the fiscal 1977 budget, the President proposed a new accelerated depreciation provision to encourage construction of new plants in areas with

unemployment in excess of 7 percent. While the concept of providing special stimulus to job creation in depressed areas is an attractive one, the President's proposal is unlikely to result in a significant net addition of jobs and would not distinguish effectively between depressed areas and others. Furthermore, the proposal would foster capital-intensive instead of labor-intensive operations. This issue is discussed more fully in Chapter VII.

Another incentive to job creation in the private sector, which should be considered by Congress, is an employment tax credit. For example, such a credit could be designed so that any employer who increases his employment in 1976 or 1977 over the previous peak level would be eligible to receive the credit. To qualify, workers hired would have to have been out of work for at least six weeks. An effective credit would probably have to be set at a level close to $1,000 per newly hired employee.

There are two problems with this proposal that should be pointed out. First, there is a potential for significant windfall payments to firms that would expand their employment during the economic recovery even without the employment tax credit. There is no way to eliminate all such windfalls. Even with the possibility of some tax windfall, the jobs created through this proposal still would involve a relatively small cost to the Federal Government. At a maximum credit of $800 per job, for example, if one-half of the jobs qualifying for the credit would have been created anyway, the other half that were due to the credit would involve an average Treasury cost of $1,600 each. If only one-quarter of the new jobs in 1976 were due to the tax credit, each of these would cost $3,200, still less than half of the cost of a public service job.

A second problem with such a proposal, however, is that one cannot predict how many jobs it would create or how swiftly it would create them.

In other words, one cannot tell how reliable such a device would be in helping to reach our unemployment targets. The Committee intends to study further the alternative methods for stimulating employment in the private sector. In addition to the proposal described above, wage subsidies should be considered, especially for improving job prospects for the structurally unemployed.

Economic Planning

One of the most serious shortcomings of our economic policy institutions is the lack of mechanisms and procedures for developing long-range policies for balanced economic growth and full employment. While the poor performance of the economy in recent years may be attributed to some extent to international events and other actions beyond the control of the Federal Government, much has been the result of inattention to structural problems and a failure to act on the basis of reasonable foresight.

We do not advocate centralized economic planning. Indeed, many of our problems may be caused by overcentralization. For example, economic policy in general is controlled on the Federal level by a handful of influential officials in the Executive Branch. A brass quintet, made up of the Secretary of the Treasury, the Chairman of the Federal Reserve Board, the Chairman of the Council of Economic Advisers, the Director of the Office of Management and Budget, and the President's White House Economic Counsel composes most of our economic policy. Congress is excluded when possible and State and local officials are rarely consulted.

These officials normally operate in a short-run context, reacting to events, with no consistent framework of longer run objectives nor any plan to achieve them. The market system can achieve much, but a market economy develops distortions because

its incentive structure often fails to reflect social costs, and its time horizon also is quite limited. Government's involvement, moreover, is inevitable and is necessary to correct this incentive structure, to provide for public services, and for other purposes. A primary problem for planning is to channel the Government's involvement in ways that consistently promote balanced growth and full employment.

Three critical questions must be asked about any system of planning. Who does the planning? What are we planning for? What gets planned? The bill introduced by Senators Humphrey and Javits, S.1795, sets up a planning board within the Executive Branch to draft a proposed plan for long-range economic policy to be submitted by the President to Congress and the Governors of each State. The proposed plan would be coordinated with the Cabinet and approved, disapproved, or modified by Congress after obtaining the views of State and local officials. Under the Humphrey-Javits bill, long-range policy recommendations would be developed jointly by the President, the Cabinet, Congress, and State and local officials.

Broad-based, democratic long-range planning is intended to complement, not to replace, the market system. The Committee does not envisage an expansion of the Government's role into the private sector. It does contemplate establishing procedures to deal in a systematic long-range way with the problems of unemployment, inflation, and structural change.

Congress should enact legislation establishing Federal planning procedures to develop long-range policies for balanced economic growth and full employment. These procedures should provide roles for Congress and the Executive Branch as equal partners in the planning process and

should provide for full participation by the private sector and by State and local governments. The goals of full employment and price stability should be high priorities in any system of economic planning.8/ 9/

8/ Senator Proxmire states: "I disagree. I oppose putting the Federal Government into the business of planning for the economy. The Government is too big now. It interferes too much, with mindless regulation and excessive paperwork requirements, with the free market."

9/ Representative Gillis Long states: "I believe the thrust of this recommendation is to coordinate the activities of the Federal Government so that the private sector will have a better idea of exactly what Federal policy is and what the intentions of the Federal Government are."

V. FEDERAL BUDGET PRIORITIES

Expenditures

As the President stated in his budget message to the Congress, "The budget reflects the President's sense of priorities. It reflects his best judgment of how we must choose among competing interests and it reveals his philosophy of how the public and private spheres should be related." This last statement concerning the division of resources between the public and private spheres has become an increasingly controversial aspect of the budget debate in recent years. For this reason, the following discussion attempts to place the relationship between the Government and the private sector in perspective before discussing priorities within the budget itself.

Many people seem to have the impression that the influence of Government is expanding inexorably and threatens to overwhelm the economy by consuming an ever-increasing portion of our national output. This impression has been fostered by statements of government officials and by individuals' own perceptions of the influence of the Government, especially government regulations, on their lives. The result seems to be a widespread desire to curtail the Government's role. Before slashing the Federal budget, however, one must ask whether a smaller Federal budget is the logical response to this desire of some people for less government involvement in the private sector. An examination of the sources of the increase in government influence on the private sector is helpful.

Table V/1 shows the relationship of Federal spending and State and local spending to the overall economy. The first three columns show the relationship that would have been observed had there been no cyclical fluctuations in the economy; the last three columns show the actual relationship. As the table shows, the Federal share of total output has been relatively stable (varying between 17 and 21 percent) when adjusted for cyclical fluctuations.

Table V/1. Relationship of Government Expenditures to Gross National Product
(NIA basis, calendar years)

Year	Adjusted for Cyclical Behavior: Federal Expenditures As % of GNP	Adjusted for Cyclical Behavior: State & Local Expenditures As % of GNP	Adjusted for Cyclical Behavior: Combined As % of GNP	Actual: Federal Expenditures As % of GNP	Actual: State & Local Expenditures As % of GNP	Actual: Combined As % of GNP
1952	20.8	7.5	27.5	20.5	7.3	27.1
1953	21.0	7.6	27.8	21.1	7.5	27.8
1954	18.5	8.0	25.7	19.1	8.2	26.5
1955	17.0	8.2	24.5	17.1	8.2	24.5
1956	16.8	8.4	24.5	17.1	8.5	24.8
1957	17.3	8.7	25.1	18.0	9.0	26.0
1958	18.1	9.2	26.2	19.8	9.9	28.4
1959	17.8	9.2	25.6	18.7	9.6	27.0
1960	17.2	9.3	25.2	18.4	9.8	27.0
1961	17.9	9.7	26.4	19.5	10.4	28.5
1962	18.6	9.8	27.1	19.6	10.3	28.5
1963	18.5	10.1	27.1	19.2	10.6	28.2
1964	18.0	10.5	26.9	18.6	10.8	27.7
1965	17.8	10.8	27.1	18.0	10.9	27.3
1966	19.4	11.4	28.8	19.1	11.2	28.4
1967	20.6	11.9	30.5	20.6	11.9	30.5
1968	21.0	12.4	31.3	20.8	12.3	31.0
1969	20.1	12.5	30.5	20.1	12.6	30.5
1970	19.7	12.9	30.2	20.8	13.5	31.8
1971	19.4	13.3	30.1	20.7	14.0	32.0
1972	20.0	13.5	30.3	20.9	14.0	31.7
1973	19.7	13.5	30.1	20.3	13.9	31.0
1974	19.5	13.2	29.8	21.3	14.3	32.5
1975 p/	20.1	12.9	29.9	23.8	14.8	35.0
1976 e/	20.6	12.9	29.8	23.6	14.6	34.2

p/ Preliminary
e/ Estimates from various budget documents, the Economic Report of the President, the Joint Economic Committee staff, and the Council of Economic Advisers. 1976 outlays are based on the proposals in this Report.

The State and local share, however, increased steadily from about 7 - 1/2 percent in 1952 to almost 13 percent in 1970. The share of total output devoted to expenditures by all governments combined increased from about 27 percent in 1952 to about 30 percent in the late 1960's and, since that time, has remained relatively stable. Since there has been relatively little growth in cyclically adjusted government spending as a percent of GNP, and since a significant part of the increase which has occurred has resulted from State and local spending, an attack on the Federal budget seems unwarranted.

Often people observe past trends and project them into the future without considering whether it is reasonable to expect that past trend to continue. This is certainly reasonable for some elements of government spending. But an examination of the reasons for growth in government spending shows that many of these sources of growth will not exist in the future. For example, much of the growth in State and local expenditures has been related to providing public education. But the postwar baby boom now is moving into the labor force, and the school-age population has ceased to grow rapidly. Hence it will be unnecessary for State and local governments to devote so many resources to providing public education. One of the major sources of growth in Federal spending has been for retirement programs. Social security benefits have been expanded to cover more and more of the retired population. Today almost 100 percent of the retired population is eligible for these benefits. Expanding coverage is not expected to be a major source of expenditure growth in the future. When these factors are considered, there is no reason to believe that government spending is out of control or that it is likely to increase as a share of total output. Projections published recently by the Congressional Budget Office demonstrate that the continuation of present policies would result in a decline in Federal expenditures to about 20 percent of GNP in 1981. Adjusted for cyclical fluctuations,

Federal outlays would be only about 18 percent of GNP in 1981. 1/

A second and legitimate concern about the expanding role of Government centers around the effect of regulations. Federal and State regulations influence most aspects of our daily lives -- transportation, communications, working conditions, power usage, and so on. Considering their far-reaching influences, regulatory agencies consume a very small fraction of government expenditures. At the Federal level, the regulatory agencies represent less than 1-1/2 percent of total Federal expenditures. Clearly, an attack on Federal spending will have little influence on the behavior of these regulatory bodies. Any serious effort to reduce unnecessary regulation will require a commitment from the Administration to rewrite many regulations within existing legal guidelines and cooperation from the Congress in changing legal guidelines that have proved unnecessarily restrictive.

We reject the notion that trends in total government expenditures can best be controlled by focusing exclusively on the Federal budget. State and local spending has played the major role in the growth of total government outlays. It is also clear that a significant part of the average citizen's interaction with the Government is not directly related to budget outlays.

In preparing our recommendations on expenditure policy; we have not found the President's budget very useful. One problem is the unrealistically high estimate of the economic growth that would result from the President's policies. As discussed in Chapter II, we estimate that the President's policies would produce an average unemployment rate exceeding 7-1/2 percent in fiscal 1977. Consequently we regard the

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1/ Five-Year Budget Projections, Fiscal Years 1977-1981, Congressional Budget Office, January 26, 1976, "Path B" assumptions.

budget estimates for unemployment compensation and related programs to be unrealistically low. Another area in which the Administration's estimates have been consistently poor is the receipts from the sale of offshore oil leases. In fiscal year 1975 these receipts were originally estimated at $6.3 billion; they are now estimated at $2.4 billion for that year. In fiscal year 1976 the original estimate was $8 billion but it has now been revised to $3 billion. The fiscal year 1977 budget estimates next year's receipts at $6 billion, but we think CBO's estimate of $2 billion is more realistic. A third problem with the President's budget estimates is that they incorporate policy recommendations unlikely to be adopted. As discussed throughout this report, many of those recommendations are unreasonable and should not be adopted. For all of the above reasons, the Current Services Budget provides a far better and more neutral starting point from which to consider budget policy for next year.

Federal budget priorities are not made in a single year and rarely are they changed radically in one year. Rather, they tend to evolve gradually over constant and steady efforts over several years. Table V/2 demonstrates how proirities have evolved since 1965 and how they would change if the President's 1977 budget porposals are adopted. This table shows that about 39-1/2 cents of each additional budget dollar spent between 1965 and 1970 went for national defense, 22 cents went for income security programs, 14-1/2 cents went to health programs, and 10 cents went for interest payments. Between 1970 and 1975 there were major changes. Only about 5-1/2 cents of each additional dollar went to national defense while income security programs received about 51 cents and health programs received

Table V/2

Percentage Distribution of Change in Budget Outlays by Functional Category, Fiscal Years 1965-1980

Category	1965-1970	1970-1975	1975-1980
National defense	39.3	5.7	29.0
International affairs	- .6	.6	2.3
General science, space & technology	-1.7	- .4	.3
Natural resources, environment & energy	1.0	4.3	3.4
Agriculture	1.7	-2.7	.7
Commerce & transportation	2.8	5.4	1.7
Community & regional development	2.7	.9	1.0
Education, training, employment & social services	7.4	5.7	.1
Health	14.5	11.3	10.0
Income security	22.3	51.2	39.0
Veterans' benefits & services	3.8	6.2	- .2
Law enforcement & justice	.6	1.5	.3
General government	.5	.9	.3
Revenue sharing & general purpose fiscal assistance	.4	5.1	.6
Interest	10.1	9.9	10.1
Undistributed offsetting receipts	-4.4	-5.9	-5.1
Allowances	--	--	6.7
TOTAL a/	100.0	100.0	100.0

a/ Individual items may not sum to totals due to rounding.

Sources: The Budget of the U.S. Government, Fiscal Year 1977, and the Office of Management and Budget.

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about 11-1/2 cents. If the projections presented in the President's 1977 budget actually occur, priorities will shift again between 1975 and 1980. National defense would receive 29 cents of each additional budget dollar. Income security programs would receive about 39 cents, and health programs would get about 10 cents. Other changes are smaller and are shown in Table V/2.

Within the total level of spending suggested by the President in fiscal year 1977, there are major changes which, if adopted, would lead to significant shifts in budget priorities. As Table V/3 shows, the increase in the total budget is about 4 percent. When compared with the projected inflation rate of 6 percent, this implies a reduction in real services. In the national defense portion of the budget, the President has requested an increase in outlays of about 7.2 percent. Thus national defense would increase in real terms. If the nondefense portion of the budget is examined separately, it shows an increase in spending of about 3-1/2 percent, or a reduction in real terms (assuming 6 percent inflation) of approximately 2-1/2 percent.

Another way to view the President's budget proposals is to compare his suggested expenditures with the level of outlays that is necessary to provide approximately the same government services in fiscal year 1977 as in the current year. This comparison is one that this Committee has found useful for several years. The current services budget provides a neutral baseline for analysis which does not contain the policy

Table V/3

Change in Federal Outlays by Functional Category, Fiscal Year 1977 Over 1976

Category	Billions of Dollars	Percent (Adjusted for Transition Quarter)
National defense	$ 8.4	7.2%
International affairs a/	- .2	- 2.3
General science, space & technology	.2	3.6
Natural resources, environment & energy	2.0	13.2
Agriculture	-1.2	-31.9
Commerce & transportation	-1.3	- 5.9
Community & regional development	.3	- 3.7
Education, training, employment & social services	-2.3	- 9.7
Health	2.3	5.6
Income security	8.6	5.3
Veterans' benefits & services	-1.8	- 7.7
Law enforcement & justice	c/	--
General government	- .1	- 2.6
Revenue sharing & general purpose fiscal assistance	.2	2.0
Interest	6.5	14.6
Allowances	2.1	--
Undistributed offsetting receipts b/	-3.6	-18.7
TOTAL d/	$19.3	4.1%

a/ Includes Export-Import Bank in 1976 total for accurate comparison to 1977.
b/ Includes a $3 billion increase in estimated receipts from sale of offshore oil leases.
c/ Less than $50 million
d/ Individual changes may not sum to totals due to rounding.
Sources: The Budget of the U.S. Government, Fiscal Year 1977, and the Joint Economic Committee

changes incorporated in the President's budget. It is a projection of the spending that would result from an extension of existing law, from changes anticipated in case loads of entitlement programs such as social security and medicare, and from a continuation of other policies now in effect.

By comparing the President's proposed spending for 1977 with the current services level of spending for 1977, one can easily see where the President has focused his recommendations for policy change. As Table V/4 demonstrates, the total reduction in expenditures would be about $29 billion, with the largest cuts occurring in income security; health; and education, training, employment, and social services. Table V/4 also indicates a decline in national defense, relative to the current policy level. There is some distortion, however, in comparing this category with other functions because of its different treatment of pay increases. The increase in pay for all civilian agency employees is lumped together in the line labeled "allowances," while the pay increase for defense employees is added to other spending in the national defense category. Since the President has proposed as a policy change to limit pay increases to an average of 4.7 percent, and the "current services" level includes approximately a 12-percent increase in accordance with the current standard providing for comparability with the private sector, there appears to be a decline in national defense. If an adjustment is made for this different treatment of military pay increases, the President's proposed expenditures for national defense would be slightly above current services levels.

Within individual program areas, there is certainly room for increased program efficiency and greater productivity. With personnel costs running above $75 billion, it would be foolhardy to suggest that improvements in efficiency and productivity are not attainable. This Committee is willing to cooperate fully with the Executive Branch in achieving those increases. In a staff study published last

Table V/4

Estimated Outlays by Function, Fiscal Year 1977
(billions of dollars)

	President's Budget Request	Projections of Current Policy a/	Change Implied by Budget Request
National defense	101.1	103.4	- 2.3
International affairs	6.8	6.8	0.0
General science, space and technology	4.8	5.0	- 0.2
Natural resources	13.5	14.4	- 0.9
Agriculture	1.7	2.3	- 0.6
Commerce & transportation	16.5	18.5	- 2.0
Community & regional development	5.5	7.7	- 2.2
Education, training, employment and social services	16.6	21.5	- 4.9
Health	34.4	37.6	- 3.2
Income security	136.5	143.4	- 6.9
Veterans' benefits & services	17.2	18.8	- 1.6
Law enforcement	3.4	3.7	- 0.3
General government	3.4	3.6	- 0.2
Revenue sharing	7.4	7.3	0.1
Interest	41.3	42.2	- 0.9
Allowances	2.3	2.0	0.3
Offsetting receipts	-18.8	-15.5	- 3.3
TOTAL	393.6	422.7	-29.1

a/ This estimate provided by the Congressional Budget Office. It is based on the mean of Path "A" and "B" as described in Five-Year Budget Projections, Fiscal Years 1977-81, Congressional Budget Office, January 26, 1976.

b/ Individual items may not sum to totals due to rounding.

December, 2/ changes in the budget were identified which, after a five-year period, could reduce outlays by about $25 billion. Without endorsing these particular changes, we feel that there is sufficient criticism of the effectiveness of these programs to suggest that they be reexamined in light of the competing demand for Federal dollars. To argue that the changes should be made is not necessarily to say that the programs are not useful but only that more efficient use could be made of these Federal funds. Table V/5 shows the savings which might be realized from an orderly reduction in the programs listed.

Another change not included in Table V/5 which needs to be considered is in the military retirement program. Unlike the civil service retirement program, which is partly funded by employee contributions, military personnel make no contributions toward their pensions. Yet military personnel usually retire earlier and draw much more in pension payments than civilian employees. Benefits paid from general funds for retired military personnel in 1977 will total about $8-1/2 billion; by 1981 these expenditures will grow to about $13-1/2 billion under current law. Since military pay now has been made comparable to civilian pay, it may be appropriate for military personnel to begin contributing to their own retirement benefits as their civilian counterparts do. Such a change might also involve altering the computation of benefits. While drawing no conclusions on this issue, we urge Congress to examine the principle of comparable pay and benefits to assure that it is being applied uniformly.

2/ An Economic Evaluation of the Current Services Budget, Fiscal Year 1977, a staff report prepared for the use of the Joint Economic Committee, December 22, 1975.

Table V/5

Possible Savings from Selected Program Changes
Fiscal years 1977-1981
(Outlays in billions of current dollars)

	1977	1978	1979	1980	1981
National Defense					
Manpower efficiency	$ .60	$1.20	$2.00	$2.80	$3.80
Procurement efficiency	.50	.80	1.00	2.00	2.00
Asian force reductions	.90	1.70	4.20	5.10	8.10
Strategic force reductions	.60	1.90	3.50	4.50	4.80
Regulatory Changes					
ICC Phaseout	.02	.03	.05	.06	.07
CAB Phaseout	.03	.06	.08	.10	.11
Retirement Changes a/					
Military Annuitants	.09	.22	.32	.50	.62
Civilian Annuitants	.08	.27	.41	.84	1.09
Other					
Ship construction subsidies	.01	.09	.18	.27	.30
Export-Import Bank loans b/	1.10	2.10	2.80	3.40	3.80
Impacted Area School Aid c/	.13	.21	.28	.34	.40
Total	$4.06	$8.58	$14.82	$19.91	$25.09

a/ Change would make increase in retirement benefits equal to increases in the Consumer Price Index.

b/ Loans would be reduced over a 3-year period with all current obligations fulfilled.

c/ The portion of impacted aid for students whose parents do not both live and work on Federal property would be phased out over three years with all present hold-harmless provisions of the law maintained.

Income Security. The 1977 budget proposes several important changes in expenditures for income security programs. The largest component of this category is social security. Here the President would: (a) eliminate the provision that allows some new retirees to receive a lump sum payment in exchange for permanently reduced future benefits; (b) convert the retirement test from a monthly test to an annual one; (c) phase out student benefits; and (d) correct the provision which gives a double inflation adjustment to current workers. All of these provisions deserve careful consideration by the Congress. Congress must realize, however, that the initial impact of these changes on budget outlays will be small. As time passes the outlay impact would certainly grow, especially in the case of the double inflation adjustment.

Much concern has been expressed recently about the basic soundness of the social security insurance system. Table V/6 shows that in fiscal 1976, for the first time, expenditures exceeded receipts, so that the balance in the Social Security Trust Fund was reduced. If laws remain unchanged, the balance can be expected to decline again in 1977 and future years. We must point out, however, that the Social Security Trust Fund is in no danger of going bankrupt in the next two or three years. The balance at the end of 1976 will exceed $45 billion, and under the economic assumptions in the President's budget, a surplus of $23 billion is projected to remain in the trust fund in 1981 under current law. Adopting the President's proposals would increase the surplus to an estimated $68 billion in 1981.

The declining trend in the Social Security Trust Fund balance is disturbing, and Congress needs to begin consideration of the solutions to this problem. If we begin now, there will be adequate time to solve these problems before they reach a dangerous level.

Table V/6

Federal Old-Age, Survivors, and Disability Trust Funds
Receipts and Outlays, Fiscal Years 1971-1976
(billions of dollars)

	1971	1972	1973	1974	1975	1976 a/
Receipts	$38.9	$43.2	$49.6	$57.7	$66.7	$70.8
Outlays	35.9	40.2	49.1	55.9	64.7	73.7
Surplus or Deficit	3.0	3.0	0.5	1.8	2.0	-3.0
Balance at end of year	40.8	43.8	44.3	46.1	48.2	45.2

Source: Department of the Treasury

a/ Estimated

The Social Security Trust Fund is in basically sound condition. The single most important thing that can be done to ensure the continued soundness of the social insurance system is to restore health to the overall economy. Even so, some changes will be necessary to avert problems in 1980 or after, but Congress has time to give careful consideration to the full ramifications to these changes.

The fact that the Social Security Trust Fund is declining is not enough information to solve that problem. One must know the cause of the decline. The single most important cause of the drop in the trust fund receipts is the economic recession.

There is no doubt that a recession causes government recepits to fall and expenditures to rise. This is observed for the Government as a whole and the social insurance funds in particular. The Secretary of the Treasury has estimated that, under conditions of full employment, social security receipts in fiscal 1977 would be nearly $10-1/2 billion higher than the actual anticipated level of $96.2 billion. Table V/7 shows how seriously the current recession has curtailed the receipts of the social insurance funds as a whole. This table includes funds for unemployment compensation, railroad retirement, supplementary health insurance and other purposes, in addition to social security. The social insurance trust funds would have collected over $40 billion in additional receipts had this recession been avoided.

The unusual combination of high inflation with the current recession also has adversely affected the Social Security Trust Fund. The base on which social security taxes are levied rises automatically over time as wages and salaries rise. Benefits paid out, however, rise automatically as the Consumer Price Index (CPI) increases. From 1974 to 1975 the CPI increased 9.1 percent; at the same time wages and salaries increased only 5.1 percent. This usual disparity between wage increases and CPI increases placed an especially heavy burden on the trust fund last year.

Table V/7

Impact of Recession on Social Insurance Fund Receipts
(NIA basis, calendar years, billions of dollars)

	Actual Tax Collections	Tax Collections at Full Employment	Revenues Lost Due to Recession
1973	79.4	82.0	2.6
1974	89.4	96.9	7.5
1975	93.5	107.5	14.0
1976 a/	104.0	121.1	17.1

a/Estimated by JEC staff. Assumes no increase in the social security tax rate and no change in unemployment taxes.

A second but less significant problem with the Social Security Trust Fund is that it is called upon to provide more than just retirement benefits. With the enactment of medicare in 1965 the trust fund was expanded to finance hospital insurance for many elderly people. A special part of the payroll tax (1.8 percent of the 11.7-percent total) is set aside to pay for hospital insurance. While we support the concept that an individual makes a contribution toward his pension by paying into the Social Security Trust Fund, we feel that it would be appropriate to change the present law so as to fund hospital insurance from general revenues. The hospitalization benefits a person receives are determined by the reimbursible costs he incurs and bear no relationship to his wages or contributions. Such a change in funding responsibility would in no way alter the balance of the Federal budget on a unified or national income accounts basis but, by holding the payroll tax constant, would increase the balance of the Social Security Trust Fund. The health insurance contributions now comprise over $10 billion per year. The 1975 Advisory Council on Social Security endorsed the idea of general revenue funding for the hospital insurance program. 3/

Since its founding, the social security system has been expanded to provide far more than just retirement benefits for those who contribute. Making many people eligible for benefits who had contributed little has placed a heavy burden on the trust fund. To relieve part of this burden and to avoid further increases in the regressive tax that finances this system, funding responsibility for the hospital insurance program should be transferred from the trust fund to general revenues. Receipts currently collected for hospital insurance should be reallocated to the Old Age and Survivors Disability Insurance Fund.

3/ Communication from Secretary of Health, Education, and Welfare transmitting the Reports of the Quadrennial Advisory Council on Social Security, March 10, 1975.

Housing. In 1968 Congress stipulated the objective of "a decent home in a suitable living environment for every American family" and established a corresponding national goal of 2.6 million housing starts per year. Two million starts were to be financed exclusively by the private sector, while 0.6 million were to be government-assisted units. This rate of building was sufficient to meet the demand for housing created by net new household formations, to compensate for attrition from the housing stock, and to replace gradually the units that were clearly substandard.

Since the enactment of this goal, demographic changes and more vigorous rehabilitation efforts have reduced the new building rates necessary to meet the Nation's housing needs. These trends have lowered the rate of new household formation and reduced attrition from the housing stock. According to the Census Bureau, the average annual increase in the number of households will be approximately 1.5 million from 1976 to 1980. In addition, approximately 0.8 million housing units must be started each year to compensate for conversion, destruction,and abandonment and to cover the natural growth in the number of second homes. Thus, 2.3 million housing starts annually are necessary to keep pace with the demand for new housing in the near future.

In the past two years, new housing construction has fallen woefully short of even the most modest projections of housing needs. In 1974 and 1975, housing starts averaged 1.25 million units annually, approximately 55 percent of prospective demand. In 1975, the annual rate of housing starts was closer to 50 percent of the Nation's goals, despite an increase that extended through the last three quarters of the year.

The recovery in the housing industry will continue in 1976. Large savings inflows into the thrift institutions will provide funds to increase mortgage loans and should depress interest rates somewhat. The economic recovery also will increase the demand for housing by raising consumer incomes. The trend

toward smaller houses should broaden the market for new homes. Nevertheless, the Committee expects only 1.5 million to 1.6 million housing starts in 1976, still far below necessary levels.

The high price of home ownership is responsible for the weakness of the recovery in the housing industry. In addition to soaring construction costs, high land prices have raised the price of new housing, and mortgage interest rates have remained high despite massive flows of savings into thrift institutions. Operating expenses also have jumped. These factors will continue to make homeownership hard to afford for many American families and will moderate demand for new housing construction in 1976. This fact was graphically made by a recent study prepared for the Committee that showed that only 15 percent of all families now can afford the median-priced new single-family home, and only 21 percent can buy the median-priced existing home.

The Committee is concerned that these factors could become a serious impediment to achieving levels of housing construction consistent with our national goals. We believe, therefore, that Congress must develop proposals to make homeownership affordable for a larger percentage of American families. Several initiatives could strengthen the demand for and improve the affordability of housing:

- The $2 billion available for use in the Government's National Mortgage Association tandem plan should be released immediately by the Administration. These funds have been appropriated by Congress and could be used to purchase mortgages on single-family or multifamily dwellings at an interest rate of 7-1/2 percent.

- A mortgage with rising monthly payments could be offered as an alternative to the existing mortgage instrument. This option could be used to minimize monthly payments at the beginning of the mortgage by requiring only interest payments or even deferring

part of the interest over the first few years. Later, monthly payments could rise as the income of the mortgagee rises. This type of mortgage instrument could be particularly useful to young families purchasing their first home.

• Mortgages with 7 percent interest rates could be offered to all households with incomes less than 120 percent of the median income in a geographic area. The size of the mortgage should be limited to the price of a median-priced home in the region. The mortgages could be made available through thrift institutions and could then be resold to the Federal Government.

Congress should enact policies designed to increase the rate of housing starts to levels that are consistent with a national goal of 2.3 units annually. This level of production is sufficient to meet the demand created by net new household formation and replacement of the existing housing stock. Top priority should be given to programs designed to make new and existing housing affordable to more families. As a first step toward implementing this recommendation, the $2 billion available for use in the Government National Mortgage Association tandem plan should be released immediately. 4/

The Committee is particularly concerned about the millions of low- and moderate-income families living in substandard housing. Traditionally these people have benefited from rapid growth in the total housing construction programs. In the last two years, neither of these beneficial factors has existed.

Government-assisted housing starts have declined significantly in the last five years from 400,000 units in 1970 to less than 100,000 units in 1974 and 1975. While the budget of the Department of Housing and Urban Affairs (HUD) indicates that more than 200,000 new assisted units will be started in 1976, HUD'S performance in the past has been so erratic that the

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4/ See Senator Proxmire's footnote on the following page.

4/ Senator Proxmire states: "I agree strongly with the recommendations. Last year was the worst year for housing starts since 1946. HUD produced less than 10 percent of the 600,000 goal for assisted housing.

"What we must have is a housing program which will meet three standards.

"First, it should meet housing needs for both the society as a whole and for low- and moderate-income families.

"Second, it should provide jobs through construction and not merely provide housing allowances for shelter in existing structures. This could provide a great economic stimulus at very little cost.

"Third, we must choose those assisted housing programs which are the least costly to the taxpayers. This means that public housing, the homeownership programs under both HUD and Farmers Home Administration, and the Section 202 elderly programs are greatly to be preferred over the new Section 8 programs, which appear to be exceptionally costly."

Committee has grounds for skepticism. There are a number of actions that the Committee believes could be taken to accelerate the construction of low- and moderate-income housing units:

• The Section 235 program,[5] recently revived by HUD, could be expanded and accelerated to provide 100,000 assisted housing starts in 1976 and 200,000 starts in 1977. This program provides 5 percent mortgages to low- and moderate-income families. It is a low-cost but effective program for encouraging the construction of new government-assisted units.

• State housing finance agencies should be encouraged to use the Federal guarantee of taxable bonds with the 33-percent interest subsidy provided for in the Housing and Community Development Act of 1974. At present, many State housing finance agencies are unable to borrow, jeopardizing the construction programs that they undertake. Utilization of Federal guarantees already enacted would ease this problem.

• The Section 8 leasing program could be used to a greater extent to encourage new government-assisted construction. Initially a requirement could be imposed on HUD that 40 percent of the units assisted under the Section 8 program be new units. This requirement could be gradually increased.

Congress should accelerate and expand housing construction programs that benefit low- and moderate-income families. Top priority should be given to programs that expand the supply of housing available to and affordable by such families.[6]

5/ Under the Housing Act of 1974.

6/ See comments by Senator Proxmire, p. 122, footnote.

67-480 O - 76 - 9

Energy. Although the Administration continues to proclaim a goal of energy independence by 1985, there appears to be no realistic way at any reasonable cost to close the gap between domestic energy production and U.S. energy demand over the next decade. Many of the production options being considered, especially the large technology development projects such as shale oil, synthetic fuels, and nuclear power seem to involve much more time and far more cost than was anticipated even a short while ago. It is now time, therefore, to place added emphasis on other potentially high-payoff possibilities such as conservation and coal. In legislating an energy policy in the long-term interest of the United States, Congress must be vigilant to weigh the relative cost-effectiveness of alternative strategies.

From this perspective, a number of approaches seem to make sense:

- A strategic petroleum reserve, authorized under the Energy Policy and Conservation Act, is the best insurance against threats of another supply interruption and should receive high priority. The President also should use the authority under the new Act to seek oil supplies at lower prices, by agreement with the exporting countries if possible.

- Conservation opportunities are widespread and in many cases very cost-effective. Unlike emergency curtailment of use, many conservation measures will create income and jobs. Much conservation will be cheaper, quicker, and less environmentally damaging than a corresponding expansion of production. Most important, consumers will realize substantial money savings through more efficient use of fuel that would not be made by expanding supply at high prices to feed our wasteful habits.

- Priorities in energy research and development also are seriously out of balance. The overwhelming bulk of R&D expenditures continues to go to capital-intensive, production-oriented projects, some of which promise uncertain benefits at very high cost.

Extremely low priority, despite much lip service, is afforded to R&D in energy conservation and renewable energy sources.

Congress should give energy conservation higher priority, moving promptly to consider economic incentives and assistance to realize energy efficiency in residential and commercial buildings, industrial processes, transportation, and electric power generation. While pursuing promising technology development based on nuclear and fossil fuels and the development and production of synthetic fuels from nonpetroleum feedstocks, Congress should provide adequate funding for research and development on energy conservation and the use of renewable energy sources. 7/

- Enactment of stripmining legislation is essential for the orderly development of coal, the Nation's most abundant fuel.

- The continuing failure of the energy industry to expand domestic production despite enormous fuel price increases raises questions about the degree of competition within the industry. Congress should consider legislation to separate the stages of operation of integrated petroleum companies, to limit their ownership of competing energy resources, and to create a Federal oil and gas corporation as a yardstick by which to measure performance in the private sector.

Agriculture. Retail food inflation moderated to 8.5 percent in 1975 from the high 14.5-percent rate of 1973 and 1974. Increased marketing spreads by middlemen accounted for almost three-quarters of the retail price rise. Consumers spent 17.1 percent of

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7/ Representative Moorhead, Pa., states: "I believe significant advantages can be gained by the commercialization of existing synthetic fuels technology. See my supplemental views, p. 264."

disposable incomes on food in 1975, up from 15.9 percent in 1973. 8/

The poor 1974 harvest and the 28-percent decline during that year in meat animal prices retarded meat supplies during much of 1975; fall pig marketings fell to a 20-year low. As a result, animal prices rose 23 percent in the past year accompanied by a strong recovery in slaughterings during the last quarter.

Realized net farm income in 1975 fell $2.7 billion from the 1974 level of $27.7 billion. Farm incomes have now fallen 13 percent since 1973. Higher livestock prices and grain marketings, including exports, did not offest the deterioration in grain prices and a 9-percent rise in the price of farm inputs. The strong late-summer surge in feed grain prices due to Soviet purchases was temporary due to the bumper American and Australian grain harvests and a good world rice crop. These bumper crops permitted the August 11, 1975, embargo on Soviet grain purchases to be lifted.

Under an October 20th sales agreement, the Soviets can purchase from 6 to 8 million metric tons of U.S. grain annually, beginning on October 1, 1976. They may acquire 3 to 4 million more tons of grain this spring and summer to supplement purchases of 13.4 million tons since July 1975.

Several factors indicate reduced farm incomes in 1976 if favorable weather again brings large crops and lower prices. Prospective planting intentions in January indicated a rise of about 4 percent in acreage devoted to field grains and cotton; only soybeans were down, under price pressure from foreign palm oil. 9/

8/ U.S. Department of Agriculture, Agricultural Situation, January-February, 1976, p. 15.

9/ USDA Crip Reporting Board, "Prospective Plantings," January 21, 1976. This projection will be updated in April.

Domestic retail food demand, after two years of recession, will be close to 1974 levels. Restoration of depleted inventories by the 1975 bumper crop also will curtail growth in domestic grain demand this year.

A slow world economic recovery could hold exports in 1976 to our traditional Organization for Economic Cooperations and Development (OECD) trading partners at 1974 levels. In fact, continued deterioration in grain prices and stabilized export quantities could result in agricultural exports in the range of only $20 billion this year, the lowest level in three years. Offsetting these negative factors will be rising feed grain demand if fed animal prices continue strong in 1976.

Stable or falling grain and livestock prices will permit the moderation in retail food inflation to continue through 1976. With good growing conditions, that inflation could be held to 4 or 5 percent, largely attributable again to rising middlemen's margins.

Minimizing Agricultural Uncertainty. American agricultural markets remained in disarray during 1975. Sharp price gyrations confirmed once again that the domestic food industry is at the crack-end of the world food whip.

Farmers continued to operate under conditions of uncertainty in which shocks affecting production intentions and income can originate from around the world. This exposure needlessly exacerbates traditional uncertainty associated with the weather. It is an uncertainty only modestly reduced by recent grain sales agreements with Japan, Russia, Poland, and Romania. It is an uncertainty aggravated by the depletion of government food stocks, by the diminution in acreage set-asides and by domestic agricultural policies of OECD nations.

This uncertainty has caused severe fluctuations in farm prices. Just since 1973, cattle prices have varied from $28 to $65 per hundredweight; cotton has fluctuated from 35¢ to 80¢ per pound. In 1975, soybeans varied from $6.25 per bushel to $4.25; and, as already noted, feed grain prices are down 40 percent since 1973. 10/ In short, American agriculture is now exposed to a degree of uncertainty and of price volatility not experienced since prior to 1950. This volatility was markedly diminished by the stabilization policies in effect from 1950 to 1971.

One major source of uncertainty is the ready accessibility of domestic commodity markets to foreign customers. While continued access by these customers is vital to the economic health of agriculture, this access should not be so unfettered that it permits minor shifts in foreign demand or supply to cause major domestic commodity price fluctuations.

The most effective price stabilization technique is the maintenance of international and domestic commodity reserves. These reserves should be acquired during bumper harvests and released according to specific reserve-stock or price triggers. As much as two-thirds of these reserves should be held in private hands.

A national food policy should be established to reduce the magnitude of commodity price fluctuations through the maintenance of international and national commodity reserves. Private holdings of such reserves should be promoted by the establishment of three-year nonrecourse price-support loans.

10/ U.S. Department of Agriculture, Agricultural Outlook, November 1975.

International Food Information System. In combination with the present weekly reporting requirement for large export contracts and the Soviet and other long-term sales agreements, a commodity reserve system may obviate the need to institute export licensing for food in short supply situations.

At the same time, it is necessary that more complete information on prospective food supplies be available to private holders of food reserves if their actions are to promote price stability. Last year the Committee urged the establishment of an international food information system, including participation by India, the Soviet Union, and China. Such a system is still necessary, but progress toward establishment of that system has been slow; the call for its establishment is renewed.

An international early warning food information system should be established to provide holders of private commodity stockpiles and the Government with information on emerging worldwide supply and demand relationships to promote commodity price stability.

Maximizing Agricultural Production. The Administration and Congress are unified in support of full agricultural production as the most effective damper to retail price inflation. Production could be maximized by price support (loan) levels equal to variable production costs of commodities. That level would enable small farmers to endure low prices due to bumper crops, it would encourage maximum planting, and it would promote reasonable retail prices without discouraging the export of bumper harvests.

As shown in Table V/7, a significant increase in loan levels for corn, wheat, and cotton is necessary to cover variable production costs. 10a/

To support maximum agricultural production, agricultural loan levels should be set equal to variable production costs.

Table V/7

Variable Costs of Production, 1975

State	Corn	Wheat	Cotton
Alabama			$0.35
Arkansas			.41
Georgia	$1.95		.52
Indiana	2.04	$3.18	
Iowa	1.82		
Missouri	1.85	4.10	
Nebraska	1.76	3.80	
Ohio	2.42	4.13	
South Dakota	1.80	2.80	
Present loan level	1.10	1.37	.34

Source: The Agricultural Situation, Hearings before the Joint Economic Committee, April 25, 1975, p. 165.

10a/ Administration endorsement of this concept did not prevent last spring's veto of the Emergency Farm Act, an Act containing loan levels well below variable production costs in 1975. See Economic Report of the President, February 1975, p. 184.

Defense Spending.[11/] The President's request for defense represents a significant shift in national priorities. While inflation absorbs much of the dollar increase, there will be a real increase in budget authority in fiscal 1976 over 1975, and there would be a slightly larger real increase for fiscal 1977. In real terms, outlays for national defense would rise very slightly in fiscal 1976 and by 2 percent in 1977. Budget authority in real terms rises by 4.1 percent in 1976 and by 4.7 percent in 1977.[12/] In real terms outlays for the Department of Defense (DOD) alone decline by 1 percent in 1976 and rise by 2 percent in 1977; budget authority for DOD would rise by 3 percent in 1976 and by 5 percent in 1977.

The disparity between defense and civilian expenditures is even greater when personnel costs are excluded from the Department of Defense budget. Pay and allowances account for 51.7 percent of the DOD budget, down from 54.1 percent in 1976. The President's proposed pay cap on military and civilian pay increases is less than the estimated inflation for next year. Thus the nonpay portion of the DOD budget rises by 16 percent in current dollars and by 9 percent in real terms.

The upward trend in defense spending is an outstanding feature of the new budget. The fact that there is a substantial real increase in DOD budget authority in the present fiscal year comes as something of a surprise, because when Congress was acting just a few months ago on the defense appropriation bill, many members believed that the amount appropriated would not comprise significantly more in real terms than in the year before. This belief was based

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11/ See qualifying comment by Representative Long in footnote on page 137.

12/ The figures cited relate to the national defense functional category in the Budget, including atomic energy defense activities and other defense-related activities. Figures cited subsequently in this section relate to the Department of Defense plus military assistance alone.

on information supplied by the Department of Defense about the amount of inflation for defense purchases. It turns out that the Pentagon overestimated the inflation rate by a wide margin. The result is that the 1976 defense budget shows real growth of over $3 billion in budget authority. The need for a better estimate of inflation in the defense sector is discussed below.

The President's 5-year forecast assumes an average real increase in nonpay defense purchases of 4 percent annually. Total outlays for national defense would reach $142.8 billion in 1981; budget authority would reach $151.5 billion. Defense outlays would rise from 26 percent to 28 percent of the Federal budget. As shown in Table V/1 above, the allocation of projected spending increases for defense and civilian programs demonstrates dramatically the Administration's decision to emphasize defense.

The wisdom and desirability of a rise in defense spending at the expense of other national needs must be questioned from an economic standpoint. It should be self-evident, despite some recent debate, that enlarging the defense budget is not an appropriate way to effect economic stimulus. Defense spending does not yield the goods and services that people need in peacetime. Its level should be determind with only national security needs in mind. The economy should be managed using other tools of fiscal policy and other macroeconomic measures. This is particularly true when, as in the new budget, the purchase of weapons takes up so large a portion of the increase. Of the $14.4-billion increase in DOD budget authority, $8.1 billion is for increased procurement.

Defense procurement continues to be plagued by cost overruns, schedule slippages, and performance failures. Problems in the aircraft and shipbuilding industries strongly suggest that more efficient operations and improved management of government programs could sharply reduce procurement costs.

For example, the large cost overrun in the C-5A cargo aircraft program is well known. Now, in addition to the overrun, structural defects in the aircraft have resulted in a proposal to rebuild the wings at a cost estimated by the Office of Secretary of Defense at $1.3 billion. If this proposal is implemented, the total C-5A cost overrun, including the extraordinary repair bill, will exceed $3 billion.

Navy shipbuilding programs have been characterized by cost overruns, lengthy delays, and large claims filed by the contractors against the Navy. A year ago the Navy asked Congress for $2.3 billion for the "unanticipated" costs of ships under construction. This request was in addition to the request for new ships. The unanticipated costs can be broken down into the impact of inflation and inefficient government management and shipyard operations. The Senate Armed Services Committee attributed the cost increases, in part, to "low productivity, construction delays, and Navy changes." 13/

Congress approved $1.3 billion of the Navy's request last year, deferring action on the remaining amount. The deferred amount has grown, in the current request, from $1 billion to $1.6 billion, although the overall impact of inflation on defense last year was less than expected. If the current request is approved, a total of $2.9 billion will have been spent for "unanticipated" costs of shipbuilding. 14/

Studies by defense experts and statements by defense officials show that additional efficiencies can be achieved in the use of manpower and military

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13/ Senate Armed Services Committee Report No. 94-196, p. 23.

14/ It should be noted that the massive increase in foreign military sales is having an adverse impact on the costs of our own defense procurement and thereby exacerbating the cost overrun problem.

bases. More than four years ago the Deputy Secretary of Defense estimated that justifiable base closings could save at least $1 billion annually. Such savings have still not been realized. It has often been said that Congress prevents the Defense Department from closing unnecessary bases. We disagree. Where it has been determined that bases can be closed or realigned to achieve economies, the authority to do so should be exercised. The costs of support and auxiliary functions have been reduced somewhat in the past 2 years but significant reductions are still possible. For example, the ratio of students to instructors is about 1.5 to 1 in military schools compared to about a 15 to 1 ratio in most colleges.

Inequities and anachronisms in the military pay system are also costly. According to a recent study by the Brookings Institution, "As matters now stand, the United States pays more than is necessary to field its military forces . . . ." 15/ Additional savings are possible through lengthening tours of duty and reducing civilian manpower in proportion to the reductions of uniformed personnel made over the past several years. The Committee notes that the number of civilians employed by the Defense Department (approximately one million) exceeds the total number of civilians employed in all the other agencies of the Executive Branch combined.16/

A strong defense is necessary but the Nation cannot tolerate wasteful practices. The fact that a large sum was reportedly added to the defense request by the President late in the budget cycle and that an additional $3 billion were tacked onto the request as insurance against congressional cuts supports the conclusion that the budget is padded and can safely be reduced.

15/ Martin Birkin, The Military Pay Muddle (1975).
16/ This comparison excludes the Postal Service, which no longer is part of the Executive Branch.

Prime candidates for close examination in the defense budget are certain portions of our strategic forces and our conventional forces for an Asian contingency. For example, a slowdown in the B-1 bomber program could result in substantial savings even when offset by the costs of developing an alternative standoff-type bomber. Without making a judgment as to the relative merits of the B-1 versus a standoff-type bomber, which would be far less costly to build, the Committee notes that the latest versions of the B-52 bomber have a useful life that will extend into the late 1990s, and current plans call for retention of them even after deployment of the B-1. There may not be adequate justification for moving immediately into production of a new bomber that will cost in excess of $20 billion not including armament, operating and support costs.

In addition, a cogent argument exists for slowing down or terminating further improvements in the capabilities of land-based intercontinental ballistic missiles, the phased withdrawal of some of the older land-based missiles, the reduction of the older B-52 bombers, and the slowdown of the advanced tanker aircraft program.

Costs of forces for an Asian contingency are estimated as high as $23 billion annually. In view of the changes that have taken place in Asia with the end of the Vietnam war and our improved relations with China, this huge expenditure should be reexamined. Not only is China perceived as far less threatening to U.S. interests as a result of diplomatic efforts but intelligence analysts no longer view China as an expansionist nation. William E. Colby, former Director of Central Intelligence, testified before the Committee that China has been in a defensive posture militarily for a number of years and that its military procurement has declined sharply since 1970. 17/

17/ Joint Economic Committee hearings, Allocation of Resources in the Soviet Union and China-1975, Part 1, pp. 45, 71, 75.

There are at present about 140,000 military personnel in the Asian region and, in addition, sizeable naval, air, and ground forces in Hawaii and in the U.S. justified by Asian contingencies. Phased reductions without removing any U.S. troops from Japan or South Korea could yield substantial savings. A cut of about one-fourth of these forces, phased gradually over a 5-year period, would reduce outlays by approximately $8 billion annually by 1981.

Potential savings through 1981 from improved efficiency and changes in strategic and Asian forces are indicated in Table V/5. Such savings could amount to $2.6 billion in outlays in 1977 rising to $18.7 billion in 1981. 18/ If the amount of padding and "cut insurance" were taken out of the budget, greater savings could be achieved.

Congress has the responsibility to provide a defense budget that will assure our national security. We believe that national security can be assured at a 1977 spending level in the range approved by Congress for fiscal year 1976 plus allowance for current inflation. This would mean a reduction from the President's request for budget authority of approximately $6 billion. The remaining amount of about $108 billion would represent a substantial increase in the dollar budget and would provide the U.S. with the resources needed to maintain the world's strongest military force. To achieve the budget reduction, Congress should eliminate waste and whatever padding is in the budget and should scrutinize the requests for new weapons development. 19/

Defense and Inflation. In earlier reports the Committee has discussed the subject of defense spending and inflation. We pointed out in our

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18/ The changes are discussed in An Economic Evaluation of the Current Services Budget, Fiscal Year 1977, a Staff Report prepared for the use of the Joint Economic Committee. December 1975.

19/ See Representative Long's footnote on following page.

19/ Representative Long states: "While I concur with the spirit of this recommendation, I will make independent judgments on defense spending as the appropriate congressional committees make their recommendations. Whether or not the result of my judgments on individual items will be above or below the specific totals listed here, I do not know. My primary concern is the continued security of the United States."

1973 report that no adequate measures of price changes in Federal defense purchases had been developed, although the Committee had urged the Department of Commerce to do so. We therefore questioned the Defense Department's assumptions about the amount of inflation in defense purchases.

The Defense Department's approach was to rely primarily on the nonpay component of the deflator for Federal purchases of goods and services. This approach was defective because the Federal purchases deflator does not separate defense from civilian purchases. The deflator used for Defense Department military and civilian pay was also inadequate because no allowance was made for increases in productivity.

The Committee concluded that, until a defense deflator was developed and published on a regular basis, it would be impossible to know how inflation is affecting defense spending, and we formally recommended that the Commerce Department develop such a deflator.

We are pleased to note that the Commerce Department has moved forward on this project. Last year it published a comprehensive study entitled Measuring Price Changes of Military Expenditure, 20/ which stated: "The most nearly universal conclusion, which can be drawn from examination of existing military price indicators of all or part of defense purchases, is that they are inadequate and possibly misleading as historical measures of price movement." 21/

The Commerce Department, having completed its feasibility study and historical survey, now has begun a major effort, in cooperation with the Defense Department, to develop a defense deflator. The Committee is hopeful that the measure of price changes developed will be specific and discrete enough to provide information about each of the defense industries and by product lines. We look forward to significant progress by next year.

20/ U.S. Department of Commerce, Bureau of Economic Analysis, 1975.
21/ Ibid. p. 267

Tax Reform

The so-called "tax expenditure budget" accounts for tax revenues lost through special tax preferences. This budget, as drawn up for 1967, consisted of 60 items with a total revenue loss of $36.6 billion.21a/ The most recent listing of tax expenditures by the Congressional Budget Office contains 82 items with a total revenue loss of $106 billion for fiscal 1977.22/

In a decade, therefore, tax expenditures have nearly tripled through increased revenue losses from pre-existing tax expenditures and through the addition of 22 new tax expenditure provisions. The growth in such revenue losses has been much more rapid than the growth of Federal outlays. Unless tax reforms are enacted, the upward trend will doubtless continue. By 1981, the total revenue loss from existing items is projected to rise by 40 percent to $148 billion.

Although revenue losses from tax expenditures equal one-fourth of budget outlays, they rarely come under close scrutiny or review. Many tax expenditures have outlived their usefulness, other are ineffectual in fulfilling their intended purposes, and many have very inequitable distributions of benefits. All such provisions withhold revenue year in and year out from the U.S. Treasury -- revenues that other taxpayers must make up.

21a/ Joint Committee on Internal Revenue Taxation acknowledged that there are many problems associated with adding up tax expenditure estimates, but the totals are useful to illustrate the order of magnitude involved.

22/ "Five Year Budget Projections, 1977-81," January 1975, p.59.

67-480 O - 76 - 10

Congress is rightfully jealous of its appropriation prerogative. The Committee believes that the time is long overdue for the Congress to establish a procedure for a systematic review of the tax expenditure portion of the Federal budget.

> To gain control of the tax expenditure budget and to ensure that each provision serves a useful purpose equitably and effectively, Congress should direct its tax-writing committees to report on all tax expenditures within five years. After critical examination, each item should either be reauthorized with or without modification for a period not to exceed five years, or else eliminated. A regular five-year review cycle should be established.

Among the tax expenditures that cause the largest revenue losses, the following ones would seem to merit reconsideration by the tax-writing Committees of Congress.23/

Exemption of Capital Gains at Death or Gift.

Under present law, individuals can escape the capital gains tax on the appreciation of assets by retaining them until death and passing them on to their heirs for whom the appreciated value becomes the new tax basis. In recent years this provision of the tax code has allowed $10 to $15 billion annually in capital gains to go completely untaxed. Many less wealthy taxpayers, however, may be forced by economic necessity to sell their assets, incurring a capital gains tax at the time of sale. The failure to tax capital gains at death causes asset selection to be based on tax avoidance rather than on pursuit of the highest current return.

23/ Representative Long states: "Certainly the provisions listed below should be scrutinized carefully. However, I will comment on those specific items that particularly concern me."

To rectify this situation, many analysts believe that capital assets held at death should be taxed as if they had been sold just prior to death. Unfair financial strains on beneficiaries' estates, particularly in the case of family businesses and farms, could be avoided by amending the tax code to make installment payments a feasible option to those who need to extend their tax payments over time. The following two exceptions also should be considered: (1) Not taxing transfers to a surviving spouse, and (2) allowing a lifetime exemption of $100,000 in capital gains from the disposition of a family farm, business or residence.

Estate and Gift Taxes. An effective estate and gift tax is important to ensure that wealth is taxed at least once each generation. It reduces large concentrations of wealth and has a minimal impact on incentives and risk-taking.

Changes in three areas should be considered. First, the estate and gift taxes could be unified into one tax schedule; the separate schedules now in effect discriminate against persons who hold their wealth until death. Second, the generation skipping trust should not remain untaxed. It raises questions of tax equity by being much less valuable to persons with smaller estates than to those with large ones. The trust could be taxed under the estate tax as if it were the property of the income beneficiaries. A third problem is that the estate-splitting provision for married couples treats couples living in community-property States differently from those in noncommunity-property States. This could be corrected by considering husbands and wives as a single taxable unit under the estate tax, exempting transfers between spouses from tax, but taxing transfers by couples to others on a cumulative basis. Provision should be made in the estate tax to avoid tax-enforced liquidation of small businesses.

Minimum Tax. A so-called minimum tax is levied on tax-preference income. The nominal rate of the minimum tax is 10 percent, but the effective tax rate has been as low as 2.5 percent. Contributing to this

very low effective rate, for instance, were the 622 individuals who in 1973 had adjusted gross incomes greater than $100,000 and still managed to pay no tax. There are three basic provisions permitting this tax avoidance: (a) the $30,000 preference-income exemption, (b) the 100-percent deduction of income taxes paid on regular income, and (c) exclusion of certain tax preference-income from the tax base for the minimum tax. Consideration should be given to altering these three provisions.

Allocation of Personal Deductions Between Taxable and Tax-Exempt Income. Many taxpayers currently pay part of their expenses out of tax-exempt income, such as interest on State and local bonds and the tax-free half of long-term capital gains, while using the full amount of deductible personal expenses to reduce their taxable incomes, sometimes to zero. It would appear reasonable to require persons with tax-exempt income to scale down the total of their itemized personal deductions by the proportion of preference income to adjusted gross income. An estimated two-thirds of the tax revenues raised by this change would be borne by taxpayers with adjusted gross incomes above $25,000. It would be desirable to safeguard the incentive for private charitable contributions.

Tax Shelters. Tax shelter investments have had a phenomenal growth in recent years. In general, they allow taxpayers to deduct certain artificial "losses" on certain investments from their regular incomes, reducing the tax on regular income. Congress is now considering a limitation on artificial losses, which would restrict the use of accelerated deductions on such investments to offset unrelated income. Many types of investments could be covered, but most of the revenue gained would come from the limitation applied to real estate, farm operations, and oil and gas property.

Domestic International Sales Corporation (DISC). 24/ The DISC provision has aroused much criticism since its enactment on the following grounds: (1) DISC does little to stimulate exports that would not take place without it; less than 1 percent of the increase in the value of exports since 1971 is attributable to the establishment of DISCs, (2) it is inefficient, costing the U.S. $2.6 billion in lost tax revenues in 1974 for an estimated $1.6 billion gain in foreign exchange, (3) export subsidies no longer are needed since the overvalued dollar has given way to flexible exchange rates, (4) DISC benefits primarily the large corporations with one-third of total benefits going to the top companies, (5) DISC violates the spirit, and perhaps the letter of the General Agreement on Tariffs and Trade (GATT), and weakens the U.S. position as a defender of the trading principles embodied in GATT, and (6) its job creation impact is quite small relative to the impact that expenditures could have in other areas.

"Intangible" Drilling Expenses.25/ Oil and gas companies are not required, like other investors, to depreciate all of their investments over time; instead they are permitted to deduct as current business expenses their so-called "intangible" drilling and development expenses on successful wells. There are

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24/ Representative Long states: "I do not support repealing DISC at this time, and I so voted when the House of Representatives considered the tax reform legislation in late 1975."

25/ Representative Long states: "I do not support this recommendation, and I so voted when the House of Representatives considered this in the tax reform legislation in late 1975. I believe that maintaining the current tax treatment of intangible oil and gas drilling expenses will help encourage increased domestic production, which, in turn, will help reduce our dependence on foreign oil."

serious questions about whether immediate deductions for labor and supply costs incurred in drilling successful wells are needed as incentives to exploration. The costs of drilling holes that turn out to be dry still could be deducted as losses.

Limitation of Mortgage Interest and Property Tax Deductions. A change suggested for consideration which would not raise much revenue but would make the tax system more progressive relates to interest and real estate tax deductions. Under current provisions for unlimited deductions the wealthy not only save more dollars in tax liability than those with low incomes, but they actually save greater proportions of their incomes. Individuals in the bottom half of the income distribution get only about 8 percent of the tax benefits from these deductions. Congress should consider placing a ceiling on the amount that can be deducted. An alternative that would also make the tax incentive more effective in encouraging homeowning would be to establish a tax credit equal to 20 to 30 percent of the presently deductible outlays up to some limit.

If Congress acted on the total package of reforms cited above, it would provide as much as $11 billion of additional revenues to the Treasury. As the following table shows, nearly 80 percent of the increased revenues would come from wealthy individuals while 20 percent would be raised from corporations.

Tax reform should be given high priority on the legislative agenda in 1976. Actions should be carefully considered which would provide a more effective and equitable tax system. Any revenue raising changes should be offset by general tax reductions.

Table V/8

Potential Revenues from Tax Reforms

Reforms Affecting Individuals (billions of dollars)		Reforms Affecting Corporations (billions of dollars)	
Taxation of Capital Gains at Death or Gift	$2.5	DISC Repeal	$1.5
Estate and Gift Taxes	2.6	Capitalization of Intangible Drilling and Development Expenses	0.8
Minimum Tax	1.3		
Allocation of Personal Deductions	1.9		
Limits on Tax Shelters	0.5		
Limits on Mortgage Interest and Property Tax Deductions	---		
TOTAL	$8.8	TOTAL	$2.3

Small Business

Small business is vitally important to the performance of the United States economy. It accounts for one-half of private employment, 43 percent of business output, and one-third of the Gross National Product. Ninety-seven percent of all businesses are classified as small. Notwithstanding the importance of the small business sector to the U.S. economy, the Federal Government frequently overlooks its needs.

A National Small Business Policy. Although most Congressmen profess a special concern for the small business sector, many of Congress' actions contain a big business bias. This is also true of the Executive Branch. The Commerce Department is primarily oriented toward big business' problems. The Federal Reserve Board does not even have one full-time employee responsible for following the condition of small business.

The Small Business Administration has not filled this policy void. It continues to be regarded primarily as a lending agency. As a small business policy advisory agency, however, it has been woefully inadequate.

Congress should review the Federal laws, agencies, and regulations affecting small business. This review should develop a National Small Business Policy that will foster a dynamic small business sector.

Capital Formation. Small business is generally last in line for borrowing from banks. In addition, equity financing for small business has been virtually nonexistent over the past two years. There have only been ten public stock issues during that time by firms with net worths of $5 million or less.

Small business' capital formation problems are magnified because it must rely more heavily than big business on short-term bank financing and

retained earnings to fund future expansion and general operations. Data from the Federal Trade Commission indicate that manufacturing firms with assets of under $10 million had 41 percent of their debt in the form of short-term bank loans in the third quarter of 1975. The share for firms with assets of $10 million to $25 million is 37 percent; for firms with assets of $50 million to $100 million is only 27 percent; and for firms with assets of $100 million to $250 million is 23 percent. Thus, small businesses are much more dependent than large firms on short-term borrowing and tend to be heavily indebted in this form. On the other hand, they have very limited access to longer-term credit, especially through securities markets.

Federal Trade Commission data also show that small businesses pay a higher effective tax rate than their larger competitors. Manufacturing firms with assets under $50 million have an effective tax rate of about 51 percent. Firms with assets of $100-$250 million, however, pay 46.1 percent. The largest firms with assets of $1 billion and above pay much less -- only 35.2 percent.

Small firms, which need high retained earnings to finance operations, pay far more of their earnings in taxes than big businesses. The Treasury Department, Federal Trade Commission, and Securities and Exchange Commission together should review the reasons for this phenomenon and make recommendations for tax code revisions to make the effective rates more equitable.

The temporary increase of the corporate income exemption from $25,000 to $50,000 should be made permanent. Also, the corporate income tax rate schedule should be changed to apply the 48 percent maximum

rate to income levels well above the present $50,000 lower bound of the 48 percent bracket. Rates should be graduated for incomes between the $50,000 level and the new lower bound of the 48 percent bracket.26/

The Small Business Administration should create a secondary paper market for the 90 percent guaranteed portions of its loan guarantees to small business.

Estate Taxes. Estate taxes adversely affect small business in two main ways. First, the laws may force liquidation of a small business to pay an estate tax bill. Second, the bias of estate taxes toward liquid assets induces owners of small businesses to sell out to larger firms to convert their liquid small business assets into money or common stock.

The Federal estate tax laws need changes in several areas. The estate tax exemption of $60,000 and the $30,000 gift tax exemption were set in 1942. Since that time, prices have risen 230 percent, but the exemptions have not been changed. Legislation has been introduced to take account of inflation since these levels were set.

The standard estate tax and gift tax exemptions should be increased to reflect the impact of inflation since 1942.

Under present law, estate taxes can be deferred if immediate payment would cause dire hardship such as the liquidation of a small business or farm. The estate executor is responsible for payment of the tax, however, and the deferral provision is almost never used because of the executor's desire to terminate this obligation.

26/ Senator Proxmire states: "The corporate income tax is not a progressive tax. Its incidence falls on consumers and employers far more than on stockholders. It inhibits investment. It should be reduced more than the President has requested."

Responsibility for payment of deferred estate taxes should be transferred from the executor to the heir. The interest rate paid under the deferred estate tax payment plan should be set at one percent below the prevailing prime interest rate.

Finally, property always is valued at its potential market value rather than its value in its existing use. If farmland is worth more for housing development, for instance, it would be valued as development property for estate tax purposes. This provision can and has caused the forced liquidation of small family farms to pay estate taxes. Property values for estate tax purposes could be restricted by limiting future use of the property through a legal covenant.27/

27/ Representative Long states: "The potentially far-reaching implications of this recommendation cause me great concern; hence, I do not support the recommendation."

VI. INVESTMENT REQUIREMENTS AND CAPITAL SUFFICIENCY

In 1973 and 1974, when goods were scarce and inflation was rampant, concern arose that a possibly chronic shortage of capital was overtaking the United States or even the world economy. The controversy over this matter, however, has been much confused by a lack of any clear definition of the issue.

Some observers foresee a general shortage of savings to fund an expected investment boom. The New York Stock Exchange, the Chase-Manhattan Bank and some Administration officials are prominent members of this group. They project that the future desire to invest, including investments to meet requirements for pollution abatement and greater energy production, will rise sharply above recent norms and will outstrip the resources available for these purposes. If this projection were to come true, the excess demand would create shortages, high interest rates and inflation, unless more capital goods were imported from abroad or the government reduced its spending. Some investments would be frustrated, and growth of output and employment ultimately would be stifled. Many people propounding this view add that Federal borrowing threatens to "crowd" private borrowers out of the credit markets. They propose new incentives to save and reduction of government spending.

Other observers suggest that although overall savings may be adequate, firms lack the incentive and the wherewithal to invest. This proposition is based on the decline in the average return on investment in the 1966-73 period and the relatively modest level of returns in several basic industries. It rests also on the general rise in prices of business installations and machinery and the cost of pollution control in several industries. Recent

experience with very high interest rates and correspondingly low securities prices also has alarmed corporate financial officials. Finally, there is much concern about the basic financial health of many firms after several years of economic turbulence and stringent financial conditions. In other words, there may be a problem in transferring existing savings to would-be investors, given standards of creditworthiness for borrowers and the liquidity needs of lenders. Many corporate spokesmen, especially those for industries expecting rapid growth, adhere to this school of thought.

Finally, there are those who fear that investment will be inadequate due to inadequate market prospects for the output of new or expanded facilities. This problem would not lead to product scarcities but simply would be one more symptom of economic stagnation due to timid government policy. Faster progress toward full resource use is a necessary precondition for a strong recovery of business investment.

In examining these issues, one must constantly distinguish between inadequate savings and inadequate investment. The Committee concludes, as discussed below, that savings are adequate and likely to remain so. A higher level of investment, however, is desirable. The primary condition for the achievement of higher investment is a more fully employed economy. Other special stimuli also may be required.

Investment Needs

Many recent projections have suggested that the volume of investment should be increased greatly over past levels. Several of these "studies" have amounted to nothing more than aggregated wish lists or extrapolations based on very dubious assumptions.

An interesting recent study prepared by the Department of Commerce for the Council of Economic Advisers, however, has projected the investment needed to accommodate a 5-percent unemployment level in 1980 with allowance for legally required pollution control and an ambitious energy program. The study projected that business fixed investment would have to increase as a share of GNP from its level of 10.4 percent in the past decade to more than 12 percent through 1980. Given the lag in investment in 1976, such an increase would add over $40 billion per year to investment needs for 1977 through 1980. Other studies, for instance by the Brookings Institution and Data Resources, Incorporated, concur that business investment should be higher in the next several years. 1/ Much of the resulting physical capital is needed to accompany the employment of our growing labor force.

The Committee agrees that a higher level of business investment may be necessary during the recovery period, subject to some qualifications expressed below. If the recovery is robust, a somewhat higher investment rate will occur normally as the upswing progresses. The main problem that exists regarding investment incentives and opportunities stems from the fact that the economy has been permitted by timid policies to decline so far below its capacity, and that it will recover very slowly if these policies are allowed to continue. How can investment in business plant and equipment be expected to go ahead of the recovery of overall demand?

1/ See Economic Report of the President, 1976, pp. 41-47; also Bosworth, Duesenberry and Carron, Capital Needs in the Seventies, Brookings Institution, 1975; and Sinai and Brinner, "The 'Capital Shortage': Near-Term Outlook and Long-Term Prospects," The Data Resources U.S. Long-Term Review, Summer 1975.

To illustrate this point, current business investment remains quite depressed due to the recession. The latest survey of investment intentions by the Department of Commerce shows that real investment in new plant and equipment for 1976 is projected by businessmen to be 4 percent below 1975 and 16 percent below the level of 1973. The results of this survey for the past several years are shown in Table VI/1. The Council of Economic Advisers has projected that real business fixed investment will increase by 4 to 5 percent from 1975 to 1976. If the economic recovery continues strong, business spending intentions will be revised upward over the course of the year, but actual outlays during 1976 probably will not rise by as much as the Council expects. Even if they do, investment will remain well below necessary levels primarily because of underutilization of existing capacity and uncertain future market prospects.

One important qualification concerning projections of investment requirements should be noted. The Council of Economic Advisers states in its Report that future investment requirements to match any given employment level are quite sensitive to the distribution of future economic growth among sectors. On this score, there is reason to believe that the growth of demand may not be so concentrated in the capital-intensive basic materials sectors as is often assumed. Because of a radical and persistent reduction in the size of automobiles and an only partial recovery in both residential and heavy construction, prospects of scarcity may not soon recur in such materials as steel, aluminum and glass. As a result, the investment booms widely foreseen for these basic sectors may be less vigorous than expected. A shift in the distribution of demand growth to less capital-intensive sectors during the upswing would reduce the volume of investment required.

Table VI/1

Spending for New Plant and Equipment By U.S. Business

	Total Spending (bil. $)	Percent Change in Spending	Percent Change in Prices	Percent Change in Real Investment
1976 (Projection)	119.7	5.5	9.7	- 3.8
1975	113.5[a/]	1.0	12.2[b/]	-10.0
1974	112.4	12.7	15.0	- 2.0
1973	99.7	--	--	--

Source: Department of Commerce.
a/ Preliminary.
b/ For first eleven months only.

Business investment may need to be proportionately greater in the next several years than in the past decade. The most serious obstacle to the achievement of needed investment is the underutilization of existing capacity and the lack of promising markets for the output of new factories. A shift in demand growth from basic materials toward less capital-intensive sectors could reduce total capital needs significantly.

Availability of Funds

The development of U.S. saving and investment rates since 1960 is shown in Table VI/2. Gross private saving as a percentage of GNP was at a quite extraordinary level in 1975 both relative to its own past levels and relative to 1975 investment. It jumped beyond all previous bounds to 19 percent of GNP in the second quarter and remained at 18 percent in the third quarter. Saving apparently remained high in the fourth quarter, although complete figures are not yet in. Gross private investment meanwhile dropped off sharply from the normal 15 percent range to only 11 percent in the second quarter, recovering to 13 percent in the third and fourth quarters.

According to the latest figures, therefore, savings are very high relative to desired investment. Meanwhile, utilization of industrial capacity stands between 70 and 80 percent. Hence present saving rates can hardly be considered deficient.

Throughout 1975, concern was voiced in some quarters that large government borrowing would "crowd" private borrowing out of the credit markets, hampering the financing of the private sector. As the year progressed it became apparent that the private demand for credit, especially bank credit, was extraordinarily weak and that crowding

67-480 O - 76 - 11

Table VI/2

Private Saving and Investment Rates, 1960-1975
(percentages of GNP)

	1960-1964	1965-1969	1970-1974	1975[c/]
Gross Private Saving	15.4	16.1	15.7	17.6
Non-Corporate Saving[a/]	7.4	7.8	8.7	9.9
Corporate Saving (including IVA)[b/]	8.0	8.3	7.0	7.6
Gross Private Domestic Inv.	14.9	15.7	15.4	12.2
Business Fixed Investment	9.2	10.5	10.1	9.9
Residential Investment	4.9	4.0	4.5	3.3
Inventory Change	0.8	1.3	0.8	-0.9

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a/ Comprises private saving and non-corporate capital consumption allowances.

b/ Comprises undistributed corporate profits, excluding inventory profits, plus corporate capital consumption allowances.

c/ Fourth quarter data for 1975 are preliminary. Undistributed corporate profits for 1975 are based on rates for first three quarters only.

out was not an immediate problem. Concern then shifted to the prospect that crowding out would become a problem in 1976 as private credit demand revived.

So far in 1976 the problem has been rather the puzzling failure of private credit demand to revive. It remains reasonable to expect that it will pick up later this year and in 1977. Credit institutions appear to be in a good position to meet these demands. Commercial banks and savings institutions have substantially increased their liquidity. The Chairman of the Federal Reserve Board recently stated that financial markets "are more comfortable now than at any time in the past two years."

Tables VI/3 and VI/4 present the Treasury's estimates of expected sources and uses of funds in 1976 compared with earlier years. As Table VI/3 indicates, savings institutions are expected to be in a position to supply growing amounts of credit in 1976. Funds supplied by commercial banks are expected to rise sharply from depressed 1975 levels but to remain below the 1973 peak. Even if the Federal deficit is somewhat larger than the Administration's projections used in these estimates, it can be accommodated without impinging on private borrowing, provided that monetary policy is not unduly restrictive.

If the Treasury estimates are correct, funds flowing into home mortgages (see Table VI/4) will rise strongly, while corporate bond issues will drop to normal levels from the extraordinary levels of the 1975 corporate long-term refinancing effort. This is not a picture which suggests crowding out.

Table VI/3

Total Funds Supplied to U.S. Credit Markets, 1972-1976
(billions of dollars)

Supplies	1972	1973	1974	1975[a/]	1976[b/]
Savings Institutions	87.9	74.6	69.5	103.5	115.0
Contractual Type[c/]	34.9	37.2	40.6	46.2	51.8
Deposit Type	49.9	35.4	27.1	59.6	64.5
Other	3.1	2.0	1.8	-2.3	-1.3
Bank[d/]	75.7	92.5	68.4	29.9	74.7
Business	18.7	15.9	12.0	12.4	22.9
Government	13.2	23.7	31.8	25.7	29.5
Foreign	10.8	3.5	12.0	11.2	14.4
Households (residual)	1.8	22.6	18.7	18.6	24.5
Total Funds Supplies	208.1	232.8	212.4	201.3	281.0

Source: Office of the Secretary of the Treasury, Office of Debt Analysis.

a/ Preliminary.
b/ Projected.
c/ Insurance companies, pension funds, etc.
d/ Including Federal Reserve Banks.

Table VI/4

Total Funds Raised in U.S. Credit Markets, 1972-1976
(billions of dollars)

Category of Funds	1972	1973	1974	1975[a/]	1976[b/]
Long-Term Funds	102.6	94.0	82.5	98.1	110.3
Mortgages	68.8	71.9	54.5	52.8	71.8
Corporate Securities [c/]	33.8	22.1	28.1	45.3	38.5
Bonds	20.2	12.5	23.4	36.2	25.5
Stocks	13.6	9.6	4.6	9.1	13.0
Government Securities	38.3	43.3	51.5	110.6	120.9
U.S. Govt. & Fed. Agencies	23.6	29.3	33.3	93.9	107.4
State & Local Govts.	14.7	14.0	18.1	16.7	13.5
Short-Term Funds[d/]	67.2	95.5	78.2	-7.4	49.8
Business Credit	29.2	66.6	62.9	-18.6	24.2
Consumer Credit	19.2	22.9	9.6	5.2	16.5
Foreign Loans	3.7	7.9	7.6	0.3	0.5
Other Loans	13.3	-3.6	-3.5	2.7	6.0
Total Funds Raised	208.1	232.8	212.4	201.3	281.0

Source: Office of the Secretary of the Treasury, Office of Debt Analysis.

a/ Preliminary.
b/ Projected.
c/ Including foreign securities.
d/ Including bank term loans and long-term Federal credits.

With financial institutions now in a more liquid position, we believe that, long-term interest rates will move down during the year despite the growing demand for credit. This should be particularly true if our targets for the reduction of inflation are met. We urge the Federal Reserve to conduct its open-market operations and the Treasury its debt management operations in such a way as to facilitate and encourage this trend.

> Private saving is presently very large relative to intended investment and the level of economic activity. Action is needed to bring about a more rapid recovery and to encourage private investors to put these savings to use. There is no danger that the credit needs of the Federal Government will "crowd" other borrowers out of the credit markets in 1976, provided monetary policy is not unduly restrictive. 1/

What about the longer-term outlook for funds to finance domestic investment? The Council of Economic Advisers projects that the rate of saving will recede soon toward its historical level, as people become less apprehensive about a loss of income through unemployment and about erosion of their assets through inflation. While savings rates will

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1/ Representative Gillis Long states: "I do not support an interpretation of this recommendation that says in essence 'private savings are undesirable.' I support private savings wholeheartedly. I interpret this recommendation to mean that more economic recovery will not only encourage private savings, but also will facilitate the use of these savings by private investors and investment institutions. This in turn will also expedite economic recovery. I think we need to find specific ways to use these savings to stimulate growth in the private sector."

decline from today's exceptional levels, the factors detailed below indicate that we are entering an era in which savings will remain above their historical rate of 15 to 16 percent of GNP. Both corporate and personal savings rates may be expected to contribute to this higher rate.

Personal Savings. The recent rise in the personal savings rate often is attributed to the recession-generated apprehensions referred to above. They undoubtedly have played a role. But the personal savings rate has shown an upward trend over a long period from 3.4 percent of GNP in 1960 to 5.1 percent in 1970 and 6 percent in 1975. There are underlying reasons for this rising secular trend that persist beyond any cyclical swings.

Important among these reasons for higher personal savings is the propensity among the swelling ranks of young couples to have fewer children at later ages and a related trend toward two-income families and, in general, a society in which women spend more of their lives in the labor force. The increasing frequency of working wives has boosted median family incomes 50 percent faster than individual earnings have risen in recent years and undoubtedly has increased average savings rates (in some families by reducing dissaving or accumulation of debt).

Beyond these trends, the expansion of tax-deferred retirement plans both for employees and for the self-employed provides a rising incentive to save as well as a new source of savings, namely, the deferred tax payment. To the extent that government adjusts its expenditures to offset the loss in tax revenues (see comments below on congressional budget reform), the rise in personal savings would be available at least in part to finance private investment. It is estimated that tax deferrals through employer pension plans will rise by more than $700 million or by more than ten percent per year for the next several years. In the recent years, moreover, Congress has consistently liberalized the tax treatment of pension contributions, and each such step yields a

one-time jump in tax deferrals and contributes to their subsequent growth. A factor offsetting these positive influences on savings rates will be the incipient decline in the number of people of middle age who have the highest propensity to save.

Corportate Savings. Profits are making a sharp recovery from the recession as productivity, price mark-ups, and sales volumes expand simultaneously.

After declining from late 1973 to early 1975, labor productivity in the private economy advanced smartly during mid-1975, and unit labor costs therefore stabilized. In fact, data for nonfinancial corporations show that unit labor costs for these firms actually declined at an annual rate of 5.4 percent during 1975's middle two quarters. These data indicate that nonlabor costs per unit also stabilized. Thus total unit costs in nonfinancial corporations declined by 3.6 percent in the middle half of the year.

Except for interest costs, which have declined absolutely, these productivity advances are due largely to fuller use of underutilized resources as output expanded. With the use of industrial capacity still only between 70 and 80 percent, productivity from this source can continue to suppress cost increases and enhance profit levels for some time to come.

Despite the stabilization in production costs, prices continued to rise somewhat throughout the nonfarm sector, following their very large increases in 1974. This divergence of prices from costs has widened profit margins. Profits per output unit for nonfinancial corporations jumped by 58 percent from the first quarter to the third quarter of 1975 and reached their highest levels since 1968. As output expands, these unit profits will be translated into very healthy rates of return on capital.

Most of the slump in operating profits during the recession came out of retained earnings, while dividends were reduced little. Likewise, the profits rebound is being largely retained at first. Thus the undistributed profits of all corporations, excluding inventory gains, rose in 1975's first three quarters by nearly 150 percent from their 1974 level as a fraction of GNP. They comprised a larger share of GNP in the third quarter of 1975 than at any time since 1968.

Economists testifying before the Joint Economic Committee concurred in the judgment that American business seems to be headed for a very profitable period. The Council of Economic Advisers has projected a further 25-percent rise in operating profits of nonfinancial corporations in 1976. If this occurs, and if two-thirds of this sum is retained, then undistributed earnings would rise by 30 percent. This may be conservative. A sharp upward trend in profits, moreover, could extend well beyond this year if the recovery continues. Given these prospects, the apprehension that has been expressed about the adequacy of rates of return on capital and of corporate internal sources of finance may well prove to be based more on hindsight than on foresight.

International Capital Flows. Devaluation of the dollar and relatively greater recent inflation abroad have improved the competitiveness of the U.S. economy and thereby enhanced its attractiveness for investment. Therefore, corporations are likely to divert fewer domestic resources than in the past to foreign investments and, indeed, can be expected to augment domestic resources with earnings and possibly with capital from abroad. This is especially so if a sustained expansion is foreseen for the United States. Recovery in many other industrial countries is likely to be delayed and more restrained.

The countries of the oil cartel, moreover, are extracting money from the consumption stream around the world and diverting it in part to investment in the West. The U.S. Treasury estimates that these

countries will have an investable surplus of $45 billion in 1976. The sum can be expected to increase for several years. In the recent past, up to one-fifth of this surplus has been invested in various forms in the United States.

Although the inflow of funds from abroad itself may be offset by the Federal Reserve and thus may not be an addition to total funds, it supports the dollar exchange rate, thereby freeing real resources through reducing U.S. exports and permitting an expansion of U.S. imports to satisfy domestic needs.

Government Saving. A fundamental change in the outlook for credit availability at full employment is likely to come through better control of the Federal budget. The need and the public demand for spending control and economic stability, together with the strong congressional budgeting procedures established under the Budget Control Act of 1974, make it quite probable that the budget will be better adapted to economic conditions in future full employment periods.

Proper budget management means a sizable deficit at a time like the present, when private spending is deficient and unemployed resources are widespread. Just as clearly, it means that deficits should be eliminated as the economy moves back into the full employment range, and it means budget surpluses if and when prosperity begins to spill over into shortages and excessive inflation. Some analysts have urged a Federal surplus, if full employment is achieved in the next several years, to ease credit markets and to facilitate the high level of private investment which they foresee.

Private saving augmented by shifts in international capital flows should remain adequate to fund desired investments at reasonable interest rates at least well into the year 1977, given proper monetary policy. If congestion appears in credit markets later in the recovery, new savings incentives or an adjustment of the Federal budget toward

surplus would become desirable. The private savings rate, however, is hard to manipulate by policy. An appropriate budget adjustment would have a prompter, surer effect.

Can Business Finance Needed Investment?

As discussed in the previous section, business is expected to enjoy a highly profitable period in the next several years as the economy recovers. Undistributed corporate profits, excluding inventory profits, are expected to reach close to 3 percent of GNP in 1976, a level not achieved since the war except in the boom periods of the mid-1950s and mid-1960s. Corporate capital consumption allowances, which have crept upward gradually since 1960 as a share of GNP should remain above 5.5 percent.2/ Undistributed profits and capital consumption allowances together would cover over two-thirds of the investment requirements projected by the Council of Economic Advisers.

As indicated in the previous section, moreover, multinational firms can be expected to shift some investment resources to the United States that earlier would have been invested abroad. The augmentation of domestic corporate resources in this way serves to finance some of the investments needed in the United States without new borrowing by the firms or issuance of new shares.

However, the challenge posed to business by the rise in prices of plant and equipment, not to mention the long-term rise in interest rates, is quite considerable. The prices of business fixed investment goods have risen somewhat faster over a long period than the prices of consumer goods and services. The contrast, of course, has been especially

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2/ Capital consumption allowances have ranged above this level every year since 1968, running over 5.8 percent in 1975.

great since 1972. The rates of change in consumer prices, plant and equipment prices, and interest rates are summarized for the past decade in Table VI/5.

Table VI/5

Rates of Change in Consumer Prices, Investment Goods Prices and Interest Rates, 1965-1975
(Compond Annual Rates)

Price Category	1965-68	1968-72	1972-75
Consumer Purchases	3.1	4.3	7.9
Business Fixed Investment	3.5	4.9	9.8
Structures	4.5	7.3	12.3
Durable Equipment	2.7	3.5	8.5
Interest Rates on Aaa Bonds	11.16	4.0	7.0

Sources: Department of Commerce and the Board of Governors, Federal Reserve.

The average cost of business investment goods has risen by 78 percent over the past decade, compared to a 63 percent increase for consumer purchases. Within the investment category, the prices of structures have risen much more sharply (115 percent) than those of machinery and equipment (58 percent), which were relatively stable until 1974-1975. The steep increase in construction costs may cause a greater propensity in the future to modernize facilities within existing structures in preference to erecting new buildings.

For some sectors, the increase in the costs of new capacity has been especially large. This has been true of oil, steel and electric power generating. These same sectors, plus nonferrous metals and paper, have been the most affected by capital requirements for pollution control.

It is equally significant for the cost of new capacity that interest rates have nearly doubled in the past decade. Rates on Aaa-rated corporate bonds went from an average of 4.5 percent in 1965 to 8.8 percent in 1975. Thus, while the price of the facilities rose over the past decade by an average of 78 percent, the amortization costs of these facilities increased by nearly 120 percent.

As one factor to relieve recent pressure on capacity costs, the Commitee expects a significant decline in long-term interest rates from their 1970-1975 levels. The trend in interest rates does not reflect a capital scarcity but rather rising premiums that lenders have demanded to offset a rising rate of general price inflation. Inflation is now declining. Short-term interest rates already reflect this fact. In longer-term credit markets, lenders take account not only of present inflation but seek a margin of insurance against a possible resurgence of inflation during the life of the loan. Thus, the decline in longer-term rates lags the progress of price stabilization. The decline in short-term

rates will spread to the longer maturities, however, as lenders become more confident that inflation is subsiding permanently. The decline should be encouraged by the Federal Reserve.

Just as soaring interest charges pushed up business costs and prices in 1974-75, declining interest rates should help to stabilize costs and prices during the recovery. This role of interest rates in the cost structure of industry is one more reason why it is vital to keep inflation under control and to hold rates down.

It has been pointed out widely that corporate debt-equity ratios have risen quite substantially over a long period. According to Federal Trade Commission data for all manufacturing corporations, the ratio of long-term debt to equity rose from about 20 percent in 1965 to about 30 percent in 1970 and remains at about this level. It is not clear whether this ratio is close to a maximum viable level, as is often intimated, but considerable resistance to further increases has appeared in the behavior of many borrowers. As a result, firms undoubtedly will turn more often to fund-raising through equity issues in the next several years than in the recent past. Of course, the expected sharp increase in corporate retained earnings -- a form of new equity financing -- will permit firms to increase borrowing without increasing their debt-equity ratios.

One reason for the increase in debt-equity ratios is the asymmetry in the tax code between the deductibility of interest payments from corporate taxable income and the nondeductibility of profits paid to equity investors in the form of dividends. This asymmetry tends to raise the cost to firms of equity financing relative to debt financing. While the Committee does not consider this asymmetry to represent a fundamental barrier to adequate funding of corporate investment, it is time for Congress to undertake a basic reconsideration of this feature of the tax code.

The effective tax rate on corporate income, however, has declined over the past 15 years from a plateau of 45 percent or more (e.g. 47 percent in 1960) to 39.2 percent in 1975. In 1974, for the first time in 25 years or more, the effective corporate tax rate fell below 40 percent. The share of total Federal tax collections received from corporate incomes has declined from 25 percent of total revenues in 1960 to 17 percent in 1970 and is projected to drop to 13 percent in 1980. This decline in the effective corporate tax rate is traceable to a number of new tax preferences extended to corporations, such as the investment tax credit, the Domestic International Sales Corporation (DISC), and accelerated depreciation range provisions. While the effective tax rate on corporations has declined, that on individuals has tended to increase as inflation lifts taxpayers into ever higher tax brackets.

Effectively designed proposals to stimulate capital formation should be given careful consideration. There are a number of tax preferences in today's corporate tax code, however, that are poorly designed or outmoded and do not serve this purpose effectively. In view of the redistribution of the tax burden that already has occurred from corporations to individuals, the revenue loss from any new corporate tax incentive should be offset by closing these ineffective loopholes. Any corporate tax reduction should emphasize reductions at the small-business end of the spectrum.3/ 4/

3/ See recommendations for changes in taxes on small business in the section on this subject at the end of Chapter V.

4/ Senator Proxmire states: "The corporate income tax is not a progressive tax. Its incidence falls on consumers and employees far more than on stockholders. It inhibits investment. It should be reduced as the President has requested. I would favor an even greater reduction."

Today's fears of capital shortage may turn out to be reminiscent of the growth-rate controversy of the early 1960s. In the wake of two back-to-back recessions from 1957 to 1961, many observers feared that the American economy was trapped in a pattern of sluggish growth and was destined to lose ground on its world-market competitors and perhaps even to be overtaken by its adversaries of the Communist world. America's confidence in her technological leadership was shaken by the early successes of the Soviet space programs. In fact, however, the American economy at that time was on the brink of one of its most prolonged periods of growth and prosperity with rapid investment and productivity gains.

Today again, after two business recessions between 1969 and 1975, separated by a period of great economic turbulence and very high interest rates, many observers fear that investment levels will not be adequate to avert future shortages and the associated inflationary pressures. The financial strength of many businesses has been sapped, and they are uncertain about the future. Substantial investment resources must be diverted for pollution control and expansion of energy supplies.

Again, however, the economy has the potential for sustained growth and productivity gains with subsiding inflation. A significant advantage over the earlier period is the present rapidly growing labor force. Thus, policies should be tailored to generate a prompt recovery of output and a sustained longer-run expansion.

Broadening the Ownership of New Capital

Wealth in the United States is concentrated in the hands of a relatively small fraction of the population. Unfortunately, the data on wealth are sparse. The last comprehensive attempt by the

Federal Government to measure its characteristics and distribution was made by the Federal Reserve Board in 1962. It was estimated that more than three-quarters of the country's total wealth was owned by less than one-fifth of the people, while more than one-quarter was owned by just the top 0.5 percent. The Federal Government should remedy the lack of up-to-date information on personal wealth through periodic surveys and comprehensive reports on this subject.

The distribution of wealth reflects in large part the pattern of ownership of non-residential capital with corporate shares being one of its principle forms. This category of wealth is much more concentrated than total wealth, with the top percentile of the personal income distribution owning 51 percent of the market value of individually owned corporate stock and receiving 47 percent of the dividends. Meanwhile, the new capital assets generated by businesses, which in recent years have averaged well over $100 billion annually, redound largely to the benefit of these persons who already have great wealth.

The number of shareholders, moreover, declined by some 18 percent from 1970 to 1975, and data suggest that young people today are not purchasing stocks in significant volume. Balancing this declining role of the individual investor has been the rise of financial institutions, which since 1950 have more than trebled their share of the market value of stock holdings.

To begin to diffuse the ownership of capital and to provide an opportunity for citizens of moderate incomes to become owners of capital rather than relying solely on their labor as a source of income and security, the Committee recommends the adoption of a national policy to foster the goal

67-480 O - 76 - 12

of broadened ownership. The spirit of this goal and what it purports to accomplish was endorsed by many of the witnesses at our regional hearings.

Without getting into specifics, the types of programs which could be established to help meet this goal will be outlined, Such alternative methods of broadening capital ownership are under study by the Committee.

In the individual firm, employee ownership can be encouraged directly through tax incentives to the employees to purchase stock or to firms to place newly issued stock into the hands of their employees. The latter approach, known as Employee Stock Ownership Plans (ESOPs), was examined in recent hearings by the Committee.

An alternative plan involves multifirm funds which would receive tax-favored contributions from affiliated firms and issue nonnegotiable fund certificates to the employees. This type of fund, which has been in operation in France and West Germany, may diversify its portfolio, although it may be limited to particular industries and regions.

Providing ownership opportunities not just to employees but to citizens at large could be accomplished through various devices. One example would be the establishment of funds which would accumulate personal savings on a tax-preferred basis and use them to acquire a diversified portfolio of equity shares in corporations. For instance, individuals with earned income not exceeding $20,000 could be allowed to save up to $3,000 a year in one or more funds and to deduct this amount from their taxable incomes.

Whatever the means used, a basic objective should be to distribute newly created capital broadly among the population. Such a policy would redress a major imbalance in our society and has the potential for strengthening future business growth.

To provide a realistic opportunity for more U.S. citizens to become owners of capital, and to provide an expanded source of equity financing for corporations, it should be made national policy to pursue the goal of broadened capital ownership. Congress also should request from the Administration a quadrennial report on the ownership of wealth in this country which would assist in evaluating how successfully the base of wealth was being broadened over time.

VII. ECONOMIC PROBLEMS OF REGIONS, STATES, AND CITIES

Operating Budgets

The rise in outlays needed to keep pace with inflation and the shortfall in tax receipts caused by recession undermined the ability of State and local governments to maintain balanced budgets in 1975. Inflation increased expenditures faster than it increased revenues, particularly for local governments that were dependent on property taxes as a major source of revenue.[1/] Recession had several adverse effects. First, it precipitated significant shortfalls in receipts from taxes that are sensitive to the level of income and employment, particularly income and sales taxes. The Economic Report of the President estimates that State and local receipts in 1975 were $27.4 billion below full employment levels. Second, recession increased the number of property tax delinquencies in areas where unemployment rates were high. Finally, the economic downturn increased expenditures for unemployment-related social programs such as welfare and public health.

Early in 1975 many State and local governments used previously accumulated surpluses to finance their current account deficits. As the recession deepened and previously accumulated surpluses were depleted, however, State and local governments were forced to impose tax increases and make expenditure cuts to keep their budgets in balance.[2/] These budget adjustments

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1/ Lags in the reassessment of property values typically cause property tax revenues to fall behind inflation.

2/ For a detailed description of State and local government budget adjustments during the current recession, see "The Current Fiscal Position of State and Local Governments," Joint Economic Committee, May 1975.

prevented State and local government budget deficits from exceeding manageable proportions. However, they also necessitated a major reduction in the level of public services provided by these jurisdictions.

Table VII/1 shows the aggregate fiscal position of the State and local governments in the National Income Accounts (NIA). It supports this interpretation of their adjustment to deteriorating economic conditions.[3/] In 1972 and 1973, the enactment of general revenue sharing and strong economic growth combined to

Table VII/1

Surplus or Deficit in State and Local Government Operating Accounts[a/]
(National Income and Product Accounts, Annual Basis)
(billions of dollars)

Year	Surplus (+) Deficit (-)	Quarters	Surplus (+) Deficit (-)
1972	+5.6	1974:I	+0.1
1973	+4.1	1974:II	-1.4
1974	-1.7	1974:III	- .9
1975	-1.1	1974:IV	-4.3
		1975:I	-5.0
		1975:II	-2.2
		1975:III	+1.7
		1975:IV	+1.4

Source: Survey of Current Business.
a/ Does not include surplus or deficit in social insurance trust funds.

3/ While the national income accounts do not measure accurately the budget balance of State and local governments, these data can be used to gauge the direction and extent of changes in this balance.

yield these governments large surpluses in operating accounts. These surpluses were used in 1974 and in the first half of 1975 to offset operating deficits. By mid-1975, however, the accummulated surpluses were depleted, forcing State and local governments to reduce the widening gap that had developed between current receipts and current expenditures. Thus, small surpluses reappeared in the accounts in the second half of 1975.

Several unique factors contributed to the shift in the fiscal position of State and local governments in the second half of 1975. First and most important, Federal grants-in-aid increased throughout 1975. As Table VII/2 demonstrates, increases in Federal grants-in-aid accounted for the entire improvement in State and local operating budgets from the first quarter of 1975 to the fourth quarter of 1975. Second, tax increases and expenditure cutbacks were significant

Table VII/2

Quarter-to-Quarter Changes In Federal Grants-In-Aid And In Balance In State And Local Operating Budgets (NIA Basis)
(billions of dollars)

	1974:IV to 1975:I	1975:I to 1975:II	1975:II to 1975:III	1975:III to 1975:IV
Grants-in-Aid	+4.7	+2.7	+4.0	+ .3
Surplus or Deficit in Operating Accounts	- .7	+2.8	+3.9	- .3

Source: Bureau of Economic Analysis, Department of Commerce.

factors in narrowing State and local budget deficits. Without these adjustments, State and local operating balances would have been much lower in 1975. Finally, the economic recovery began to increase tax receipts in the second quarter. Despite the contribution of economic recovery, however, it is clear that tax increases, expenditure cutbacks, and grant-in-aid increases were the primary factors in the improvement in State and local government balances in the second half of 1975.

In 1976, if the economy recovers at projected rates, the outlook for the aggregate State and local government sector should improve slightly. Expenditures should increase by 8 to 9 percent, while receipts from taxes and fees should increase by a slightly larger percentage. Since grants-in-aid are expected to increase by 9 to 10 percent from 1975 to 1976, the aggregate State and local government sector should be in balance or experience a slight surplus in 1976 if present tax rates and expenditure rates are continued. Many individual governments, however, will continue to experience severe financial difficulties.

However, this balance in the State and local government sector can be accomplished only by holding services at levels significantly below those provided prior to the recession. Thus, while the aggregate State and local sector will experience an easing of budget pressures in 1976, there is no prospect of returning to balanced budgets and also providing pre-recession service levels.

The outlook for State and local governments in 1977 will be considerably more bleak if the President's budget proposals are adopted. The slow growth rate in gross national product associated with the President's restrictive budget would cause State and local government receipts from their own revenue sources to grow more slowly than current services expenditures. Thus the gap would widen once again between State and local receipts and expenditures, precipitating a new round of tax increases and service

cutbacks. These budget adjustments can be avoided only if the economic outlook improves more than projected or if Federal grants-in-aid are increased sufficiently to reduce the budget deficits that will otherwise develop.

The level of grants-in-aid suggested in the Administration's budget would not be sufficient to stabilize State and local government finances in 1977. Federal grants-in-aid to State and local governments are projected to remain essentially unchanged in current dollars from FY 1976 to FY 1977. Even with the most favorable assumptions about inflation during this period, real grants-in-aid to State and local governments would decline under the President's request by 4 to 5 percent from FY 1976 to FY 1977. This decline in the real value of Federal grants-in-aid would exacerbate the financial difficulties that State and local governments already would experience if the economy's growth rate slows markedly in 1977.

Moreover, the President's budget also contains several proposals that would increase the costs and responsibilities of State and local governments significantly. Four of these changes would be particularly significant in 1976 and 1977. First, the President's proposal to increase the social security tax rate would require State and local governments to increase their annual contributions to the Social Security Trust Fund in behalf of their employees by $300 million. Second, the proposal to reduce the portion of transportation block grants that can be used for mass transit operating subsidies from 90 percent to 50 percent could require local governments to increase their own expenditures for mass transit above expected levels by as much as $250 million. Third, the President's proposal to phase out extended unemployment compensation benefits and public service employment programs could transfer as many as 600 thousand households to the welfare rolls by mid-1977, thus increasing State and local government expenditures

for public assistance by as much as $1 billion. Finally, the four grant consolidations proposed by the President would reduce total outlays in FY 1977 for the programs they combine by $1.35 billion without an offsetting change in the responsibilities of State and local governments. These changes are summarized in Table VII/3. If carried out, they would increase the pressure on State and local government budgets as their financial positions weaken in 1977.

As long as the economy operates significantly below capacity, the real value of Federal assistance to State and local governments should not be allowed to decline. Congress should reject changes in Federal policies that significantly increase the costs and responsibilities of State and local governments.

While the fiscal position of the aggregate State and local government sector should improve in 1976, there are many jurisdictions that still will experience major budget difficulties. In particular, central cities in the Northeast and Midwest and several States in the Northeast will experience continued budget pressures because unemployment rates in these areas will remain high and revenue shortfalls will persist. Moreover, many of these governments currently are experiencing budget deficits that will have to be offset by balanced budgets or surpluses next year necessitating further tax increases and expenditure cutbacks.

Last year, this Committee recommended that Congress enact a countercyclical revenue assistance program to mitigate the impact of high unemployment on State and local government receipts and expenditures. The Committee suggested that this program could be used to prevent State and local government tax increases and employee layoffs during periods of high unemployment. Congress recently approved this proposal as Title II of the Local Public Works Capital Development and Investment Act of 1975. Unfortunately, however, the bill was vetoed by the President on

Table VII/3

Effect of Proposed Grant Consolidations on Federal Outlays in Fiscal 1977
(millions of dollars)

	Proposed Block Grant	Programs Prior to Consolidation	Change in Outlays due to Consolidation
Financial Assistance for Health Care Act	$ 9,001	9,629	$- 628
Child Nutrition Reform Act	2,367	3,107	- 740
Financial Assistance for Elementary and Secondary Education Act	294	322	- 28
Financial Assistance for Community Services Act	2,500	2,460	+ 40
TOTAL	$14,162	$15,518	$-1,356

Source: Budget of the United States, FY 1977.

February 13, and Congress failed to override the President's veto. Since this legislation is part of the Congressional budget and since many State and local governments will continue to experience unemployment-related budget difficulties, the Committee continues to favor enactment of this important program. Countercyclical assistance should remain available as long as the national unemployment rate exceeds 5-1/2 percent.

The countercyclical grant-in-aid program should be reenacted by Congress and signed by the President. It should remain in effect as long as the national unemployment rate remains above 5-1/2 percent.

This year, Congress also must decide whether to extend the General Revenue Sharing Program. This program has provided approximately $6 billion annually to 39,000 State and local governments from which the recipient governments could meet locally determined priorities. The program, which has been in existence for five years, is due to expire in December, 1976.

Since its enactment General Revenue Sharing has become an increasingly important component of State and local government operating budgets. While many governments initially used revenue sharing funds for capital construction projects, this assistance recently has been relied on heavily for operating purposes. This trend accelerated in 1975 as the combination of inflation and recession required State and local governments to marshall every available source of funds merely to maintain reasonable levels of public services. Moreover, this shift can be expected to continue in the next two to three years as the budget pressures on these governments persist. Thus a failure to renew the General Revenue Sharing Program in 1976 would significantly weaken the halting progress toward stability in State and local government finances and would precipitate large tax increases and expenditure cutbacks in 1977. For this reason the Committee supports a three year extension of general revenue sharing.

Several minor changes should be made in the program as part of the three year extension. First, the provision in the existing program which limits the per capita allocation to individual local governments to 145 percent of the statewide average per capita allocation should be eliminated. This provision has reduced the amount of assistance that otherwise would be available for the most financially distressed local governments. Many central cities in the Northeast and Midwest would receive increased allocations if this artificial constraint were removed. This limitation should remain in effect, however, for local governments that have adjusted taxes in excess of $400 per capita due to large concentrations of industry and small populations. Second, the constraint mandating that all local governments receive a per capita allocation of at least 20 percent of the statewide average per capita allocation should be removed. This provision provides excessive assistance to jurisdictions that perform only marginal functions, thus encouraging a proliferation of local governments with few responsibilities. Finally, the civil rights enforcement and public participation requirements in the existing legislation should be strengthened and enforced.

The General Revenue Sharing Program should be extended for three years so that State and local governments are assured of receiving this source of Federal assistance to meet current services needs without substantially increasing taxes. The artical constraints on per capita assistance that limit allocations to financially distressed local governments and increase allocations to governments that perform only marginal functions should be phased out. The civil rights enforcement and public participation requirements should be strengthened. 4/

4/ Senator Proxmire states: "I disagree. Revenue sharing should be ended forthwith and Federal tax sources should be shifted to the States instead. Revenue sharing from the discipline and pain of raising the taxes."

While the General Revenue Sharing program currently is an integral component of most State and local government budgets, the Committee believes that two major changes should be incorporated in the program as the economy returns to full employment. First and most important, the allocation formula should be altered to reflect the disproportionate financial burden that low-income families impose upon State and local governments through their greater requirements for services and lower contributions to revenues. This change should make the revenue sharing formula more redistributive, allocating a larger percentage of shared revenues to the most financially distressed State and local governments.

Second, the revenue sharing program should incorporate financial incentives to encourage the reform of State and local government revenue systems. At the State government level, these incentives should favor State governments that rely more heavily on progressive income taxes as a source of revenue. At the local level, they should encourage regional cooperation among local governments through tax base sharing, consolidation, annexation or other methods designed to distribute local government tax burdens more equitably.

Any further extension of general revenue sharing beyond three years should incorporate the following changes in the program:

(a) Inclusion of incentives to induce greater State use of progressive personal income taxes and more regional cooperation among local governments through tax base sharing, consolidation, or other methods which distribute local government tax burdens more equitably.

(b) Alteration of the allocation formula to direct a larger portion of shared revenues to

<u>those local governments that have higher percentages of low-income families within their boundaries, thus reflecting the disproportionate financial burden that low-income families impose.</u>

Sustaining State Unemployment Funds

One of the most critical problems of 1975 was the heavy strain placed on State unemployment insurance funds due to severe unemployment levels. Fifteen States were able to maintain unemployment benefit payments during the year only by borrowing from the Federal Government, and by the end of 1976 approximately 30 States will require Federal assistance.

In the 1977 budget, the President has proposed replenishing State unemployment insurance funds through an increase in the unemployment insurance tax rate on employers and an increase in the maximum income on which the tax is collected.

The President's proposal, however, would increase the cost of unemployment insurance to the Nation's employers by $2.1 billion in 1977 alone. Like the proposed increases in social security taxes, it would significantly increase the cost to firms of hiring new workers and would discourage new private sector jobs in the early stages of the recovery.

<u>The proposed increase in the unemployment insurance tax rate and tax base should be postponed until the economy returns to fuller use of capacity. Until that time, State benefits should continue to be funded when necessary by borrowing from the Federal Government or by direct Federal grants.</u>

The Municipal Bond Market

In 1975, the municipal bond market was characterized by strains and disorders of unusual severity for this normally stable market. Many institutional investors demonstrated a reluctance to increase or even maintain investments in tax-exempt securities. Underwriters reduced their participation in certain new offerings, resulting in a larger share of new issues sold through negotiated rather than competitive bids. Even activity in the secondary market for outstanding municipals was slowed during the periods of heightened uncertainty.

Much of this disarray in the tax-exempt market can be attributed to developments which were unique in 1975. The temporary default of New York State's Urban Development Corporation early in the year, New York City's financial crisis, and the borrowing difficulties of two States and several large cities contributed to an erosion of investor confidence in tax-exempt securities. Investors demanded greater risk premiums as concerns, however unjustified, developed about the credit worthiness of State and local governments in general.

Due in part to these concerns, yields on tax-exempt securities rose relative to yields on comparable corporate securities to their highest levels since 1969 and 1970. The increase in relative yields in 1975 was evident for both high-grade issues and low-grade issues and accelerated as New York City's financial difficulties developed. Even when New York City's immediate problems were resolved at the end of the year, relative yields on tax-exempt securities declined only marginally and the risk premiums required to interest investors in lower grade, tax-exempt securities remained virtually unchanged.

The market's lack of response to the resolution of New York City's problems suggests that other longer-term trends in the tax-exempt market also have placed upward pressure on tax-exempt interest rates by increasing the supply of and decreasing the demand for these securities. With respect to supply, the dollar volume of long-term, tax-exempt issues has increased at a compound annual rate of 11 percent from 1970 to 1975. Much of the increase in volume can be attributed to an expansion in State and local government construction activity. This increase is unlikely to be duplicated in the next year or in the period from 1976 to 1980.5/

Another component of the growth in volume of tax-exempts, however, is the increase in State and local government borrowing for non-governmental purposes, particularly to finance private sector investments in pollution control.6/ While the expansion that has occurred in this use of tax-exemption could hardly have been anticipated when it was first authorized by Congress in 1969, the passage of environmental protection legislation has caused an enormous increase in tax-exempt borrowing for this purpose. The total volume of reported

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5/ A reduction in the rate of growth in State and local government construction programs, the demonstrated reticence by voters to support new bond issues, and more cautious expenditure programs by State and local governments should contribute to a reduction in the future rate of growth of new tax-exempt issues for government purposes.

6/ As a result of provisions in the Tax Reform Act of 1969, State and local governments can issue tax-exempt securities and use the proceeds to purchase and lease pollution control equipment to private industry. Through this method, private industry is able to finance pollution control expenditures at below market interest rates.

tax-exempt bonds issued for pollution control purposes has increased from $93 million or 0.3 percent of all long-term bonds issued in 1971, to approximately $2.5 billion or 8 percent of long-term issues in 1975. According to available evidence the total volume of unreported issues, if it were known, would increase this total significantly.

Environmental protection is a laudable and legitimate public purpose, but the use of tax-exempt securities to subsidize these expenditures is undesirable for several reasons. First, the expanded use of tax-exempt securities to finance private sector pollution control investments has significantly increased the supply of tax-exempts, increasing borrowing costs to State and local governments. Most estimates suggest that the use of tax-exempts for this purpose will continue to expand through the remainder of the decade unless it is legally restricted. Second, the use of tax-exempt bonds is an inefficient means of subsidizing pollution control investments because a sizable portion of the subsidy is received by the purchaser of the bond. Third, this practice discriminates against smaller companies that are unable to prevail upon municipalities to issue tax-exempt bonds in their behalf. Finally, this practice could encourage the use of capital-intensive pollution control techniques even where material-intensive or labor-intensive processes may be more efficient.

The practice of permitting funds to be raised in the tax-exempt bond market for private, profit-making corporations to make pollution control investments should be gradually curtailed. Congress should develop more efficient and equitable methods for subsidizing pollution control expenditures.

There also have been major changes in the demand for tax-exempt securities which have increased State and local government borrowing costs. Commercial banks which in the past have been the largest purchasers of municipal bonds, held 45.7 percent of the outstanding tax-exempt securities in 1975. In recent years, however, as volume has increased in the municipal market, banks actually have reduced the dollar volume of net new issues that they have purchased from $12.6 billion in 1971 to less than $6 billion since 1973.

The main reason for the decline in bank purchases is the wide range of new tax shelters the Bank Holding Company Act has made available. Under this Act, banks can qualify through holding companies for accelerated depreciation, investment tax credits and other shelters for their earnings. This reduces the banks' dependence on tax-exempt securities as a shelter.

It is unlikely, moreover, that the decline in bank demand for tax-exempts will be offset by an increase in demand by the other major purchasers of tax-exempt securities without even higher interest rates for these issues relative to others. Fire and casualty companies, that held 15.5 percent of the outstanding municipal bonds in 1975, have reduced their demand for these bonds as the rate of growth in their profits declined. Individual investors, who held 32.4 percent of the outstanding tax-exempt bonds in 1975, are unlikely to be attracted in greater numbers to the tax-exempt market unless tax-exempt interest rates rise sufficiently to attract individuals in marginal tax brackets lower than those of current tax-exempt investors. Individual investors, moreover, are likely to be particularly apprehensive about the general solvency of State and local governments.

The Committee is concerned that State and local government borrowing costs may remain high because the demand for tax-exempt securities remains weak. This problem could be alleviated by broadening the demand for State and local government bonds by offering these governments the option of issuing taxable securities with a Federal subsidy of approximately 40 percent of the interest costs.

These taxable securities with an interest subsidy would have several advantages. First, they would broaden the market for State and local government securities. At present, pension funds, life insurance companies, and other institutions do not purchase State and local bonds because their own tax-exempt or tax-sheltered status has made the lower yield on municipal bonds unattractive. Most families are not in high enough marginal tax brackets to be attracted to tax-exempt securities.

Second, a taxable bond option would reduce State and local government borrowing costs by permitting these governments to issue securities in whichever market offers the lower interest rates. If a 40 percent subsidy is adopted, State and local government borrowing costs should never exceed 60 percent of comparable taxable borrowing costs.

Third, this proposal would increase the progressivity of the Federal income tax system. At present, 70 to 80 percent of the income from tax-exempt bonds goes to households with marginal tax rates above 50 percent. To the extent that State and local governments use the taxable option, this inequity will be eliminated.

Finally, a taxable bond option would increase the efficiency of the subsidy to State and local governments. Various studies have demonstrated that the net revenue loss to the Treasury due to tax-exempt bonds, significantly exceeds the interest savings realized by State and local governments. If a taxable bond option were utilized, the interest savings to State and local governments would be substantially greater than the amount of Federal subsidy.

State and local governments should be offered the option of issuing taxable securities accompanied by a Federal subsidy of about 40 percent of the interest payment. The option of issuing a taxable bond with an interest subsidy should be available to all general purpose units of government but should not affect existing provisions of law that permit these governments to issue tax-exempt securities.7/

7/ Senator Kennedy and Representative Reuss state: "The Committee's Annual Report provides strong additional support for the legislation we have introduced in the Senate and the House of Representatives to establish the taxable municipal bond as an alternative to the traditional tax-exempt bond approach to State and local financing. To gain acceptance by State and local governments, the taxable bond option (TBO) should meet three key tests: (1) to avoid unnecessary Federal intrusion into State and local affairs, the interest subsidy should be automatic and non-discretionary, in the sense that jurisdictions electing to issue taxable bonds will automatically qualify for the subsidy; (2) to avoid the vagaries of the annual appropriations process, the subsidy should be funded through a permanent appropriation; and (3) the subsidy should be set at a level high enough to establish its use as a viable method of State and local financing, but not so high that it disrupts the existint tax-exempt market or causes unnecessary Federal expense -- be believe that a 40 percent level for the subsidy meets this requirement."

At present, there is very little accurate, comparable, and timely information with which to evaluate the fiscal condition of the State and local governments as a whole or to ascertain the budget position of specific jurisdictions. This information would be useful to Congress, the Executive Branch, and the public in several respects. First, accurate and timely information about the fiscal positions of State and local governments is needed to develop and evaluate Federal assistance programs more effectively. Second, a timely financial reporting program could act as an early warning system, identifying potential financial problems before they occur. Third, accurate and timely information about the finances of individual State and local governments would improve the quality of credit ratings and make credit analysis more meaningful. Finally, this information could be used to identify clearly the relationship between the State and local government sector and the national economy.

State governments and local governments with populations in excess of 25,000 should be encouraged to submit annual reports to the Federal Government which provide accurate, timely, and comparable information about their current and future financial positions.8/

8/ Representative Long states: "I am not convinced of the necessity of requiring State and local governments to report their financial condition. As I indicated in my supplemental views, I believe the autonomy of State and local governmental units must be preserved."

Chronically Depressed Regional Economies

While the national economy will continue to gain strength in 1976, not all regions and areas within regions will participate equally in this recovery. Many regions and areas will approach full utilization of labor and capital resources early in the recovery. Others will lag well behind the national recovery rate, experiencing unacceptably high unemployment rates even as the national economy approaches full utilization of labor and capital resources.

Overall fiscal and monetary policies are not designed to respond to the widely varied economic conditions that individual regions experience. These policies attempt instead to regulate aggregate demand in the hope that all regional and local economies will be reached by their effects. As this Report suggests in other sections, monetary and fiscal stimulus is necessary now and will continue to be appropriate as long as the economy operates significantly below capacity. As the national economy approaches full employment, however, additional fiscal and monetary stimulus would only place upward pressure on wages and prices in tight labor markets, while doing little to reduce unemployment in depressed areas. Therefore, regional economic policies should be developed to reduce unemployment in regions and areas, particularly core areas of central cities that will not share fully in the recovery.

Chronically depressed regional and area economies are characterized by exceptionally high unemployment rates, net losses of private sector jobs, rapidly declining shares of national income, growing percentages of the National poverty population, and deteriorating public and private infrastructure. Generally, these regions and areas already were experienceing relative economic decline prior to the 1973-1975 recession, and the disparity in economic welfare has widened in the past two years.

The Northeast, and to a certain extent the Great Lakes and Mid-Atlantic regions, have experienced the most significant declines in relative economic growth. In the past 15 years -- and more rapidly in the last 5 years -- the growth in private sector jobs and population has shifted from those regions to the South, Southwest, and West. This trend was exacerbated by the recession, because these regions contain the oldest, least efficient manufacturing facilities, which are the first to be closed as production is reduced. The relative decline is particularly acute in the central cities of these regions, because they have been affected by intraregional migration to suburban and outlying portions of metropolitan areas, as well as interregional migration.

To a large extent, the migration of population and employment opportunities is occurring in response to real economic forces affecting the cost and efficiency of production. The widespread availability of airconditioning since 1960, lower wages in some areas, lower tax burdens, relatively lower energy costs, and the availability of cheap land for new plants have contributed to the movement of jobs and people. The migration that has occurred in response to these factors has contributed to overall efficiency and productivity in the private economy and should not be discouraged. This movement also increases the total cost of delivering public services, however, by allowing underutilization of public infrastructure in areas experiencing outmigration, while requiring large expenditures for new infrastructure in rapidly growing areas.

While the tradeoff between private benefits and public costs is difficult to evaluate, the Committee is concerned that these shifts among regions are creating a mismatch between the location of jobs and the location of individuals seeking work, posing a potential obstacle to the achievement of full employment. For this reason,

the Committee believes that it may be necessary to initiate regional economic development programs in chronically depressed regions as the economy recovers. These programs should focus first on reducing or stabilizing the outmigration of jobs and skilled people.

Federal Government efforts to promote economic recovery should be accompanied by programs designed to reduce unemployment in regions and in areas within regions that experience chronically high unemployment rates.

The first initiative necessary to prevent a further decline of these chronically depressed areas is to insure that the State and local governments can provide adequate public services without imposing excessive tax burdens on businesses and residents. Past decline already has undermined the ability of some local governments, particularly the central cities, to maintain public services. Outmigration has raised the per capita cost of providing essential services and has eroded the tax base so severely in some cases that the absence of services itself now is contributing to the exodus of jobs and people. This secondary movement, unlike previous migrations, is not only a result of businesses seeking more efficient locations and individuals seeking better jobs, but it is also a flight away from low-quality public services and onerous tax burdens. Continuing budget pressures on States and localities in declining regions augur further tax increases and service cuts, ultimately leading to further decline in these regions.

This secondary movement should be discouraged because it contributes little or nothing to overall efficiency . The Committee believes that additional Federal assistance must be made available to these areas to arrest this downward spiral by preventing severe public service declines or major tax increases. The Committee realizes that the Federal

Government cannot completely offset the effects of economic decline but believes that it is necessary to provide stabilization assistance to cushion the impact of decline on public services. This stabilization assistance could be provided by funding public service employees in these jurisdictions, by increasing revenue sharing assistance to these governments, or by developing a new program of stabilization grants.

The deterioration of public services and the escalation of taxes in chronically depressed areas should be slowed to reduce further migration of employment opportunities and people from these areas.

Federal employment and procurement can be an effective tool for increasing economic activity in chronically depressed regions and areas. In recent years, however, the largest increases in direct Federal employment have occurred in precisely those regions that are experiencing the greatest private sector growth. Federal nonmilitary payrolls as a percentage of nonfarm income is often three to four times higher in growing States (i.e., Colorado, Arizona, New Mexico), than in stable or declining States (i.e., New York, Ohio, Illinois). Federal procurement expenditures also tend to be concentrated in growing regions.

Many of these contract and payroll expenditures could be shifted feasibly to high unemployment areas. Regional unemployment rates could be used as one criterion in allocating these expenditures. For example, the Federal Government might accept bids that are up to 10 percent higher than the lowest bid, if this would shift work into chronically depressed regions. While there is certainly a limit on the level of additional cost that is acceptable, concentrating Federal Government purchases of goods and services in chronically depressed regions could make a contribution to increasing employment in these areas.

Federal contract and payroll expenditures should be concentrated, wherever costs are reasonable, in regions or areas within regions that experience chronically high unemployment.

While maintaining public services and targeting Federal Government contracts and payroll expenditures will assist in stabilizing these declining regions, private sector investments also must be made if the chronically high unemployment rates are to be reduced significantly. Several Federal initiatives could encourage the development of private sector employment opportunities in these regions. Without examining all of these proposals in detail, the Report will specify criteria that should be met by any proposal designed to encourage private sector investment in depressed areas.

First, any program to encourage investment in depressed regions should be designed to provide the assistance only to chronically depressed areas, thus minimizing the cost and maximizing the effectiveness of the program. For instance, targeted investment programs could be applicable only in areas that have had unemployment rates at least 1 percent above the national average and growth in total employment below the national average in each of the previous three years. This will prevent areas that have experienced sharp but brief cyclical fluctuations from becoming eligible. Second, the assistance should be concentrated in as small a geographic area as is feasible. This will encourage investment close to the unemployed workers, minimizing transportation costs and maximizing accessibility. It also will concentrate investment within the boundaries of the local governments that are experiencing the greatest fiscal

difficulty.9/ Third, targeted investment programs should encourage the development of labor-intensive as well as capital-intensive activities. If preferential treatment is available only for capital investments, its effectiveness will be weakened, particularly in central cities where the large amounts of vacant land necessary for modern manufacturing processes are difficult to assemble.

The President's budget for fiscal 1977 contains a proposal to encourage investment by offering rapid amortization of newly constructed buildings and capital equipment in areas with unemployment rates above 7 percent. While the Committee supports the objective of encouraging investment in high unemployment areas, it is clear that this proposal would not effectively target investment into those areas that need it most. According to the Treasury Department, investment in areas containing approximately 80 percent of the labor force would be eligible for rapid amortization. Thus, the President's program fails to separate chronically depressed areas from areas that have unemployment rates below the national average. Entire labor market areas would be eligible, moreover, which would allow investments to occur in low unemployment jurisdictions of metropolitan areas that may not be accessible to people seeking employment. Third, the President's proposal for rapid amortization of facilities is most attractive to activities that are capital-intensive.

Proposals to encourage investment in high-unemployment areas should be accepted only if the proposal targets assistance to the most chronically depressed regions and areas.

9/ A wealthy suburb with low unemployment rates that is located in a metropolitan area with high unemployment should not be eligible for preferential treatment.

As an alternative to rapid amortization, the Committee recommends that Congress examine the feasibility of a development bank. Such a bank could encourage investment in chronically depressed areas by making available low-interest loans to businesses. The bank could also make loans to State and local governments for investments in public infrastructure in chronically depressed areas that may be necessary to encourage private sector development. The interest rate on all loans should not exceed the Treasury's borrowing costs plus a small service charge.

The bank initially could be capitalized with public funds and with receipts from a public stock offering. After its initial capitalization, the bank should be made selfsustaining as a revolving fund. State and local governments also could be required to support the bank by contributing a small percentage of the increment in tax receipts that results from development.

This proposal, if structured correctly, could meet all the criteria established to evaluate programs to encourage investment in depressed areas. Loans could be limited only to jurisdictions with unemployment rates that are consistently above the national average. Assistance could be made available for land and working capital, as well as for investment in plant and equipment. Finally, as the bank developed an effective analytical capability, it could channel its assistance to encourage investments that otherwise would not occur.

<u>As an initial effort to encourage the development of private sector job opportunities in chronically depressed areas, Congress should consider establishment of a regional economic development bank. The bank should be designed to make low-interest loans to businesses and State and local governments for the purpose of encouraging investment in chronically depressed regions or areas.</u>

The Need for Regional Economic Information

In the past economic policy deliberations have focused little consideration on the impact of economic policies on regional economies and the location of working and living opportunities within and among regions. Despite this lack of consideration of regional and area economies, Federal tax, expenditure, credit, and employment policies have been influential factors affecting the location decisions of individuals and businesses. For instance, Federal policies have encouraged new housing construction at the expense of rehabilitation; they have supported the rapid turnover of real estate and investment holdings; they have provided the transportation facilities necessary for the decentralization of housing and jobs. Moreover, Federal policies concerning trade, transportation, procurement, and employment have contributed to rapid economic growth in some regions while exacerbating economic decline in others.

Not enough is known about the extent to which national economic policies affect the economies of regions and areas within regions. This information would be gathered if the economic planning proposals in Chapter IV of this Report were fully implemented. Until that time, however, the Committee believes that major economic programs and policies should be preceded by a special analysis of their impact on regional and local economies.

Major executive and legislative proposals should be accompanied by an analysis of their impact on economic activity in regions and in areas within regions.

The failure to develop economic policies that recognize regional economic variations can partially be attributed to the unavailability of accurate, comparable, and timely information about regional and local economies. Information about

local unemployment rates, the composition of local labor forces, the availability of underutilized public infrastructure, the composition of local industrial bases, the availability of vacant land, or other important factors is difficult to obtain.

Federal Government data on regional and local economies should be improved. Better information is required to evaluate the efficacy of Federal, State, and local government programs. Second, programs that are targeted to meet specific regional needs are dependent on the availability of accurate and timely information to identify regions or areas with critical needs. Finally, the increasing reliance on formula allocations (block grants) as a method for redistributing Federal assistance to State and local governments requires timely and accurate information to insure proper allocations.

A commission should be appointed to make recommendations for improving the accuracy, timeliness, and comparability of information available on regional and local economies. The commission's recommendations should include proposals designed to provide the Congress, the Executive, and the public with whatever information the commission believes necessary for the development and evaluation of effective regional economic policies.

VIII. INTERNATIONAL ECONOMIC ISSUES* **

Monetary Reform

On January 8, 1976, the Interim Committee of the International Monetary Fund (IMF), meeting in Kingston, Jamaica, announced agreement on a set of reforms that members of the Fund had been struggling to devise since the summer of 1972. The compromise includes an increase in IMF quota contributions and hence the Fund's lending capability, an amendment to the Articles recognizing the right of member countries to let their currencies float rather than establish par values, and an arrangement to disperse some of the Fund's gold in a manner that will assist low-income countries. The Congress will be called upon to approve the quota increase and various amendments to implement the other provisions of the Kingston accord.

The Congress should endorse promptly in 1976 the legislation required to amend the IMF Articles so as to permit early full implementation of the agreement on monetary reform announced in Kingston, Jamaica, on January 8. This legislation should include provisions requiring congressional approval of any proposal to dispose of the remaining 100 million ounces of Fund gold or of a proposed return to a par value for the dollar. It should also include instructions to the Secretary of the Treasury indicating that any intervention in exchange markets conducted by or cooperatively participated in by U.S. monetary authorities should be short-term, for the exclusive purpose of combating disorderly conditions in exchange markets, and should under no circumstances attempt to alter the trend of exchange rates.

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* See Senator Humphrey's remarks at the end of Chapter VIII.

** These views are endorsed jointly by the majority and minority members of the Committee.

The features of the Kingston agreement, its impact, and the reasons why the Congress should approve it -- given adequate safeguards -- are explained below.

The Quota Increase

The International Monetary Fund obtains from quota contributions most of the assets that it in turn lends to member countries. The size of an individual member's qouta is determined by its gross national product (GNP), per capita income, its proportionate share of world trade, the fraction of its total output that is traded internationally, and a few other factors. The Fund Articles provide for a general review of quotas every five years. Two kinds of adjustments are made during these reviews.

First, the quotas of virtually all members are increased absolutely in order that the Fund's total lending capacity will expand as seems appropriate in light of growing international trade and capital flows. The last general quota increase occurred in 1970. The expansion agreed to in Kingston would increase total quotas by 9.8 billion Special Drawing Rights (SDRs)1/, or by just over a third, from 29.2 to 39 billion SDRs. In previous years 25 percent of each member's quota subscription was, according to the requirements of the Articles, paid in gold. The amendments in the Articles now contemplated will abolish this gold subscription requirement, and future quota contributions will be made entirely in national currencies.

1/ Special Drawing Rights are currently worth about $1.17 apiece. Thus, the total quota increase will amount to approximately $11.5 billion.

The second type of adjustment undertaken during general quota reviews is to modify the proportionate share of certain members' quotas in the total to reflect significant changes in their relative positions in the global economy. As a result of the substantial increase in the revenues of oil-producing countries since 1973, the quotas of the 12 members of the Organization of Petroleum Exporting Countries that belong to the IMF will be increased from 5 to 10 percent of the total. While this change increases the voting power of the oil producers in the IMF, it is also intended to expand the ability of the Fund to draw upon the financial resources of those countries and to use these assets to assist other nations suffering the balance-of-payments consequences of high oil prices.

The United States quota is projected to drop from 22.9 to about 20 percent of the total. Since the most important decisions on the part of the IMF will require approval by nations with 85 percent of the aggregate voting power, the United States will retain a veto capability with respect to critical decisions.

Exchange Rates

The Joint Economic Committee has supported the March 1973 decision to let the dollar float in exchange markets, i.e., to let its value be determined primarily by the interaction of private supply and demand. In June 1973 and again in July 1975, the Subcommittee on International Economics conducted hearings to determine how well a floating dollar was working for the United States and for the international monetary system as a whole. The conclusion reached from both these investigations was that the advantages to the United States of floating have outweighed the disadvantages and that the dollar should continue to float for the foreseeable future. Moreover, U.S. monetary authorities should attempt to influence the external value of the dollar through intervention in exchange markets only to combat

67-480 O - 76 - 14

disorderly conditions in those markets. In a report published in August 1975, the Subcommittee on International Economics of the Joint Economic Committee and the Subcommittee on International Trade, Investment and Monetary Policy of the House Committee on Banking, Currency and Housing jointly recommended that

> The United States monetary authorities should intervene in exchange markets only to combat or to prevent the emergence of disorderly conditions. Intervention should not attempt to influence the trend of exchange rate movements. Swap borrowings and loans entered into between the Federal Reserve and foreign monetary authorities should normally be liquidated, i.e., the position fully reversed within six months of the initial transaction. Only as a result of the most extraordinary circumstances should swaps remain outstanding for more than a year. U.S. monetary authorities should not accumulate additional reserves in the form of foreign exchange.

What are the advantages and the disadvantages of floating versus fixed exchange rates? In general they can be summarized as follows:

First, national monetary authorities enjoy greater independence for implementing monetary policy under floating than under fixed rates, because external conditions need not induce purchases or sales of the domestic currency that can decrease or increase commercial bank reserves in conflict with domestic policy objectives.

Second, private speculative capital movements are smaller under floating than fixed rates because individuals with liquid assets can no longer be certain which way an exchange rate reflecting current economic conditions will move.

Third, since rates of productivity growth, inflation, and wage rate increases will inevitably differ among countries, exchange rates can never remain constant for long, and some type of adjustment mechanism is essential. The small continuous exchange rate adjustments permitted by floating are less costly to international traders and investors and to central banks than large abrupt changes.

Fourth, with floating exchange rates, nations can make smaller investments in stocks of monetary reserves than if rates are fixed.

Fifth, under floating exchange rates, controls over international capital movements are likely to be less extensive than if rates are fixed.

Some of the consequences of the move from fixed to floating exchange rates are subject to conflicting interpretations. Among the major questions are the following:

First, floating exchange rates have been described as more inflationary than fixed rates due to a "ratchet effect." Since prices and wages in industrial countries are generally rigid downward, cyclical variations in exchange rates produce price increases in nations with depreciating currencies but no corresponding reductions in other countries whose monies are appreciating. On the other hand, it has been maintained that the fixed exchange rate system of the late 1960s and early 1970s became an engine of inflation as a result of very large increases in the exchange reserves and, consequently, the domestic money supplies of some surplus countries.

Second, some analysts have maintained that floating rates discourage international trade because of the increased costs of covering exchange risks. But until the onset of the recent recession, trade continued to expand briskly.

Third, it is sometimes maintained that floating exchange rates complicate medium and long-term planning for businessmen. But exchange rate adjustments must occur: the choice is whether they take place in small continuous steps or in major jumps.

Aside from this theoretical accounting of the pros and cons of different exchange rate regimes, what has been the practical impact on the United States of the adoption of a floating dollar? The most dramatic impact of the decline in the external value of the dollar under floating exchange rates can be seen in the reversal of the net merchandise trade balance. During the late 1960s the dollar became seriously overvalued. Consequently, U.S. export growth stagnated, imports surged, and Americans invested abroad at cut-rate prices -- all of which destroyed jobs in the United States. In 1971 the United States suffered a merchandise trade deficit of $2.3 billion, and this deficit grew to $6.4 billion in 1972. By 1973 the effects of exchange rate changes were becoming evident, and a $1 billion surplus was recorded. The quadrupling of oil prices in 1973 forced the merchandise trade balance into deficit for 1974 to the extent of $5.3 billion. By contrast, 1975 marked a record $9.1 billion trade surplus for the United States. This reversal in the U.S. trade position was a consequence of several factors, including abundant U.S. harvests when foreign crops failed and stagnant domestic demand for imports during the recent recession. But a reversal of these dimensions surely would not have come about without the exchange rate changes that have occurred since 1971.

The Exchange Rate Arrangements Agreed To In Kingston

Released in Kingston was the text of the proposed new Article IV of the IMF's charter, the article specifying the obligations of members regarding exchange rate arrangements. One of the chief obstacles to agreement on reform of the International Monetary Fund had been a disagreement between the United

States and France on the right of member countries to let their currencies float. The United States had insisted on the right to float in part because it is a large country with most of its GNP generated by domestic transactions. U.S. international trade constitutes only 18.5 percent of our total output of goods. Thus, for the United States to expand or deflate its economy in order to correct a trade or payments imbalance is far less efficient than for, say, France whose combined exports and imports total 35 percent of GNP. Preserving the option to float within the IMF is therefore critical to the United States.

The meeting of the heads of state of six industrial countries at the Chateau de Rambouillet from November 15-17, 1975, produced a compromise under which France relinquished its demand that the members of the IMF pledge a general return to par value exchange rates by a specific date. This compromise paved the way for the Kingston agreement and adoption of an Article IV that preserves the option to float for IMF members.

The philosophy behind the new Article IV is that stability in exchange markets is tenable only if it results from stability in underlying economic and financial conditions. Furthermore, the goal of stability should not be used as a rationale for imposing strictures on domestic economies that would force nations to depart from their own individual objectives regarding employment and price levels. The proposed Article IV does allow for a general return to par values in the event that countries with 85 percent of the voting power in the Fund agree. Even if a general return to par values is voted sometime in the future, an individual country will still be able to elect to float; that decision also can only be overturned by the Fund in the event of an 85 percent majority vote. Since the United States will retain over 20 percent of the voting power, it will under all circumstances preserve its option to float. Legislation ratifying the

Kingston agreement should provide for congressional approval in advance of any decision by U.S. monetary authorities to return to a par value exchange rate for the dollar.

The draft of the proposed Article IV obliges Fund members to

> avoid manipulating exchange rates or the international monetary system in order to prevent effective balance-of-payments adjustment or in order to gain unfair competitive advantage over other members.

Precisely what is an "unfair" competitive advantage is not defined, but it would apparently result from intervention that depressed the external value of a nation's currency in order to foster exports and expand domestic employment. Apparently the drafters of the proposed Article IV did not feel compelled to include an injunction against the opposite type of exchange rate manipulation. A country with excess domestic demand could export some of its incipient inflation by holding the exchange value of its currency at an artificially high level.

The practical meaning of the strictures against exchange rate manipulation must be that, except for brief periods of disruption, the market must be allowed to determine what exchange rates are appropriate. The choice is between the collective outcome of the decisions of thousands of exporters, importers, and investors, on the one hand, and bargains struck by five or ten finance ministers, on the other hand. Errors by the former private interests come as losses out of their own pockets; errors on the part of officials tend to be sustained by the expenditure of billions of dollars worth of national treasure and by the imposition of restrictions upon international transfers of goods and capital.

The Treasury agrees with the Joint Economic Committee's view of the respective roles of commercial interests and monetary authorities in exchange markets. In answer to a question asking whether the Treasury subscribed fully to the Joint Economic Committee recommendation on intervention in exchange markets cited on page 204 above, the Secretary responded as follows,

> We agree fully that the purpose of these swaps should be to finance market operations undertaken to counter disorderly conditions and not to influence the trend of exchange rate movements. Swap positions should normally be reversed in the short term -- say, six months.

What Happens When The Dollar Appreciates?

Since 1971, when the post-World War II monetary system began to fall apart, the foreign exchange value of the dollar, weighted according to the volume of trade with our major commercial partners, has declined by some 10 or 12 percent. As noted above, this depreciation in the value of the dollar has helped stimulate sales of American exports, has protected domestic industries from foreign competition, has discouraged U.S. investment abroad, and has encouraged foreigners to buy financial assets and productive facilities in this country. Although these exchange rate changes helped fuel the boom and accelerate the rate of inflation before the onset of the recent recession, during 1975 the export sector lent considerable strength to the U.S. economy. The question quite logically arises, therefore, will U.S. official advocacy of a floating dollar reverse when, as will inevitably happen sooner or later, the dollar begins to appreciate in exchange markets and exporting becomes more difficult, the price of imports decreases, and investment abroad becomes relatively more attractive?

The real economic consequences of a rise in the exchange value of the dollar will vary depending upon what produces that rise. If the dollar is strong internationally because wage rates have risen less in the United States than in other countries and because the rate of inflation in this country is lower than in others, then dollar appreciation will most likely only offset in part a competitive advantage that the United States has already captured. On the other hand, if the appreciation is the result of capital inflows responding to higher interest rates in the United States than abroad, a boom in the New York stock market, or a faster growth rate in the United States than elsewhere, the impact on output and employment in the United States will tend to be more severe. In either case, however, the effects can be absorbed. Merchandise exports and imports (including military equipment) are equivalent to about 18.5 percent of U.S. output of goods. Dollar appreciation will have a marginal impact on that proportion. Moreover, the Trade Act of 1974 liberalized the provisions for granting adjustment assistance to workers, firms, and communities injured by import competition. If necessary, such assistance can be granted.

The benefits the United States has gained and is likely to realize under floating exchange rates substantially outweigh the prospective costs. The greatest single advantage is that floating rates have freed the U.S. economy from politically imposed constraints on this Nation's ability to compete internationally. While the market can be influenced temporarily by major private transactions and official intervention, neither of these can easily displace the trend of exchange rate developments. The market establishes rates impersonally and without regard to the appeals of major industry groups or labor unions to their respective governments. A decision by governments to allow exchange rates to be determined by the interaction of supply and demand in the market constitutes a decision by political authorities to keep

hands off. An agreement of this type is much the same as the resolve expressed within the GATT to lay down guidelines under which governments mutually agree to desist from certain trade practices defined as unfair. Public authorities then largely withdraw and let the producers of each member country compete equally in determining what the eventual outcome shall be regarding trade patterns and volume.

Legislation ratifying the amendments to the Fund Articles required to implement the Kingston agreement should include instructions to the U.S. monetary authorities specifying that intervention in exchange markets should be short-term, i.e., normally reversed in a matter of months, and should not attempt to alter the trend of exchange rates. Exchange markets may from time to time become disorderly in reaction to abrupt changes in economic conditions or extreme uncertainty. Disorderly markets are characterized by an unusually low volume of transactions and abnormally wide spreads between bid and asked prices for at least some currencies, i.e., there is a heavy supply of some currencies but virtually no purchasers, while other monies are in strong demand but only small amounts are offered. When markets are disorderly exchange rates are likely to fluctuate erratically. The purpose of intervention should be to combat disorder and to facilitate the efficient working of exchange markets. Monetary reform legislation should include guidelines establishing for U.S. monetary authorities the circumstances under which intervention may be desirable, and by contrast, the purposes for which intervention ought not be used.

The Gold Accord

The IMF's Interim Committee agreed substantially on arrangements regarding gold last summer and announced their consensus on August 31, 1975. It was the question of acknowledging the right of IMF members to float that held up endorsement of a complete package until January 1976. The gold agreement contains

three major parts. (a) The official price of gold will be abolished, members of the IMF will no longer be required to use gold as a portion of their quota contributions or in other payments to the Fund, and central banks will be able to buy and sell gold at whatever price they choose. (b) One-sixth or 25 million troy ounces of the IMF's gold will be sold in the market over a four-year period. The profits, determined by the difference between the sale price and the official price of about $42 per ounce, will be used to benefit developing countries. About 70 percent of these profits will be placed in a trust fund. This facility should be used to subsidize the interest cost of regular IMF loans, given the usual repayment criteria, to poor countries experiencing exceptional payments deficits.2/ The remainder of the profits will be distributed to the developing country members of the IMF in proportion to their quotas. (c) Another 25 million ounces of the Fund's gold will be sold to members at the official price and in proportion to their current quotas. This transfer is referred to as "restitution."

Abolition of the official price of gold and of the requirement that members make certain gold payments to the IMF will require amendment of the Articles. According to the Bretton Woods Agreements Act of 1945, U.S. approval of amendments to the Articles requires that the proposed change be endorsed by a

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2/ Senators Ribicoff, Taft, and Fannin and Representatives C. Brown, G. Brown, and Rousselot state: "It is the Treasury's understanding and intent that the Trust Fund be administered with the same care and conditionality as the IMF's normal loan facilities. Nonetheless, there are indications that many other members of the IMF view the Trust Fund as a source of inexpensive loans not necessarily tied to balance-of-payments problems, or to efforts to correct those problems. The outcome of the debate is far from certain."

majority of both the House of Representatives and the Senate. Sales of gold for the benefit of developing countries and restitution, on the other hand, do not require the formal approval of the Congress. The Fund has under the existing Articles the authority to sell gold in exchange for the currency of member states. Thus, by interpreting broadly this authority, it can finance the Trust Fund and accomplish restitution. Title to the gold being sold is held by the IMF. Under the existing Articles, only a majority of the Board of Executive Directors is needed to approve sales of gold in order to "replenish" Fund holdings of national currencies. According to the revised Articles, however, the approval of countries holding 85 percent of the voting power in the Fund will be necessary to dispose of the remaining two-thirds or 100 million troy ounces of IMF gold.3/

Approximately 28 percent of the 25 million ounces of gold that is scheduled for "restitution." or about 7 million ounces, will be distributed to developing countries, since this is their proportionate share of total IMF quotas. Consequently, about 32 million of the 50 million ounces of gold that will be dispersed by the Fund will benefit developing countries either directly or indirectly.

In order to begin the process of diminishing the international monetary role of gold, and more immediately, to provide additional financial resources for the developing countries in 1976 as a substitute for the expiring Special Oil Facility, Fund officials expect to begin gold sales and establish the Trust Fund early this year. The distribution of profits from gold sales both directly and through the Trust

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3/ The use of gold in "regular" operations will require only a 70 percent majority.

Fund, and the restitution of gold to developing countries could yield a maximum of $3 billion in additional funds for these nations over four years, or an average of $750 million annually. Of course, if the market price of gold declines substantially in the face of sales by the IMF, the additional funding available will be correspondingly reduced.

The primary reason the Fund is divesting itself of one-third of its gold stock is to begin the process of replacing the gold with SDRs in international reserve stocks. Supporting the market price of gold at a high level would be contrary to this objective. Adjusting the schedule of IMF gold sales according to the level of market prices would be much the same as establishing an official floor under the market. The market would then dictate the pace of sales. No such development should be permitted, and under no circumstances should the schedule of IMF sales be extended beyond the four-year period announced.

During the interim before the IMF Articles have been amended to abolish the official price of gold, it will continue to be illegal for monetary authorities of IMF member countries to purchase gold at above the $42 per ounce official price. The January 8 communique of the Interim Committee states, "It is understood that the Bank for International Settlements would be able to bid in these [IMF gold] auctions." While the Bank for International Settlements (BIS) is not a member of the IMF or a monetary authority of any member country, it is controlled by the central banks of Fund members. The BIS may well purchase some IMF gold for its own account, but if it acts as the agent of a member's central bank, that member will be violating the existing IMF Articles. The Secretary of the

Treasury in his February 3, 1976, letter to the Chairman of the Subcommittee on International Economics stated that,

> The Fund will not knowingly sell gold [at] above the official price to the monetary authorities, or the agents of monetary authorities, of IMF countries prior to amendment of the IMF Articles abolishing the official price of gold.

In answer to another question, the Secretary said,

> We would expect the IMF to state, in connection with any auctions, that it would not accept bids above the official price from the monetary authorities, or the agents of monetary authorities, of IMF member countries, and to request bidders to specify the capacity in which they are bidding. We will seek the inclusion of such a provision when details of auction procedures are discussed in the Board (of Executive Directors).

Under the amended IMF Articles, approval of countries with 85 percent of the voting power will be required before disposing of the remaining two-thirds or 100 million ounces of Fund gold. Thus, such a decision is being recognized as an important policy question, which has not formally been the case in deciding upon sales of 25 million ounces for the benefit of developing countries or in voting a similar amount for "restitution." Although these decisions have in fact required virtual unanimity, they will be approved formally by a simple majority in the Board of Executive Directors.

In the future the United States will have the capability to veto any plan for further distribution of Fund gold. Since a decision of this type will entail a policy choice rather than a day-to-day question of Fund management, the legislation approving the proposed amendments to the IMF Articles should include a requirement to obtain congressional approval before the Secretary of the Treasury instructs the U.S. Executive Director to the IMF to vote in favor of any proposed gold distribution.

Coping With Oil Deficits

In 1975 the industrialized countries managed their external deficits resulting from higher oil import costs far more successfully than was expected. The countries of the Organization for Economic Cooperation and Development (OECD) as a group narrowed their current account deficits from $32.5 billion in the previous year to $5 billion. The United States and Germany will achieve estimated surpluses of $12 billion and $4 billion respectively. While energy conservation efforts have had some impact on narrowing payments deficits, the economic slowdown in most of these countries was responsible for cutting further the demand for energy imports. At the same time, exports to the Organization of Petroleum Exporting Countries (OPEC), particularly from the larger industrialized countries, rose far more rapidly than had been projected. While recovery is likely to increase the deficits of the industrialized countries, concern that these countries would be unable to meet the strains caused by the quadrupling of world oil prices during 1973 has now abated.

The $25 billion Financial Support Fund, first proposed by the Secretary of State in November 1974 and finally negotiated by the OECD in March 1975, was designed to insure that no industrialized country would be threatened with financial collapse as a result of increased oil import costs. This Fund, which would provide collective guarantees for member borrowings, contingent upon acceptable programs for adjusting to higher oil costs, has yet to be endorsed by Congress. During the first two years after the oil shock some countries like the United Kingdom, Denmark, and Italy had extraordinary financing demands arising from their oil deficits; they were able to draw on the IMF's Oil Facility. Today's financing problems in the OECD countries, however, are more the consequence of other structural problems rather than high oil import costs. Italy's recent foreign exchange losses, for example, result largely from political uncertainties and a recent surge of inflation. To meet such financing

needs regular IMF drawing privileges should be exhausted before the proposed Financial Support Fund would be utilized.

Potential OPEC surpluses, though still large, no longer seem unmanageable. OPEC nations have shown themselves far more capable than expected of accelerating their development plans. In Iran, with a prospective deficit for 1976, imports are already approaching a limit. As recovery in the industrialized economies proceeds, increased demand for oil could lead to higher prices and thus potential larger surpluses. OPEC countries have diversified their investments more than was initially expected. The global financial system bolstered by flexible exchange rates has financed during the past two years an enormous increase in payments deficits. OPEC has limited ability to wreak havoc on exchange markets.

The burden of the adjustment to higher oil import costs has fallen most heavily on the developing countries that have no oil. Their cumulative current account deficit rose from $2.5 billion in 1973 to $17.5 billion in 1974 and further to an estimated $27 billion in 1975. Not only have these countries had to adjust to the quadrupled price of oil imports, but they have suffered a sharp decline in export earnings due to the economic slowdown in the industrial world. They have been forced to scale down development plans made in the boom years (1972-73) of skyrocketing commodity prices.

Economic recovery in the industrialized nations will help the developing countries by increasing the demand for the latters' exports. But poor countries' payments gap will be among the serious economic problems of 1976. Although the two-year authority for the IMF's Oil Facility ended in December 1975, countries that have not exhausted their normal IMF drawing rights can turn to the Fund to meet their payments deficits. At its January meeting in Jamaica, the IMF Interim Committee agreed to expand regular credit lines by 45 percent to tide countries over until the recently approved

quota increase has been ratified by national legislatures. The Interim Committee also agreed to move ahead promptly with the sale of IMF gold and provide some resources for developing countries (as described above). The Trust Fund, which will be established outside the formal IMF structure, will use the profits of IMF gold sales, as well as contributions from member countries, to subsidize interest rates on regular IMF drawings.

During 1974 and 1975 the richer developing countries borrowed heavily in the Eurodollar market and in the United States against reserves accumulated during the previous years of high commodity export prices. As a result of these borrowings, albeit at relatively high interest rates, many of these countries have been able to put off the ultimate adjustment to higher oil import costs. Now, still faced with a problem of curtailing development expenditures in favor of current consumption, these countries must begin repaying the heavy borrowings. Existing private loans to countries unable to repay are likely to be extended. But because the outlook for the developing countries will not be reversed as quickly as it has been in the industrial nations, there is likely to be a substantial drop in new private bank lending, even to the richer developing countries.

Poor countries will be under great pressure to make the adjustments to higher oil prices and to use their available resources as efficiently as possible. Failure to do so can lead to economic stagnation, famine, and widespread political crises. The danger for the rich countries is that large scale default by the poor could send tremors through financial markets or lead to demands for large infusions of aid to maintain political stability. This situation will require very careful monitoring in an effort to prevent such a deterioration.

67-480 O - 76 - 15

Commitment To Concessional Aid

Economic growth in the poor countries is unlikely to proceed satisfactorily without maintaining the flow of real resources from the industrialized world. During 1975 the International Bank for Reconstruction and Development (IBRD) opened its Third Window to provide loans for development at interest rates below those for regular World Bank projects but higher than the concessionary rates of the International Development Association (IDA). Several OPEC countries and industrial nations have already contributed to this facility. The OPEC nations have agreed to establish a development fund of $800 million to assist the poorest countries; this fund is in addition to individual bilateral development aid efforts. Some rich countries are considering donating to poor countries the profits from the sale of gold "restituted" to them under the recent IMF agreement. This example, if followed by the United States and other countries, could achieve the goal of giving all the windfall gains from the sale of gold to those who need it most.4/

4/ The Minority Members of the Joint Economic Committee, except Senator Javits, state: "We are unaware of any countries who have announced their willingness to donate their share of the profits, but even if there are such countries, we dissent from implication that the United States should donate to the poorest countries our share of the gold returned to us under the recent IMF agreement. To give these profits away confuses the issue of international monetary reform and development aid, and also fragments our own aid program into a noncoordinated complex of regular and special aid efforts. In fact, we believe that development aid should be restricted to fewer individual authorization and appropriation measures, so that the true dimensions of our total aid program can be better understood. In

(Footnote, continued)

this regard, we share the sentiments of the Senate Report on the Foreign Assistance Appropriations Bill of 1975:

> In the past, an unnecessary fragmentation of U.S. foreign assistance has been the source of much confusion and has led many to charge that the U.S. is doing less than its fair share in responding to the needs of the world's less fortunate nations.
>
> . . .Much of the confusion arises from the fact that major components of U.S. foreign assistance are considered in several different authorization and appropriations bills. In annual budget presentations, the multitude of agencies and departments which administer foreign assistance programs quite naturally justify only their part of the total program, often neglecting its relation to the whole. This separate and selective justification of individual programs frequently blinds the Congress and the American public to the totality of foreign assistance."

The proliferation of aid-giving efforts does not eliminate the need for commitment of additional funds for low-interest development loans. The Joint Economic Committee has continually supported concessional assistance to properly managed multilateral development banks. Congress should promptly appropriate its fiscal '76 contributions to IDA and to the Asian, African, and Inter-American Development Banks.

This year donor countries will be deciding on their commitments to the Fifth Replenishment for IDA. Even to maintain the current level of IDA disbursements without providing for an increase in the transfer of real resources will require a 50 to 60 percent increase over the $4.5 billion total to be paid in under the Fourth Replenishment. Because of the tremendous need to increase IDA's resources, a coordinated effort should be made to expand the number of countries contributing to IDA to include those which are newly rich. Kuwait participated in the Fourth IDA Replenishment. It is hoped that other wealthy OPEC states will contribute to the Fifth Replenishment. Criteria need to be established now for the progressive inclusion of richer developing countries in the process of assisting the poorest.

The United States will not make the last of its payments to the Fourth Replenishment until fiscal 1979, two years after other IDA donors. Our appropriations were delayed on the Third Replenishment, and the U.S. contribution was deliberately stretched out over an additional year for the Fourth Replenishment. Whether or not the United States is willing to use additional resources -- such as profits from the sale of its share of IMF gold "restitution" -- to catch up with other donors, it must now consider the appropriate level of U.S. participation in the Fifth Replenishment so as not to delay the aid-giving efforts of other countries.

The President, in consultation with the Congress, should forthwith determine the appropriate level of U.S. participation in the Fifth Replenishment of the International Development Association. 5/ 6/

Consumer-Producer Conferences

OPEC's price revolution has led to increasing demands by the poor countries for other changes in the international economic system to benefit them. Even though the quadrupling of oil prices has hurt the poor countries severely, they have allied themselves with OPEC in a joint campaign for a so-called "new international economic order," including higher prices for their export commodities. To provide a forum for discussion of energy prices as well as related issues, the Conference on International Economic Cooperation (CIEC) was established last fall. With a limited number of

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5/ The Minority Members of the Joint Economic Committee, except Senator Javits, state: "This section of the Report, dealing with the International Development Association, does not accurately reflect our views on development aid. First, we would stress the fact that the United States has consistently supported channeling a portion of our aid through well-managed regional development banks such as the Asian Development Bank, the International Development Bank, etc. Second, we believe that the new-found wealth of the oil rich countries places a responsibility on them to assume a greater share of the aid burden; this point should enter into any calculation of how much development aid should be undertaken by this country."

6/ Senator Fannin and Representative C. Brown state: "We favor the phase-out of foreign aid an an instrument of national policy. We would support a multilateral approach through the use of development banks and private investment, which would better develop foreign markets and establish improved overall trade opportunities for the developing nations."

industrial countries, oil producers, and developing countries represented, the CIEC has been organized into four commissions on the following subjects: (1) energy, (2) other raw materials, (3) development problems, and (4) financial aspects of the other three issues.

Of particular concern to the developing countries has been the vulnerability of raw materials prices to market fluctuations. The recent decline of most commodity prices during the recession, combined with high and inflexible prices for oil, has heightened their concern. Unable to achieve the shift in the terms of trade that OPEC has obtained, the other developing countries want commodity price stabilization agreements to protect them from sharp declines in the prices of their exports.

In May 1975, the Secretary of State announced that the United States would be willing to consider commodity price stabilization agreements on a case-by-case basis. Since then the President has announced that he will seek congressional ratification of U.S. participation in the International Tin Agreement. The United States, however, has decided not to participate in the recent cocoa agreement and has asked for renegotiations because its pricing provisions are considered too rigid. If the United States is going to consider commodity agreements individually, Congress must still determine what criteria should be used to determine U.S. participation.

The Joint Economic Committee believes that commodity price agreements that fix prices at artificially high levels or that seek to transfer resources would not be successful over the long run in providing the development benefits sought by poor countries. Instead, such agreements would lead to substitution of alternative products, uneconomic investments, and threats of politically motivated disruption of trade.

By contrast, commodity agreements whose objective is to stabilize prices around an underlying price trend could facilitate planning both in developed and developing countries and help control inflation. Identifying and agreeing upon this underlying trend of market equilibrium prices, however, is almost impossible. The problems of policing agreements on commodity prices are even greater. The required production controls and the financing of buffer stocks would be a continous source of dispute. Furthermore, commodity price arrangements, and even an integrated commodity scheme such as that proposed by the United Nations Committee on Trade and Development (UNCTAD), would tend to benefit rich raw material producing countries, including the United States, rather than the poorest with scant resource endowments.

While recognizing the difficulties price fluctuations can cause exporters, the United States has favored efforts to provide compensation for lost export earnings rather than fix prices. In his September speech to the Seventh United Nations Special Session, the Secretary of State announced U.S. support for expansion of the IMF Compensatory Financing Facility. The IMF Facility compensates for export losses due to forces beyond a member country's control and is based on the expectation that such earnings declines will be reversed. The Facility's use has been limited, and the IMF's Executive Board has now moved to liberalize the borrowing requirements. However, this Facility is not meant to provide long-term transfers of resources to poor countries.

Trade liberalization and concessional aid should be the sources of permanent benefits for the poor countries. In January 1976, Generalized Special Preferences (GSP) went into effect. Under this scheme, tariffs on many manufactured goods from developing countries were unilaterally cut. The United States is now participating in a new round of multilateral trade negotiations (MTN) in Geneva. In his September U.N.

speech, the Secretary of State also recommends the elimination of duties on tropical products exported from many poor countries. Reduction of tariffs on processed raw materials would likewise help by permitting the poor to develop local industries.

As a means to protect poor countries from sharp fluctuations in export earnings, the United States should continue to support the expansion of the IMF Compensatory Financing Facility rather than endorse commodity price stabilization agreements. The United States should reduce tariffs on tropical products and processed raw materials. 7/ 8/

International Energy Policy

Since OPEC's quadrupling of world oil prices, the United States has sought to bring together the industrialized consuming nations in the International Energy Agency (IEA) to present a common front in dealing with the oil producers. With the passage of the Energy Policy and Conservation Act in December 1975, the Congress ratified U.S. participation in the IEA and its emergency oil sharing program.

In January the IEA Governing Board agreed to a long-term energy program which provides for cooperation in research and development, a joint program of guarantees for development of synthetic and conventional

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7/ Senator Humphrey states: "I believe that such reductions should be undertaken only after careful analysis of the impact of such action on American farmers or raw materials producers, and on a case-by-case basis."

8/ Representative Gillis Long states: "This entire question needs further study by the appropriate Congressional committees before I can endorse such sweeping proposals."

fuels, continued efforts at energy conservation, and maintenance of an oil floor price (termed a minimum safeguard price).

While a framework for cooperation in energy planning is essential, the effort to set a price floor under oil imports is ill-advised. In a report issued in June 1975, the International Economics Subcommittee opposed the oil floor price as an inappropriate means for encouraging development of conventional energy resources. The Secretary of State has indicated that he will come to Congress if implementation of the oil price floor becomes necessary. While an oil floor price level of $7 per barrel (f.o.b. Persian Gulf) does not threaten to lock the United States into particularly high-cost energy, the floor price could be raised by a majority vote of the IEA Governing Board to a higher level. Since a floor could encourage investment that would otherwise be uneconomic, the Congress should reject the proposed floor price agreement 9/

Now that some unity among consumer countries has been achieved, this bloc has turned to a dialogue with the oil producers in the Conference for International Economic Cooperation as discussed above. This conference will place the major consumers face-to-face with OPEC to discuss energy problems. The producers continue to seek a longer term guaranteed return for their resources. With the renewal of economic growth in the industrialized countries, demand for energy will rise despite accelerated domestic energy development and conservation efforts. Under these conditions, some

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9/ Senators Taft and Fannin and Representatives C. Brown, G. Brown, and Rousselot state: "Phased deregulation of energy prices would provide further incentives for both production and conservation of energy."

countries may find it difficult to resist demands to fix prices as an assurance against sharp short-term increases. But since real energy prices can be expected to fall over the long run, any U.S. commitment to import predetermined quantities of OPEC crude or to insure continued high prices under a commodity agreement would be counter to our national interest.

The United States should not support an energy agreement between oil producers and consumers which would fix or index future energy prices. Moreover, the Congress should reject legislation to implement the oil floor price recently agreed to in the International Energy Agency Governing Board. 10/

Achieving World Food Security

The United States continues to support the proposal to eliminate world hunger made by the Secretary of State at the World Food Conference in Rome in November 1974. Among other things, this proposal included the establishment of an international system of nationally held grain reserves. These reserves were meant primarily to insure the availability of adequate resources to meet potential shortfalls in food grains production and particularly to insure against famine in the poorest developing countries. With improved harvests the United States has already begun to replenish its stocks. U.S. stockpiles alone are not enough; an international system which will provide for the broadest participation of producing nations and clear guidelines for building up and distributing reserves is essential.

10/ Representative Gillis Long states: "While I oppose energy price fixing as a general rule, I support the concept of a floor under international oil prices. This will guarantee a minimum price for oil that will encourage increased production -- and should oil prices fall in future years, the international price floor will help stabilize prices. I do not wish to associate myself with any specific international oil price to be used as the floor price, but I do support the concept."

The United States, as a major food producer, remains committed not only to providing food aid for the neediest but also to assisting rural development programs that will lead to greater agricultural production worldwide. The United States has concentrated its aid efforts on technical assistance and research on fertilizer, storage, transportation, and pest control. The OPEC nations also have proposed a new International Fund for Agricultural Development. The United States has indicated its willingness to participate in this Fund when other contributions are forthcoming.

<u>The United States should continue to seek early establishment of an international system of nationally held grain reserves. It should also seek speedy establishment of the International Fund for Agricultural Development.</u>

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* Senator Humphrey states: "Looking ahead, there is need for clearer perspective in our international economic policies. Too often in recent years we have moved with timidity and uncertainty. Events in the past five years have dramatized the growing interdependence of world economies. In the past, America, Europe, and Japan have pursued independent economic policies, often at each others' expense, as was illustrated in the worldwide boom of 1971 and 1972 and the recession that followed.

"The United States, Europe, and Japan must make a greater effort to coordinate their domestic economic policies. I believe the United States should take greater initiative to develop such coordination, working closely with the OECD. We have some precedents, of course, but it seems to me essential to discuss mutually acceptable policies for energy, food, employment, trade, and inflation. Such coordination within OECD can also serve to bring about a more rapid growth of markets for both OECD and Third World products.

Footnote * continued

"I also think America has a significant role to play in creating a strategy to meet the development needs of the poorest nations. The cornerstone of that policy should be increased food production.

"Industrialized nations now have a unique opportunity to increase agriculture production in the developing world through the International Agricultural Development Fund. But unless we act promptly, world food deficits might run as high as 71.6 million tons of grain by 1986. If prompt action is taken, it can be held as low as 15.8 million tons.

"The development of a self-sufficient food policy for the Third World should be accompanied by creation of a world food policy in which the United States plays a major role. The major components of this policy, in my view, must be international food reserves and a full and free exchange of food production and marketing information."

SUPPLEMENTAL VIEWS OF
VICE CHAIRMAN WRIGHT PATMAN

For the most part, I am in full agreement with the findings and recommendations of this Report which reflects the high degree of leadership and competency of the Committee Chairman and the Committee staff.

In particular, I wish to applaud the Committee for recommending significant structural changes in the Federal Reserve. Among these are proposals to reduce the terms of Federal Reserve Board members from 14 to 7 years, to provide representation for labor, agriculture, consumers and small business on the Board, to require that Federal Reserve operations be funded through congressional appropriations and that the system undergo periodic audits by the General Accounting Office.

These are meaningful, long-needed steps to assure that monetary policy is conducted in a way which is consistent with congressionally determined economic goals. To these recommendations for structural change I would add only the recommendation that the term of Federal Reserve Board Chairman be made coterminous with that of the President so that appointment can be made as soon as possible following inauguration. Ideally, the terms of Board members should be reduced from 14 to 5 years so that the President can appoint and the Senate can confirm a majority of Board members during the President's first term. However, a reduction of these terms by one-half, from 14 to 7 years, as the Report recommends, draws very close to this target.

I wish I could say at this point that the recommendations of the Report regarding the Federal Reserve and other Federal agencies having responsibility for the Nation's banking industry were complete.

Unfortunately, the recent series of major bank failures and public disclosure by the press that a large number of major banking organizations are on the problem lists of regulatory agencies makes this impossible.

It is obvious that to a very large extent, these banking disasters and the poor financial condition of many other large banks reveals serious inadequacies in the way in which all of the Nation's banks, subject to Federal regulation and insurance, are examined and supervised. The failure of the Franklin National Bank of New York, U.S. National Bank of San Diego, Hamilton National Bank of Chattanooga and others, and the fact that more than 60 of the Nation's holding company banks are on the problem lists of bank regulatory agencies, along with several hundred other banks, makes additional reform legislation imperative.

At the very least, the Report's legislative recommendation to require the Federal Reserve to undergo periodic and full-scale audits, including bank examination activities, must be extended to all activities of the other Federal bank regulatory agencies; namely, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation.

Just as it is of vital importance that the Federal Reserve be accountable for its activities and expenditures through full-scale GAO audits, so too is it equally important that the other banking agencies be held fully accountable to Congress and the public through comprehensive GAO audits which would include a thorough evaluation of examination procedures, findings, and corrective actions.

Equally important, the issue of inadequate bank regulations goes directly to the question of

conflict of interest among the directors and officers of the Federal Reserve district banks, the Office of Comptroller of the Currency and the Federal Deposit Insurance Corporation.

Each Federal Reserve district bank has a nine-member board composed of three "A" class directors representing member banks of the district, three "B" class directors representing commerce and industry in the district, and three "C" class directors representing the public interest in the district.

All of the "A" and "B" directors are elected by member banks of the district. "B" directors are prohibited from being an officer, director, or employee of a bank.

"C" directors are elected by the Federal Reserve Board and are prohibited from being an officer, director, or employee of a bank or owning stock.

Although "B" directors are prohibited from being an officer, director, or employee of a bank, they nevertheless can own bank stock. In reality, "B" directors represent some of the largest borrowers of the member banks which elected them to the Federal Reserve Board. The relationship is made even closer in instances when "B" directors own stock in, and are employed by companies having substantial loans or lines of credit outstanding with banks represented by "A" directors on the Federal Reserve bank board

The conflict of interest potential is tremendous. For example, the Federal Reserve district banks have primary responsibility for examination and supervision of all bank holding companies and all State chartered member banks in their respective districts.

Thus, the "A" directors and their "B" director friends control the board of the Federal Reserve district banks which have primary responsibility for examining and supervising the commercial banks which employ the "A" directors and provide loans to the companies employing the "B" directors.

An example of these classic conflict-of-interest situations is provided by none other than David Rockefeller, Chairman of the Board of the Chase Manhattan Corporation, parent holding company of the Nation's third largest commercial bank. Rockefeller sits as a director of the New York Federal Reserve Bank whose examiners have placed Chase Manhattan on the Federal Reserve's list of problem bank holding companies because of poor management and inadequate capitalization.

Another example is presented by J. Wallace Ely, President of Security Trust Company, owned by the Security New York State Corporation, a holding company located in Rochester. Ely is a director on the board of the Buffalo Branch of the New York Federal Reserve Bank. His holding company is also on the Federal Reserve problem list.

The responsibility for examination and supervision of bank holding companies and State chartered member banks is shared by the Federal Reserve district banks with the Federal Reserve Board in cases involving problem banking organizations. Structural conflict-of-interest situations similar to the ones indicated above, extend to the Federal Reserve Board through the Federal Advisory Council. The Council, as its label implies, is designed to assist the Federal Reserve Board in its deliberations. Twelve representatives of the banking industry, one from each of the Federal Reserve districts, comprise the Council.

Conflict of interest on this level within the System is exemplified by cases like that of Richard D. Hill, Chairman of the Board of the First National

Bank of Boston, a bank holding company which is on the Federal Reserve's problem list. Another case is that or James F. Bodine, President and Chief Operations Office of the First Pennsylvania Corporation, of Philadelphia, which is also on the problem list. The corporation is the parent of the First Pennsylvania Bank of Philadelphia. Both men are members of the Advisory Council.

Conflict-of-interest situations some times extend directly to the very bank examiners employed by bank regulatory agencies. For instance, Richard Spencer was among the examiners of the staff of the Office of the Comptroller of the Currency assigned to evaluate the conditon of U.S. National Bank of San Diego during the 1960's when millions were being funneled out of that institution in fraudulent loans. Spencer was appointed a vice president of the bank in 1973, the same year it collapsed as the result of one of the biggest banking scandals of the century.

The possibility of conflict-of-interest extends to the highest levels of bank regulatory agencies, as indicated by histories of J. Dewey Daane, former Federal Reserve Board Member, and James Smith, currently Comptroller of the Currency.

Daane retired from the Federal Reserve Board in February of 1974. Three months later he was elected vice chairman and a director of the Commerce Union Bank of Nashville, the 114th largest commercial bank in the Nation. In 1975, he was elected vice chairman of the Tennessee Valley Bancorp, parent bank holding company of Commerce Union.

Smith assumed his present position after serving as a lobbyist for the American Bankers Association.

The cases of Spencer, Daane, and Smith make it clear that more than thorough evaluation of bank examination and supervisory practices by the

67-480 O - 76 - 16

GAO is needed. To avoid even the appearance of conflict of interest, all retiring officers, directors and employees of Federal bank regulatory agencies should be prohibited from employment by banking organizations for a period of at least two years after leaving the agencies.

A note of caution is warranted regarding the Committee's recommendation for use of variable interest rate residential mortgages as an alternative to fixed-rate mortgages in order to stimulate housing production and homeownership for low- and moderate-income families. Such proposals provide that interest rates on such loans would rise as the cost of money increases, regardless of whether the income of the borrower has improved. In such a situation, the home loan borrowers are required to shoulder the risk of future market uncertainties with little, if any, expertise to guide them. By the same token, lenders can make such loans on a virtually risk-free basis since they are assured that mortgage interest rates on outstanding loans will increase as the market interest rates and the cost of money to them increases. The result can prove disastrous for low- and moderate-income families who could find themselves having to cut back on expenditures for essential items in order to meet mortgage payments or even be forced to sell homes they no longer can afford.

Finally, I wish to congratulate the Committee for proposing establishment of a National Development Bank to provide adequate credit on reasonable terms for State and local governments and for business in depressed areas. Adoption of this proposal, which calls for creation of a Federal bank as a lender of last resort for priority area borrowers, is long overdue. The chronic financial problems of State and local governments, small business and industry, and the urgent need for low- and moderate-income family housing graphically illustrate the need for such an institution.

SUPPLEMENTAL VIEWS OF SENATOR WILLIAM PROXMIRE

We have no disagreement with the general thrust of the Committee's Economic Report, but we disagree about methods and policies.

The country needs a higher rate of economic growth than the President's policies call for. Unemployment is excessive and will continue to be excessive even if the President's goals are met. We must reduce it further and more rapidly than he proposes. Inflation, which has not been caused by too much money chasing too few goods as in periods of wartime and shortages, must be reduced to historical American levels. This can be done by attacking inflation where it exists -- in sticky industrial prices and excessive energy costs.

Thus while we agree with the Report with respect to goals -- faster growth, less unemployment, lower inflation -- we advocate a different prescription to achieve them.

Don't Spend More

There is too much emphasis in the Report on spending -- on the fiscal stimulus. The $418 billion outlay level recommended by the Report is excessive. President Ford's proposal of $394.2 is much preferable, and even it could be cut by a critical congressional analysis of the individual programs from the bottom up. While we are not specifying any particular cuts, it is public knowledge that several billion was added to the defense budget above the figure recommended by the Office of Management and Budget, foreign military aid is often counterproductive, and many civilian programs have not met the test of efficiency or effectiveness.

Government at all levels is too big. Further, anyone who has examined the budget requests of a particular department or agency knows that 5 to 10 percent

of the funds could be cut without harming the efficiency of the agency and, in fact, would most likely improve its performance.

In addition, many of the specific proposals to increase the budget and produce jobs are selfdefeating. They cost too much to produce a job -- often as high as $25,000 -- there is a considerable substitution effect, especially in the public service job area; and much of the proposed spending advocated in the Report would take effect two or three years after the need exists.

A Constructive Alternative

What then do we advocate to stimulate economic growth, reduce employment, and inflation, and get the economy moving again?

A tight budget and strict fiscal policy -- which can reduce inflationary expectations -- must be accompanied by a much more stimulative monetary policy. Further, budgetary savings should also be returned to the public and taxpayer through larger personal and business income tax cuts than the Report proposes. Tax cuts are as stimulative as spending increases and have the virtue of letting private individuals rather than Government make more of the basic economic decisions. Strict budget limitations also make it possible for a far more expansive monetary policy without rekindling inflation than would otherwise be the case.

Such policies should have the desired effect of stimulating the economy, reducing unemployment, lowering interest rates, and reducing price levels.

What additional government stimulus is needed should be done through an emergency housing program where a job can be created for about $500 instead of the $8,000 to $9,000 cost of a public service job, the $16,000 cost of a highway job, or the $25,000 cost of many public works jobs. A small interest subsidy for housing has the additional advantage that 98 to 99

percent of the total cost of the house comes from the private sector. In addition, unlike added spending for weapons and many public works, housing fulfills a basic family need and the funds are committed and spent quickly.

Conclusion

For all these reasons we much prefer holding the line or cutting the President's budget while stimulating the economy through an easing of monetary policy and tax cuts, plus small additional outlays ($300 million would stimulate 500 new units and produce 1 million jobs) for housing.

This is the effective and noninflationary way of getting the economy moving again.

SUPPLEMENTAL VIEWS OF SENATOR ABRAHAM RIBICOFF

Although I generally support most of the recommendations in the Committee's Annual Report, I am presently opposed to the establishment of a system of international and national commodity reserves which would be promoted by a three-year nonrecourse price support program.

In my view, agricultural price supports are anticompetitive and lead to higher food prices for the consumer.

Our farmers have the ability to compete in domestic and international markets without raising loan levels considerably above their present level.

I am pleased that the Committee has given high priority to the enacement of sound tax reform legislation. The Senate Finance Committee plans to consider this important issue this year.

Many of the tax expenditures and preferences need study and review. Each needs to be looked at on an individual basis.

Only after this is done can the Federal tax system be made more equitable for our citizens.

SUPPLEMENTAL VIEWS OF SENATOR LLOYD BENTSEN

I believe that the Joint Economic Committee in its Annual Report has, once again, focused much better than the President on the need to put America back to work and get our nation's economy back on the path to longrun stable economic growth with balanced budgets.

But I am sufficiently at variance with some of the Committee's recommendations that I do not feel that I can associate with the Report in its entirety.

There are areas in the Report, however, where I am in substantial agreement with the Committee's recommendations.

Monetary Policy. The Nation's recovery from the 1974-75 recession will be inadequate unless long-term interest rates fall enough to spur business investment and new homebuilding. These two sectors have led us out of past recessions, yet during this recovery both remain in the doldrums, with real business investment in 1976 predicted to be 10 percent below the 1974 level and new homebuilding actually declining for each of the past four months. Recovery in these sectors is highly sensitive to long-term interest rates, and these remain too close to their 1975 peaks. Therefore, I agree with the Committee's recommendation that monetary policy this year be conducted with a view not only toward keeping down short-term interest rates, but, more important, toward bringing down long-term rates.

Youth Employment. High and prolonged unemployment among young people will impose a tremendous cost to the Nation long after we return to full employment. Without jobs during the first years after high school or college, young people lose the priceless opportunity to develop job skills, to experiment with different jobs, and to become

productive, wage-earning, tax-paying members of our society. As a result, many will become wedded to a life of dependency, on welfare, with no ties to the dreams and aspirations of the vast majority of Americans.

Our young people are desperately in need of help, and I believe that the Committee's recommendation that Congress develop a comprehensive program aimed at the job needs of youths is an excellent one.

In particular, I believe that a Youth Employment Service within the United States Employment Service, or any appropriate agency, is needed to bring job counseling and job placement services to young people when they are still in school and just entering the labor force, and long before they get trapped in low-skilled, boring, poorly paying jobs -- or even worse, experience years of debilitating unemployment -- simply because they never had the chance to talk with a trained guidance counselor or placement officer. I have introduced a bill which would establish a Youth Employment Service, and I welcome the Committee's support.

Stimulating Jobs in the Private Sector. As the Committee points out, over 85 percent of American workers depend on a vigorous and healthy private sector for their jobs. Stimulating recovery in the private sector is the best way of providing unemployed Americans with the jobs that use their skills and fulfill their job goals.

An employment tax credit, as discussed in the Report, would be an excellent way of stimulating the development of new jobs in the private sector, and I wish the Committee had made a forceful recommendation of an employment tax credit as a major priority of this Congress. In my supplemental views to the Committee's Midyear Review, I urged adoption of an employment tax credit similar to

the one discussed by the Committee in this Report, and I reiterate what I said then:

> We should concentrate on providing more incentives for the creation of new jobs in the private sector. Private jobs do not have to be phased out during a recovery; the Treasury cost is much less than comparable public service jobs; and by expanding the supply of goods and services they help dampen inflationary pressures.
>
> An employment tax credit, allowed to any firm which increased its employment in 1976 over its 1975 or 1974 peak, would be a very effective incentive for firms to accelerate their hiring plans, especially during a recovery. A credit equal to 10 percent of the wages of each new position, up to a maximum of $800 per year, could create up to 400,000 more jobs in 1976 than we would otherwise have, at a cost to the Treasury of less than $600 million.
>
> To reduce the likelihood of firms receiving windfall tax credits for hiring workers that would have been hired anyway, an employment tax credit bill should also specify that firms must hire the long-term unemployed to qualify for the credit, and that firms must plow the credit back into new capital investment.
>
> Even with the possibility of some people being hired who would have been hired in the absence of the credit the average Treasury cost per job through an employment tax credit is $1,400 compared with perhaps $8,000 for public service jobs. I favor a continuation and improvement of the public service job program. However, we should not neglect opportunities to move the

unemployed back into permanent private employment and to do so as quickly as possible.

Finally, I believe we must reform the tax system to provide more incentives and resources for business investment in new productive capacity -- especially during the remainder of this decade -- than are contained in the recommendations in Chapter VI of the Committee Report. My Subcommittee on Financial Markets of the Senate Finance Committee is currently engaged in a review of the effect of the tax system on investment incentives to determine what changes are needed.

SUPPLEMENTAL VIEWS OF SENATOR EDWARD M. KENNEDY

I generally support the goals and recommendations of the Committee's Annual Report, but I believe it is worthwhile to state these separate views on two key aspects of the issues addressed by the Report.

The Economic Myths of 1976

To a person in public life, nothing is more distressing than the massive cynicism, hostility and outright distrust of government that is threatening our Nation's basic faith and confidence today.

A recent issue of the widely respected journal, The Public Interest, was devoted to a survey of the state of the American Commonwealth in 1976. One distinguished contributor, Harvard's newest professor and our former ambassador to the United Nations, Daniel Patrick Moynihan, puts the thought as darkly as any I have heard. "Democracy on the American model," he says, "has simply no relevance to the future. America is where the world was going in the past, not where it is going in the future."

I would venture that our economic troubles are at the heart of these pessimistic views about the condition of America and its implications for our leadership in the world.

Nothing is more responsible for this pessimism in recent years than the inability of government to keep the economy on an even keel, with stable prices, with jobs for all who want them, with reasonable interest rates, with taxes people can afford to pay.

Second only to the responsibility of government to maintain law and order is government's responsibility to keep the economy strong and healthy, by establishing the framework that allows private enterprise and human progress to flourish side by side.

The most difficult economic challenge we face is not jobs, or prices, or taxes, or interest rates,

or energy, or agricultural policy, or foreign trade. The most difficult challenge is a psychological one -- the challenge to overcome the pervasive economic myths that undermine the people's confidence in the economomy and that cripple our efforts to deal sensibly and realistically with basic human needs like prices and unemployment.

One of President's Kennedy's most famour speeches was the commencement address he gave at Yale University in 1962. He spoke about the misconceptions and distortions that plagued the economic policies of his Administration. His remarks helped to dispel the fog and cobwebs. They led to a better public understanding of the complex economic issues of the 1960's, and helped to set the stage for what became the longest uninterrupted period of economic growth and price stability in our history.

We can do the same today. But first we have to dispel the distortions of our own day and generation. The answers of the Sixties will not work. But nothing else will work either unless, as many distinguished economists have argued, we clear the air and dispel the fog that keeps our modern economy sick.

In testimony before our Committee, Professor Walter Heller of Minnesota, put it well. Professor Heller, a former Chairman of the Council of Economic Advisers, spoke of his concern over what he called "the distressing tendency in recent years to miseducate and, wittingly or unwittingly, mislead the American people on vital issues of economic policy and fact.

Professor Heller persuasively articulated several key examples which may be summarized as follows:

The first and most damaging misconception is the myth of the mushrooming Federal government. The Federal budget is an easy target to hit on many things. But one of them is not the growth of Federal spending. Of course, federal spending has grown in recent years. But so has the economy. The only valid comparison is

the ratio of spending to GNP. And that proportion has remained almost precisely constant, at about 20% ever since the early 1950's.

The most serious problem of federal spending in the past was not the fact of growth, but the fact that the growth was undirected. The new congressional budget reform procedures of the past two years have brought this problem under control. The process is working, and I am confident that Congress intends to keep it working well in future years.

We should reject the counsel of those whose policy on federal spending is to cut for the sake of cutting. Asking the federal government to go back to the spending levels of earlier, simpler eras of American life is like asking Detroit to go back to the Model T. It can't be done. And even if it could, we wouldn't like the ride.

The second myth is the so-called "crushing burden of federal debt." In 1950, when the country emerged from World War II, the federal debt was an incredible 82% of the Nation's GNP. In 1974, the level was a modest 26%. To hear the Treasury describe it, you might think Washington was wallowing in red ink. But the truth is vastly different. The debt is at a very manageable level now, and it is going to stay that way.

A third and related myth is the myth of the dangerous deficit. The federal deficits of recent years are a symptom of our sick economy and the serious recession of the past two years. Those deficits have been swollen by the inability of our economic policies to bring the economy promptly back to health.

We will have a $70 billion deficit for the present fiscal year, the largest deficit in our history. But if the economy were at full employment now, the deficit would be close to zero. All of that $70 billion in red ink is accounted for by the recession and unemployment. If America were back at work, the

Treasury would be taking in $50 billion more in revenues. It would be paying out $15 billion less in unemployment compensation, and $5 billion less in related programs like Medicaid and food stamps, whose costs are higher because of the recession. The point is obvious. The way to cut the deficit is to put America back to work. It is time for this country to provide jobs for those who want them. The dole is bad for the health of the human spirit, and it is just as bad for the health of the American economy.

A fourth myth, one we are hearing much about today, is that the Social Security System is nearly bankrupt. They say we need a payrool tax increase at once, to save the system for the future.

There are problems with Social Security. But they are long range problems that cannot be cured overnight. They cannot be cured by a sudden tax increase on workers' wages, an increase that might well make today's recession worse.

We must take appropriate steps to keep the Social Security System sound. But we must also avoid the sort of loose talk and precipitate proposals that scare the daylights out of senior citizens, the millions of men and women whose lifeline is their Social Security check.

A fifth myth is the myth of America's declining role in the world economy. Our economy is still the strongest in the world. Of course, the nations left prostrate after World War II have made a strong recovery. They are growing stronger every year. Of course, some can point to apple-and-orange figures comparing American investment and American rates of growth with those of other nations in other states of development.

Other comparisons are more meaningful and reliable. In recent years, the United States has actually been growing more competitive compared to other industrial nations. Our unit labor costs rose only

10% from 1970-74, at a time when the costs were rising 29% for Canada, 90% for Germany, and 100% for Japan.

America's productivity is still the highest in the world. France and Germany may be the economic wonders of modern Europe, but their productivity is still only 80% of the level we have achieved at home.

In drawing the lessons from these myths and their perpetuation, Professor Heller made an additional telling comment:

> "One hesitates to fix the blame for this retrograde movement in the economic education of the American public. Much of it stems, as it has from time immemorial, from the selfserving efforts of particular groups to "sell" particular policies, positions, preferences, and prejudices. Note how many of these positions serve a bias toward smaller government, cutbacks in federal spending, tax reductions for business, preferential tax treatment of capital investment, and restrictive fiscal and monetary policies."

We need a new and wiser public understanding of our economy. We need policies capable of meeting the Nation's basic goals -- and capable of getting the Nation there by responsible steps that do not make inflation worse, that do not jeopardize the recovery from the recession, and that do not impose unfair burdens on New England or any other section of the country.

No one wins if there is constant antagonism between Congress and the Administration. It is through cooperation, not confrontation, that we can best achieve the goals we seek.

We can put America back to work. We can end the tragedy of unemployment for millions of our people. We can restore the people's confidence, and bring the economy back to health. We can do all the other things we have to do in areas like health and ed-

ucation, housing and crime control, transportation and the environment.

There is no cause for serious pessimism about our country's future, so long as we can debate the issues responsibly, and find persons willing at every level to join in the search for answers adequate to our modern needs.

Tax Reform -- Dream Or Reality

I also endorse the important thrust of the Committee's major recommendation on tax reform. But what I welcome most of all is the signal by the Committee that it will be active this year in the drive for tax reform.

Two prominent economists, Joseph Pechman and George Break, entitled their recent book, "Tax Reform: The Impossibel Dream?" In view of the fate of tax reform efforts by Congress in recent years, the question cannot be regarded as simply part of a catchy title. The question is a serious one. A review of the tax legislation enacted since the 1969 Tax Reform Act by and large would suggest that the dream is in fact an impossible one.

True, Congress has enacted badly needed tax reductions for low and middle income workers. But apart from these worthwhile structural actions, the tax legislation passed by Congress in the past six years has generally been the antithesis of tax reform. Indeed, a major tax reform bill could be enacted if we simply repealed the tax legislation -- other than the structural tax reductions -- enacted since 1969.

However, the Senate is now presented with the opportunity to turn "tax reform" from an impossible dream into reality. My purpose here is to outline the constructive steps that I believe can and should be taken to give American taxpayers the reality of true tax reform.

The Opportunity For Tax Reform

Tax reform is one of the most important domestic issues facing the United States. Perhaps the most important legislation this session of Congress will adopt in 1976 is the major tax bill now pending in the Senate Finance Committee -- H.R. 10612, "The Tax Reform Act of 1975." That bill passed the House of Representatives last December. It represents a significant and valuable cornerstone on which the Senate can build. It contains provisions to reform our income tax laws in many critical areas. In several respects, the measures contained in the Housee bill are close to the reforms that many of us in the Senate have recommended previously, such as the provisions dealing with tax shelters and the minimum tax. Even here, however, the provisions can and should be strengthened and improved.

In the coming weeks, I intend to provide detailed and specific suggestions to insure that the use of syndicated "tax shelters" will be eliminated and that the minimum tax will realize its full potential for insuring that wealthy Americans pay their fair share of income taxes. In addition, I will propose that the Senate add significant reforms in other areas of tax injustice that are in glaring need of change -- most notably the taxation of capital gains on transfers at death or by gift.

But I hope we can join now in recognizing that the House-passed bill represents a solid step in the direction of tax reform -- a step that gives us a real chance this year for a constructive effort to improve our federal income tax system. If all we do is extend the tax reductions scheduled to expire this June, the effort will have failed. The opportunity is at hand to do a better job. We owe it to the American people -- especially the lower and middle income workers who pay a disproportionate share of total income taxes -- to see that the opportunity is not wasted.

67-480 O - 76 - 17

The Need For Tax Reform

The data that regularly issue forth from the Treasury and other sources provide continuing evidence of the need for tax reform. In 1973, over 3,000 persons with adjusted gross incomes in excess of $50,000 paid no Federal income tax at all. This privileged group represents the wealthiest one-half of one percent of all families in the United States. Yet they paid not one dime in Federal income tax.

What do these data -- drawn from dry statistical tables -- mean to the average wage earner in real everyday terms? The data mean that average working families making $7,500 to $15,000 per year must pay higher taxes than they should have to pay for Federal programs, or that they must accept reduced Federal services. The average taxpayer does not have to be -- and should not be -- put to this choice.

The House Ways and Means Committee examined actual returns filed by some of these wealthy "non-taxpayers." The picture painted by these returns constitutes a source of discouragement and cynicism for the average worker, who pays his income taxes at the rates prescribed by the Internal Revenue Code. Consider these actual cases:

-- A corporate executive with $155,000 of income paid no taxes because of tax shelters in movies;

-- A laywer with $151,000 of income paid no taxes because of tax shelters in cattle;

-- A businessman with $262,000 and a doctor with $105,000 of income paid no taxes because of tax shelters in real estate.

Of course, the operation of income tax preferences and tax shelters is not limited to those instances in which the combination of tax preferences produces no Federal tax liability. These cases are only the tip of the iceberg. Beneath the surface is

the massive corrosive influence of many more thousands of wealthy individuals, paying tax at effective rates equal to/or lower than those paid by the lowest bracket wage earners in the United States. Other examples tell the story:

-- The corporate executive with $448,000 of income who paid tax at an effective rate of 3/10 of 1 percent;

-- The stockbroker with $181,000 of income who paid tax at an effective rate of 1/2 of 1 percent;

-- The corporate executive with $1,875,000 of income who paid tax at an effective rate of 5.3 percent.

Nor is the need for income tax reform confined to the individual income tax. The corporate income tax system reveals equally great inequities. Basically, the corporate income tax provides for a 48 percent rate on net profits by large corporations -- historically those with taxable incomes above $25,000. Until last year, small corporations -- those with taxable income below $25,000 -- were taxed at a 22 percent rate. But information filed with the Securities and Exchange Commission reveals how far the reality of the corporate income tax deviated from this norm.

For example, in 1974, Westinghouse, one of the nine largest corporations in the country, paid tax on its net profits at a rate of only 16.1 percent -- 25 percent less than the rate applicable to small corporations.

The corporate income tax not only fails to operate fairly between large and small companies -- it is not even equitable between companies competing in the same market. For example, among banks in 1974, the effective tax rates ranged from 35.7 percent paid by Citicorp, to 18.1 percent paid by Manufacturers Hanover, to 3.6 percent paid by Wells Fargo.

In the weeks ahead, as the Senate moves more deeply into the process of considering the tax reform bill before it, I shall present in more concrete detail the case for Federal income tax reform. But these data, even in this brief form, demonstrate clearly the pressing need for tax reform.

Achieving Tax Reform

The Senate has the opportunity for tax reform and the need is clear. Concrete and constructive actions are necessary, however, if tax reform is to become a reality.

First, we must articulate and apply clear and consistent principles in voting for tax reform measures.

Taxation has come to represent a dense and virtually incomprehensible subject to the average American. But it is essential that we speak plainly and simply to the American people if we are to achieve any significant tax reform. The language of the tax laws may be sophisticated and complex, but the principles of tax reform need not be incomprehensible to the ordinary citizen who pays the tax.

We can best achieve this goal if we reaffirm the two basic principles of tax fairness that govern our Federal income tax system:

-- Persons with the same amount of net income should pay the same amount of Federal income tax;

-- Persons with greater amounts of net income should make a relatively greater tax contribution for public needs than persons with lesser amounts of income.

These are simple, clear and straightforward propositions. If the Senate will test proposals that com before it in light of these basic principles, we can readily demonstrate to the American people whether

or not we are moving in the direction of real tax reform.

I do not expect us to achieve a perfect income tax system in the current tax bill. I am not urging a utopian approach to tax reform that, upon closer examination, holds out no real hope for progress. But it is helpful to use these principles as signposts to guide us in our tax reform deliberations. We can test particular proposals against them to determine whether they constitute genuine "tax reform."

If the Senate accepts these principles, then it must reject the cynicism that says tax reform "means anything that can muster 51 votes in the Senate." To call a tax measure "tax reform" does not make it so. A measure that secures 51 votes on the Senate floor is not tax reform if it moves in the opposite direction from the principles just stated. And a measure that gets only one Senator's vote remains a true "tax reform" if it would move toward fulfillment of those principles.

The American people understand that not every change in the tax laws is "tax reform." To create a new tax loophole and then call it tax reform turns the dream of tax reform into a nightmare of tax loopholes. This kind of tax change actually shortchanges millions of average taxpayers, and makes them pay more taxes than they would if the laws were fair and just.

In the coming weeks, the Senate Finance Committee will conduct its hearings and mark up of the pending bill. I hope that all Senators will make known to the Committee their views on tax reform, and that all Senators will measure the results of the Committee action against the standards of true "tax reform" -- standards that have guided congressional deliberations on those occasions in the past when Congress has enacted legislation that has produced a fairer tax system.

I also hope that Senators concerned about this issue will be prepared to work together on the Senate floor, to ensure that the bill that finally passes the Senate is worthy of the title "tax reform."

In this connection, it is important that there be ample opportunity for adequate discussion and debate on the Senate floor. Since the present tax reductions expire on June 30, it is clear that legislation must be enacted before that date. The Senate and the American people are entitled to an unhurried, reflective, and constructive discussion by the full Senate on this bill.

Second, we must develop concrete proposals to build upon tax reform efforts begun by the House. In the weeks ahead, I will offer to the Finance Committee and to the full Senate the specific actions that I believe are essential to ensure that H.R. 10612 emerges as an effective tax reform measure.

In broad terms, the proposals will fall into four categories. In the first category are measures that the Senate should add to the House bill where it has failed to take needed action, such as taxation of gains at death or upon gifts; repeal of the maximum tax on earned income; and reforms to ensure that the major oil companies and the large multinational corporations pay their fair share of taxes, including changes to restrict the use of the deduction for intangible drilling and development expenses and to end the abuses of deferral of U.S. income tax on income earned abroad by such corporations.

In the second category are proposals to improve basically sound actions adopted by the House. We should tighten the tax shelter rules, strengthen the minimum tax, and make the investment and child care credits more equitable and effective.

In the third category are provisions passed by the House that the Senate should eliminate from the bill, such as the expansion of the use of capital

losses against ordinary income.

Finally, we must reject proposals to amend the bill -- advanced principally in the so-called energy tax bill and by the President and his tax advisers -- for the addition of new tax loopholes, such as the massive tax relief for corporate dividend payments.

Third, we must use the reformed Congressional budget process to enhance the cause of tax reform. The Budget Reform Act of 1974 formally stated what had been obvious for some time -- that the Federal income tax system is itself a vehicle for vast Federal spending programs. These "tax expanditures," in the aggregate, disbursing more than $100 billion in Federal funds each year. These tax expenditure programs operate in the same areas as direct expenditures for regular budget items. Therefore, the 1974 Budget Reform Act properly recognized that Congress must deal with both tax expenditures and direct expenditures if it is to achieve effective oversight and control over total federal spending.

The relevance of budget reform to tax reform is clear when we recognize that almost every tax reform adopted by the House represents a change in a Federal tax expenditure. In some instances, the tax expenditure is reduced in amount. In others, it is increased. But the central point is that when the Senate considers tax reform, it is considering changes in the levels of tax expenditures.

This point has some important implications for tax reform efforts this year. It is essential that Members of this Committee work closely with the Senate Budget Committee to ensure that the First Budget Resolution provides significant tax reform, and that tax reform proposals presented in the Finance Committee or on the Senate floor are consistent with the Resolution.

In 1975, in its first-year of operation, the Senate Budget Committee moved with extraordinary effectiveness to hold down direct expenditures, and I

hope the Committee will do the same this year with respect to tax expenditures. During the past decade, direct Federal spending rose 130 percent. But in the same period, spending via the tax system increased even faster, rising by 180 percent. Tax expenditures now amount to $100 billion, on top of direct spending of $400 billion. Total Federal spending is thus $500 billion a year. If we are concerned about the level of Federal spending, we cannot deal only with direct expenditures. We also have to be concerned with tax expenditures, which are running out of control today and have been out of control for many years.

The Budget Committee clearly understands the need. The Committee signaled its intent during debate on the Second Concurrent Resolution for Fiscal Year 1976 last November. Although that Resolution did not deal with tax expenditures, the Committee Report states the Committee's intention to deal with the issue this year:

"The Committee believes the Congress should address the issue of major tax reform to promote prosperity and eliminate serious inequities....

"Most tax expenditures are enacted for indefinite periods of time and resemble permanent authority for direct expenditures in that they continue in effect year after year at a substantial cost of budgetary resources until they are amended or terminated by specific legislation. Therefore, tax expenditures have important long term impacts on the Federal budget which the Committee will take into account in future resolutions.

"The Committee will be examining both tax expenditures and the operations of off-budget agencies. Thus, the Committee will be able to evaluate the economic effects of congressional action whether or not the action results in a specific budget outlay. These additional dimensions will allow the Committee to take a long-range comprehensive view of national priorities in arriving at its First Budget Resolution for Fiscal

Year 1977."

And, during the Senate floor debate, the Committee Chairman, Senator Muskie, emphasized the Committee's "intent to deal forcefully with tax expenditures in the future."

My hope is that the First Concurrent Budget Resolution in fiscal year 1977 will provide for a significant reduction in tax expenditures. It should begin with the $1.5 billion reduction in the House bill, and it should reflect substantial additional reductions to be achieved in the Senate bill.

My preliminary estimate at this time is that a realistic target for a reduction in tax expenditures, reflecting responsible Senate action on tax reform, would be in the vicinity of a $2.5 to $3 billion for calendar year 1977, representing additional Senate reforms of $1 to $1.5 billion over and above the House bill. This calendar year figure for reduction in tax expenditures would translate into a somewhat lower figure in the Budget Resolution, which applies to the fiscal year.1/

1/ The figure is lower in the Budget Resolution because not all of the calendar year 1977 revenues from tax reforms will be received in fiscal year 1977. The full $1.5 billion in House-passed reductions will be received in fiscal year 1977, since the reforms will take effect on January 1, 1976. But the additional Senate reforms will probably take effect on January 1, 1977. Only part of the revenues from such reforms will be received in the fiscal year, which ends on September 30, 1977; the remainder will be received in the fiscal year, which ends on September 30, 1977; the remainder will be received in fiscal year 1978.

With respect to many of the proposed reforms, the revenue effects in future years will be substantially larger than in fiscal year 1977, as the reforms are gradually phased in or achieve their full impact.2/

The fact that tax reform involves changes in tax expenditures also requires that in evaluating a particular tax reform proposal, we ask not only whether it represents a stop in the direction of greater tax equity, but also whether the change in Federal spending policy is sound. The same questions must be asked of tax expenditure programs as we routinely ask of direct expenditure programs:

1) Is Federal financial aid needed?

2) Do the benefits of the program justify its costs?

3) Are the benefits equitably distributed among income groups?

Some of the tax expenditures that will be considered in the current tax reform bill fail all three tests. In these cases, the Federal tax expenditure should be eliminated. The DISC provision appears to be a prime example in this category, although further study may be appropriate with respect to continuing it for a limited time for small businesses, until a more effective small business export incentive can be developed. The argument presented to the House -- that the repeal of DISC will result in a loss of jobs for American workers -- now appears to have been a red herring, designed to divert attention from the inequity and inefficiency of the DISC provision.

2/ With respect to capital gains at death, for example, the current tax expenditure is estimated at $7.28 billion for fiscal 1977, but a realistic reform would in all likelihood produce negligible revenues in fiscal 1977 and more modest revenues in future years.

In other cases, it may be appropriate to reduce or eliminate the tax expenditure program -- because its costs outweigh its benefits, or because its benefits are distributed unfairly -- but part or all of the revenues saved need to be added to more efficient and more equitable Federal programs in the same budget areas. For example, tax shelters for real estate should be eliminated because they are a source of serious tax inequity and because there is substantial evidence that the tax expenditures involved in real estate tax shelters are inefficient and counter-productive. But, the revenues gained by reducing this tax expenditure must be committed by Congress to direct spending programs for the construction and rehabilitation of low and middle income housing. This stimultaneous action is required to meet our housing needs and to ensure that needed tax reform does not produce unnecessary disruption in the construction industry.

It is important that we amend the House bill by developing stronger antitax shelter rules ready to go into effect. But the House bill wisely delays until 1981 the imposition of its tax shelter rules in the case of the construction of low income housing. In the interim, Congress should require HUD to develop and submit an alternative direct spending program to encourage construction and rehabilitation of low income housing.

We should not support any proposal to change the present tax benefits for low income families until a better alternative program is designed. We can then use the revenues gained from closing down tax shelters to help fund more effective and more equitable methods of providing low income housing. In this way, tax reform and spending reform can go hand in hand.

In other instances, the tax expenditure techniques may offer the best means of providing Federal financial assistance. I believe that the investment credit is one such provision. But changes can and must be made to ensure that this tax expenditure does

not operate to violate tax equity. I will propose changes in the investment tax credit -- to make it refundable and to ensure that it becomes a more effective and equitable Federal program to encourage needed investment, and to ensure it will not be a source of tax inequity. I will propose similar improvements in the tax credit for child care expenses.

Making Tax Reform A Reality

In sum, the necessary ingredients for the Senate to convert the "impossible dream" of tax reform into a reality are present. We have the opportunity, the need, and the tools to do the job. The Committee's Annual Report is an excellent guidepost for the effort. The Senate should act this year to fulfill the long-neglected promise of tax reform to the American people.

SUPPLEMENTAL VIEWS OF REPRESENTATIVE WILLIAM S. MOORHEAD

What this country needs -- and needs desperately -- is a good synthetic fuels program. The problem is not technological. At today's OPEC oil prices commercially competitive synthetic fuels can be produced.

The problem and its solution are both economic.

Many businessmen would be willing to invest in the synthetic fuel production plants were it not for the fear that the OPEC countries might arbitrarily drop their oil prices which would make the synthetic fuel no longer competitive and wipe out an investment of many millions of dollars. One way of protecting the investment in synthetic fuel plants would be to set an international floor price for oil. I agree with the Committee that this is the wrong thing to do.

The correct economic solution would be for the Government by contract commitment or otherwise to protect the synthetic fuel investment from the very remote possibility of an OPEC drop in oil prices.

This could be done under the principles of the Defense Production Act. To that end, I have introduced H.R. 11494 which would amend the Defense Production Act to include synthetic fuel in the same manner as other vital commodities are covered.

This would give all U.S. industries, large or small, the financial confidence -- security if you like -- they need to spend the vast amounts of money required for investment in producing and developing synthetic fuels.

Last year President Ford said Americans needed many American coal gasification plants.

Today, a year later, we do not have any even under construction. Europe and South Africa have in operation coal gasification plants built with American technology.

We also need plants to produce synthetic gasoline made from nonpetroleum feedstocks. The technology exists today to make large quantities of methanol and benzene from coal and solid waste. Methanol, for example, is much more widely used in Europe where plants exist to produce it. Without modification, today's automobiles can operate with 5 percent of their fuel consisting of methanol at an estimated retail cost of 40¢ per gallon. Why is our government so unwilling to make a commitment similar to European nations, or even establish a climate whereby such U.S. industries and the financial community could join hands to produce synthetic fuels on a large scale? The time for talk is long past. What is needed now is action.

We can reduce U.S. dependence on Arab oil earlier than 1985, despite this report's assertion to the contrary, if we are willing to make the commitment. And we must do so. Failure to take such a step will imperil our country -- economically, militarily, and perhaps even politically.

SUPPLEMENTAL VIEWS OF REPRESENTATIVE GILLIS LONG

In my opinion, this Report presents an accurate assessment of the present condition of the economy, as well as the alternatives for national economic policy -- and I believe the Committee's primary recommendations will help achieve the kind of healthy, sustained economic recovery America needs.

Of course, the American economy is a very complex creature. No single set of policy initiatives can be easily and quickly designated as "the answer," because there are no easy answers. Policies to stimulate recovery always run the risk of stimulating too much. Policies to curb inflation always run the risk of rejuvenating recessionary pressures. And policies to reduce unemployment rapidly always run the risk of too much government intervention.

Considering all of this, I still subscribe to the general approach used by the JEC for its goals and recommendations for 1976 and 1977. Certainly the Committee's goals represent a higher level of aspirations for America than the Administration's statement of economic policy as set forth in the Economic Report of the President. By the President's own admission, the Administration's policies would keep inflation at 6 percent while the goal of the JEC's policies is to bring the inflation rate down to between 4 and 5 percent. Where the Administration's policies should achieve a minimum real gross national product (GNP) growth between 4 and 6 percent, the JEC's policies should achieve a minimum real GNP growth rate of 7 percent. Where

the Administration's policies would keep unemployment at or above 7 percent, the JEC's policies should reduce unemployment to between 6 and 7 percent. The levels of the deficit would be approximately the same under either set of policies. Clearly, the Committee's program is superior.

I believe that the recommendations to curb inflation will be more successful than those delineated by the Administration. Considering the Administration's admitted concern with inflation, I thought it was especially notable that the President's Economic Report made no mention whatsoever of the role of the Council on Wage Price Stability. I concur with the JEC that the Council can be one of the most important inflation-fighters in Government, and I support its continued activity wholeheartedly.

I believe the tax policy set forth in Chapter III is prudent at this time. The continuation of the tax cut we enacted last December is necessary for the remainder of 1976 at least. As the year progresses, we will continue to monitor the progress of the recovery and, if further cuts are needed for 1977, we will consider the questions of size and duration later this year when more data will be available on the outlook for 1977. Certainly this is not only a prudent tax policy, but a necessarily cautious one as well.

The JEC's policy on jobs and unemployment is also a prudent one considering the present levels of high unemployment, considering the fact that unemployment has been extremely high for well over a year, and considering that unemployment under the Administration's program is not expected to fall

below 6 percent in the next several years. Given these considerations, the Joint Economic Committee could easily have opted for a much larger program that would have reduced unemployment at a faster rate. However, the JEC chose a more cautious path because of budgetary and inflationary considerations.

While I have serious reservations about the magnitude and duration of public works jobs programs (the primary emphasis should be on the private sector rather than the public sector), I believe the JEC policy is a far better alternative than the Administration program, which is more welfare and fewer jobs. The social and economic costs of unemployment are devastating. I believe one of the most crucial factors for a durable recovery will be a policy to put our people back to work -- to take them off the welfare and food stamp rolls and return them to the tax rolls. This also will have beneficial effects on reducing inflation.

For these reasons, I agree with the view of Arthur Burns, Chairman of the Federal Reserve Board that when the private sector is unable to provide enough jobs to keep unemployment at or below 4 percent, the Federal Government has an obligation to become an employer of last resort. That is precisely what the JEC is recommending, and I believe our policy is an appropriate one.

Also in this regard, I am quite pleased to see that the Joint Economic Committee has recommended an in-depth review of eligibility requirements for unemployment assistance. I think this is a proper response to allegations of abuses in the unemployment assistance system.

67-480 O - 76 - 18

It also is important to take a long-range look at our economic prospects. The overwhelming majority of the witnesses who were questioned on this matter indicated that while the outlook for 1976 is respectable (largely due to an economic upturn in the first half of 1976), the outlook for 1977 will be quite bleak if the Administration's $395 billion budget for fiscal 1977 is adopted. Real GNP will plummet, unemployment will soar, and inflation and the deficit will experience little change from their present levels. As the Report states, we must take actions in 1976 to help ensure sustained recovery in 1977. I believe the JEC's recommendations will help achieve this goal.

Still, I would like to reiterate a caveat I made in last year's Joint Economic Committee Report. I always am concerned about the degree to which the Federal Government intervenes in the private sector. In my own opinion, the success of the Nation's economic recovery hinges on the ability of the private business sector to participate fully in the recovery, so that the Nation can benefit from the many resources and capabilities of our free enterprise system. I am one who believes that the Federal Government cannot do everything, that the efforts of State and local bodies are vital to the success of any program, and that all Federal programs must be carefully constructed to preserve the integrity and autonomy of State and local governmental unity.

While I have this general reservation about Federal intervention, I believe that the condition of the economy is such that government support is warranted to some degree at this time. I believe prudent policy will dictate that we watch the economy carefully, that we take a relatively cautious

approach consistent with achieving a healthy recovery and, as recovery appears stronger and more sustained that government intervention should gradually recede.

The public works jobs programs in this Report manifest that kind of cautious approach by using so-called "trigger mechanisms" that automatically turn on and turn off programs as needs indicate. I am referring particularly to the programs that add on jobs as the unemployment rate climbs and terminate jobs as the unemployment rate falls.

The same is true of our tax policy. The Committee has taken a cautious approach that allows for consideration of the progress of the recovery before recommending tax cuts for 1977. In this manner, we can evaluate the state of the recovery before making decisions.

In sum, I believe the JEC has a sounder policy than the Administration for assuring the Nation's economic recovery. Primary emphasis is on making the recovery healthy and sustainable so that the private sector can assume the burden of the recovery as rapidly as possible. We have designed a set of policies that will achieve specific goals: Reducing inflation, the deficit, and unemployment; keeping a watchful eye on Federal spending and intervention; and increasing the levels of real GNP growth. I am reasonably confident that these policies can and will do the job, especially if they are expeditiously implemented, carefully monitored, reviewed and revised as needed to meet changing circumstances, and given wholehearted support by the American people.

MINORITY VIEWS

on the

1976

ECONOMIC REPORT OF THE PRESIDENT

CONTENTS

Minority Views. 271

I. Introduction. 275
II. Economic Outlook. 277
III. Monetary Policy 281
IV. Fiscal Policy 285
V. Employment. 289
VI. Energy. 293
VII. Capital Formation 297
VIII. State and Local Governments 304

Supplemental Views of
Senator Jacob K. Javits. 314

Additional Views of
Senator Charles H. Percy 334

Additional Views of
Representative Garry Brown 335

Additional Views of
Representative John H. Rousselot 339

I. INTRODUCTION

Optimism about the solid recovery which is now underway must be tempered somewhat by concern for the lingering unemployment of Americans who have been affected by the recent recession. And, the current 6-1/2 percent rate of inflation, though vastly improved over last year's pace, still hurts us all, especially those on fixed incomes. Many Americans have found it extremely difficult to maintain their standard of living. For example, after adjustment for inflation, the per capita income for Americans has stayed virtually constant for the last two years.

But, as we seek to solve these serious problems and to advance our economic growth, we must avoid creating even more difficult problems in the future.

From a business point of view, there have also been strains during the last decade. One need only read constituent mail to get an idea of the problems facing small businesses in America today. The problems range from inflation, how to comply with new and often costly Federal regulations, how to obtain credit when lenders have tightened their guidelines, to how to survive in a stop and go economy.

In this Bicentennial Year, it seems appropriate to affirm, or question, the presuppositions on which our founding fathers based their idea of the American Revolution. In a passage which sounds surprisingly modern, Alexander Hamilton pointed out that those governments which foster commerce had a more viable economic base whereas in some of the most fertile and populous territories of Europe, governments which had failed to foster commerce could boast but a meager base. (The Federalist No. XII)

The same proposition holds true two hundred years later. Commerce is best fostered in an atmosphere of stability and certainty, and yet we have seen sharp gyrations in economic activity, and a legislative and regulatory climate that is stifling business. Commerce is at its best in an atmosphere

where a business can expand normally to meet market needs, and yet the energy crisis and certain legislated costs, such as mandatory pollution control equipment, have eaten substantially into the ability of businesses to increase production or reduce costs.

Although individual studies have been made of the dollar costs of pollution control equipment, safety improvements, pension reform, new energy costs, and tax increases (especially local taxes), we suspect that the total costs which have been imposed on businesses as a result of these measures exceed the sum of their parts. Rapid change, whether induced by inflation or new government regulations, is usually accompanied by transitional inefficiencies as businesses and consumers attempt to adjust to their new and uncertain situation.

One purpose of government is to induce stability which is needed to foster increased business activity and, hence, higher employment and wages. And yet, it is often government which is the cause of unfavorable changes in our society. As we review the economic policies which are needed for 1976 and beyond, we strongly believe that a conscious effort must be made to restrict those areas which should be controlled by government and expand those which can best be left to private markets. In this context, we share the concern expressed in the President's budget that, "...if we continue to increase Government's share of our economy, we will have no choice but to raise taxes and will, in the process, dampen further the forces of competition, risk, and reward that have served us so well."

II. ECONOMIC OUTLOOK

Following a year of difficult transition from recession to recovery, the economy has turned around definitively and there is general agreement among economists that 1976 will see significant improvements in employment, production, and prices without additional government stimulus. History will probably record that the 1974-75 recession bottomed out in March 1975. Since then, figures on total nonagricultural jobs, industrial production, output per man-hour, layoff rates and gross national product (GNP) compare very favorably with the experience of previous postwar recovery periods.

We disagree with those who maintain that this recovery is a fragile one. With the exception of the two points discussed below, the economy is following a typical recovery pattern, and there is every reason to believe that the next 12 months will see sustained economic growth, with record numbers being added to the job totals.

In only two respects is this recovery different from earlier expansion periods. Manufacturing and trade inventories usually start falling some months prior to the trough of a recession, and usually bottom out within six months after the trough. In 1975, however, liquidation of total business inventories, which were at unusually high levels at the peak of economic activity, continued well into the fourth quarter of last year. With regard to inventories of durable goods, the adjustment process has lagged even further, with liquidation not really beginning until the economy reached its trough in the spring of 1975.

This process of inventory adjustment has tended to mask the underlying movement of real final sales, since businesses have continued to draw down their inventories to meet any demand until there have been clear signs of a resurgence in new orders. However, economists generally expect that, with the increase in orders (which has already begun for durable goods), and with potentially powerful inventory stockbuilding

on the horizon, this sets the stage for high levels of production during 1976.

Monetary aggregates have also departed from the average experience of previous recession and early recovery periods.1/ Since July, the rate of growth of cash plus demand deposits (M_1) has been only 2.5 percent on an annual basis, which, after being adjusted for inflation, amounts to an actual decrease in the real money supply. Positive real growth of M_1 is more typical of this stage of a recovery. (A more complete discussion of monetary policy appears below.) At the present time, we feel confident that the technical reasons given by the Federal Reserve System for the different behavior of the rate of money growth are

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1/ Representative Rousselot states: "It is by no means clear that 'monetary aggregates have...departed from the average experience of previous recession and early recovery periods.' If M_1 growth is measured over a one-year period beginning at the trough of the recession, which occurred during the first quarter of 1975, the figure for M_1 growth following this recession would be almost exactly 5 percent (measured from mid-February 1975 to mid-February 1976), according to statistics provided by the Federal Reserve Bank of St. Louis. Comparable figures from the past four recovery periods, calculated from data supplied by the Federal Reserve System, are as follows: 3rd qtr. 1954 to 3rd qtr. 1955, 3.2%; 2nd qtr. 1958 to 2nd qtr. 1959, 4.5%; 1st qtr. 1961 to 1st qtr. 1962, 3.1%; 3rd qtr. 1970 to 3rd qtr. 1971, 6.5%. Thus, it will be observed that the M_1 growth rate of about 5 percent during the present recovery falls well within the range of previous experience. I would also observe that while the real growth of M_1, when considered along with velocity, is a relevant measure of the behavior of monetary aggregates, to use real, rather than nominal, money supply growth as a target, would cause the same mischief which results from using interest rate targets; namely, extremely rapid inflation or deflation."

sufficient to justify the present course of Federal Reserve System policy.

Our major concern is that massive borrowing by the Federal Government could have the result of crowding out private borrowers from the capital markets, at a time when the private sector needs will be growing strongly. Such a situation should be avoided. For this reason, as we explain below, we believe that the Federal Reserve System must continue to be flexible in its use of monetary aggregates in achieving a non-inflationary policy goal.2/

During the Annual Hearings of the Joint Economic Committee, several Members questioned some of the Administration's economic forecasts. One area of concern was that the proposed Fiscal Year 1977 budget calls for real Federal expenditures below the level of spending assumed by private forecasters. In part, the issue revolves about the levels of private business activity which economists see as probable during 1976.

2/ Representative Rousselot states: "Excessive Federal spending is the primary cause for crowding out to occur in private capital markets. Some believe that crowding out is the result of two economic conditions: Deficit spending and rigid, noninflationary monetary policy of the Federal Reserve System. While both indeed can be considered contributing factors, I maintain that the primary and overriding reason for crowding out is to be found in the practice of deficit spending and not in the nature of Federal Reserve monetary policy. Moreover, when crowding out does occur, the Federal Reserve should not be encouraged to print more money to make room for both government and private borrowing which could serve to rekindle the fires of inflation. Funds which would tend to mitigate the cash scarcity and renew borrowing would naturally be lured from foreign capital markets because of the higher interest rates that would result, thus precluding the need of the Fed to take any exceptional action to expand money supply. To avoid the problem of crowding out entirely, and to ensure the availability of adequate funds to meet private sector borrowing needs, Congress must eliminate budget deficits."

The largest differences of opinion center about the strength of investment in fixed assets in 1976. The Administration suggests that business will increase its spending on new plant and equipment by 4 to 5 percent in real terms over 1975. This figure is matched by some private forecasts. Chase Econometrics and Irving Trust, for example, currently project 5 percent real growth rates in business fixed investment.

This projection is at the upper end of private forecasts, and is well above present expectations of businesses themselves. However, levels of business fixed investment typically exceed planned expenditures during a recovery, and the Administration's own projections are moderate compared with the record of previous recoveries. This is due in part to the behavior of consumer spending which, though predicted to rise appreciably during 1976, will be transplanted into revised business investment plans only when these plans materialize.

Consumers will enjoy increased real disposable income as progress is made against inflation and as the recovery brings increased employment. Recent surveys also point to an increase in consumer confidence, which usually translates directly into renewed spending. Furthermore, figures on high personal savings levels during the recent recession, enhanced consumer liquidity in hand with a clear-cut moderation in consumer debt suggest that consumers are now in a position to help spur the economy this year. Thus, the Administration's forecasts are attainable. However, we recommend that the Administration formally monitor the course of the recovery throughout 1976, and set intermediate goals along the way, so that the progress which has been charted can be compared with actual developments.

III. MONETARY POLICY

In view of the current rapid rate of growth of the higher order monetary aggregates, the recent decline in interest rates, and the general availability of credit, the Minority feels that the present course of monetary policy is consistent with a vigorous economic recovery. We do not support demands that the Federal Reserve System become more expansive at this time, nor are we alarmed by the recent drop in the rate of growth of M_1 relative to the other monetary aggregates, which has caused concern in some quarters.

Because of the recent discussion of the behavior of M_1 relative to the gross national product (GNP), there have been recommendations that the Federal Reserve System depart from an intermediate target based on monetary aggregates in favor of one based on nominal interest rates.

• The Federal Reserve System should not revert to interest rate targets.

We agree with the large body of economic literature which concludes that it is theoretically impossible for the Federal Reserve System to control the real rate of interest (i.e., the difference between the nominal interest and the expected rate of inflation). Quite aside from the disastrous historical experience we have had, particularly during the World War II to Korean War period, in attempting to "peg" nominal interest rates through the use of Federal purchases of government debt, we believe that other more effective tools exist for congressional oversight of a monetary policy which contributes to our economic growth.1/ While it is possible to set and achieve interest rate targets, it is possible only in the short run. As we state below, any departure from the principle that the

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1/ Representative Rousselot calls attention to an article which explains why monetary policy cannot peg interest rates for more than very limited periods. See Milton Friedman, "The Role of Monetary Policy," The American Economic Review: Volume LVII, Number 1, March 1968.

growth in monetary aggregates should be consistent with long-term growth potential of GNP poses serious risks of either accelerating inflation or causing deflation. The danger of hewing to an interest rate target is that this fundamental principle gets lost.

For these reasons, we would oppose a return to an interest rate formula. Instead, we continue to support H.Con.Res. 133, which calls upon the Federal Reserve System to report semi-annually to each House of Congress about its "objectives and plans with respect to the ranges of growth or diminution of monetary and credit aggregates in the upcoming 12 months." The resolution permits the Federal Reserve System to deviate from its announced targets if the Fed determines "that they cannot or should not be achieved because of changing conditions" and provides that the Fed shall report to Congress "the reasons for any such determination during the next hearings held pursuant to this Resolution."

In January, the Senate Banking Committee conducted its second set of hearings under H.Con.Res. 133 and reported that, "The Federal Reserve appears to have achieved its earlier announced target for growth in the money supply... The Committee believes that this has contributed to the Nation's economic recovery." (S.Rept. 94-591)

The Minority understands that the traditional relationship between M_1 and nominal gross national product (GNP) may be altered by consumer behavior and other factors. The public is economizing on demand deposits because of higher nominal interest rates on other forms of assets and regulations which permit the wider use of time deposits by corporations. In addition, better money management may be giving an increase to velocity, thereby temporarily reducing the need for normal rates of creation of M_1, or even of M_2. For example, firms have recently been permitted to switch their funds out of demand deposits and into time deposits. This temporarily changes the traditional relationship between the level of M_1 and nominal GNP. However, since the deposits are primarily

moving between one part of M_2 and another, it leaves the relationship between M_2 and nominal GNP nearly unchanged.

We would therefore understand if the Federal Reserve System were to downplay somewhat the importance of M_1 in its calculations, and would not be particularly alarmed if the Federal Reserve System placed greater emphasis on M_2 or M_3. In its deliberations concerning the behavior of the monetary aggregates, the Federal Reserve System should continue to take interest rate characteristics, velocity, rate of inflation, consumer confidence, and the condition of inventories into account as it formulates its policies, which are, after all, aiming at more basic goals: Price stability and full employment.

Monetary targets should be consistent with long-term growth potential.

Once these other considerations are taken into account, the week-to-week policy actions of the Federal Open Market Committee should aim at reaching a monetary target consistent with the goals of stable growth of GNP and reasonable price stability and full employment. The Minority fully expects that (except for temporary adjustments in monetary supply levels to allow for changes in the banking system or consumer preferences among assets) such a monetary target will involve the steady growth of the seasonally adjusted money supply at rates comparable to the potential long-term growth rate of the economy. While it is unrealistic to expect the Federal Reserve System to be able to anticipate and counter random weekly movements in the monetary aggregates, nonetheless, the Federal Reserve should make every effort to smooth the growth of such aggregates on a quarterly basis. In the long run, stable interest rates, stable prices, and full employment can best be promoted by the consistent pursuit of responsible monetary and fiscal policies.

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In the event that the historically stable relationship between the monetary aggregates and GNP should change, the Federal Reserve System should make a full report to the appropriate committees of the Congress on the altered circumstances, as it has recently done.2/

2/ Senator Taft states: "Should a serious supply disruption, such as another oil embargo, threaten to create a temporary upsurge in the price indices, the Federal Reserve should not respond as if this were due to a demand-pull inflation. I agree with the 1975 Brookings Institution report entitled, Higher Oil Prices and the World Economy, that the Federal Reserve should be free to take appropriate measures to offset this real shock to the economy. These measures should in turn be offset as the situation returns to normal. As the Brookings report states,

> 'It becomes clear with the benefit of hindsight--and it should have been clear at the time--that the uncompensated loss of consumer purchasing power stemming from the OPEC price rise would generate a substantial reduction in aggregate demand in the industrial countries. But the same price increase also gave an additional jolt to an inflationary process that had already been accelerating sharply...
>
> 'Indeed, far from desiring to compensate for the loss in purchasing power, some welcomed the oil price increases as an "excise tax" that imposed badly needed demand restraints on an inflationary world in which political caution prevented policy makers from pursuing sufficiently spartan economic policies. In most countries, therefore, not only was there no stimulative offset provided, but fiscal and monetary policy became even more restrictive in response to the increase in inflation that higher oil prices generated...
>
> 'But the cost of pursuing this path was a large increase in idle resources and, in some countries, the severest recession of the past 30 years.'"

IV. FISCAL POLICY

The $394.2 billion cap on Federal expenditures marks the determination of the Administration to set certain priorities for Fiscal Year 1977. These priorities include: (1) slowing the trend of continually rising outlays; (2) less intervention by Government in the private sector and a concurrent stimulation of private enterprise; and (3) a realistic appraisal of objectives needed to be achieved and those that are possible to accomplish.

While there is congressional disagreement over the choice of certain objectives, there is a consensus that the increasing rate of all government expenditures must be slowed significantly over the long term. The major trend in the composition of budget outlays over the last 20 year has been the rapid growth of domestic social assistance programs and a corresponding relative decline in spending for direct Federal operations, particularly defense. Over the past two decades, outlays for domestic social assistance have far exceeded the rate of expansion in the economy, and have grown more rapidly than total Federal outlays.

Total government spending (Federal, State and local) averaged about 35 percent of the gross national product (GNP) in 1975, compared to 27 percent in 1960, and 21 percent in 1950. If the same trend continues for the next 20 years, it could mean that decisions for more than half the economy will be made collectively by Government rather than by individuals and business -- an awesome prospect as we reflect in the Bicentennial Year on the founding of our Nation to assure individual independence and initiative. In 1975, one out of six workers was a government employee; in 1950, this ratio was only one out of ten. In dollar terms, government spending on all levels has grown from $61 billion in 1950 to $136 billion in 1960, and to $525 billion in 1975. Use of total government expenditures tends to inflate the measurement of outlays since a portion of Federal spending is reallocated to State and local governments for their programs. (However, increases in State and local spending have been spurred by Federal matching programs as well as Federally mandated

expenditures for minimum wages and social security.) Nonetheless, the increasing inroads of decision-making by the Government sector into the private economy raises concerns as to the course our country is taking.

One of the most difficult times to make the correct fiscal policy decisions is in a period of transition between recession and recovery, such as today. While unemployment is still high and expansion in many industries is still spotty, timely policies must be developed to stimulate the recovery while at the same time preventing the resurgence of inflation. Short-term and long-term priorities must be balanced at every stage of our deliberations. Congress must evaluate every initiative to determine consistency with longer-term goals and reject those policies that provide merely temporary relief or are actually counterproductive. This hard decisionmaking will have its costs but it is evident that those costs must be met.

In this regard, we believe that a definite consideration in the budgetmaking process must be a hard look at the way government affects private decisionmaking. The domination of the Federal Government in our society has become quite overwhelming. Policies must be pursued to permit the private sector to respond more freely to swiftly changing economic developments.

There are three distinct areas of proposed changes that we support as conducive to strengthening the private sector. The first is the continuation of the cut in personal income taxes which will assure a fairly buoyant rate in personal consumption expenditures this year. A further cut is justified if spending is also reduced so as not to enlarge anticipated deficits this year. In addition, lower business taxes and other incentives would encourage business to raise its investment plans, an essential step in stimulating growth in output, employment and real wages.

The second area for emphasis is the encouragement of investment to meet long-term economic objectives, especially energy. The history of rising energy costs should continue to stimulate investment

in capital equipment which is less energy-intensive and more efficient.

A third area focuses on institutional reform, which touches on such sensitive issues as environmental and safety costs and the role of Federal regulatory agencies. All of the above have grown to form substantial impediments to the efficient operation of private enterprise. For example, we suspect that the benefits derived from many governmental regulations are exceeded by the costs of their administration. We also believe that many actions of regulatory agencies, whose powers may be justifiable as a constitutional delegation of congressional authority, should nonetheless be subject to congressional review before being put into effect. And, at the very least, Congress should exercise more oversight after the fact to determine the economic impact of regulation. Finally, we believe that the entire regulatory structure simply cries out for elimination of inefficiency. Paperwork burdens, administrative delays and conflicting regulations -- the result of Federal actions -- have caused hundreds of businesses to close their doors. We welcome the exploratory initiatives already taken by the Administration and congressional committees in this area.

The correct role of Federal fiscal policy in the development of the private sector must be understood. The Federal budget is not an oversized family budget. Balancing the budget is not equivalent to balancing a personal checkbook. While many individual decisions of the private sector create a certain forward thrust for the economy, the Federal Government should aid our economic growth by providing a healthy environment, as well as give some direction and guidance to the private sector. The budget is the basic expression of government priorities, jointly decided by the Legislative and Executive Branches. And, it is the Federal budget which will help to mold the direction of economic activity over the next few years. Thus, Congress must proceed with great care in enacting expenditure programs in the next few months.

While we support the overall spending ceiling contained in the President's budget for Fiscal Year 1977, the ultimate test of our budget is whether it will assist in producing the hoped for results of increased employment and renewed vitality in the private sector. Finally, we renew our commitment to the reduction in the growth of government spending and, accordingly, a decreasing role for the public sector.

V. EMPLOYMENT

After reaching a high of 8.9 percent last May, the unemployment rate by January 1976 had dropped to 7.8 percent. Since October, unemployment has declined by 770,000, after having held close to the 8-million mark since April. At 86.2 million persons, the employment level was 2.1 million above last March's recession low and very close to the prerecession peak reached in July 1974. While these few last months' statistics are welcome news, we enter 1976 with the unemployment rate higher than the peak rate recorded at the trough of the four previous recessions since 1950 (6.2 percent was the average). Even after several more years of strong economic growth, the unemployment rate is still not expected to go below 5 percent until the early 1980s.

Contributing to this are structural factors. Changes in the structure of the labor force in the last decade have increased participation rates for female and teenage workers while the participation rates for male workers have declined. Other institutional changes and different needs of our society also call for greater urgency in reexamining the entire issue of the opportunity for work in the United States. These longer run issues cannot be forgotten while we continue to grapple with the short-term problems that face us. Programs designed for short-term countercyclical needs are becoming less appropriate as the recovery progresses.

During the next few years Federal assistance for the unemployed and for training in employment services will continue. Outlays provided to States and localities for training programs and employment services as well as public service jobs are expected to be $5.0 billion in 1977, $1.9 billion less than in 1976, because of the phasedown of public service jobs as regular employment continues to increase. Temporary employment assistance has been provided by additional budgetary authority of $1.7 billion in 1976 which will permit the continuing operation of the program until January 1977, with a gradual phaseout through September 1977 as the economy continues to improve. In order to focus this additional aid where the need is greatest, funds will be distributed in areas with rates of

unemployment over 6.5 percent. Under the Comprehensive Employment and Training Act of 1973 (CETA), the Federal Government will expend $2 billion in 1977 which will provide 515,000 man-years of training and work experience through institutional training, remedial education, on-the-job training, child development, vocational counseling, and supporting services. In 1976, outlays for these programs are expected to be $495 million higher due to the effect of startup delays in 1975 spending. A special summer youth employment program will be funded in both 1976 and 1977. Outlay estimates for 1976 are $440 million to support 740,000 jobs, and for 1977, $400 million to support 670,000 jobs. These public employment programs should continue to temper the cruel effects of unemployment until the economy creates higher general levels of private employment.

In our Annual Hearings this year, the Council of Economic Advisers testified that several studies have indicated that public service employment programs, when viewed as long-term unemployment measures, have exhibited two substantial problems. The first problem associated with these programs seems to be the large displacement ratio of public service employment for other jobs in the public sector; that is, out of every ten jobs created through these programs, only one is a net new job creation. Secondly, public service jobs have an exceedingly high cost per job. Unfortunately, the Council of Economic Advisers studies analyze earlier programs of a smaller scope and extrapolate these results to current programs. Also, a distinction between longer term programs and countercyclical proposals was not made clear in the Administration's testimony nor in material submitted later to the Committee. Countercyclical programs, which seem to be more effective and with lower displacement ratios, have occurred at a time when the private sector was not creating jobs. Therefore, people were employed when they would not have been otherwise, albeit not in producing consumer or investment-oriented goods.

As the unemployment level continues to be too high through the next several years, the inherent problems of these public service programs will become manifest and unfavorable effects such as high cost and the rising displacement ratio crop up. The Council felt that the best way to combat unemployment was an indirect approach; i.e., a tax cut which would assist the normal economic forces to stimulate growth and employment. However, the Council has not yet supplied this Committee with the estimated number of jobs that would be created by a tax cut, or the speed with which they would be produced.

• We recommend first of all that significant and substantial analysis be devoted to the relative cost effectiveness of these public service job programs and private sector stimulation, with some comparison of favorable and unfavorable effects, both in the short run and in the long run.

• Second, after the above deficiencies are identified, we also recommend that new policies be formulated, if possible, that avoid these detrimental effects.

• Third, stimulative policies such as tax incentives to business to develop increased employment in the private sector should be encouraged.

By mid-1976, there will be over one million people who have exhausted their unemployment compensation benefits. Congress needs to address this issue since some of these people may not qualify to receive welfare payments. The Aid to Dependent Families with Children (ADFC) obviously would not apply to those individuals who did not have children, and thus omits many unemployed. Although there are other State and local welfare programs, the tight fiscal position of most municipalities has been well publicized. It would be difficult for these municipalities to assume a large onslaught of welfare dependents without some Federal aid. Many workers now on unemployment compensation would fail the asset test now required for welfare recipients. In other words, people who own their own homes and own automobiles would not be

eligible. Families might also find it necessary to wait several months before applying for welfare benefits under certain Federal programs such as ADFC, as the past income from unemployment compensation would boost their 12-month average income above the permitted limit for eligibility.

The Joint Economic Committee has explored the employment experiences of some other countries such as the Canadian Local Initiatives Program (LIP) and Local Employment Assistance Program (LEAP). Other alternatives to aid the unemployed, such as a negative income tax or a low-income credit, should also be studied. However, a final judgment cannot be made until more evidence has been gathered.

We recommend that Congress develop several alternate solutions to our unemployment problems as quickly as possible.

VI. ENERGY

The Energy Policy and Conservation Act fell far short of our goal to establish an effective national energy policy. The compromise oil pricing provisions are counterproductive to achieving energy self-sufficiency and will escalate our level of oil imports, but the Act incorporates other provisions that can contribute to the eventual realization of energy independence. These include the establishment of a strategic oil reserve, conversion of oil and gas fired plants to coal, and emergency standby authorities. It also provides for mandatory automobile fuel economy standards, mandatory energy efficiency reporting by the ten most energy consumptive industries, energy labeling and efficiency targets for major home appliances and a technical and financial assistance program to aid the states in developing and implementing energy conservation programs.

We cannot be lulled into believing that this initial step can resolve the Nation's energy problems. There remain several pieces of pending legislation which must be enacted to effectively complete the energy program, building upon groundwork laid by the Energy Policy and Conservation Act.

An adequate energy supply is the key to the future prosperity of the United States. Sufficient domestic supplies of both oil and natural gas are essential, as is the expeditious development of alternative sources such as coal gasification and liquefaction, solar, geothermal, and nuclear energy sources. Decontrol of oil and natural gas is fundamental to an energy policy.1/ Government

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1/ Representative Heckler is in substantial disagreement with the proposal to decontrol oil and natural gas prices.

policy must provide a conducive atmosphere within which these resources and alternative fuels can be developed and brought to market.

The Emergency Petroleum Allocation Act fails to provide sufficient incentives for increased domestic production to reduce foreign crude oil imports. Last year the United States consumed approximately 16.3 million barrels of petroleum per day, for which declining domestic production accounted for only 10 million barrels. Petroleum use represented about one-half of our total energy consumption.

It is clear that the world's fossil fuel supplies are limited. This reality combined with our need to develop energy independence requires us to promote the development of alternative energy sources. According to the Energy Research and Development Administration (ERDA), 75 percent of the United States energy consumption is based on petroleum and natural gas, with coal providing less than 20 percent of current needs although it represents about 80 percent of the Nation's present energy resources. Development and use of enhanced recovery technology for petroleum, and development of alternative fuels, must be accelerated.

Tax incentives for home and business use of solar and geothermal energy could help to make these energy alternatives price competitive. In addition, Congress should take steps to clarify the issue of whether depletion allowances and the write-off of intangible drilling costs apply to geothermal energy, so the way can be cleared for further utilization of this source.

Special efforts should be taken to assure the involvement of small businesses in the expanding energy field. Voluntary programs to enhance industrial energy efficiency should remain a high priority, as should the education of the general public on conservation methods in all forms of energy utilization.

As they have for the past two years, utilities will continue to suffer from large fuel cost increases and difficulty in financing new construction for additional generating capacity. Consumers will be faced with higher rates, even as coal conversion takes place, due to continuing high costs of emission controls and the high cost of maintaining peak-load capacity. To make power users more aware of actual service costs, strong consideration should be given to the encouragement of various pricing methods to even out power demands during the course of the day. Hopefully, both industrial and residential users will adjust their demands accordingly, resulting in a significant reduction in peak period demands.

The Administration has estimated that capital requirements for energy over the next decade will total about $1 trillion. While other studies vary somewhat from this figure, each one proclaims substantial investment needs. The pressure for capital investment in other sectors is equally as great, as is discussed in the next section, and this only serves to underscore the importance of a pricing structure for energy that will attract capital.

Now that we have started to resolve some of the measures necessary to achieve our national energy goals, we must continue to emphasize that conservation is not only vital to the national welfare but also to the economic self-interest of most individuals and businesses. We must ensure the ability of industry to generate sufficient income for reinvestment. And, if we are serious about gaining energy self-sufficiency, decisions must be made concerning incentives for massive investment of new capital in the energy industry.

• We should continue to seek the gradual decontrol of oil and natural gas prices as a means of encouraging both production and conservation and enhancing the economic viability of alternative energy sources.2/

2/ Representative Heckler is in substantial disagreement with this recommendation.

- We recommend that tax incentives and additional research and development programs be enacted to promote more sophisticated recovery technology of existing resources, primarily through the private sector.

- Congress should be very careful to avoid tax reform provisions that would tend to discourage the massive capital formation which will be needed to expand future energy production.

VII. CAPITAL FORMATION

There is a long-term economic problem that needs careful attention -- capital formation. In recent years, energy requirements, the need for pollution abatement equipment, housing, mass transportation, and the requirement to replace and modernize many existing production facilities in basic industries have intensified the demand for industrial capacity. It is difficult to put precise dollar figures on the amount of investment needed. A New York Stock Exchange study has tallied the requirement at $4.7 trillion over the next decade.

To accomplish this huge job, major changes in the tax structure and a change in attitude concerning the relative importance of savings versus consumption are necessary. Our present tax structure encourages consumption and discourages savings and investment by placing a heavier tax liability on dollars saved or invested than on dollars spent. This misdirected policy stifles needed capital formation, a fundamental prerequisite for solid economic growth.

Regardless of the type of economic system, savings and investment are necessary to job creation, economic growth, and the improvement of the well-being of all people. Capitalist, socialist, and communist societies all have this economic need in common. The difference is in the manner in which resource allocation decisions are made. In socialist and communist economies, the government determines what portion of the national income is saved, where it is invested and what is available for consumption. Capitalist societies, on the other hand, depend on the mechanisms of diverse markets to allocate financial resources. Government policies may affect those market allocation decisions, but they do not mandate them. Individuals and businesses maintain the prerogative to invest or consume as their needs demand.

There is a problem with regard to capital formation and we must face up to it. Compared with other industrialized nations, the United States is trailing in real economic growth. The average annual rate of real economic growth during the decade of the 1960s for the 20 nations then in the Organization for Economic Cooperation and Development (OECD) ranged from a high of more than 11 percent for Japan to a median of about 5 percent for Australia, the Netherlands and Norway, to a low of 2.8 percent for the United Kingdom. The United States during this time had an average growth rate of only 4 percent a year -- ranking us 17th among the 20 nations. This is a poor record for a nation of our abundant resources, labor talent, and productive history.

Over the long run, economic growth depends on many basic factors, including the size and quality of the labor force, the availability of land and natural resources, increases in output per man-hour (productivity) and many intangibles such as inventive genius, managerial skills, the organization of the economic system, and the nature of the infrastructure of transportation, communication, and financial facilities. Land, other finite natural resources and the size of the labor force are relatively inflexible. However, we can affect productivity, chiefly through policies which impact on the supply and utilization of capital equipment.

Of all these factors, therefore, capital investment is probably the key to economic growth. The United States retains a position of economic leadership only because we have been building on a long history of high levels of productivity and we have a large accumulated stock of productive assets. However, examination of the trends in productivity and the relative rates of new capital investment during the 1960s and early 1970s shows weaknesses in our economic underpinnings.

The United States ranks last in a list of seven major nations in productivity growth over the period 1960-1973. Table 1 below shows that growth of the U.S. gross domestic product per employed person averaged 2.1 percent annually over these 14 years, less than half the average of the six other listed countries. When figures on manufacturing output per manhour are compared the rates of growth are larger but the relative position of the United States is not changed.

TABLE VII/1

Productivity Growth, 1960-1973
(Average Annual Percentage Rate)

	Gross domestic product per employed person	Manufacturing output per manhour
United States	2.1	3.3
Japan	9.2	10.5
West Germany	5.4	5.8
France	5.2	6.0
Canada	2.4	4.3
Italy	5.7	6.4
United Kingdom	2.8	4.0
Average for the six foreign countries	5.1	6.2

Source: U.S. Department of the Treasury.

It is not mere coincidence that comparisons on productivity and comparisons on new capital investment go hand-in-hand, since capital investment is such a key determinant of productivity.

There is a widening gap between United States investment as a share of national output and the ratio of capital investment in other industrialized nations. Treasury Department figures in Table II below show that total U.S. fixed investment was 17-1/2 percent of real national output over the period 1960-1973, ranking the United States last among the listed nations.

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TABLE VII/II

Investment as Percent of
Real National Output 1960-73*

	Total Fixed**	Nonresidential Fixed
United States	17.5	13.6
Japan	35.0	29.0
West Germany	25.8	20.0
France	24.5	18.2
Canada	21.8	17.4
Italy	20.5	14.4
United Kingdom	18.5	15.2
Average for the six foreign countries	24.4	19.0

* OECD concepts of investment and national product. National output is defined as "gross domestic product," rather than the more familiar measure of GNP.

** Including residential.

Source: U.S. Department of the Treasury.

Data on per capita capital formation tell a similar story. While it is true the United States still maintains a considerably higher overall capital-to-labor ratio than the average for Europe or Japan, our advantage has deteriorated as other nations have increased their investment per worker. The Commerce Department estimates that since 1960 the existing base of plant and equipment assets nearly doubled in France and Germany and more than tripled in Japan. The U.S. ratio increased only 50 percent over the same period.1/

1/ Senator Taft and Representative Rousselot state: "The capital-labor ratio has a great impact on real wages and per capita income. (Footnote continued)

(Footnote 1/ continued)

"Sweden and Switzerland have had investment rates similar to those of the rest of Europe, and far higher than the U.S. rate. Since 1950, when per capita income in the United States was nearly double that of Sweden and Switzerland, these countries have grown more rapidly than the United States, and actually surpassed us in per capita income in 1974."

	Per Capita Income (Current Dollars)	
	1950	1974
United States	$1890	$6640
Sweden	$ 830	$6720
Switzerland	$ 980	$6650

Capital formation requires the efforts of both individuals and corporations. Individuals make it possible to add to the capital base by depositing money in savings accounts and purchasing securities, thereby providing funds for borrowers to invest, and by investing directly in business ventures. Corporations add to the capital base in a similar fashion, using retained earnings (corporate profits) and borrowed funds to invest in productive capacity. Retained earnings have been the most important source. However, corporations have faced growing difficulty in generating investment funds from earnings. In 1970, a total of 29 percent of the outlays for new plant, equipment and inventories were financed by borrowed capital. In 1974, over 40 percent came from outside sources; and if this trend continues, it will be over 50 percent by the end of this decade. Good corporate profits are essential for capital investment and economic growth.

Basically, businesses rely on four sources of capital. However, there are current problems associated with each source.

First, depreciation charges allow a business to set aside a certain percent of its income as a reserve to replace worn out equipment. But, depreciation is based on historical costs, rather than replacement costs, and the latter costs rise with inflation. Aggravating the situation, profits during times of rapid inflation are artificially high, thereby causing higher taxes and reducing net real cash for investment. It has been estimated that corporations have understated "real" depreciation by $29 billion in the first four years of this decade and have therefore been short of the funds they really need to replace plant and equipment.

Second, retained earnings are a major source of capital, with shareholders taking only about 40 percent of earnings as dividends. In recent years, as earnings have been depressed, dividend payments have eaten into retained earnings. Thus, industry has been deprived of needed capital from this source.

Third, needed funds can be obtained through the issue of new equity securities. Although firms have tried to maintain dividends to keep their shares attractive, it has become increasingly difficult to float new issues except at prices unacceptable either to management or to shareholders, as the return demanded by potential investors has risen because of inflation, high interest rates and stock market uncertainties.

Fourth, and partly because of the above problem, a substantial proportion of companies are finding it necessary, yet difficult, to borrow funds for investment. Many have already reduced their maximum debt capacity, as the average debt-to-equity ratio for industrial companies has increased from 25 to more than 40 percent in the last decade. In addition, many businesses which would like to borrow more may be crowded out as a result of extensive government borrowing.

Congress must take steps at once to modify our Federal tax policies to direct more financial resources into productive capacity. Any one, or a combination, of several approaches could be taken, including: (1) liberalization of the investment credit; (2) liberalization of depreciation allowances; (3) elimination of double taxation of corporate income and stockholder dividends; (4) reduction of corporate income tax rates; (5) more favorable treatment of net operating losses; and (6) tax incentives for personal savings.

These are types of tax incentives that will facilitate capital investment and thereby enhance the ability of the private sector to grow, to provide new jobs, to increase productivity and wages, to help us achieve energy independence, and in general to promote the economic well-being of our citizens.

VIII. STATE AND LOCAL GOVERNMENTS

The healthy fiscal status that State and local governments enjoyed in the early 1970s came to an abrupt halt in 1975. The recession, which increased the level of welfare services, began to take its toll on accumulated surpluses, and the inflation raised the cost of services. As a result, many State and local governments were forced into program cutbacks and some into tax increases to maintain balanced budgets. The The New York City crisis also served as a catalyst to many State and local public officials to put their fiscal houses in order.

Outlook for Fiscal Year 1977

With the economy now in recovery, the fiscal outlook for State and local governments is much improved. But, projecting the actual pace of recovery is an imprecise task. While sales tax receipts and State income tax receipts have dropped as the recession worsened, the major source of local government revenues, the property tax, has remained constant. Therefore, an improvement in the economy will have some beneficial impact on State and local government budgets, but it will not be a comprehensive increase.

The immediate impact of the recession unfortunately is the loss of assistance to many individual recipients. But, there is a side benefit in that many marginal programs, once subjected to the critical standard of benefit versus cost, have been eliminated.

The necessary reduction in services at the local level has been accompanied by an Administration push for restructuring of Federal assistance to State and local governments. Federal assistance should be related to the type of services needed at the local level.

Although actual dollar transfers may decrease, the real value of Federal assistance to State and local governments will increase if the assistance reduces the costly administration of rigid categorical assistance, and reduces limitations on the use of such grants.

The 40 years of grant-in-aid proliferation to State and local governments has produced a system which does not respond to individual State and community needs. It places an unbearable burden on local government bureaucracy to cope with Federal standards and it does not begin to approach cost-effectiveness.

The President has proposed four grant consolidations in health, child nutrition, assistance to elementary and secondary schools, and community services, which would reduce Federal outlays by $1.4 billion. Despite the reductions, these consolidations represent the direction Federal assistance should take in the years ahead.

Present Federal assistance in most areas is simply not doing the job. By almost every standard, the quality of services delivered to the American people has declined. This is due in significant measure to the regimented nature of the programs imposed on local governments. Flexibility to respond to unique needs, broad guidelines for operation, and a reduction in the expensive administrative restrictions of categorical assistance should produce improved services. This improvement will be further enhanced by economic recovery.

• A form of countercyclical assistance should be enacted to cope with unemployment in areas of especially high need.

The Senate recently sustained a veto by the President of H.R. 5247, the Public Works Unemployment Assistance Act of 1975. Title II of that legislation contained a proposal to provide additional fiscal assistance to local communities with severe unemployment problems. The concept was appealing, but the procedure contained in H.R. 5247 was not sound.

There is an opportunity now for the Congress to enact a countercyclical program that relates the assistance to the needs of individual communities.

If it is to be truly countercyclical with regard to the capacity of the local governments to render services, it must be related to a decline in revenues of the recipients, and not exclusively to the percentage of unemployed. The vetoed proposal did not make such a distinction.

• General Revenue Sharing should be immediately reenacted for 5-3/4 years.

By December 31, 1976, $30.2 billion of Federal revenues will have been distributed to nearly 39,000 State and local governments under the program known as General Revenue Sharing. Enacted in 1972, revenue sharing represents the most significant change in Federal-State-local relations since the implementation of the progressive income tax.

Regrettably, the Congress has not acted with dispatch in reenacting a program that has become an integral part of State and local budget planning. Due to expire at the end of this year, revenue sharing cannot be incorporated into local Fiscal Year 1977 budgets until the Congress acts.

State and local governments' budgets must be in balance before they are approved by the appropriate local government organizations. The lack of a definitive revenue sharing plan past December 31, 1976, will force either an increase in local taxes or a further reduction in services. Neither prospect is likely to enhance the economic recovery now underway.

To oppose renewal of the program for the full 5-3/4-year period proposed in H.R. 6558 reflects a total lack of understanding of local budgetary needs and requirements.

Advocacy of its elimination represents a return to categorical programs as the exclusive means of assisting State and local governments. This would be a major blow to reform of State and local assistance.

It is important to examine several basic issues that have been raised during the debate over renewal of revenue sharing.

Formula Considerations

It is necessary to understand two basic features of the revenue sharing program. First, the amount of money in the annual distribution is fixed. There are no cost-of-living escalators or other indexed increments. There is a flat $150 million added each year, which is only a 2-1/2-percent increase.

The second basic feature is that if one jurisdiction gains, another must lose. Therefore, any modification inevitably produces losers as well as winners.

Simplistic suggestions that certain modifications will resolve existing problems with the formula reflect both a lack of understanding of the formula and the basic thrust of the program. It was meant to be general fiscal assistance to State and local governments. It is not a welfare program. It is not a big cities program. It is not a small rural development program. It is, and should remain, general fiscal assistance.

The 145 Percent Ceiling Restriction

One element of the revenue sharing distribution formula is that the highest allocation that any recipient government can receive shall not exceed 145 percent of the average per capita entitlement for the State in which a municipality is located. It has been argued by some that this ceiling unfairly burdens jurisdictions that would be entitled to more money if the formula were not constrained.

Several analyses have been done by the Intergovernmental Relations Subcommittee of the House Government Operations Committee. The results when the ceiling is raised to 175 percent produced some surprises.

First, while some communities that were constrained increased their entitlement, others that were similarly restricted did not. The reason for this is the closed nature of the formula. When there is a modification in the distribution, every recipient's position changes relative to every other recipient's. Therefore, some previously constrained communities wind up below the constraint level of 145 percent because their position has changed relative to all other communities.

Second, advocates of a change in the ceiling predicate their recommendation on the theory that central cities will benefit. Some do; others do not.

For example, the increase in the 145 percent ceiling shifts so much of the entitlement in Pennsylvania and Missouri, that major cities such as Pittsburgh and Kansas City lose while Philadelphia and St. Louis increase their entitlement.

Generally, when this modification is made, very small municipalities and counties, along with large municipalities and States gain, while townships and small- to medium-sized cities and counties over 25,000 population lose.

Eliminating or Reducing the 20-Percent Floor

Some critics of General Revenue Sharing contend that the program props up insignificant units of government. This is accomplished, the critics contend, by a provision that requires that any unit of local government receive at least 20 percent of the average per capita entitlement if they would receive at least $200 under the formula.

When the 20-percent floor is eliminated, 14,000 units of local government are eliminated, primarily townships, and about $38 million is redistributed to larger municipalities and counties.

This modification does not produce sufficient additional revenues to significantly impact the winners and does not deal at all with the question of the function of units of local government. It is related exclusively to "how much" a unit receives and is, therefore, not a realistic suggestion for modification.

Increasing the $200 De Minimus Rule

Closely related to the 20-percent floor is the provision that includes any unit of local government if it is entitled to at least $200 under the distribution formula. It has been suggested that this floor should be raised to a more realistic figure, again with the goal of eliminating small governments.

Increasing the $200 to $5,000 would eliminate over 17,000 units of local government, without relating the elimination to the service load. It would free up $32 million for redistribution. But here again, there is no consideration of what the Government does. It is based instead exclusively on size.

Service demands in smaller communities are as intense and require as much attention as those in larger governments. Without relating some modification of the formula to the service load of local governments, an arbitrary mathematical calculation will destroy the benefit of revenue sharing to many of the rural sections of the country.

Defining Need

There has been a substantial amount of discussion about the redistributive effects of revenue sharing. Some critics state that too much money goes to the suburbs and not enough to the cities. An examination of the actual distribution belies that

assertion. For example, in Michigan, the City of Detroit receives $27.79 per capita: the suburb of Gross Point Farms receives $3.83 per capita. The following table illustrates other examples.

TABLE VIII/I

Per Capita Revenue Sharing Entitlement
In Selected Central Cities
And Their Suburbs

Central City and Surburban Cities	Per Capita Entitlement
Los Angeles	$12.56
Beverly Hills	$ 4.33
Chicago	$19.89
Winnetka	$ 3.68
Minneapolis	$14.50
Edina	$ 4.11
Cleveland	$18.13
Shaker Heights	$ 2.97
Milwaukee	$19.38
Fox Point	$ 4.55

The question must be faced as to whether the Federal Government wants to once again encourage a policy which will soon place the suburbs in the same position as the cities with regard to the property tax. A substantial amount of General Revenue Sharing funds have been used for property tax relief both in central cities and suburbs. The regressive nature of the property tax makes this use a most important and productive one. We cannot afford to adopt national policies which place the private ownership of real property outside the reach of more and more people. A knee jerk reaction to redefining need in the revenue sharing program would bring about that unfortunate result.

Civil Rights Enforcement

The one weak link in the operation of General Revenue Sharing has been the system created to enforce the civil rights provisions of P.L. 92-512, the original General Revenue Sharing legislation passed in 1972. The Office of Revenue Sharing has relied almost exclusively on complaints filed by individuals or organizations alleging discrimination in the use of revenue sharing funds.

There has been virtually no initiative by the Department of Treasury or the Office of Revenue Sharing to investigate possible discrimination at the State and local level. While several voluntary agreements have been reached with violators, there has been no litigation initiated by the Treasury Department or the Justice Department.

For revenue sharing to function effectively, and instill new vitality in the Federal system, the civil rights enforcement mechanism must be improved.

Conclusion

General Revenue Sharing remains one of the most significant innovations in American domestic policy of the last 40 years. It is the beginning of the end of rigid structuring of Federal assistance. In reality, there is no such thing as "Federal dollars." There are only taxpayers to supply those dollars. The relatively simple manner in which funds are transferred from the Federal raising source to the State and local spending outlet has a significant impact on the quality of services. But, from 1933 to 1972, the major emphasis was on quantity of dollars rather than the results those dollars produced.

General Revenue Sharing, block grants, and grant consolidation represent a hopeful beginning of a major restructuring of the interrelations of American units of government.1/

1/ Representative Rousselot asserts that the Federal

(Footnote 1/ continued)

Government's financial condition is far more serious than that of State and local governments who benefit from the General Revenue Sharing program and hence, the National Government can ill-afford to continue this program beyond 1976. Representative Rousselot states: "Irrespective of the many arguments surrounding the questionable value and worthiness of the Revenue Sharing Program -- and they are considerable -- it is my opinion that on the basis of cost alone, General Revenue Sharing should be discontinued. Without denying the good intentions and worthy goals of the program, I believe that we simply cannot afford to 'share' revenue that we do not have."

"When the program began to receive widespread attention in 1964, it was believed it could be financed out of budget surpluses produced by an expanding economy. While it is true that the Federal Government did realize a budget surplus of $3.2 billion in Fiscal Year 1969 when President Nixon first submitted his General Revenue Sharing proposal to the 91st Congress, past experience has demonstrated that budgetary surpluses have been the exception rather than the rule. And, there is no evidence to cause us to believe that this trend is going to be reversed in the immediate future. Indeed, since the beginning of the program in 1972, over $150 billion of debt has been incurred by Congress.

"While the condition of our Federal finances steadily worsens, there are valid reasons to question whether State and local government financial needs still are as pressing as when General Revenue Sharing was initially recommended. In the aggregate, and on a national income and product accounts basis, State and local governments have run surpluses for the last several years ranging from a high of $19.6 billion for the fourth quarter of 1972 (at a seasonally adjusted annual rate) to the most recent figures of $12.9 billion for the third quarter of 1975. Compared with the multi-billion dollar deficits that the Federal Government is accustomed to running, it would

(Footnote 1/ continued)

appear that perhaps the States are in a better position to help than be helped.

"A better program to meet the needs of local governments would be to restore to them a substantial part of the tax base which the Federal Government has preempted. State and local governments would then be free to determine their own priorities and policies, and could tax and spend accordingly. The results would be more responsive government and a healthy diversity, both of which are natural by-products of a dynamic Federal system."

SUPPLEMENTAL VIEWS OF SENATOR JACOB K. JAVITS

The Minority Report is well tempered and cautious, and contains many statements with which I would agree, but I feel I would better serve the public purpose this year by writing my own views on the economy. This is because I feel that this year as we come out of the deepest recession since the Great Depression of the 1930s, I must state my independent views as to the role of the Federal Government in the national economy. However, I wish to note, and to commend the excellence of, the analysis of the Minority's Report on unemployment compensation, productivity growth, investment and national outlook, and capital to labor ratio.

While the Majority places great emphasis on the reduction of unemployment through direct government intervention, the Minority seems to believe that providing the proper climate and stability for expanded business activity is the major function of government in relation to the economy. Although the Minority Report mentions the "concern for the lingering unemployment of Americans" and the President's Economic Report speaks of "the social hardships and economic waste associated with the current level of unemployment," both the Minority views and the President's Economic Report move quickly to devote their prime attention to stability for the business community, with overwhelming emphasis on the need to check inflation through slower growth.

I am as concerned as the other Minority Members about preventing the resurgence of inflation, and I recognize clearly the terrible damage to our economy and to consumer confidence wrought by inflation in the last few years. But, I would hope we would not be like the mythical generals who are continually fighting the battles of the last war while losing the present one. Hence, I see other dimensions to the Government's role in the economy.

In my view, the big issues now paralleling the curbing of inflation are: (1) Utilizing a greater percentage of our productive facilities in this country; (2) more rapid reduction of unemployment;

(3) a quantum improvement in U.S. productivity; and
(4) a resumption of major technological advances through stimulation of research and development.

I shall discuss my own views and the possibility of renewed inflation in the context of my proposals for a more expansionary fiscal policy. At this point, however, I would argue that we are dangerously wrong to regard inflation as the chief cause of the recession we have recently experienced. Rather, it seems to me that restrictive government policies may have substantially deepened the recession in attempting to fight worldwide food and energy price hikes through traditional tools of monetary and fiscal policy.

Similarly, there is great concern about the magnitude of the Federal budget deficit and its relation to inflation. I would like to quote what I wrote last year in my supplemental views to the Annual Report: "The slow path of recovery advocated by the Minority will further erode our tax base and cause huge outlays for unemployment compensation and public service jobs. Recent testimony before the Joint Economic Committee by Professor Walter Heller, former Chairman of the Council of Economic Advisors, was quite explicit on this trend. He said: 'The $70-$75 billion deficit is being identified with profligacy in spending and fiscal irresponsibility when, in fact, it is almost entirely a hostage to recession. If we were operating at full employment, tax revenues would be $50-$55 billion higher than they are; unemployment compensation would be about $15 billion lower; and other cyclically responsive outlays like food stamps, Medicare and Medicaid, and the like, would be about $5 billion lower. So almost all of the deficit is the product of the recession.'"

The Minority Report reflects a strong feeling that the Federal Government is dominating our society and that we must turn to policies that will strengthen the private sector at the expense of the Federal Government. But, it is somewhat simplistic to believe that most of our economic problems are the result of the confrontation between the Federal Government and the private sector when the growth of government is in fact in response to the increasing complexity of

the economy. Dismantling the Federal machinery of government will not cure the underlying structural defects of the economy nor is the health of the business community an inverse relationship to the strength of the Federal Government.

I am in agreement with policies that will stimulate the private sector and lead to greater employment opportunities in this sector, but we delude ourselves if we think that this alone is the answer to the massive problem of unemployment that seems to promise to remain with us until the end of the decade, even with the quite optimistic growth rates projected in the President's Economic Report. Macroeconomic policies alone are insufficient to deal with present and projected levels of unemployment; hence the need for targeted public service programs to deal with those people the private sector will hire only in boom periods.

The Minority suspects, on what basis is not made clear, that the total costs of various governmentally mandated measures relating to pollution, safety, pension reform, and energy exceed the sum of their parts. We cannot so easily forget that these measures were needed because business would not undertake them voluntarily, and as a group was unlikely to undertake these reforms on a consistent and relatively uniform basis. Thus, it is not enough to provide a climate for expanded business activity and leave the rest to the free play of economic forces. There are social costs and requirements for which the Federal Government must assume final responsibility. The debate over the size of the Federal Government in the economy is a false one. The real debate is over the effectiveness of government in meeting the needs of our people.

The Minority has expressed certain major concerns. An important example is the rapid growth of domestic assistance programs. In order to deal with this problem, I have recently introduced legislation to federalize welfare benefits. My bill is similar to one introduced by former Representative Martha Griffiths of Michigan, which is the product of her former Subcommittee on Fiscal Policy of the

Joint Economic Committee. This bill is designed to provide a system of rebatable tax credits and cash grants so that a family of four, for example, would be guaranteed a minimum annual income of $4,300. As an incentive to employment, cash grants could be supplemented by earnings with the grant being reduced 50¢ for every dollar earned. Because of the guaranteed minimum income, various Federal assistance programs, such as Aid for Dependent Children and food stamps, would be abolished, and unemployment benefits would be reduced to 26 weeks, with the new program providing for the long-term unemployed. It is this sort of fundamental reform of the Federal system that goes to the heart of the debate on the role of the Federal Government that is needed, and not the unproved assertion that the mere size of the Federal Government can be reduced without thought as to what takes its place.

Fiscal Policy

I do not share the Administration's optimism that the economy can attain the growth rate target set by the President.

I am concerned that with such a large amount of slack expected to remain in the economy throughout 1976, a harshly restrictive budget would impede the return to full employment. Economists estimate that even if the GNP growth rate target expressed by the President is achieved -- an improbability without unusual strength in consumer and business demand -- recessionlike levels of unemployment, capacity utilization, and a gross national product (GNP) "gap" will prevail well into Fiscal Year 1977.

The unemployment rate is now 3.3 percentage points above the level associated with full employment. Assuming 4-1/2 percent annual GNP growth as the minimum requirement to keep the unemployment rate at its present level, at least 7-1/2 percent annual real growth will be required over each of the next three years to achieve full employment by 1980. On this basis, I believe a significantly more rapid rate

of economic growth than that proposed by the President is required for Fiscal Year 1977. Only in this way have we any hope of a return to reasonably full employment in the early 1980s.

What of the danger that a more vigorous rate of growth will soon reignite inflationary fires? Only when aggregate demand growth begins to press upon the limits of productive capacity can expansionary fiscal policy precipitate demand inflation. The enormous amount of idle productive capacity that is expected to persist for several more years makes a reignition of demand-induced inflation most improbable. Furthermore, the relative stability of unit labor costs indicates that productivity growth is now capable of absorbing reasonable compensation increases, precluding the justification for cost-based price increases and preventing resumption of a wage-price spiral.

There is always the possibility, however, that inflation may develop for reasons unrelated to demand and cost pressures. But, those varieties of inflation do not lend themselves to macroeconomic or budgetary influence and arise from circumstances not germane to fiscal policy considerations. External or structural inflationary pressures resulting from variable oil or food prices and from monopolistic elements in the economy can be neither exacerbated nor alleviated by budgetary policies. For this reason, restrictive fiscal policy ought not to be utilized inappropriately to prevent their resurgence.

On the basis of these considerations, I advocate a Federal budget rather more expansionary than that endorsed by the Minority Members of the Joint Economic Committee. To be sure, a more expansionary policy may very well be associated with some deficit in the full employment budget. Nevertheless, such a discretionary deficit is mandated by the necessity of expediting the return to full employment. To insist on balance in the full employment budget at this particular time would, I feel, prevent the exercise of a fiscal policy capable of maintaining and ensuring the forward thrust of economic activity. The President has proposed a

budget that incorporates a $19 billion increase in the full-employment budget surplus in one year. I believe this abrupt shift in fiscal policy runs the risk of choking off the recovery in early 1977.

Furthermore, I believe it is necessary to tolerate a deficit in the full-employment budget as long as there persists a serious deficiency of private investment with respect to private saving. In order to prevent inflation, Federal outlays and revenues must be in balance at full employment, but private saving and private investment need to be in balance as well. But, when it is apparent that private saving will far exceed private investment through 1976 and well into 1977, a discretionary fiscal policy that is not arbitrarily restricted to the full employment budget balance is required for the restoration of full employment.

In this context, it is important to address the question of the relative shares of the Federal and private sectors in the American economy. The following Table on the share of the Federal Government in the GNP from 1950 to 1975 demonstrates that the role of the Federal Government has remained relatively constant over the last quarter century.

TABLE I

Year	Federal Outlays (in Billions)	GNP (in Billions)	Federal Outlays as Percent of GNP
1950	$ 42.6	$ 284.8	15.0%
1951	45.5	328.0	14.0
1952	67.7	346.0	19.5
1953	76.1	365.0	20.8
1954	70.8	365.0	19.4
1955	68.5	398.0	17.2
1956	70.4	419.0	16.8
1957	76.7	441.0	17.4
1958	82.6	447.0	18.5
1959	92.1	483.0	19.1
1960	92.2	503.0	18.3
1961	97.8	520.0	18.8
1962	106.8	560.0	19.1
1963	111.3	590.0	18.9
1964	118.6	632.0	18.8
1965	118.4	685.0	17.2
1966	134.6	750.0	18.0
1967	158.2	794.0	20.0
1968	178.8	864.0	20.6
1969	184.5	930.0	19.7
1970	196.5	977.0	20.1
1971	211.4	1055.0	20.0
1972	231.8	1158.0	20.0
1973	246.5	1295.0	19.0
1974	268.4	1407.0	19.0
1975	324.6	1499.0	21.0

One thing is apparent from perusal of this table: the role of the Federal Government in the economy has remained constant. Some increases have occurred when the GNP declined during a period of recession -- such as in 1953, 1958, and 1975. With a return of prosperity, however, the underlying share of the Federal Government has returned to about 18 percent of the GNP.

A word of caution is in order in this regard. Experience has indicated that where the share of the Federal Government is permitted to fill the vacuum created by the decline of the private sector in recession periods, an environment of fundamental economic strength is maintained as an incentive for the post-recession growth of the private sector. The Federal Government is obliged, therefore, to preserve the upward momentum of the general economy, so that the private sector may reassert itself when confidence in the durability of the recovery has been established.

Premature dismantlement of the Federal Government's balancing role courts the risk of stalling economic growth and destroying any incentive the private sector may have to expand in Fiscal Year 1977.

Monetary Policy

I do not share the belief that the technical reasons given for the different behavior of the rate of money growth are sufficient to justify the present course of Federal Reserve policy. Since July, the growth of M_1 has been about 2.5 percent, well below even the revised target rate of 4-1/2 to 7-1/2 percent. A justification of this slow money supply growth rate in terms of the more rapid growth of M_2 appears to me to miss the essential difference between M_1 and M_2 as these different measures impact upon the level of spending in the economy. The growth rate of M_1 is not now sufficient to ensure continued economic growth, and the presence of larger M_2 balances does not remove the need to fortify the most liquid balances.

I estimate that in order to achieve 7 percent to 8 percent real GNP growth in 1976, assuming inflation of 6 percent and velocity increasing by 5 percent, the money supply must grow at a rate of 7 percent to 9 percent in 1976. I agree with Chairman Burns that this kind of growth rate cannot safely be maintained for an indefinite period of time. But, the goal of full employment by 1980 requires a significant acceleration in the growth of the money supply, if interest rates are to be prevented from returning to the levels of 1974.

I urge the Federal Reserve System to examine the feasibility of adopting interest rate targets during the coming year in the event that the growth of demand for loanable funds begins to press upon the available supply. I am concerned that if the Federal Reserve adheres rigidly to the lower end of the target for growth of the monetary aggregates, money supply growth may be insufficient to support the growth of spending in the economy. I do not believe that the Federal Reserve ought to attempt to "peg" real or nominal rates of interest however. In an atmosphere of rising credit demands on the part of the private and public sectors, such pegging could lead to excessive monetary growth and, perhaps, a resurgence of inflation.

The Federal Reserve should follow a flexible monetary policy in 1976 and endeavor to prevent interest rates from rising prematurely. As I have stated above, this can be achieved without reigniting inflation if money supply growth is kept in the 7 to 9 percent range.

Employment

The employment situation has somewhat improved, but many unanswered questions remain. Rates of unemployment that were seemingly unacceptable and intolerable in the recent past are now cited as desired goals.

Notwithstanding the creditable improvements in our economy over the past six months, with a commensurate drop in the unemployment rate from a high in May 1975 of 9.2 percent (8.9 percent revised) to the January 1976 level of 7.8 percent -- 7.3 million people still remain jobless. Primary interest, on which the Congress must focus, centers on the needs of those who will exhaust unemployment benefits during the coming year and on the long-term unemployed.

The fact that this country has experienced excessively high rates of unemployment for more than one year has produced enormous hardships for rising numbers of the long-term unemployed workers and their families. We have, to a substantial degree, met the subsistence income needs of many of the long-term unemployed through several extensions of unemployment insurance. Unemployment insurance expenditures have nearly tripled to an annual level of almost $20 billion as a result of persistent high unemployment rates. These expenditures, which threaten the integrity of the entire Federal-State unemployment insurance system, can be reduced through more job creation programs. These programs must supplement our manpower training programs.

Comprehensive manpower training services to the long-term unemployed, provided under the Comprehensive Employment and Training Act of 1973 (CETA), should be made available and incorporated into our present manpower system. Our policy should be to harness our resources to provide additional training for those who have or are about to exhaust these benefits. It is estimated that there will be at least 2-1/2 million exhaustees in 1976, who will have no recourse but welfare. There is a recognition that there will be no longer an attachment to the labor force for many of these exhaustees and that retraining and services should be provided to enable them to find suitable employment again.

In this context, retraining and services should strive to increase education where the skills are needed, and not simply provide training in upgraded skills for its own sake. It is time to begin to

look at a system for the training and relocation of displaced workers who have no hope of regaining their former jobs because of the changing labor market.

The time for undiluted optimism about the economy has not arrived. The Administration's call for a continuation of Public Service Employment through 1976, and then a total phaseout in Fiscal Year 1977 is premature and insensitive to the problem. With its program, the Administration forecasts an unemployment rate of 6.9 percent -- about 7 million unemployed -- at the end of 1977. This is not a level in which I find solace. Therefore, job creation at the Federal level must continue to be a priority.

By designing a temporary program, with projects of limited duration -- no longer than one year -- job creation can be effectively maximized to provide those necessary public services not presently available because of local budget limitations.

Ultimately the private sector must expand and provide more jobs to reabsorb the unemployed. A proposal such as the Administration's which provides for tax incentives to spur employment may offer some long-term benefit, but does little for the immediate problem.

The Government's capacity to expand public service jobs employment, to provide useful and meaningful employment for the individual -- and necessary services for the community -- must be utilized. The mechanism for the program is in place and the program can be expanded to one million otherwise unemployed without additional administrative expense.

The problem of substitution of Federal funds for State and local expenditures has been exaggerated by critics of this approach. This position is based upon studies of a program of limited size and scope (the PEP program of 1971), and not on current information on the present expanded public service employment program. And, if such a problem does exist, it can

be alleviated by restructuring part of the program to a project oriented approach, such as the successful Local Initiatives Program (LIP) carried out in Canada.

These initiatives can be undertaken immediately, with an average cost of $8,500 per job per year, and have very little inflationary impact. The argument against a public works program -- that the impact can be felt only in future years when the economy may not require any boost -- cannot validly be made. Our experience with Public Sector Employment programs is by now considerable and solid.

Serious consideration must be given to areas of unemployment which have not benefited from the upswing in the economy and are sticky. Initiatives are needed in the area of youth unemployment, which has remained around 20 percent throughout 1975. The staggering rate for minority urban youth is over 40 percent. Last year, funds for the summer at the minimum wage for a nine week period provided 860,000 jobs, for this age group. The Administration's request is for $440 million for Fiscal Year 1976 and $400 million for Fiscal Year 1977. The 1976 figure would provide for 740,000 summer jobs.

Again, these requests are based on assumptions of an improving economy. The unemployment rate for this age group has remained steady despite the improved economy. There should not be a decrease in our funding for summer jobs. If anything, these tragic figures require an increase in appropriations for this purpose.

And, this realization requires further examination of our traditional education system as it relates to the prospective work force. The relationship of school to work recently has been the subject of studies which have restated the need for a reevaluation of our present system to orient it more to work-study. The persistently higher rates of unemployment of this group is a telling indicator of what should be a priority in our thinking.

The Cities

Apart from the recession, the major economic event of 1975 was the near-bankruptcy of the Nation's largest city. In part, the New York City situation reflected the general economic malaise of the country: A stagnant economy which tended to depress tax receipts and to increase spending, especially in such areas as unemployment compensation and welfare payments. In part, the New York City situation was also the direct result of a system of financial mismanagement which had been allowed to reach crisis proportions before comprehensive steps of reform were initiated.

On another plane, however, the New York crisis illustrates the weaknesses of our Federal system. The way our tax system has grown, the Federal Government has access to the most flexible and progressive sources of taxation; on the other hand, the real problems facing Americans on a day-to-day basis and to which they look to Government for a solution more often than not become the responsibility of local government. By this I mean, the problems of demographic population shifts, environmental pollution, congested traffic, rising crime rates, education, health care, etc.

And, a related issue, and one which must be addressed by the Congress as its symptoms become more apparent, is the effect which regional and National growth patterns will have on the older more crowded, less efficient cities of the Northeast and Northern States.

The New York City crisis was "solved" last December with the passage of the Intergovernmental Emergency Assistance Act, which authorized the Secretary of the Treasury to make direct loans to the City for seasonal cash flow needs. The dollar limit of these loans is $2.3 billion, and in keeping with the intent that these loans be for seasonal financing only, they must be paid by the end of each Fiscal Year. This congressional action is a part of a complicated financial package involving the City, the

State, major financial institutions which have loaned to the City in the past, pension funds of public employees, and investors holding outstanding City notes.

The danger inherent in New York City's situation is that Congress will believe that, having voted the $2.3 billion aid package, it has fulfilled all its obligations with regard to New York City. In fact, this is far from the case. The revised financial plan which New York City submitted to the Treasury Department on February 15, 1976, is within $62 million of meeting the projections on revenues and expenditures contained in its $10 billion plan which forms an integral part of the congressional aid package. In other words, the $2.3 billion aid figure is proving at the present time to be just enough to enable New York City to breathe -- to scrape along. The City will be forced to meet this kind of stringency over the three-year period covered by the financial plan and the Federal legislation.

But, this begs the question of whether the New York City crisis would have occurred if the proper Federal policies had been in effect -- and what should be such policies. For, in fact, this Nation has continued for some decades without a true urban development policy designed to foster our metropolitan areas. Instead, we have a "de facto" urban policy which encourages suburban growth at the expense of the central cities. By this I mean the combination of a highway system which facilitates commuting from relatively large distances outside the cities, VA and FHA loans which have helped spur the boom in suburban one-family housing, a tax treatment of real estate transactions which has encouraged real estate developers to build suburban-type housing developments, etc.

I do not mean to belittle or criticize these measures, which have been major factors in our post-war economic growth. However, I strongly believe that the central city values are vital too, and that this country suffers from a lack of a national policy on such urban affairs.

The enabling legislation of the Department of Housing and Urban Development makes no distinction between small communities and major urban centers such as New York City. Thus, I believe that Congress must direct its attention at the earliest possible time to developing a coordinated policy on urban affairs. This would involve the designation of an Under Secretary at HUD whose responsibility would be for urban affairs exclusively, and a concerted Federal effort to identify those present policies which help or hinder our metropolitan areas. Such a recommendation is made with a long-range view.

Over the short-term, Congress must act on legislation which has been proposed to help alleviate the financial squeeze facing many cities and even States. In this regard, I fully support that part of the Minority Report which recommends a continuation of the General Revenue Sharing Program and the establishment of a system of countercyclical grants to State and local governments. General Revenue Sharing, if continued on an automatic basis for another 5-3/4 years, will enable State and local governments to continue planning their budgets with the certainty that revenue sharing monies will be forthcoming. Should Congress fail to enact the program, or enact a revenue sharing program consisting of annual appropriations, this State and local planning process will be disrupted, and revenue sharing monies will be devoted to one-shot budget items of dubious value rather than being integrated into the comprehensive budget process to be undertaken by each unit of government.

A system of countercyclical grants, keyed to unemployment, to State and local governments, such as was voted by the Senate last year, is also essential to help enable governments across the country to weather the hardships of the business cycle. Such governments do not have the ability of the Federal Government to engage in Keynesian pump-priming during recessionary periods, and instead must cut back on spending, thus doing the exact opposite of what is needed to get local economies moving again. A system

of countercyclical grants would implement the principle that State and local government spending can help counter the effects of a business recession.

One lesson which the New York City crisis taught us is that the country's tax-exempt markets can be a very unwelcome ally in times of stress. As a technical matter, the New York City crisis flared up when the city government found the private financial markets closed to it, despite massive seasonal borrowing needs. Although there are many reasons for this phenomenon, one important reason was the relative thinness of the municipal bond market and its inability to respond to the stress of the New York City situation. This thinness, according to the experts, is a function both of a waning demand for tax-exempt paper, and a rapidly growing need by the issuers of such paper for financing. Thus, many policies for future balanced urban living must include a close examination of the municipal bond market and the steps which could be taken to improve its efficiency. In this context, I welcome the effort which is being made by the Administration, in the establishment of a Municipal Finance Division within the Treasury Department, to get to the heart of the problem.

Among the factors which this office should consider are the widening of the emergency New York City legislation voted last year, in order to provide aid to States setting up Big MAC-type agencies; the establishment of a Federal insurance facility for new tax-exempt issues (which I proposed in legislation last year); the possibility of a taxable option feature, with a subsidized interest rate, for municipal securities; and the possibility of curtailing the tax-exempt feature of industrial development and pollution control bonds. Each of these measures would either widen the market for tax-exempt securities or restrict the number of such securities being issued, and thus facilitate financing of priority projects by State and local governments.

If we can learn from the New York City situation that the country as a whole faces a critical problem of decaying urban centers, of which New York

City is only the tip of an iceberg, then the crisis of 1975 can be turned to good use. If, however, New York City is considered to be simply a unique case with no spillover effect on the rest of the country, then I am certain that we face further crises as we once again fail to measure up to the needs of our urban areas -- and are doomed to repeat the experience from which we will have failed to learn.

Energy

There are several points I want to add to the Minority Report on energy, a great deal of which I agree with and want to second.

I believe the enactment of the Energy Policy and Conservation Act is a turning point in American energy policy. We have resolved, at least for 40 months, the most controversial political question relating to energy -- the price of gasoline. Although this issue will confront us again and again over the next three years, the structure and constraints have been set and will not be rethought.

This gives us the opportunity to deal more fundamentally with the system and structure of American energy so that security and sufficiency of supply, at prices that are competitive and economic, will become our primary objective.

My main point of disagreement is in the Minority's recommendation that we must press forward toward decontrol of oil and gas prices. I would support decontrol only to the extent that there are structural changes to guarantee the working of a truly open marketplace factor in the production and sale of oil and gas.

We cannot decontrol the prices of a commodity as critical to our individual and national well-being as energy when there is an international cartel (OPEC) manipulating a shortage and dictating an administered price to the world. This is not competition, and until competition returns to the energy sector, I must support some governmental input to control prices so they do not become any more excessive.

I believe we must seriously study the proposals for restructuring of our petroleum enterprises so as to provide a framework either for the real working of the marketplace or for public assurance as to an opportunity for product innovation and for establishing reasonableness in prices in the energy industry.

We must also not forget the lessons of the embargo: Our domestic energy industry must invest its excess profits in activities that serve the public interest of the American people. Either through tax recaptures or by direct regulation, we must insure that these profits are invested in expanding our domestic energy sources and will help to free us from insecurities in foreign supply.

Although this domestic investment must come primarily from the private sector, I believe a role for the Federal Government is critical to its success; and this may include viable public-private partnerships, where the largest and riskiest of enterprises -- but enterprises that contain the promise of commensurate public benefit in energy supply -- may be financed. This should be done with due regard for environmental quality as an essential factor, too.

My final point relates to conservation, the method of achieving both greater supply and reasonable environmental benefit in the short- and medium-term, the period we must concern ourselves with the most. Conservation of insecure supplies involves both the elimination of waste and inefficiency and the replacement of oil and gas with existing alternative fuels. We should redouble our efforts to increase efficiencies of the oil consuming sector, and similarly to increase the development of better uses of coal to replace large portions of our imported petroleum. By finding and implementing methods for the clean burning of coal, we will give ourselves the time we need to move rationally and systematically into the era of renewable energy resources, such as solar and fusion power.

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Housing

Housing is one sector of the economy that has suffered terribly in the recession and has not made a strong recovery. At the end of January housing starts were averaging 1,220,000 on an annual basis, which is still far below a healthy level. Unemployment in the construction trades is still 15.4 percent, far above the average for other sectors of the economy. Adding to the problem is the fact that many State and local housing agencies have experienced financial difficulties and cannot supply needed mortgage money to the housing markets.

On the Federal level, there is, for all practical purposes, only one subsidy program that is being used to produce new or rehabilitated housing; the Section 8 program which was established by the Housing and Community Development Act of 1974. All the other subsidy programs have been phased out or are in the process of being phased out. The Section 8 program, which provides a subsidy to low- and moderate-income tenants so they will not have to pay more than 25 percent of their income (or less than 15 percent) for rent, has taken a very long time to implement and has proven very costly. It cannot be counted on to play a significant role in increasing housing production and rehabilitation without additional tools.

First, the conventional public housing program should be significantly increased in size. This program was cut severely when the new Section 8 program was enacted and has been limping along since that time. However, conventional public housing has a fine record of production and operation among housing programs. Social services, security and adequate housing are provided to low-income tenants at reasonable rents. The program is also one that operates at a lower cost to the Federal Government than other programs like Section 8. There are presently 155,000 families on the waiting list for public housing in New York City alone and reinvigoration of the public housing program would be extremely useful for New York and other areas of the country with similar problems.

Second, a new program for rehabilitation of transition neighborhoods is needed to curtail the spread of decay in our urban centers. Heretofore, national housing efforts have focused mainly on the production of new housing while neglecting the existing housing stock. We need a new program which would deal with the problem of conserving existing low- and moderate-income housing stock and generating private capital for repairs and rehabilitation. This type of program could do much to stop the abandonment of hundreds of thousands of units in our central cities and thereby would provide much needed housing at a lower cost.

Finally, new mechanisms must be found which will encourage a larger flow of mortgage money into the housing market. Banks and pension funds should be encouraged to invest in housing, and adequate guarantees may have to be provided to make an investment in housing more attractive to institutional lenders. Similarly, we must continue the investment incentives for individual investors by tax advantages if we are able to thereby increase the flow of dollars into low- and moderate-income housing.

It is imperative that a greater effort be made in the public and private sectors so that housing construction and rehabilitation, which is a critical part of our economy and means so much to many people, is stimulated to proper levels.

ADDITIONAL VIEWS OF SENATOR CHARLES H. PERCY

I concur in large part with the views expressed by the Minority. I do have differences on several significant points.

While I share the concern of my colleagues on the Minority about restraining the growth of Federal spending, I believe that too restrictive a fiscal policy would endanger the economic gains made over the past six months. A final decision on the appropriate fiscal stimulus for Fiscal Year 1977 can be made better this May when the Congress must establish Federal spending and deficit levels under the First Concurrent Resolution on the Budget.

Second, although I am encouraged by the recent decline in the unemployment rate, I believe that with the rate at an unacceptably high 7.8 percent level it is unwise to plan phasing down public service job programs. Indeed, it may be that public service job programs should be increased to assist those who will exhaust their unemployment compensation benefits during 1976. In my judgment, public service jobs have generally proved to be an efficient and relatively noninflationary means of aiding the unemployed.

Third, I agree with my Minority colleagues that a truly effective countercyclical assistance program for local governments should be related as directly as possible to the decline in revenues of the recipients. However, the locality-by-locality statistics that are necessary for the use of such a distribution formula are not available at this time. I believe the program is sufficiently important that it should be enacted now in its admittedly less than perfect form. Such assistance would be invaluable to depressed areas such as Rockford, Illinois, where the unemployment rate is 11.8 percent and East St. Louis, where unemployment is now 9.4 percent.

ADDITIONAL VIEWS OF REPRESENTATIVE GARRY BROWN

It has been estimated that the Federal Government spends over $130 billion annually in regulating our lives. Distributed among America's families, that means each pays on the average of $2,000 a year for Federal government regulatory activities.

Can anyone say benefits are commensurate?

Yet, ironically, there persists, at the same time today, strong advocacy by the Majority Members of the Joint Economic Committee for still new government agencies and regulations to protect the consumer. I cannot help but think, however, that if the consumer knew in advance the cost of each new law and each new proposed rule, both of which are borne by the public, that government regulations -- to the extent they are excessive -- would definitely be curbed.

By far the most serious problem this Committee should highlight is excessive government regulation. The Federal Government too frequently is found intervening directly in the marketplace, fixing prices, erecting questionable barriers to entry, allocating markets, sanctioning collusive bidding, and delaying or even prohibiting necessary technological progress.

Something is wrong when a small airline operating within a State can profitably fly passengers for as little as $15 a trip, while an interstate airline, which must operate under regulations established by the Civil Aeronautics Board, must charge $31 for the same trip. There is something wrong when a company owning three small TV stations must file a license renewal application with the Federal Communications Commission weighing 45 pounds.

There are few apparent benefits to the consumer from this kind of interference.

Turning next to the question of economic stabilization, there is obviously a decisive role to be played by fiscal and monetary policies in smoothing out extreme moves in the economy. There have been

times, however, when such moves have been counterproductive. For example, from the testimony this Committee has heard, additional "stimulus" (in the form of increased government spending) frequently takes effect at times when the total productive capacity of the economy cannot absorb the increased demand for goods and services. The result is inflation, dislocations in the economy, and unemployment.

We must avoid abrupt and excessive changes in government expenditures. No matter how well intentioned, such sharp swings in spending tend to accentuate rather than stabilize the business cycle and serve to increase the uncertainty of developing policies to meet future needs. In turn, this uncertainty is felt in the consumer markets, in the markets for capital goods, and in financial markets.

In addition to government expenditures, I am concerned with the size of the Federal deficits, particularly the negative impact on financial markets and capital formation. The rise in Federal expenditures has exceeded the growth in revenues resulting in Federal budget deficits in sixteen out of the last seventeen years.

It should be emphasized that the Federal deficit places the Department of the Treasury in a position of competing for funds with the private sector. The recent avalanche of Treasury securities has created distortions in the traditional patterns of funds being raised by various sectors in the capital markets as well as in the sheer magnitude of total funds raised. This, in turn, has contributed to making our financial markets less efficient in channeling the savings of society to investment opportunities.

The achievement of our capital formation goals depends on the necessary expenditures being financed in the private sector. In turn, the adequacy of capital flows depends on the savings of society being less and less used to finance Federal expenditures and more and more focused on capital formation. This is the <u>only way</u> we can sustain a durable recovery and bring down the level of inflation.

Finally, on the subject of unemployment, the Federal Government does have an important role in providing temporary assistance to moderate the negative impact of economic recessions. However, many of the programs enacted to supposedly assist the jobless end up being too costly, poorly administered, and implemented too late.

In view of this problem, I recently introduced H.R. 11860, a bill developed after much deliberation which is a much more direct, effective, efficient, and equitable program of relief for those areas and communities especially hard-hit by unemployment.

This proposal utilizes the existing distribution of funds mechanism already included within the Housing and Community Development Act of 1974. This mechanism can provide the conduit for the immediate financing of projects on an accelerated basis, whereas many Federal programs are usually delayed for months while the necessary guidelines, regulations, and qualification standards are being adopted and promulgated.

Under my bill, the supplemental assistance could be activated when the national unemployment rate is over 7 percent, as it is now, and would make available for distribution each calendar quarter a sum determined by multiplying $15 million by each one-tenth of 1 percent by which unemployment exceeds 7 percent. Since under my proposal distribution of funds is based on the next preceding quarter's unemployment, and since unemployment the last quarter of 1975 was 8.5 percent, as of April 1 of this year $225 million could be available for distribution for that calendar quarter -- 8.5 percent minus 7 percent equals 1.5 percent, and 15 times $15 million equals $225 million.

If unemployment remained at the 8.5 percent level, a total year's funding of this type of program would, therefore cost $900 million -- four quarters multiplied by $225 million. However, since unemployment has been dropping and is expected to continue to fall during the next year, the bill would call for a total authorization of $780 million.

Approximately 75 percent of the assistance could be provided to cities and urban counties with unemployment over 8 percent, based directly and proportionately on the extent to which their unemployment exceeds 8 percent. In the same manner, the remainder of the funds could be distributed to States for distribution in nonurban areas having unemployment over 8 percent.

A program envisioned in H.R. 11860 would do much for the jobless, and in a shorter period of time, than most of the other pieces of unemployment legislation urged this year.

ADDITIONAL VIEWS OF REPRESENTATIVE JOHN H. ROUSSELOT

Fiscal Policy

The $394.2 billion limit on Federal spending that the President has recommended for the coming year is a commendable goal compared to the budget ceilings offered to us by many majority congressional leaders. It reflects sound and worthy fiscal priorities that are essential to an effort to return to responsible government budgeting. It should be pointed out, however, that Federal spending could -- and should -- be maintained at Fiscal Year 1975 levels.

There are those, for example, who believe that the United States should easily be able to live on a budget equal to Fiscal Year 1976 outlay levels of $374 billion. A budget of this size would require no adventurous cuts or rescissions, but rather simply a determination to leave current budget expenditures at their present figures. Others, however, believe that a further step should be taken toward responsible government spending.

One hundred twenty-seven of us in the House of Representatives insist that true fiscal responsibility involves more than just "reducing" or "limiting" deficits;[1]/ it means eliminating them entirely and living on a balanced budget. For the coming year that means running the Government on anticipated revenues of $350 billion.

If we are in fact concerned about fiscal integrity and the profligacy that has characterized Federal spending in recent years, then we must start now to live within our means. In my view, the Federal Government should be constrained to recognize the same economic rules as the rest of society. Every American family, every small business and large corporation, every State and local government agency and institution

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1/ Number of votes favoring the Balanced Budget Amendment to the Second Concurrent Resolution to the Fiscal Year 1976 Budget (H.Con.Res. 466, November 12, 1975).

is compelled by prudence and good economic judgment to spend no more than it receives. The Government of the United States should be no exception.

Some suggest that running the country on a balanced budget under present economic conditions would create undue economic hardship and unrest. This is not true.2/ It is, in fact, deficit spending that precipitates these problems, and not balanced budgets. The evidence of the past 16 years, during which we have incurred 15 deficit budgets, shows that bloated deficits -- deficits that sap needed money from capital markets and that aggravate inflation -- have only exacerbated the problems of unemployment and recession, and the burden of proof should rest with those who prescribe this cure for our economic ills to prove otherwise.

Employment

The January 7.8 percent level of unemployment continues to be unacceptably high by any standards. While the January figures provided welcome news after several months of 8 percent plus unemployment, it is still a far cry from solving the problems of the millions who are still without jobs and without paychecks.

Over the years, remedies to the dilemma of the unemployed have been concocted under the headings of "public service jobs," "public works projects," CETA, PWIP and others. No matter the title, though, they are all stopgap measures that merely seek to paint the

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2/ A balanced budget was run on the Chase Econometric Model in November 1975, at the request of Representative Rousselot. The "run" was conducted by the staff of the House Budget Committee and showed many extremely favorable results which would stimulate the economy. Among them were: Increase in housing, massive budget surpluses, rise in personal disposable income, and increased business profits for capital formation.

problem of unemployment a prettier color. When jobs have been ostensibly absent in the private sector, a cry is raised among many to make the Government the employer of those who have lost their jobs or have been otherwise displaced. The decisionmakers in Washington have found comfort in assuring themselves that by pumping taxpayer or borrowed dollars into such "make-work" programs they have done their duty to alleviate the burden of the jobless. It is sad to note that few realize that such an assumption is a dangerous and misleading one -- dangerous in its effect on the economy, and misleading to the faithful public who trust its elected officials to find genuine solutions to the Nation's unemployment problems.

Somehow we are slow to learn that the type of "countercyclical" programs that are mentioned above, only disguise the underlying problem of unemployment and in the end results are counterproductive, the more so because the stimulative effects of programs enacted to combat recession are often not felt until recovery is in full swing.

Public service jobs and public works programs are inordinately expensive. Some cost as much as $25,000 in taxpayer's money to create one job with only one-tenth of the sum being used for the worker's income. Furthermore, few countercyclical programs have actually created many new jobs. The National Planning Association concluded that only one of every two public service jobs created by the Federal Government represented a new increase in public employment. A similar conclusion was reached in a study conducted by the Urban Institute.

The lasting solution to the problem of unemployment is to be found in the elimination of deficit spending, in tax policies that promote savings and capital formation, and in other appropriate incentives that would permit the private sector, rather than the Federal Government, to be the provider of jobs.

Public service jobs and public works programs currently in operation, or proposed for future enactment, should be carefully scrutinized on a cost-benefit basis in an effort to determine which should be retained and which should be discontinued because of their ineffectiveness and high cost. Such a comprehensive review process should begin immediately. Other government programs that ostensibly serve to mitigate the painful personal effects of unemployment should likewise be reevaluated.

One example of a program badly in need of reexamination is unemployment compensation, the funds for which could be better used to finance capital growth and expansion in the private sector. It has been observed that benefits offered under the unemployment insurance program are currently being ill-used to provide an artificial sense of security for the individual who is unemployed. Knowing that gratis income will be coming in for up to 65 weeks has led many to turn down job offers early in their unemployment, saying in some cases that the job is demeaning, only to find that after the chance has passed there is nothing better available. It is too often the case that staying home to collect tax-free government unemployment checks is more convenient than working at what some might consider "undignified" work which, in many cases, produces less net pay than the government-provided insurance. I heartily endorse Dr. Arthur Burns' recommendation, given before the House Banking Committee, "...to take a careful look at the disincentive effects of our rapidly expanding unemployment compensation system."

Minimum wage laws also serve to aggravate the problem of unemployment. While many are of the belief that these laws promote a higher standard of living and help to eliminate poverty, the opposite is actually true. Through minimum wage laws, the Government has artifically mandated unrealistically high labor costs, as a result of which many Americans are denied employment simply because employers cannot meet the arbitrary wage standards set by law. For example, an individual who is only capable of producing goods and services worth $1.50 an hour is prevented from being hired since the Government says he must produce goods and services worth at least $2.30 an

hour. (In the view of many, the minimum wage is actually $3.22 an hour. Payroll taxes, indirect wages, overhead costs, plus the employer's profits, increases the productivity needed to support the official minimum wage of $2.30 an hour by at least 40 percent.) Thus, workers who are unable to meet such a standard and produce goods and services worth the government minimum wage, are forced onto welfare rolls or into crime in order to sustain themselves since they are in fact legally barred from working. Tragically, the burden falls most heavily upon minority groups and young people. It is unfortunate to consider that it is against the law to offer to underprivileged minority groups work which pays $75 a week, thereby implicitly suggesting that it is better to be prevented from earning $75 a week and go on welfare, if one cannot earn the minimum wage of approximately $100 a week.

Such a capricious and arbitrary legislative decree encourages slothfulness, fattens welfare rolls, and generally promotes unemployment in our country.

COMMITTEE AND SUBCOMMITTEE ACTIVITIES IN THE PAST YEAR

Public Law 304, 79th Congress, directs the Joint Economic Committee to report to the Congress by March 1 on the main recommendations of the President's Economic Report. Due to the late filing of the President's Economic Report, the Joint Economic Committee's filing date was extended to March 26, 1975. The Committee is also required by the Law to make a "continuing study" of the economy. This report is intended to serve as a guide to the several committees of the Congress dealing with legislation relating to economic issues.

The work of the Full Committee and the Subcommittees for the past year is summarized below.

FULL COMMITTEE

Review of the Economic Situation

In early January the Committee heard from two former Chairmen of the Council of Economic Advisers and from a former Budget Director in response to the President's request that the Congress move immediately to consider his economic proposals as presented in his State of the Union Address.

1975 Joint Economic Report

The Committee conducted 15 days of hearings during January, February, and March 1975, in its annual review of the President's Budget and Economic Report.

Testimony was received from private witnesses representing labor and management, public utilities, small business and investment sectors, and was followed by testimony from academicians, local government spokesmen from various areas, and Administration spokesmen, including the Chairman and Members of the Council of Economic Advisers, the Treasury Department, the Office of Management and Budget, the Council on Wage and Price Stability, and the Federal Energy Administration. A panel of experts presented testimony on the social costs of inflation and unemployment and another on the economic outlook based on alternative policy assumptions (econometric forecasting organizations). The Committee heard also from senior citizen and retired persons organizations, members of minority groups, and private forecasters.

International aspects of the President's Report were discussed by private experts and academicians in early March before the Subcommittee on International Economics. A discussion of this day's hearings appears under the activities of the International Economics Subcommittee.

The Annual Report of the Joint Economic Committee was filed with the Congress on March 26, 1975 (S.Rep. 94-61). The Minority Members of the Committee released to the press separately the Minority Views to the Committee's Report.

The fifth and final volume of the printed hearings on the President's Economic Report contained invited comments from leaders of agriculture, banking, business, labor, and private research groups.

Adequacy of U.S. Oil and Gas Reserves

The Committee held hearings in February on the adequacy of U.S. oil and gas reserves, taking testimony from the Interior Department, the U.S. Geological Survey, the National Academy of Sciences, and from a representative from Resources for the Future. The hearings were a result of a report of the National

Academy of Sciences which seriously questioned the adequacy of oil and gas resources to realize the ambitions of Project Independence.

A Reappraisal of Project Independence Blueprint

The Project Independence Blueprint, the "Bible" of energy information, occasioned hearings in March to critique the projections of future energy demand and supply. The Acting Deputy Federal Energy Administrator appeared before the Committee, along with a professor from Massachusetts Institute of Technology, and a member of Battelle Memorial Institute.

The Agricultural Situation

In April the Committee held hearings focusing particularly on the deterioration in agricultural prices. The hearings were designed to review the entire range of agricultural questions, including the widening farm-retail price spread, commodity reserves, agricultural trade regulations, and the agricultural outlook for 1975. The Secretary of Agriculture and Commissioners of Agriculture from Minnesota, Pennsylvania, and South Dakota testified, as well as economists from the Universities of Minnesota and Chicago. Representatives from the National Farmers Union, the American Farm Bureau, and the Midcontinent Farmers Association also appeared.

Financial Aspects of the Budget Deficit

The Committee heard testimony in April from experts on monetary policy from Harvard University, Massachusetts Institute of Technology, and Yale University on the credit market outlook and monetary and debt management policies. Preceding the hearing, a letter was written to the Secretary of the Treasury asking for full, factual information on the credit market outlook. A number of economists and financial experts were also asked for their views on this issue. The Chairman of the Joint Economic Committee released in a floor speech

67-480 O - 76 - 23

in May responses from the economists and financial experts in response to his inquiry regarding the credit market impact of the budget deficit. It was the consensus that the deficits can be financed without seriously interfering with private credit demands. Twenty-eight individuals responded to the inquiry -- 20 of whom held this view, 5 of whom dissented, and 3 who were uncertain.

Fast Breeder Reactor Program

Hearings in April and May elicited testimony from numerous Administration witnesses, including the Comptroller General of the United States, the Director of the Office of Federal Activities of the Environmental Protection Agency, and a representative from the International Research and Technology Corporation. Also testifying was the Administrator of the Energy Research and Development Agency, spokesmen for public citizen groups, the Natural Resources Defense Council, and the President of the Atomic Industrial Forum. The focus of the hearings was the economics of the liquid metal fast breeder reactor, with particular emphasis on the consumption by this program of over one-third of the Government's total energy R&D budget.

The Economic Situation

The Chairman of the Council of Economic Advisers testified before the Committee in May on the economic situation and outlook in order to assist the Committee in formulating its judgments regarding economic policy needs.

Monetary Policy and the Economic Outlook

In May a panel of economists discussed the impact of alternative monetary policies on the vigor and duration of an economic recovery as a result of the Federal Reserve Board's announced targets for monetary policy during the coming year.

The Secretary of the Treasury testified in early June on the outlook in light of revised budget estimates and the policy targets of the Federal Reserve. In addition the hearing focused on the budgetary situation and debt management operations. Questions were asked regarding the direction in which the economy is going and what further actions are needed to insure a strong and sustained recovery.

National Economic Planning, Balanced Growth, and Full Employment

Mid-June hearings were held on the need for national economic planning. Representatives from labor, banking, and manufacturing testified, along with academicians and outside experts.

National Economic Planning

In November the Committee held additional hearings to examine appraisals for and against national planning. The November hearings received testimony from an outspoken opponent of national economic planning, a member of General Motors Corporation, and from representatives of business and investment firms. The Governors of New Jersey and Pennsylvania appeared, along with the Mayor of Detroit, Budget Director from the City of Philadelphia, and a financial expert testified in late June on the question of the ability of the tax-exempt market to provide sufficient financing of State and local governments, and whether sufficient funds will continue to be available.

A report is described under the Urban Affairs Subcommittee's activities and is titled, "The Current Fiscal Position of State and Local Governments."

Availability of Housing for Middle-Income Families

A study prepared for the Committee by the Congressional Research Service of the Library of Congress was released in April in which the conclusion was

reached that rising home costs, high interest rates, and soaring utility bills have combined to price many middle-income families out of the single-family housing market. The study points out that the minimum income required to afford a median-priced home has risen 23 percent from 1973 to 1974.

Current Economic Situation and Outlook for the Housing Industry

A hearing in late June focuses on the housing sector and the present situation in the housing industry. Testimony was received from the National Association of Home Builders, the National Housing Conference, the National Savings and Loan League, and the United States League of Savings Associations.

Housing Outlook

The Secretary of Housing and Urban Development appeared before the Committee in July to comment on the role of the housing industry in economic recovery and the Administration's initiatives for dealing with the housing depression.

A letter from nine Members of the Joint Economic Committee was sent to the President in mid-June urging him to sign the Emergency Housing Act of 1975. The letter pointed out that the Act would create important new jobs, assist middle-income families with home purchases, and prevent the foreclosure of mortgages held by unemployed persons.

Private Sector Credit Availability

In mid-July a rural banker, a financial consultant and a professor from Massachusetts Institute of Technology testified on the availability of credit to fuel a strong economic recovery and whether the Federal Reserve Board is pursuing a monetary policy which will accommodate the predicted surge in real economic growth.

The 1975 Midyear Review of the Economic Situation and Outlook

In late June the Committee began its midyear review of the economy. Distinguished private economists and Administration officials addressed such questions whether the economy had "bottomed out," whether it would be vigorous enough to help bring unemployment down quickly, whether energy policy could be managed in such a way as to help rather than harm the economy, and what new policies are needed to insure that the recovery would be both strong and sustained.

The Midyear Report on the Economy was issued in early October as a result of these hearings, accompanied by a separate release of Minority views.

New York City Financial Crisis

The Chairman of the Committee sent letters in early September to the Chairman of the Board of Governors of the Federal Reserve System and to the Secretary of the Treasury regarding the severity of New York City's financial crisis. The letter from the Treasury Department in response to the Committee's inquiry was released in mid-September, followed by testimony from the Secretary shortly thereafter. In early October, the Chairman of the Federal Reserve Board of Governors testified on the economic and financial consequences of New York City's financial situation.

Fourteen Mayors from various cities in the United States met with the President in late September and appeared before the Committee earlier the same day to testify about the national consequences of the problems of New York City.

New York City's Financial Crisis: An Evaluation of Its Economic Impact and of Proposed Policy Solutions

On November 2, the Committee released a study examining the economic consequences of New York City's financial difficulties. The report stressed the seriousness of the failure of the Federal Government to provide a source of credit to New York City.

In a separate release, the Minority views on the New York City situation were released to the public.

Jobs and Prices in Chicago

The Committee in October began a series of regional hearings focusing on unemployment, jobs, and prices, and on achieving full employment and stable prices. The regional hearings are to be followed by a national conference and supplemented by a series of staff economic studies, and will comprise the Joint Economic Committee's Thirtieth Anniversary review of the Employment Act of 1946, the principal Federal statute for managing the national economy.

The Chicago hearing devoted special attention to the unique economic aspects of the Chicago region, including problems of agriculture and energy. The hearing, open to the public and televised over public television, heard testimony from the Mayor of Chicago, representatives from labor, banking, farmers groups, local professors, a member of the Chicago Board of Trade, and others.

Long-Range Economic Growth

Economic experts testified in late October on future economic growth in the United States. The hearing was the first in a series of hearings to be based on a recently launched study series related to long-range growth.

Minnesota Energy Outlook

A hearing was held in Minneapolis in October in which testimony was received from a panel of energy officials, including the Deputy Administrator of the Federal Energy Administration, the Director of the Minnesota Energy Agency, and the Chairman of the Minnesota Public Service Commission. A second panel included representatives from the Northern Natural Gas Company, the President of Q Petroleum Corporation, the President of the Minnesota Farmers Union, the General Manager of Boise-Cascade, the Chairman of the International Falls City Council, and Vice President of Koch Refineries.

The hearing was directed toward the energy problems confronting the Upper Midwest and particularly the Northern Tier States. Other hearings were planned for other sections of the country.

The President's Proposed Tax Cut and Budget Ceiling

Administration witnesses from the Council of Economic Advisers and the Treasury Department testified in October and November on the President's request for a $28 billion tax cut in 1976 and $395 billion spending ceiling in fiscal 1977. The Committee felt that careful analysis of the President's proposal was essential and justification of both short- and long-run consequences was necessary.

Pollsters Report on American Consumers and Businessmen

The Joint Economic Committee received testimony on October 30th from top pollsters in the United States on the mood of American consumers and businessmen. The Committee was hopeful that it could learn more about what economic remedies consumers favor and would be enabled thereby to formulate policies that a majority of the American people would support.

The Pollster hearing generated an unusual amount of public interest and in November the Committee released a packet of their statements for public dissemination.

Impact of New York City's Economic Crisis on the National Economy

On November 10th, the Committee held the second of its series of regional hearings in New York City. The Governor of the State and the Mayor of New York City were the leadoff witnesses, followed by a panel discussing the general economic situation. The afternoon session discussed policies for achieving full employment. As in other of the Committee's regional hearings, statements were received from members of the audience who wished to be heard.

Impact of Federal Estate and Gift Taxes on Small Businessmen and Farmers

An August hearing was held in Minneapolis, Minnesota, jointly by the Select Committee on Small Business and the Joint Economic Committee. Testifying were representatives from industry, local farmers, insurance underwriters, and spokesmen from the legal, accounting, and press sectors.

Joint Hearing To Assess the Capital Formation Problems of Small Business

The Senate Select Committee on Small Business and the Joint Economic Committee in November held the second in a series of joint hearings on the role of small and independent businesses in the economy. The Secretary of the Treasury led off the hearings to present the Administration's plans to resolve problems of the small business sector. The Secretary was followed by a Governor of the Federal Reserve Board, President of the New York Stock Exchange, and the Acting Administrator of the Small Business Administration.

Jobs and Prices in Atlanta

On December 8 the Committee continued its series of regional hearings in Atlanta, Georgia. The Governor and the Mayor of Atlanta were leadoff witnesses, followed by panels on the employment outlook, the social impact of unemployment, and job creation programs. Statements were also taken from members of the audience.

Current Services Budget

The Director of the Congressional Budget Office, the Deputy Director of the Office of Management and Budget, and the Chairman of the Council on National Priorities and Resources were joined by a professor from Oakland University in a hearing in December to evaluate the current services budget for fiscal 1977. The current services budget is an estimate of what spending would be in 1977 if there were no policy changes. The questions addressed included what would be a good budget policy for 1977 from the standpoint of overall fiscal policy and how better to meet the essential public needs of the American people. The Committee reviewed the policy changes which might be needed in order to go from the hypothetical current services budget to an actual budget which would support a continued economic recovery and meet essential public needs in an efficient manner.

An Economic Evaluation of the Current Services Budget: Fiscal Year 1977

A staff report analyzing the fiscal 1977 budget outlook and presenting estimates of budget receipts and outlays on a current services basis for the next five years was released in late December. The study was prepared under the provisions of the Congressional Budget Act of 1974, requiring the Committee to submit such an evaluation to the Budget Committee in December of each year.

Hearings on Employee Stock Ownership Plans

ESOPs -- Employee Stock Ownership Plans -- were discussed in hearings in December by economists, lawyers, financial analysts, labor and business representatives. The merits and deficiencies of the plans were discussed in an effort better to judge whether such plans do or do not have a potential for stimulating economic growth.

Employment-Unemployment

As in past years, the Committee continued its monthly review of unemployment, with appearances by the Commissioner of the Bureau of Labor Statistics before the Full Committee on February 7, March 7, April 4, May 2, June 6 (when it was announced that unemployment had risen to 9.2 percent in May), July 3, August 1, September 5, October 3, November 7, and December 5.

Labor union officials appeared before the Committee in March to discuss unemployment problems. The President of the Service Employees International Union, and the President of the Building and Construction Trades Department of the AFL-CIO appeared.

Full Employment Conference

The Committee participated in an all-day conference in December that was conducted by the Council for National Policy Planning from New York City. The possibility of achieving full employment in the United States without producing runaway inflation and related questions on the Nation's unemployment problems were discussed. Several Members of Congress were cosponsors who brought together two dozen of the Nation's leading economists, business leaders, and labor experts to discuss the problems of chronic high unemployment. The morning and afternoon sessions consisted of spontaneous, give-and-take discussions between Members

of Congress and the visiting experts on a wide range of subjects relating to national employment policy.

Special Studies

Studies in Price Stability and Economic Growth -- Inflation and the Consumer in 1974

In February the Committee released Paper No. 1, a staff study, on the impact of inflation on consumers in 1974. Pointed out in the study was the fact that the biggest increases in the middle-income family's budget resulted from higher social security and income tax payments, and the fact that taxes rose faster than any other consumer expenditure during this period of rapid inflation. The study was prepared for the Committee under Senate Concurrent Resolution 93.

Economic Policy and Inflation in the United States

A study entitled "Economic Policy and Inflation in the United States: A Survey of Developments From the Enactment of the Employment Act of 1946 Through 1974," was prepared for the Committee by the Congressional Research Service of the Library of Congress under S.Con.Res.93. The paper, number 2 in the Committee's study series on "Price Stability and Economic Growth," was released on April 17 as part of the Committee's mandate to make an "emergency" study of the economy. The study is a valuable reference work regarding the history of economic policy over the last 30 years.

International Aspects of Inflation in Recent Years

Two studies, papers numbers 3 and 4 under S.Con. Res.93, were released in August. The analysts who prepared the studies for the Committee were, at the time the studies were done, employed by the Federal Reserve System.

Food Prices in 1975

Also under S.Con.Res. 93, a study appraising the outlook for food prices in 1975 was released. The study is an evaluation of the impact of poor crops in 1974 on prices and an estimate of the effects of exports on foods prices.

The Impact of Inflation on the Full Employment Budget

Two studies analyzing the usefulness and possible extension of the full employment budget concept were released in early June by the Committee. They are papers number 6 and 7 under S.Con.Res. 93. The Committee Chairman, in releasing the studies, emphasized that the studies are thorough and fair and will contribute to the Congress understanding of the significance of interyear budget comparisons.

JEC Recommendations to the House and Senate Budget Committees on Fiscal Policy for 1975

The first in a series of yearly reports required under the Congressional Budget Act was presented to the Budget Committees in March. The Report, supported by all Majority Members of the Committee, contained the fiscal policy analyses and recommendations required by the Act. Separate views of the Minority Members of the Committee were filed with the Budget Committees prior to the March 15 deadline.

China: A Reassessment of the Economy

A compendium of papers prepared for the Joint Economic Committee was released in July in which there was a current reexamination of U.S. Asian policy. A significant new factor emerged -- the prospect that the People's Republic of China may become not only one of the world's leading oil producers, but a major exporter as well. The study was prepared by the Congressional Research Service of the Library of Congress.

Nine Members of the JEC Urge President To Extend Price Controls on Old Domestic Oil

The Committee Chairman released the text of a letter sent in August to the President, and signed by nine Members of the Committee, urging the President to extend price controls on "old" domestic oil for six months.

Achieving the Goal of the Employment Act of 1946 -- Thirtieth Anniversary Review

A comprehensive investigation regarding the ills of the economy, which would enable the Committee and the Congress to formulate new economic policies to fulfill the goals of the Employment Act of 1946, was announced in September. The studies, to be prepared by the JEC staff, the Library of Congress, and private experts from the United States and abroad, will be released during the next year and a half.

The Chairman of the Economic Growth Subcommittee released the first paper in this series, "On Giving a Job: The Implementation and Allocation of Public Service Employment." As a result of this study, the Subcommittee Chairman urged Congress to undertake a complete reevaluation of public service employment. The first paper in this series was prepared by a professor from the University of Berkeley.

Toward a National Growth Policy: Federal and State Developments in 1974

A study released in September was prepared by the Congressional Research Service of the Library of Congress. The study was an update of earlier reports and was presented with the view of being of value to the Congress in developing coherent and comprehensive policies governing the future growth and development of the United States.

Impact of Russian Grain Purchases on Retail Food and Farm Prices

A study released in October was prepared for the Committee by a professor of Agricultural Economics at Pennsylvania State University and evaluated the impact over the next 12 months on food prices and farm incomes of the sale of additional grain to the Soviet Union.

Wharton Analysis of Veto of Tax Cut Extension and Oil Decontrol Legislation

An analysis prepared by the Wharton School of Finance was released in December showing the combined impact of a veto of both the tax cut extension bill and the oil decontrol legislation. The study concluded that these two vetoes would mean consumers would be hit by a tax increase in January and that energy prices would take a sharp increase upward. The effects of such vetoes, according to the study, would increase unemployment by the end of 1977. The study disagrees in several respects with the Administration's analysis of the vetoes.

CONSUMER ECONOMICS SUBCOMMITTEE

Economic Impact of Forthcoming OPEC Price Rise and "Old" Oil Decontrol

Two days of hearings were held in July to evaluate the economic impact of decontrolling so-called old oil and of a further rise in OPEC oil prices. The hearings were designed to clarify Administration intentions regarding old oil decontrol and tax cuts or rebates to moderate the impact of decontrol. Administration witnesses from the Council of Economic Advisers, Federal Energy Administration, and Commerce testified, along with economic experts from The Brookings Institute, Data Resources, and Chase Econometrics.

Following the hearings, a study released in mid-July, compiled by the staff of the Committee, pointed out that the Administration's oil decontrol

plan grossly understated the drastic consequences of the program.

Members of the Subcommittee are: Senator Hubert H. Humphrey, Chairman, Senators William Proxmire, Abraham Ribicoff, Edward M. Kennedy, Jacob K. Javits, and Charles H. Percy; Representatives Richard Bolling, William S. Moorhead, Gillis W. Long, Garry Brown, and Margaret M. Heckler.

ECONOMIC PROGRESS SUBCOMMITTEE

Credit Flows and Interest Costs

A staff study released in March under S.Con.Res 93, measures the flow of credit into each major economic sector over the past five years, and particularly during the 12 months ending September 1974.

Members of the Subcommittee are: Representative Wright Patman, Chairman, Representatives Henry S. Reuss, Lee H. Hamilton, Gillis W. Long, Garry Brown, and Margaret M. Heckler; Senators William Proxmire, Lloyd M. Bentsen, Jr., Paul J. Fannin, and Jacob K. Javits.

PRIORITIES AND ECONOMY IN GOVERNMENT SUBCOMMITTEE

Five-Year Budget Projections

Administration witnesses from Treasury and the Office of Management and Budget, along with the newly appointed Director of the Congressional Budget Office, appeared before the Subcommittee in April to discuss the Administration's five-year budget projections. This was the first time the Administration had presented to the Congress a detailed set of five-year projections. The hearing inquired into the economic assumptions underlying the forecast and projections and into the priority decisions implicit in the forecast.

Defense Procurement in Relationships Between Government and Its Contractors

April hearings received testimony from the Acting Chairman and members of the Renegotiation Board regarding Administration "promises" to reinvigorate the Board. The economic effects of defense procurement and the relationships that exist between the Government and its contractors were discussed. The Board has responsibility for recapturing excess profits on defense contracts. The Administration's failure to appoint a new Board Chairman was also discussed.

The Director of the Naval Nuclear Propulsion Program also testified regarding the Board.

Midyear and Long-term Budget Projections

The Director of the Office of Management and Budget, the Chairman of the Council of Economic Advisers, and members of The Brookings Institution appeared before the Subcommittee in June regarding midyear and long-term budget projections.

Allocation of Resources in the Soviet Union and China -- 1975

Hearings before the Subcommittee, held in Executive Session in June and July, were released by the Subcommittee later in the year. Testifying were the Director of the Central Intelligence Agency and the U.S. Army Director of the Defense Intelligence Agency. U.S. and Soviet military manpower costs were discussed, as well as cost and maintenance estimates of various types of weapons systems.

Members of the Subcommittee are: Senator William Proxmire, Chairman, Senators John Sparkman, Abraham Ribicoff, Hubert H. Humphrey, Edward M. Kennedy, Charles H. Percy, and Robert Taft, Jr.; Representatives Wright Patman, Lee H. Hamilton, Gillis W. Long, John H. Rousselot, Clarence J. Brown, and Garry Brown.

INTER-AMERICAN ECONOMIC RELATIONSHIPS SUBCOMMITTEE

Canadian Foreign Investment Screening Procedures and the Role of Foreign Investment in the Canadian Economy

The Acting Chairman of the Subcommittee began a series of hearings in December to examine national regulation of foreign investment in the Western Hemisphere by considering the new Canadian foreign investment screening procedures and the role of foreign investment in the Canadian economy. The Chairman of the U.S.-Canada Committee of the U.S. Chamber of Commerce appeared, along with academicians and the President of the Ford Motor Company of Canada, Ltd.

Members of the Subcommittee are: Senator John Sparkman, Chairman, Senators Lloyd M. Bentsen, Jr., Edward M. Kennedy, Robert Taft, Jr., and Paul J. Fannin; Representatives Gillis W. Long, Lee H. Hamilton, Margaret M. Heckler, and John H. Rousselot.

INTERNATIONAL ECONOMICS SUBCOMMITTEE

International Monetary Situation and the Administration's Oil Floor Price Proposal

International monetary conditons and proposals were reviewed before the Subcommittee in late March. Testimony was received from the Secretary of the Treasury and the Under Secretary of Treasury for Monetary Affairs, who commented specifically on the outlook for international monetary reform, U.S. policies regarding gold, intervention in exchange markets by U.S. monetary authorities, and international energy policy.

Subsequent hearings were planned to hear from private and additional official witnesses on these subjects.

67-480 O - 76 - 24

Oil Floor Price Proposal

An April hearing to consider the Administration's proposal for a common oil price floor heard testimony from academic, industry, and research organizations. The hearing examined domestic and international issues raised by the proposal.

The State Department Oil Floor Price Proposal: Should Congress Endorse It?

The Subcommittee released a report as a result of its hearings on the oil floor price proposal. The report analyzed arguments for the floor price and reached the conclusion that a minimum price for oil imports is an inappropriate method of protecting domestic investments in conventional energy resources from becoming noncompetitive if world oil prices were to drop.

International Monetary Reform and Exchange Rate Management

Hearings in July were held jointly with the Subcommittee on International Trade, Investment, and Monetary Policy of the House Committee on Banking and Currency and focused on the problems of international monetary reform and exchange rate management.

Discussed were floating versus fixed exchange rates; intervention in exchange markets; the need for IMF authorization regarding floating versus fixed rates; and the sale of gold in the free market. Testimony was received from commercial bank officers, businessmen, importers, and economists, as well as from the Secretary of the Treasury and a Member of the Board of Governors of the Federal Reserve System.

Exchange Rate Policy and International Monetary Reform

A report based on the July hearings was released in August. In the report, the two Subcommittee Chairmen expressed strong support for the Administration's position on floating exchange rates.

IMF Agreement on Gold

An October hearing to consider the gold agreement reached by the International Monetary Fund Interim Committee received testimony from the Executive Director of the IMF, academicians, investment bankers, and an insurance representative.

The Proposed IMF Agreement on Gold

A report on the October hearing was released in December. The report criticized the restitution provision of the agreement on gold and recommended reconsideration and redrafting to eliminate inequities and to strengthen the commitment to phase out monetary gold.

Members of the Subcommittee are: Representative Henry S. Reuss, Chairman, Representatives William S. Moorhead, Lee H. Hamilton, Clarence J. Brown, Garry Brown, and John H. Rousselot; Senators John Sparkman, Abraham Ribicoff, Hubert H. Humphrey, Lloyd M. Bentsen, Jr., Edward M. Kennedy, Jacob K. Javits, Charles H. Percy, and Robert Taft, Jr.

FISCAL POLICY SUBCOMMITTEE

The Equal Opportunity Program for Federal Nonconstruction Contractors Can Be Improved

A report was issued in May which was prepared by the General Accounting Office at the request of the previous Chairwoman of the Fiscal Policy Subcommittee and the then Ranking Minority Member of the Committee. The report was occasioned as a result of hearings held

in 1973, and focused on Federal efforts to end job discrimination and the enforcement of Executive Order 11246, prohibiting Federal contractors from discriminating on the basis of race, sex, creed, or national origin.

The report found that Federal enforcement efforts were riddled by inefficiencies and that the Labor Department lacked the means for evaluating the progress of Federal contractors in complying with the Executive Order.

Studies of Public Welfare

In late May, the Subcommittee released Paper No. 20, the final volume in its series "Studies of Public Welfare." The handbook, a revision of Paper No. 2, gives current information on income security programs.

General Revenue Sharing Program

In June the Subcommittee held hearings focusing on evaluations of the present distribution formula and suggested alternatives regarding the General Revenue Sharing Program. Principal researchers of alternative formulae projects, funded by the National Science Foundation, appeared to advance suggested alterations in the program based on their research and findings. An expert in the field of public finance acted as discussant at each of the hearings.

Members of the Subcommittee are: Representative Richard Bolling, Chairman, Representatives William S. Moorhead, Gillis W. Long, Lee H. Hamilton, Clarence J. Brown, and John H. Rousselot; Senators William Proxmire, Lloyd M. Bentsen, Jr., Robert Taft, Jr., and Paul J. Fannin.

URBAN AFFAIRS SUBCOMMITTEE

The Current Fiscal Position of State and Local Governments

A comprehensive study of State and local government finances was prepared by the staff of the Joint Economic Committee and released in May. It presents the results of a survey of 48 State governments and demonstrates the devastating effect the recession has had on State and local government budgets.

Members of the Subcommittee are: Representative William S. Moorhead, Chairman, Representatives Richard Bolling, Gillis W. Long, Garry Brown, Margaret M. Heckler, and John H. Rousselot; Senators Abraham Ribicoff, Hubert H. Humphrey, Lloyd M. Bentsen, Jr., Edward M. Kennedy, Charles H. Percy, and Jacob K. Javits.

ECONOMIC GROWTH SUBCOMMITTEE

Labor Market Policies for Full Employment

The Secretary of the Department of Labor and the President of the AFL-CIO appeared before the Subcommittee in May to assist in a thorough examination of the policies which are needed to begin reducing unemployment quickly and keeping it coming down over the next several years in ways consistent with regaining reasonable price stability.

A panel of labor experts testified in early June regarding manpower and labor market policies which could be developed and which would work with fiscal and monetary policies to accomplish a goal of full employment without inflation.

Employment Problems of Women, Minorities, and Youth

Two days of hearings were held in July regarding policies needed to restore full employment, especially among women, minorities, and youths. Representatives testified from academia, the National Urban League, the National Association for the Advancement of Colored People, leaders of recruiting and training programs, a former Assistant Secretary of Labor for Manpower, and the Secretary-Treasurer of the American Federation of State, County, and Municipal Employees of the AFL-CIO.

Technology and Economic Growth

Three past Presidential Science Advisers testified in mid-July, along with academicians, a former AEC Chairman, the Director of the Office of Invention and Innovation from the National Bureau of Standards, and a Winner of the Nobel Prize in Physics on the lack of a national technology policy and its impact on the economy. The lack of a policy adapted to meet new emerging priorities -- economic growth, environmental soundness, export competitiveness, and social welfare -- were discussed. Also testifying was the author of a special study, released concurrently and commissioned by the Committee, of the U.S. technical progress and technology policy. The study is entitled "Technology, Economic Growth, and International Competitiveness."

Achieving the Goals of the Employment Act of 1946 -- Thirtieth Anniversary Review - Volume 1 - Employment - Paper No. 1. On Giving a Job: The Implementation and Allocation of Public Service Employment

The Subcommittee released in August the first paper in the series, "Achieving the Goals of the Employment Act of 1946. . ." The Subcommittee as a result of this study, urged the Congress to undertake a complete reevaluation of public service employment.

The paper was prepared by a professor from the University of Berkeley.

Members of the Subcommittee are: Senator Lloyd M. Bentsen, Jr., Chairman, Senators William Proxmire, Abraham Ribicoff, Hubert H. Humphrey, Edward M. Kennedy, Jacob K. Javits, and Charles H. Percy; Representatives William S. Moorhead, Clarence J. Brown, and Margaret M. Heckler.

ENERGY SUBCOMMITTEE

The Joint Economic Committee Chairman announced in July the formation of a Subcommittee on Energy to deal exclusively with the economic aspects of energy. The Subcommittee's role was envisioned as analyzing the many complex economic aspects of the current energy crisis in the Nation's domestic and foreign policy and finding a way to end the impasse over energy between Congress and the Administration. Without jeopardizing the Nation's recovery from the current recession, the Subcommittee seeks to play a role in reaching solutions to meet the goals of increased domestic energy production and increased energy conservation.

U.S. Foreign Energy Policy

Two days of hearings in September received testimony from a former Secretary of Commerce, the President of the Overseas Development Council, a professor from Yale University, focusing on a comprehensive reexamination of the U.S. foreign energy policy. Topics discussed included whether the United States should be seeking to become self-sufficient in energy or working out cooperative relationships with other countries.

On the second day of the hearings, the Secretary of State appeared to testify on the Administration's policies in this important area. The Secretary appeared before the Full Committee, chaired by the Energy Subcommittee Chairman.

Achieving the Goals of the Employment Act of 1946 -- Thirtieth Anniversary Review - Volume 2 - Energy Paper No. 1 -- Oil Profits, Prices, and Capital Requirements

A staff study was released in September demonstrating that high oil prices and windfall oil profits in 1973 and 1974 have resulted only in a very high-cost energy industry instead of increased oil production in the United States.

In a separate release, the Ranking Minority Member on the Joint Economic Committee disavowed any Minority connection with the study.

Control of Energy Resources

The Subcommittee held hearings in November on the control of energy resources, focusing on the extent and significance of integrated control by oil companies over competing energy fuels and how the Federal Government in framing a national energy policy, should deal with trends toward increasing concentration.

Testimony was taken from the Mayor of San Francisco, the Federal Trade Commission, the Tennessee Valley Authority, academicians, and industry experts regarding this significant aspect of the ongoing debate over national energy policy.

Energy Conservation in Massachusetts

In mid-November, a hearing was held in Waltham, Massachusetts, concerning energy conservation in the State. Testifying, among others, were the Mayor of Waltham and the Assistant Administrator for Conservation and Environment of the Federal Energy Administration. The hearing was an attempt on the part of the Subcommittee to determine ways in which the Federal Government can promote and encourage energy conservation at the State and local levels without inflicting record-high energy prices on citizens least able to

bear the economic burdens. The Subcommittee hoped to learn how energy-saving approaches and technologies being developed in the State of Massachusetts could be applied for the benefit of all Americans.

Also testifying were the Director of the Massachusetts Energy Office, a representative from the New England Center for Energy Policy, a member of the Massachusetts League of Women Voters, an industry spokeman, and representatives of banking and realty trust associations.

Members of the Subcommittee are: Senator Edward M. Kennedy, Chairman, Senators Hubert H. Humphrey, William Proxmire, Abraham Ribicoff, Jacob K. Javits, Charles H. Percy, and Robert Taft, Jr.; Representatives Wright Patman, William S. Moorhead, Lee H. Hamilton, Gillis W. Long, Clarence J. Brown, Garry Brown, and John H. Rousselot.

STAFF PARTICIPATION IN MEETINGS WITH OUTSIDE GROUPS

In addition to conducting formal studies and arranging hearings for the Committee and Subcommittees, the staff participated in discussions of economic problems and research techniques with outside groups. The following list illustrates the nature of these activities in wnich the staff took part in 1975:

American Economic Association Convention, Dallas.
American Enterprise Institute.
American Institute of Architects.
Brookings Institution.
Carnegie-Mellon University-Rochester University, Joint Conference on Economic Policy Issues.
Chamber of Commerce of the United States.
Columbia University.
Conference Board, Capital Markets and Water Quality Needs Conference.
Council on Foreign Relations 1980's Project.
Data Resources Conference - in New York and Washington.
Federal Deposit Insurance Corporation Seminar with Financial Executives.
George Washington University Seminar on Developing a National Model for Public Policy.
Habitat Institute Seminar on Economic Growth.
Initiative Committee Conference on National Planning.
Library of Congress Conference on Urban Growth.
Limits to Growth 1975 Conference, Houston.
National Governor's Conference.
National League of Cities.
National War College.
North American Study Group of the Middle East, Columbia University.
Organization of European Economic and Community Development.

Rutgers University.
Southern Economic Association Convention, Atlanta.
Taxation, Resources and Economic Development
Conference, Madison, Wisconsin.
Treasury Conference on the Eurodollar Market.
United Nations Association.
Urban Institute, Land Use Seminar.
Urban Institute, Seminar on Social Security.
Vail V Symposium, Vail, Colorado.
Wharton Econometric Forecasting Associates
Conference on the Economic Outlook.
World Bank Annual Meeting.
World Future Society General Assembly.

The Executive Director and other professional staff members addressed or presented papers to the following:

American Bar Association.
American Public Works Association.
American University Washington Semester.
Bluffton College, Bluffton, Ohio.
Civil Service Commission Executive Training
Seminars.
Clemson University.
Conference of Democratic Mayors.
Council on Urban Economic Development.
Environmental Protection Agency Congressional
Briefing Conference.
International Management and Development Institute.
International Monetary Fund, Washington, D. C.
Kennedy Institute of Politics, Harvard University.
Lintas Seminar, International Business Executives.
Midwestern Mayors and Local Officials, convened by
Congressman John Dingell.
Minnesota Energy Conference.
Mitre Corporation, McLean, Virginia
National Acadamy of Public Administration,
Meeting on National Growth Policy.

National Association of State Budget Officers.
National Contract Management Association.
National Economists Club.
National League of Cities.
New York State Savings Bank Association.
Presidential Classroom.
WAMU Radio, American University.

The Executive Director accompanied the Chairman to a meeting of the International Economic Association, in Stockholm, Sweden, where he addressed the Association. The Executive Director conferred with officials of the O.E.C.D. on matters of public economic policy.

A senior staff economist of the Joint Economic Committee spoke for the U. S. Information Agency in Tokyo, Seoul, Hong Kong, Bangkok, Vientiane, Kuala Lumpur, and Wellington, on international monetary reform and the outlook for growth and inflation in the United States. Another senior economist participated in a conference in Ditchley, England, on the political problems of inflation. A staff economist studied economic planning activities in Norway and Sweden.

CHANGES IN COMMITTEE MEMBERSHIP

There were no changes in Committee Membership during the 1st Session of the 94th Congress. In July 1974 a Subcommittee on Energy was formed to deal exclusively with the economic aspects of energy. The Members of this Subcommittee are listed under Subcommittee Membership, which follows.

CHANGES IN COMMITTEE STAFF

Leaving the staff during the year were: Anne Annette, Minority Secretary; Leslie Bander, Minority Economist; Jeanine Drysdale, Secretary, Gail McCallion, Research Assistant; John Raffaelli, Intern; Carl Sears, Research Assistant; and Caterina Sparacino, Financial Clerk. Additions to the professional and administrative personnel staff include: William Buechner, Economist; Jane Harty, Minority Secretary; Louis C. Krauthoff II, Professional Staff Member; Barbara Levinson, Secretary; Catherine Miller, Minority Economist; Beverly Mitchell, Secretary; Ralph Schlosstein, Economist; Dee Roi B. Stewart, Secretary; and Milton Tillery, Intern.

DISTRIBUTION OF COMMITTEE PUBLICATIONS

In 1975 the Joint Economic Committee distributed over 350,000 copies of current and previous years' publications to individuals, libraries, and organizations the world over.

Since the time of our last Annual Report, the Committee has released 21 reports and studies and has published 53 sets of hearings, for a total of 74 publications.

Also, during the past year, the Superintendent of Documents sold over 135,000 copies of current and previous years' publications. Economic Indicators, which are sold by monthly subscription through the Superintendent of Documents, were received by 12,000 subscribers in 1975.

In addition, Committee prints, released by the Joint Economic Committee, are mailed to over 700 depository libraries throughout the country by the Government Printing Office.

SUBCOMMITTEE MEMBERSHIP, NINETY-FOURTH CONGRESS

CONSUMER ECONOMICS

Senators	Representatives
Hubert H. Humphrey, Chairman	Richard Bolling
William Proxmire	William S. Moorhead
Abraham Ribicoff	Gillis W. Long
Edward M. Kennedy	Garry Brown
Jacob K. Javits	Margaret M. Heckler
Charles H. Percy	

ECONOMIC PROGRESS

Representatives	Senators
Wright Patman, Chairman	William Proxmire
Henry S. Reuss	Lloyd M. Bentsen, Jr.
Lee H. Hamilton	Paul J. Fannin
Gillis W. Long	Jacob K. Javits
Garry Brown	
Margaret Heckler	

PRIORITIES AND ECONOMY IN GOVERNMENT

Senators	Representatives
William Proxmire, Chairman	Wright Patman
John Sparkman	Lee H. Hamilton
Abraham Ribicoff	Gillis W. Long
Hubert H. Humphrey	John H. Rousselot
Edward M. Kennedy	Clarence J. Brown
Charles H. Percy	Garry Brown
Robert Taft, Jr.	

INTER-AMERICAN ECONOMIC RELATIONSHIPS

Senators	Representatives
John Sparkman, Chairman	Gillis W. Long
Lloyd M. Bentsen, Jr.	Lee H. Hamilton
Edward M. Kennedy	Margaret M. Heckler
Robert Taft, Jr.	John H. Rousselot
Paul J. Fannin	

INTERNATIONAL ECONOMICS

Representatives	Senators
Henry S. Reuss, Chairman	John Sparkman
William S. Moorhead	Abraham Ribicoff
Lee H. Hamilton	Hubert H. Humphrey
Clarence J. Brown	Lloyd M. Bentsen, Jr.
Garry Brown	Edward M. Kennedy
John H. Rousselot	Jacob K. Javits
	Charles H. Percy
	Robert Taft, Jr.

FISCAL POLICY

Representatives	Senators
Richard Bolling, Chairman	William Proxmire
William S. Moorhead	Lloyd M. Bentsen, Jr.
Gillis W. Long	Robert Taft, Jr.
Lee H. Hamilton	Paul J. Fannin
Clarence J. Brown	
John H. Rousselot	

URBAN AFFAIRS

Representatives	Senators
William S. Moorhead, Chairman	Abraham Ribicoff
Richard Bolling	Hubert H. Humphrey
Gillis W. Long	Lloyd M. Bentsen, Jr.
Garry Brown	Edward M. Kennedy
Margaret M. Heckler	Charles H. Percy
John H. Rousselot	Jacob K. Javits

ECONOMIC GROWTH

Senators	Representatives
Lloyd M. Bentsen, Jr., Chairman	William S. Moorhead
William Proxmire	Clarence J. Brown
Abraham Ribicoff	Margaret M. Heckler
Hubert H. Humphrey	
Edward M. Kennedy	
Jacob K. Javits	
Charles H. Percy	

ENERGY

Senators	Representatives
Edward M. Kennedy, Chairman	Wright Patman
Hubert H. Humphrey	William S. Moorhead
William Proxmire	Lee H. Hamilton
Abraham Ribicoff	Gillis W. Long
Jacob K. Javits	Clarence J. Brown
Charles H. Percy	Garry Brown
Robert Taft, Jr.	John H. Rousselot

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