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THE 1977 JOINT ECONOMIC REPORT

REPORT

OF THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

ON THE

JANUARY 1977 ECONOMIC REPORT OF THE PRESIDENT

TOGETHER WITH

STATEMENT OF COMMITTEE AGREEMENT, MINORITY AND ADDITIONAL VIEWS

MARCH 15, 1977

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Union Calendar No. 41

95TH CONGRESS } HOUSE OF REPRESENTATIVES { REPORT
1st Session } { No. 95-75

REPORT ON THE JANUARY 1977 ECONOMIC REPORT OF THE PRESIDENT

MARCH 15, 1977.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

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

REPORT

together with

STATEMENT OF COMMITTEE AGREEMENT, MINORITY AND ADDITIONAL VIEWS

[Pursuant to sec. 5(a) of Public Law 304 (79th Cong.)]

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.

STATEMENT OF AGREEMENT BETWEEN MAJORITY AND MINORITY MEMBERS

1. Real output growth of 6 percent for 1977, a reduction in the unemployment rate to 6.5 percent and an abatement of inflation by the end of the calendar year remain desirable goals.
2. If adopted this year, a fiscal stimulus package should substantially improve the prospects for economic growth this year and for the longer term.
3. Achieving a reduction in unemployment will require a combination of overall economic stimulus and targeted employment programs.
4. Youth unemployment is a serious problem requiring particular targeted solutions. It is a structural problem which will not be solved by countercyclical policies affecting the recovery as a whole. A means must be found to enable every young worker to obtain the training he or she needs to succeed in a useful career.
5. The Minority and the Majority discussed at length some of the definitional problems of full employment. The question of defining full employment is fundamental to the proper design and execution of economic policy and intensive analysis by the Committee should precede any determination of the figures.
6. The danger to the economy implicit in the current upsurge of prices is serious. If such inflation rates continue, they will make it extremely difficult to pursue economic growth policies sufficient to reduce unemployment and to induce industry to invest more rapidly in new facilities with enhanced productivity. The recent behavior of industrial prices is not dictated in most cases by tight markets. Thus it is vital that industries exercise restraint in their pricing decisions.
7. Because the Administration's stimulus package will increase the Federal deficit and may put some upward pressure on interest rates, an appropriate monetary policy is of great importance.
8. If temporary tax cuts, enacted for 1977 or 1978, expire at the end of those years without some form of extended tax reduction, effective personal tax rates will rise sharply. Tax reform legislation, which will be offered later in this Congress, and which will seek to provide long-term tax adjustments, should be developed to merge smoothly with general tax levels in effect under any temporary measures previously passed.
9. Government agencies frequently appear as advocates of programs and regulations without presenting adequate analyses of costs of these activities. Congress should insist on adequate cost-benefit analysis, including inflation impact statements, which is essential for proper planning and efficient government.
10. Business investment in the United States is substantially below the levels necessary to maintain a modern and efficient private sector. Strong and sustained economic growth goes hand in hand with a healthy resurgence of investment.

Report of the Joint Economic Committee on the January 1977 Economic Report of the President

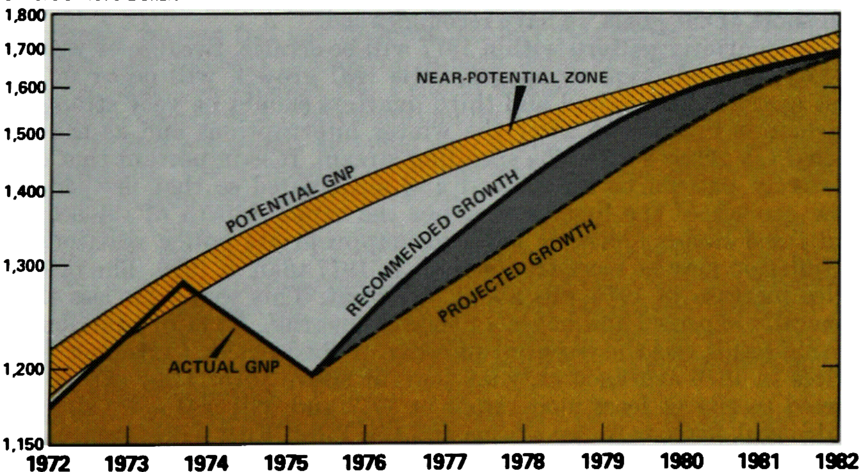
I. INTRODUCTION AND RECOMMENDATIONS

In March 1977, two years after the economy began its recovery from the 1974–75 recession, the unemployment rate still hovers close to 8 percent; inflation is still troublesome; and growth prospects for the current year are somewhat disappointing.

This is true despite the fact that Congress and the new Administration are acting quickly and constructively to adopt stimulative tax and spending measures which will improve the growth prospects for this year and next. Assuming the adoption and implementation of these new measures and assuming a complementary monetary policy, it should be possible to reduce unemployment to slightly less than 7 percent by year end. This will represent important progress, but it still will leave the Nation very far from its goal of full employment.

Two years ago this Committee recommended that policy be directed at achieving an 8.8 percent rate of real output growth in 1976 and 7.5 percent in 1977. Had this objective been achieved, the unemployment rate would presently be below 7 percent and headed below 6 percent by year end. Put simply, the failure to adopt and successfully to pursue sufficiently ambitious growth targets has put us a year behind schedule in regaining prosperity and full employment. During 1976 alone, failure to achieve the recommended growth path has resulted in about $43 billion of lost output or $200 per person for every individual living in the United States, Chart I–1 compares the recovery path recommended by this Committee with actual developments and present prospects.

Alternative Recovery Paths



Sources: Department of Commerce and Joint Economic Committee.

The lost year will not be regained in 1977. Although we once thought that the zone of full employment could be reentered in 1978 or 1979, it now appears unlikely that the unemployment rate can be brought below 5 percent before 1980, and even this assumes that quite rapid growth can be achieved in 1978 and 1979. Thus, the entire latter half of the 1970s seems destined to stand as a stark reminder of the immense difficulties of pulling out of a serious recession once it has been allowed to take hold.

1977

The stimulative program embodied in the recently enacted Third Concurrent Resolution on the Budget for Fiscal Year 1977 improves growth prospects considerably for the U.S. economy in 1977 and 1978. This in turn will benefit a world economy in which nearly all major countries experienced a "pause" in economic recovery in the latter half of 1976. Similar stimulative action by Germany and Japan would strengthen the world economy further.

With the stimulative program, real gross national product (GNP) should grow by about 6 percent from the fourth quarter of 1976 to the fourth quarter of 1977. This forecast makes the following key assumptions:

- Monetary policy will be formulated so as to complement fiscal policy;
- Federal spending will not fall short of the Third Resolution's target;
- State and local governments will promptly and fully respend the increased Federal grants they will be receiving, and their offsetting reductions in other planned spending will be minimal; and
- No further interruptions in production due to weather conditions will occur and fuel supplies will be adequate to permit most first quarter production losses to be made up before the year is over.

There is considerable uncertainty about each of these assumptions. Thus ours is, in a sense, a best-case forecast in which all of these uncertainties are assumed to be resolved favorably. Even so, growth will fall short of the goals we have recommended.

The quarterly pattern within 1977 will be erratic. Because of weather-related production stoppages, little real growth will occur in the first quarter. The second and third quarters should be very strong as production catches up after the winter interruptions and as the expected tax rebates enter the spending stream. It is important that this quarterly pattern be understood and anticipated so that neither the slow growth of the first quarter nor the rapid growth of the second and third causes alarm or leads to inappropriate policy reactions.

Inflation may be more troublesome in 1977 than in 1976. The rate of price increase in 1976 was about 5 percent. This was a bit less than generally expected and hence a pleasant surprise. A major contributor to this result was the essential stability of food prices. Consumer food prices in 1976 averaged only 0.6 percent above 1975. They can be expected to rise at least moderately in 1977 and will rise more sharply if drought persists in the Plains and the West. Fuel prices, especially prices for natural gas, also must be expected to rise sharply. Thus, even though wage increases have been moderating, and although there certainly is no general excess demand, food and fuel price increases

probably will bring the 1977 inflation rate somewhat above that of 1976—perhaps to 5½ percent.

This worsening of the inflation rate will be in no way related to adoption of the stimulative program. Nor will it constitute a valid argument for increased caution in bringing unemployment down. As the 1974 experience demonstrated, rising food and fuel prices cannot be controlled by restricting aggregate demand. Attempts to counteract them in this way succeed only in depressing the level of production and employment.

1978

Under presently foreseeable conditions, 1978 promises to be another year of moderate GNP growth. What is required, however, is a year of strong growth—6 to 7 percent in real terms—so that steady reduction in unemployment can continue.

Such strong growth often occurs spontaneously in the early stages of a recovery, as it did from mid-1975 to mid-1976. This was due to inventory rebuilding and consumer purchases of the durable goods that had been postponed during the recession. In the later stages of recovery however, these spontaneous forces are no longer present to the same extent. Continuation of above average economic growth thus requires an active push from the Federal Government.

Our specific recommendations for the fiscal year 1978 budget are presented later. Here we wish to stress the basic point that, if unemployment is to be reduced further next year, the budget must continue to provide stimulus to the private economy to expand faster than it otherwise would do.

The Five-Year Prospect

For the next two years, the basic objectives are clear: rapid growth, steady reduction of unemployment and further reductions in the inflation rate. These objectives are not in conflict with one another.

For the medium term, however, the choices are more difficult. The question arises whether, over the next four or five years, we can simultaneously restore full employment, achieve reasonable price stability, finance new Federal initiatives in such fields as energy and welfare reform, and also balance the Federal budget. Achieving all of these objectives together will be exceptionally difficult if not impossible. Yet, each of them is a widely accepted goal which will be hard to relinquish or postpone. The following questions and apparent conflicts must be resolved before these goals can be met:

- What constitutes full employment? We do not accept the contention of the former Council of Economic Advisers (and many others) that the unemployment rate marking full employment should be raised to 4.9 percent from its traditional 4-percent level, and we intend to reexamine carefully the question of appropriate medium-term employment goals in light of the changing circumstances giving rise to this contention.
- How can Congress provide the tax cuts needed in 1977 and 1978 to sustain above-average growth in the private economy while maintaining the revenues to initiate new programs in 1979 and 1980 and to balance the Federal budget by 1981?

• How can new Federal programs be financed without subjecting citizens to a rising tax burden? Tax reductions, as in the past, to hold personal income tax collections to a constant share of GNP would eliminate the Federal budget surpluses which are projected based on the extension of current law. Without such reductions the effective tax rate on personal income would rise from its recent average level of about 8.5 to about 11 percent by 1981 through the effects of inflation and rising real incomes in pushing tax payers into higher tax brackets.

All of these objectives—full employment, moderation of inflation, a balanced budget and certain new programs—are of very high priority. Clearly the basic element in making them mutually achievable is rapid growth and a return to full employment in the private economy. Another vital element is careful timing and phasing of the policy steps to reach these goals. The difficult nature of these questions, however, shows that policymakers over the next five years will need great skill in managing responses to competing claims on our national resources. Unpleasant and unpopular choices will have to be made. Each of the other major industrial countries faces similarly difficult choices within its own domestic economy. If these hard choices are not made wisely in each of the next five years, the consequences during the last two decades of our century may prove to be disastrous for our economy and also for the other mixed economies of the free world, strong and weak alike.

Chapter II of this report reviews recent economic developments. Chapter III presents the economic outlook as seen by the Committee for 1977 and 1978. Chapter IV discusses appropriate economic goals for this period and beyond, while Chapter V deals with the fiscal, monetary, price-wage and international policies needed to reach these goals in 1977 and 1978. Chapter VI addresses certain issues of budget policy and potential improvements in the budgeting process for the longer run.

Our main conclusions and recommendations are summarized below.

Recommendations

Economic Objectives

In formulating economic policy, Congress should first establish specific quantitative goals for output and employment. Fiscal, monetary, and other appropriate policies should then be designed to meet these goals.

Real GNP growth of 6 percent for 1977 and a reduction in the unemployment rate to 6.5 percent by the end of the calendar year remain desirable goals. The present course of fiscal policy appears likely to leave the economy somewhat short of these goals, but every effort should be made through monetary policy and other available policy tools to come as close as possible to achieving them.

Real GNP growth of 6 percent and a reduction in the unemployment rate to between 5½ and 6 percent by the end of the calendar year are realistic goals for 1978. Fiscal and

monetary policy should be designed to achieve these objectives.

The Council of Economic Advisers, in cooperation with other appropriate government agencies, should undertake promptly further studies of potential GNP with the objectives of revising and resuming publication of an official historical series and of providing the best possible estimates of potential GNP growth over the next decade.

Policies To Achieve Our Objectives

The proposal to give business firms the choice of an income tax credit against social security taxes or a larger investment tax credit would introduce into the tax law a constructive method of offsetting the undesirable economic effects of rising payroll taxes, and we support this proposal. While we also support further efforts to develop an employment tax credit which will help to moderate cyclical fluctuations in employment and/or to encourage hiring of the disadvantaged, we do not believe that time permits adequate consideration of such a proposal for inclusion in the program of temporary stimulative measures currently under consideration.

Young Americans 16 to 24 years old suffer from higher unemployment rates than any other group of workers. Much youth unemployment is due to the basic structure of the economy and the society and would not be alleviated by a return to prosperity and full employment in the economy at large. The severity of this problem requires the enactment of specially targeted training, employment and counseling programs for youths. To address the variety of problems faced by unemployed youths, the following components should be included : (1) A program of youth jobs on projects which provide needed services to local communities or the Nation; (2) a conservation corps which provides jobs in the National Forests and Wilderness; (3) a program to develop private sector jobs for youths and an increase in on-the-job training; (4) an expansion of work-study programs to integrate the processes of education and work; (5) an expansion of the Job Corps; and (6) an upgraded information, counseling, and placement service for youths.

In addition to the countercyclical spending increases recommended by the Administration, the First Concurrent Resolution on the Budget for Fiscal Year 1978 should contain an unallocated "jobs fund" of $5 billion. At the time of the Second Concurrent Resolution on the 1978 Budget in September 1977, such part of this fund as appears needed can be allocated to those countercyclical programs which are proving most effective and most suitable to expansion. Any unneeded portion of the jobs fund can be eliminated from the budget.

The large increase in the share of personal income taxes in GNP which would occur under the Administration's proposed budget for fiscal year 1978 should be avoided. This will require a tax reduction somewhat larger than just the extension of the present personal tax credits. In the First Concurrent Resolution on the Budget for Fiscal Year 1978 Congress should make provision for this larger personal tax reduction.

The conduct of monetary policy in 1977 should be consistent with the need for real economic growth and stability. Monetary policy should not only accommodate but actively complement the efforts of the Congress and the Administration to spur economic activity. Efforts should be made to keep short-term interest rates low and to reduce long-term rates further to facilitate a continued recovery in residential construction and an upswing in business investment. The Federal Reserve should not attempt to offset short-term increases in the money supply caused by the fiscal stimulus program nor tighten money in response to price increases caused by shortages of individual commodities. A posture of flexibility should be adopted toward the targeted ranges for the monetary aggregates. Given the uncertainty about the year-to-year needs of the economy and the changing technical relationships among components of the money supply, a one-percentage-point addition to the upper limit of the target ranges for the monetary aggregates would be prudent.

Legislation should be enacted authorizing the Council on Wage and Price Stability to require prenotification of planned price increases from selected industries and to delay for modest periods wage or price increases which could have serious inflationary effects on the economy.

Legislation should be enacted extending the Economic Impact Statement program now covered by an Executive Order to require all Federal agencies and departments to prepare Economic Impact Statements in all instances where proposed programs, procurement actions and regulations will have significant economic impact. An agency such as the Council on Wage and Price Stability or the General Accounting Office should be equipped with sufficient staff to enable it to assess the Economic Impact Statements and to make independent studies of the economic effects of new proposals on a selected basis. The Economic Impact Statements and the assessments of the statements should be performed in a timely manner and before the new proposals are adopted.

The President should support the efforts of the Council on Wage and Price Stability by directing all government agencies to cooperate with it and to make available such information and assistance as the Council may require. The President should also be prepared to help make available

to the public the facts, findings and recommendations developed by the Council.

Congress should develop its own capabilities for assessing the economic effects of legislative proposals before they are acted upon.

The United States should encourage Japan and Germany to stimulate their economies and let their exchange rates appreciate.

Improving the Budget Policy Process

OMB and CBO should undertake a systematic program of assisting individual agencies in making accurate outlay estimates and scrutinizing agency estimates to eliminate any remaining bias. At the beginning of each budget year, OMB should publish an expected quarterly outlay path for the year (on a unified budget basis) so that actual spending each quarter can be measured against expectations.

The Budget Committees and the Joint Economic Committee should work together to develop answers to the following questions:

(*a*) What size and kinds of departures from planned outlays require corrective action?

(*b*) What type of corrective action is appropriate?

(*c*) What authority, if any, should Congress give to the Executive Branch to adjust either taxes or discretionary spending temporarily in amounts necessary to carry out the intent of the Congressional Budget Resolution?

As in 1977, economic developments will at times depart from expectations, necessitating amendments to the Budget Resolution. In anticipation of such occurrences, Congress should develop a list of agreed policy tools for achieving short-run and temporary changes in fiscal policy. Such a list might include:

(*a*) Variations in countercyclical spending programs, such as countercyclical aid to State and local governments; and

(*b*) Temporary tax changes, including tax rebates.

Fundamental changes in the tax structure or in permanent spending programs should be decided on their own merits rather than as part of an adjustment in fiscal policy for a year already underway.

Each one of the "off-budget" agencies should be carefully reviewed. Unless there are strong reasons for not doing so, they should be incorporated as part of the regular Federal budget.

II. RECENT DEVELOPMENTS

GNP and Its Components

In the second quarter of 1975, the United States economy began its recovery from the long recession that began in October 1973. Although displaying an erratic quarterly pace, the growth of real GNP averaged 7.3 percent for the first year of recovery. In the remaining three quarters of 1976, however, the economy lost its momentum. Real GNP growth dropped to an annual rate of only 3.6 percent. This so-called "pause" confirmed this Committee's fears, expressed in March 1976, that the economy might falter unless additional fiscal stimulus were applied.[1]

Table II–I shows the development of GNP and its main components in real terms in 1975 and 1976. The top row of data shows their levels at the end of 1974. The remaining rows show the quarterly changes in each major GNP component since that time in billions of constant (1972) dollars at seasonally adjusted annual rates.

TABLE II-1.—GROWTH IN REAL GNP AND ITS MAIN COMPONENTS, QUARTERLY FOR 1975-76

[Billions of 1972 dollars at seasonally adjusted annual rates]

Quarter	Gross national product	Personal consumption expenditures	Gross private domestic investment [1]	Government purchases of goods and services [2]	Net exports of goods and services
1974/IV	1,191.7	748.1	169.1	256.9	17.7
Change from previous quarter:					
1975/I	−30.6	6.5	−39.8	0.1	2.4
II	16.0	13.1	−3.1	2.1	4.2
III	32.2	7.8	22.5	3.6	−1.5
IV	9.9	8.6	−1.7	2.7	1.3
1976/I	27.1	16.8	20.1	−3.2	−6.5
II	13.7	7.9	4.6	1.7	−.6
III	12.2	7.1	3.5	1.8	−.3
IV	7.7	14.0	−5.4	−.2	−.7

[1] Encompasses residential investment (mainly housing), nonresidential fixed investments, and the change in business inventories.

[2] Government purchases as defined in the national income accounts include only direct purchases of goods and services and grants. They do not encompass transfer payments, such as social security and medicare or revenue sharing payments to State and local governments.

[3] Exports minus imports of goods and services.

Source: Department of Commerce, national income accounts.

Looking behind the pattern of overall GNP growth, Table II–1 shows that growth in personal consumption spending led the initial recovery from recession. Spurred in part by the personal tax rebate

[1] The 1976 Joint Economic Report contained the following recommendation (p. 13): "The strength of the recovery should be carefully monitored during the next few months. Should output 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."

in the spring of 1975, it contributed four-fifths of the total growth in real GNP in that quarter. It advanced at a slower rate thereafter, except for surges of consumer spending in the first and last quarters of 1976. This irregular pattern reflected the behavior of real disposable personal income, which fell in the quarter following the tax rebate and expanded at only 4.1 percent from the third quarter of 1975 to the same period of 1976.

It appears from the table that consumer spending staged a rebound in the final quarter of 1976, giving rise to reports of improved business conditions in some sectors despite the conspicuous weakness in all other major components of GNP. It remains to be seen whether consumer spending will continue its more rapid growth in the face of the layoffs and uncertainty caused by fuel shortages and crop losses stemming from the exceptionally cold winter.

Although consumer spending is by far the largest component of GNP, Table II–1 shows that private investment is the most volatile. In fact, GNP growth was carried to its highest levels during the recovery by powerful surges of investment spending attributable mainly to shifts in business inventory policies. These occurred in the third quarter of 1975 and the first quarter of 1976. The inventory buildup in early 1976 was complemented by the rapid growth in consumption spending already noted and was partially offset by sharp drops in net exports and in government purchases of goods and services. For reasons to be examined carefully below, investment spending has not provided any strong thrust to GNP growth since early 1976 and in the latest quarter exerted a significant drag.

Government purchases of goods and services grew in 1975 at a slow but steady rate. Over 60 percent of these purchases are made by State and local governments. Total government purchases dropped in real terms in early 1976, and this decline was barely recouped during the remainder of the year. The increase in net exports contributed to the recovery's initial strength, but a reversal of the trade accounts, particularly through the large rise in imports in early 1976, has exercised some drag on the economy throughout the past year.

A Closer Look at Private Investment

As noted above, GNP growth has been closely correlated with the behavior of business inventories. On the other hand, the response of business fixed investment to the general economic recovery has been disappointingly slow and halting. For both of these reasons, a closer look at the subcomponents of investment spending seems warranted. Table II–2 displays these subcomponents. As in Table II–1, the top row shows the level of each spending category at the end of 1974, and the lower panel shows their quarterly changes in billions of 1972 dollars at seasonally adjusted annual rates.

TABLE II-2.—GROWTH IN REAL PRIVATE INVESTMENT AND ITS SUBCOMPONENTS, QUARTERLY FOR 1975-76

[Billions of 1972 dollars at seasonally adjusted annual rates]

Quarter	Gross private domestic investment			
	Total	Nonresidential fixed investment	Residential investment	Change in business inventories
1974/IV	169.1	121.8	39.3	8.0
Change from previous quarter:				
1975/I	−39.8	−7.4	−3.9	−29.5
II	−3.1	−3.8	1.4	−.7
III	22.5	−.5	2.8	20.2
IV	−1.7	.4	2.3	−4.5
1976/I	20.1	2.1	2.2	15.9
II	4.6	2.3	1.6	.7
III	3.5	2.6	1.7	−.9
IV	−5.4	.4	3.7	−9.3

Source: Department of Commerce, national income accounts.

All components of private investment can exhibit a pronounced business cycle pattern. As Table II-2 shows, however, the quarterly swings in the behavior of business inventories in this recovery have been quite large and have played a dominant role in determining the quarterly pattern of GNP growth. In fact, it is no exaggeration to say that GNP has grown rapidly only in those quarters when major shifts took place in business policies toward rebuilding inventories. This occurred especially in 1975's third quarter, when the recession-motivated inventory sell-off was halted, and in 1976's first quarter, when the process of restocking began. With the exception of occasional spurts of consumer spending, there has been little else working to sustain the economy's recovery.

The sharp drop in the change in business inventories in the fourth quarter signifies a virtual halt in the inventory buildup that had progressed at a steady rate in 1976 prior to that time. It is not clear whether businesses chose to halt their buildup because of deteriorating business conditions or whether inventories were depleted by the jump in consumer spending and residential investment. As industrial production also was rising during the period, the latter explanation seems likely. In any event, the ratio of nonfarm inventories to sales in real terms dropped sharply in the quarter and appears to be at its lowest level since 1966. Thus, business could be on the verge of a rapid new inventory accumulation, particularly if final sales continue a healthy rate of growth.

Economic observers have waited impatiently for nonresidential fixed investment to show signs of greater vigor, but up to now this element has recovered very slowly from its recession levels. Its fourth quarter level in real terms was 12.5 percent below its record high in the first quarter of 1973. The dominant subcomponent of business investment, producers' durable equipment, suffered a relapse at the end of 1976. This relapse probably reflects postponements and cancellations of equipment deliveries resulting from a recognition by business of the economy's weakness.

The widespread anticipation of a business investment boom in 1976 was based largely on simplistic interpretations of past business cycle patterns and the present situation. Some observers, for instance, have implied that investment should be expected to exceed its previous peak at a particular time in the recovery based on past experience. By this

standard, investment has remained perplexingly dormant. But the incentive to business to invest cannot be judged in terms of the time elapsed since the start of recovery, nor can the rise in investment be validly compared to the gain in other components of GNP. Investment instead is a sensitive function of the utilization of productive capacity and of expected future economic growth. Business investment cannot be expected to enter a significant upswing until there are grounds to expect tight market conditions when new capacity enters production.

The 1973–75 recession was exceptionally long and deep, but the recovery has been rather ordinary. As the Chairman of the Council of Economic Advisers pointed out in testimony before the Committee, real consumer income in the fourth quarter of 1976—the seventh quarter of the recovery—was only 4 percent above its prerecession peak; in the same quarter of previous postwar recoveries, this indicator was up by an average of 8 percent. The gain in industrial production at the equivalent point in previous business cycles also averaged 8 percent; this time industrial production has barely reached its earlier peak level. Utilization of industrial capacity remains in the depressed range of about 80 percent. Worst of all, the economy's growth has nearly stalled at this level, which is well short of what is necessary to spark a takeoff in business investment.

Another year may be required to reach levels of income, production, and plant utilization to set off a wave of business capacity expansion. Because investment is quite sensitive to expectations, however, it will rise to new high levels rapidly if new policies succeed in putting the economy onto a steady growth path without excessive inflation.

Residential investment (housing) has come back in measured steps each quarter since the recovery began. Housing starts in 1976, at 1.54 million units, were about 30 percent above the very depressed level of 1975 but still about 35 percent below the record of 2.36 million starts attained in 1972. Within this total, single-family houses were built at the second highest rate in history, while multifamily construction remained at less than half of its earlier peak.

As Table II–2 indicates, housing construction improved greatly toward the end of 1976. Starts ran at a seasonally adjusted annual rate of 1.8 million in the fourth quarter. In fact, housing construction and personal consumption expenditures were almost the only components of GNP that did not grow more slowly in the fourth quarter than in the quarter before. In the case of housing, this performance was attributable in no small part to greater Federal assistance for subsidized multifamily rental housing. It is thus important for this assistance to be continued.

Employment and Unemployment

The development of employment in 1976 mirrored the pattern of overall economic growth. Civilian employment rose rapidly through May but then leveled off until late in the year when its growth resumed. The labor force continued to grow steadily in 1976, adding 2.8 million persons (2.9 percent) to the number wishing to work. The unemployment rate dropped correspondingly from 7.8 percent in January to 7.3 percent in May but returned to 7.8 percent in July and remained at this high level or above through the end of the year.

The unemployment rate ended 1976 right where it began. The rate for adult men, however, was three-tenths of a percentage point higher at year's end, while that for adult women was one-tenth lower. The teenage rate declined slightly but remained at the very high level of 19 percent. Significant also was a rise in the unemployment of full-time workers together with a fairly marked decline in that of part-timers.

In January 1977, the labor force declined by a startling 440,000 persons. Together with an increase of 117,000 in the number of jobholders, this decline brought the unemployment rate down suddenly again to 7.3 percent, seasonally adjusted. This labor-force decline seems to have been due in large part to the effect of January's harsh weather on the job-seeking efforts of unemployed persons.

In February, the latest month for which data are available, the labor force rebounded with a massive gain of 630,000 persons. Thus the January dropouts seem to have returned in large numbers. Despite the fact that more than 200,000 persons are estimated to have been rendered unemployed through layoffs in February, there was a net employment gain for the month of 400,000 jobs, the fourth consecutive monthly gain; weekly hours of work snapped back from their January slump. The unemployment rate rose moderately to 7.5 percent, however, and the number of persons working part time for economic reasons (related mainly to the weather) rose quite sharply. The unemployment rate for teenagers, however, continued to decline.

It appears that the worst effects of the harsh winter on employment were too short-lived to be reflected in the monthly employment survey either in January or in February. While many persons, primarily in manufacturing, lost their jobs due to fuel shortages and severe weather, others gained at least temporary employment combating the effects of the cold. Meanwhile, substantial employment gains were reported outside of manufacturing and government, especially in the trade and service industries and in construction. The employment statistics may be expected to display considerable irregularity over the next few months as the temporary after-effects of winter, including catchup production efforts, work themselves out.

Earnings and Productivity

Adjusted real hourly earnings in private nonagricultural employment rose by 6.9 percent in 1976, down from 8.9 percent in 1975. The 1976 increase, however, represented a larger gain in purchasing power because of the lower rate of consumer price inflation. This measure excludes the influence of changes in the amount of overtime in manufacturing and the effects of interindustry employment shifts. Average gross weekly earnings, which include the effects of changes in hours, rose by 7.3 percent in 1976 (2.4 percent in real terms), compared to 6.1 percent (0.9 percent) in 1975.

Wage and benefit gains negotiated in major collective bargaining agreements during 1976 averaged 8.5 percent for the first contract year, down from 11.4 percent in 1975; they averaged 6.6 percent annually over the life of contracts signed in 1976, compared to 8.1 percent for contracts signed in 1975. These data cover some four million workers mainly in the automobile, construction, trucking, apparel, electrical equipment and rubber industries. A general decline in inflationary psychology undoubtedly underlies this pervasive deceleration of wage rate increases.

First-year settlements declined by substantially more in nonmanufacturing industries and construction than in manufacturing. Subsequent-year changes stemming from contracts signed in 1976 are down substantially from 1975 in all sectors.

Contracts containing escalator clauses, covering 57 percent of the workers under major settlements, provided for annual wage-rate increases of 5.7 percent, while those without escalator clauses contain annual adjustments of 7.3 percent.

Productivity in nonfinancial corporations increased by 4 percent in 1976, the largest annual increase since 1964. Unit labor costs, therefore, rose at only 3.6 percent during the year—a rate somewhat less than the increase in prices. It should be noted, however, that productivity rose most rapidly in the first quarter and nearly halted in the last quarter, while unit labor costs rose faster toward the end of the year, reaching 8.2 percent for the nonfarm business sector in the fourth quarter. Both of these phenomena are consequences in the main of the economy's slump.

Prices

As Table II–3 shows, the rise in wholesale prices, which ran at 21 percent in 1974, slowed abruptly in 1975. Wholesale prices rose at a somewhat faster but still moderate rate in 1976. The farm price index declined slightly for the year, and processed foods and feeds fell in both 1975 and 1976. These two ctaegories, with a relative importance of somewhat less than one-quarter in the wholesale index, made possible a rate of inflation of less than 5 percent for both wholesale and consumer prices in 1976. But this stability probably will not continue. In fact, wholesale food and feed prices in the fourth quarter were on the rise, and farm prices continued to rise rapidly in January.

TABLE II–3.—PERCENT CHANGE IN PRICE MEASURES, 1973–76

Index component	Year [1]		1976, by quarters [2]			
	1975	1976	I	II	III	IV
Wholesale Price Index:						
All commodities	4.2	4.7	1.6	6.4	3.3	7.4
Farm products, processed foods and feeds	−.3	−1.1	−9.5	12.7	−12.2	6.6
Industrial commodities	6.0	6.4	6.1	4.5	8.2	7.8
Fuels, related products, and power	12.7	8.1	−6.9	5.6	18.8	16.8
Consumer Price Index:						
All items	7.0	4.8	3.9	6.1	5.3	4.2
Food	6.5	.6	−5.4	6.2	1.6	0
All items less food	7.1	6.2	5.3	7.0	7.4	5.3
Energy (gasoline, motor oil, fuel oil and coal, gas, and electricity)	11.6	6.9	−5.9	10.9	10.9	13.1
All items less food and energy	6.7	6.1	8.0	5.8	6.5	4.6

[1] From December to December.
[2] Quarterly changes at seasonally adjusted annual rates.

Source: Bureau of Labor Statistics.

Wholesale industrial prices, on the other hand, rose throughout the year, reaching levels in December 1976 that were 6.4 percent above their December 1975 levels. In fact, they rose slightly faster in 1976 than in 1975, despite continuing weak market conditions indicated by rates of manufacturing capacity use in the range of only 80 percent. Three important categories of industrial products have weights of 10 percent or more in the index. Among these, metals and metal products rose by 7.3 percent; machinery and equipment by 5.9

percent; and fuels and electric power by 8.1 percent. As the table shows, the fuels category declined in the first quarter, due to a rollback in oil prices, but it jumped sharply in the latter half of the year; within this category, natural gas prices rose by 38 percent from December 1975 to December 1976. In other industrial sectors, lumber and wood products rose by 20 percent; paints by 16 percent; hides, leather and related products by 11 percent; and tires and tubes by 12 percent. As the table shows, the industrial price increases tended to speed up in the latter half of the year. In addition to the influence of fuel prices, this acceleration of prices probably was associated with faster unit cost increases which appeared as the economy's growth and the attendant productivity gains slowed down.

In fact, 1976's generally good news on wholesale prices was blemished by the high rate of increase in the year's final quarter. This quarter illustrates what happens when rapidly rising industrial prices are joined by a recovery in farm and processed food prices. This combination lifted the overall Wholesale Price Index at a 7-percent annual rate for the three months ending in December. Industrial price increases decelerated somewhat in both December and January, although farm prices continued to rise.

None of these data includes the full effect of severe winter weather on fuel and vegetable prices. In any case, as a result of increases in wholesale prices already in effect, a bubble of materials cost increases is now working its way through the stages of processing and is only beginning to manifest itself at the consumer level.

As Table II–3 shows, consumer prices in 1976 continued the process of stabilization begun in 1975. The CPI rose at only 4.8 percent. The increase was held down throughout the year by the small net rise in food prices, which reflects the behavior of food prices at wholesale. In particular, retail meat prices fell by 10 percent.

Prices of other consumer goods and services rose much faster than food, except in the second quarter, when food prices nearly matched their pace. As Table II–3 shows, consumer energy prices rose by 6.9 percent for the year but were increasing at a 13-percent annual rate in the final quarter. Moreover used car prices rose during the year by 19 percent. A hefty boost in prices of services was accounted for largely by transportation services (air, train, bus, and taxi fares) and medical services, each fo which rose by an average of 11 percent.

The Consumer Price Index rose by 0.8 percent in January (seasonally adjusted), its largest one-month rise in well over a year. This upsurge stems from large rises in all categories. Possibly the wholesale price bubble is now appearing at the consumer level. The January survey of consumer prices also was taken before the full price effects of severe winter weather were felt. Thus, the Consumer Price Index may well bring further bad news in the next few months.

The danger to the economy implicit in the current upsurge of prices is serious. If such inflation rates continue, they will make it extremely difficult to pursue policies sufficiently expansionary to reduce unemployment and to induce industry to invest more rapidly in new facilities with enhanced productivity. They could, in fact, condemn the Nation to a further period of economic stagnation or even a new recession. The behavior of industrial prices clearly is not dictated by tight markets. Thus it is vital that industries exercise restraint in their pricing decisions in the interest of the economy's overall health. If they do

not, it is inevitable that Government will intervene even more directly—not necessarily with desirable results.

Money Supply and Interest Rates

Short-term interest rates fell steadily through most of 1976. The Federal Funds rate, the rate on three-month Treasury bills and the rate on prime commercial paper (four to six months) were all well below their 1975 levels.

Long-term interest rates also declined somewhat. Rates for the highest quality (Moody's Aaa) corporate bonds, high grade municipals and long-term Treasury issues were lower than in 1975. Interest rates in the mortgage markets were somewhat mixed. Rates fell in the secondary market (according to the Federal Housing Administration opinion survey) but actually rose in the primary market (according to the Federal Home Loan Bank Board series). Part of the rise in the primary market is explained by exhaustion of federally subsidized mortgages (the tandem plan) early in the year. In any case, funds for future mortgages continued to flow in sizable volume into the thrift institutions.

Starting in May 1975, the Federal Reserve Board began projecting growth rates for three monetary aggregates for the year ahead. For the most part, the actual growth of the monetary aggregates has been within or just above the ranges projected by the Federal Reserve Board. The principal change in the projected ranges has been to decrease the lower limit.

By historical standards, however, the rate of growth in M1 (currency and demand deposits) has been slow. The growth in the velocity of M1 (nominal GNP over M1), however, has been high by historical standards. The Federal Reserve Board links the rapid increases in velocity to regulatory changes and technological innovations that allow money for financial transactions to be held in various types of interest bearing accounts. The slow growth of M1 also reflects the weak demand for business loans.

In the last quarter of 1976, there were several indications that the demand for money had begun to grow. Commercial and industrial loans have increased and both short and long-term interest rates have begun to turn upward.

During this period, the Federal Reserve has taken some small steps to increase the money supply. The discount rate was lowered in November, and reserve requirements were reduced in December.

There is ample evidence, however, that the credit markets will be subjected to a number of additional pressures. The Administration's stimulus package will increase the Federal deficit and may put some upward pressure on interest rates. Because recent Treasury borrowing has acted to lengthen the average maturity of Federal obligations, there may not be quite as much pressure on long-term interest rates as the size of the deficit would suggest.

III. THE OUTLOOK FOR 1977 AND 1978

The economic outlook for 1977 may be described as good, but not good enough. Production will increase, unemployment will decline, and the inflation rates will accelerate only slightly. However, following on the disappointing performance of the latter half of 1976, this will leave the Nation at the end of this year still far short of the goals and expectations established earlier. The unemployment rate may be slightly under 7 percent at the end of this year—a goal previously established for the end of last year. The inflation rate may be about 5½ percent this year, far below the alarming 1974 rate, but far above the ultimate goal of approximate price stability.

In short, the economy is presently at least one full year behind the time table previously recommended by this Committee and others for recovery from the 1974–1975 recession. The present year offers no prospect of regaining this lost ground.

Chart I–1 (p. 8) compares actual developments and present prospects with the recovery path recommended by this Committee two years ago in its 1975 Annual Report. The loss of output during 1976 just from falling short of the recommended recovery path amounts to about $43 billion or an average of about $200 per person for each individual living in the United States.

THE COMMITTEE'S FORECAST FOR 1977

Our assessment of the 1977 outlook assumes that the stimulative program contemplated in the Third Resolution on the Fiscal Year 1977 Budget is carried out on schedule. Should elements in this program fall behind schedule or should monetary policy fail to complement the recovery program, economic performance could be considerably weaker than our forecast.

Real GNP is expected to grow about 5 percent in 1977. The inflation rate should be about 5.5 percent for the year (as measured by the GNP deflator), and the unemployment rate is expected to average about 7.3 percent for the year as a whole. Measured from fourth quarter to fourth quarter, real GNP will grow about 6 percent and the deflator will rise almost 6 percent. Aided by the enlargement of the public service jobs program, the unemployment rate should drop slightly below 7 percent in the fourth quarter.

As shown in Table III–1 our forecast is slightly stronger than the most recent Congressional Budget Office (CBO) forecast, but slightly below the estimates presented by the Carter Administration. The differences among the forecasts are relatively minor. All present a picture of moderate GNP growth, a fairly stable inflation rate, and slowly declining unemployment.

Quarterly Pattern

The quarterly pattern of GNP growth in 1977 will be erratic. Interruptions of production caused by the severe winter weather will prevent

real GNP from growing very much at all in the first quarter. These production losses will be largely made up in the second and third quarters. These same middle quarters will also be strengthened by the tax rebate payments to be made this spring.

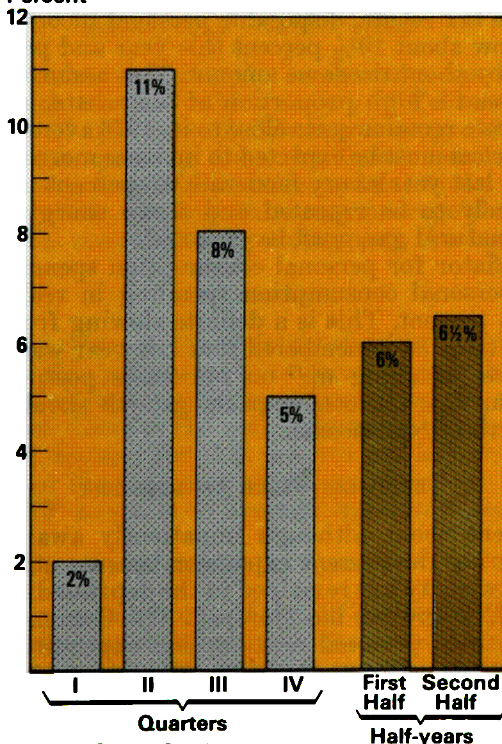
TABLE III-1.—ECONOMIC FORECASTS

[Annual averages for calendar years]

	1976 (actual)	1977 forecasts		
		Carter administration [1]	Joint Economic Committee	Congressional Budget Office [2]
Real GNP (percent change)	6.1	5.4	5.0	4.7
GNP deflator (percent change)	5.1	5.6	5.5	5.2
Unemployment rate (percent)	7.7	7.1	7.3	7.3

[1] Fiscal year 1978 budget revisions, February 1977.
[2] 5-yr economic projections, February 1977.

As shown in Chart III–1, our forecast shows real GNP growing at only about a 2 percent annual rate in the first quarter, but at an 11 percent rate in the second and an 8 prcent rate in the third. The fourth quarter drops back to a 5-percent growth rate. No great importance should be attached to these precise numbers, since quarterly growth



Source: Joint Economic Committee.

patterns are almost impossible to predict accurately. However, it is most important that the general quarterly pattern be anticipated and understood. Growth will be very slow in the first quarter, quite rapid in the second and third quarters and moderate in the fourth. This phenomenon stems in part from the weather and in part from the timing of the stimulative program. It would be quite mistaken to conclude either that a new recession is imminent when the first quarter estimates are released or that the economy is dangerously overheating when the second and third quarter pattern becomes known.

Viewed by half-years, the growth pattern will be much less erratic. Growth during the first half of the year (from the fourth quarter of 1976 to the second quarter of 1977) will be at about a 6 percent rate and during the second half growth could reach a 6½ percent rate.

Outlook by GNP Component

Personal consumption spending in 1977 will grow only moderately, the long-awaited business investment pickup still shows litle sign of emerging, and net exports will decline. Realization of the overall growth rate we are forecasting thus depends upon a relatively strong housing sector, a restoration of presently somewhat depleated business inventories, and a marked increase in State and local government spending reflecting the increased Federal funds being made available for public service employment, public works, and countercyclical aid.

PERSONAL CONSUMPTION

Aided by the tax rebate, disposable personal income in current dollars should grow about 10½ percent this year and personal consumption spending by about the same amount. This assumes that consumers will in fact spend a high proportion of the rebate, and that the personal savings rate remains quite close to its 1976 average of 6.5 percent.

Consumer prices must be expected to increase more rapidly this year than last since last year's very moderate 0.6 percent rise in retail food prices is unlikely to be repeated and sharp energy price increases, especially for natural gas, must be expected.

With the deflator for personal consumption spending rising about 5¾ percent, personal consumption spending in real terms will rise only about 4½ percent. This is a definite slowing from last year's 5.6 percent, but it must be remembered that last year was a year in which consumers were "catching up" on purchases postponed during the recession. From now on, consumption growth should follow closely the trend growth of real income.

BUSINESS FIXED INVESTMENT

An investment boom, although impatiently awaited, has not yet taken place during the present expansion because utilization of existing industrial capacity has remained in the depressed range of about 80 percent, and GNP growth has slumped. The Committee's forecast of moderate growth of personal consumption expenditures implies that capacity utilization will remain below 85 percent at year's end. This in turn offers little prospect of a major upswing in business investment in 1977.

Our forecost of business fixed investment incorporates a sharp, 10 percent drop in nonresidential construction in the first quarter as a result of the harsh winter weather. About 70 percent of this loss in production is assumed to be made up later in the year. Although the year-to-year growth in business investment is lower on this account, the growth rate from the fourth quarter of 1976 to the fourth quarter of 1977 will be raised, because more of the spending is squeezed into the later parts of the year.

Real investment in producers' durable equipment, which declined slightly toward the end of 1976, is projected to stabilize in the first quarter and then to resume its growth at a 10 percent annual rate, declining in the final quarter to 5 percent. Delays in building completions will reduce equipment purchases late in the year.

These projections for nonresidential structures and durable equipment combine to yield an increase in total real fixed investment of a little over 5 percent. The fourth quarter level would be a 8.4 percent above 1976's same period.

The survey of business plans for plant and equipment investment, released by the Department of Commerce in January, revealed that the firms questioned intended to boost outlays by about 11 percent in current dollars in 1977. The businesses surveyed expected their costs to rise about 8 percent, implying a rise in real investment spending of only 3 percent. Our somewhat more optimistic forecast assumes that the stimulative program adopted since that survey was taken will have some favorable effect on business investment and also that price increases will be somewhat less than businessmen anticipate.

RESIDENTIAL CONSTRUCTION

Housing starts dropped sharply in January due to the severe weather. Even with a considerable recovery in February and March, the first quarter will appear weak. We expect no growth in real residential construction spending from the fourth quarter to the first. Much of the January drop will be made up later in the year, however. For the year as a whole, housing starts may average about 1.8 million and real residential construction spending may rise by about 15 percent above last year.

NET EXPORTS

The net export balance declined fairly steadily during 1976, and it seems likely that this pattern will continue during the first half of 1977, with increased fuel imports necessitated by the cold weather a contributing factor. Later in the year, a stronger world economy could produce increased demand for U.S. exports and halt the deterioration in the balance. For the year as a whole, we expect net exports as recorded in the GNP accounts to average between 0 and −$5 billion.

THE GOVERNMENT SECTOR

Most of the spending elements of the 1977 stimulative program will take the form of increased transfers to State and local governments, the three main programs being public service employment, public works, and general countercyclical assistance. In our forecast, we have assumed that these funds are respent promptly by the local govern-

mental units and that this spending largely is additional to the spending that would otherwise have occurred, that is, that the substitution rate is quite low.

These program have elements built into their design to encourage prompt use of funds and to discourage substitution, and we feel our assumptions are reasonable. In this regard, however, we are at variance with most other forecasts, which assume smaller and slower additions to the spending stream as a result of these programs. This must be regarded as an area of special uncertainty in the forecast, and it is important that these programs be carefully monitored and efforts undertaken to ensure that the funds are spent for the purposes intended and that this spending is not offset by cutbacks in other State and local government activity.

If the spending levels established in the Third Resolution are realized, Federal purchase in real terms will average about 6 percent higher in calendar 1977 than in 1976, giving some impetus to economic growth. However, as discussed elsewhere, spending fell substantially short of congressional intent in 1976. Presently available data indicate that some spending shortfall is almost inevitable again this year. In the first four months of fiscal year 1977, actual outlays fell some $7 to $8 billion short of the spending plan prepared at the beginning of the year. This does not necessarily mean that the outlay reduction will be this large for the year as a whole, as some part of it is likely to be reversed.[1] However, the shortfall could well be large enough to have a noticeable economic impact. This is an area of uncertainty in the forecast which demands careful monitoring to assure that timely corrective or offsetting action is taken.

FINAL SALES

Adding up the above sectors, final sales (all components of GNP except the change in business inventories) may be expected to grow between 4½ and 5 percent after correction for inflation. This would be very slightly above last year's 4.4 percent.

BUSINESS INVENTORIES

Inventories were drawn down in the final quarter of 1976 due to unexpectedly strong retail sales. Severe weather conditions are holding down production in the first quarter of this year, making it unlikely that inventories can be replenished in the current quarter. Therefore, we expect considerable demand for stock building in the remaining three quarters of the year. This will cause total GNP growth to exceed the growth of final sales slightly, but the difference will not be nearly as great as last year when real final sales grew 4.4 percent but total real GNP grew 6.1 percent.

OUTLOOK FOR UNEMPLOYMENT

By the end of the year, the unemployment rate should be in the range of 6.8 to 6.9 percent. GNP growth should suffice to reduce the

[1] For example, because of the favorable state of the mortgage market, the Department of Housing and Urban Development advanced sales of mortgages planned for later in the year. This is recorded in the budget as a negative outlay and contributed to the shortfall.

rate by almost a full percentage point, from 7.9 percent in the fourth quarter of 1976 to 7 percent in the fourth quarter of this year. The additional 0.1 to 0.2 percent reduction should follow from the enlargement of the public service employment program which, because of its high employment content, has a larger impact on the unemployment rate than would be the case if the same GNP growh were obtained in other ways.

Outlook for Inflation

The underlying trend of the inflation rate should still be moving slowly downward as cost increases experienced in 1973 and 1974 finish working their way through the economy and as wage settlements trend downward. However, two special factors will work in 1977 to interrupt this favorable trend. One is the expected further increase in energy prices, especially natural gas prices. The other is a faster rate of increase in retail food prices.

In 1976, farm prices averaged no higher than in 1975, which in turn was 3 percent below 1974. Consumer food prices also were essentially stable in 1976, rising only 0.6 percent. This compares with increases of 20 percent in 1973, 12 percent in 1974, and 6.5 percent in 1975. In 1977, consumer food prices are expected to rise between 3 and 5 percent, with the higher of these figures likely if dry weather in the Plains and the far West persists.

Even if price increases in other sectors moderate in 1977, food and fuel prices seem likely to bring the overall inflation rate to about 5.5 percent, compared to 5.1 percent in 1976. It should be stressed that this somewhat higher inflation rate will not result from adoption of the stimulative program. In fact, there is sufficient slack in the economy to grow considerably faster than is contemplated without in any way worsening inflation. As in 1974, more rapid price increases will stem largely from factors such as food and fuel price rises, which are entirely outside the control of macroeconomic policy. The magnitude fortunately will be far less than in 1974, when prices rose about 10 percent, but the sources are the same. Restrictive macroeconomic policies would not be effective against this type of inflation, but could badly damage the already lagging effort to regain prosperity and full employment.

The Outlook for 1978

It is difficult to foresee the exact shape of the 1978 economic outlook at this time. Available forecasts predict another year fairly similar to 1977: real GNP growth of about 5 percent, an inflation rate of 5.5 to 6 percent, and a further reduction of about 0.8 percentage points on the unemployment rate (from about 7.3 percent in 1977 to perhaps 6.5 percent in 1978).

Realization of this forecast is predicated on the following assumptions:

- Steady growth of personal consumption in line with income growth, meaning that the personal savings rate does not go above 6.5 percent;
- A fairly strong growth of business fixed investment, as the long-awaited pickup finally gets under way;

- A reasonably good year for residential construction, with housing starts in the 1.8 to 2 million range;
- Continued strong growth of State and local spending as increased Federal transfers are respent; and
- No further deterioration of the net export balance.

If realized, the growth of real output at about 5 percent next year would represent something of an accomplishment for economic management. There have been relatively few past occasions when expansion has been maintained at a steady pace of this strength for a third full year following a recession.

Even so, as in 1977, a good year is not good enough. Unemployment will still be far too high in 1978 and further steady reduction will be needed. This will require a real growth rate of at least 6 percent. Indeed, we would prefer a growth rate of 7 percent and would be pleased if this were to occur. However, unless some sector of the private economy exhibits greater strength than presently appears probable, we would doubt that a 7 percent growth rate can be achieved. Therefore, as discussed in the next Chapter, we urge that 6-percent growth of real GNP and a reduction in the unemployment rate to 6 percent by the fourth quarter be adopted as minimum objectives for 1978. Achieving these goals will require a somewhat more stimulative fiscal policy than has been recommended by the Administration. This too is discussed in Chapter V.

IV. THE GOALS OF ECONOMIC POLICY

It is widely agreed that strong economic growth and a steady reduction in unemployment will be required throughout 1977 and 1978. Success in achieving these objectives will be more likely if specific quantitative targets for output and employment are established and policy is then designed to reach these targets.

Goals for 1977 and 1978

In its 1976 Annual Report, this Committee recommended that policy be directed toward attainment of a 7 percent rate of real GNP growth throughout 1976 and 1977 and reduction of the unemployment rate to 7 percent by the end of 1976 and about 6 percent by the end of 1977. We stressed that sufficient idle capacity existed throughout the economy to make this rapid growth fully consistent with steady reduction in the rate of inflation.

Subsequently, in its First Resolution on the Budget for fiscal year 1977, Congress adopted a fiscal policy designed to meet the somewhat less ambitious goal of 6 percent real growth in 1977.

Economic performance in 1976 fell considerably short of the goals recommended by this Committee. Real GNP averaged 6.1 percent higher than in 1975, but grew only 5.0 when measured from fourth quarter to fourth quarter. This slowing of the growth rate during the year brought a halt to progress against unemployment, and the unemployment rate was actually higher (7.9 percent) in the fourth quarter than it was in the first (7.6 percent).

In light of this disappointing performance in the latter part of 1976 and the probability that 1977 might fall similarly short of congressionally established economic goals, a Third Concurrent Resolution on the Budget for fiscal year 1977 was enacted in March. This resolution provided for both tax and spending measures to stimulate more rapid economic growth in calendar 1977 and 1978.

As evaluated by the Joint Economic Committee staff, this amended fiscal policy is expected to produce about 5 percent real GNP growth in 1977 and to reduce unemployment to about 6.8 or 6.9 percent by the end of the year. If these results are in fact achieved, the economy will fall far short of the 1977 goals suggested by this Committee a year ago. It also will fall somewhat short of the 6-percent real growth target and the 6½-percent year-end unemployment rate that we now believe to be appropriate and attainable goals for this year.

This Committee feels strongly that economic performance last year and this year has been hampered by the failure to adopt specific consistent goals and then to shape the policies necessary to meet the goals. Too often, the process has been carried out in reverse, by abandoning the goals rather than by adopting policies to reach them.

In formulating economic policy, Congress should first establish specific quantitative goals for output and employment. Fiscal, monetary, and other appropriate policies should then be designed to meet these goals.

Still further modification of the fiscal 1977 budget may be necessary to cope with the consequences of unusually severe weather this past winter or with other contingencies which cannot presently be foreseen. With the fiscal year presently almost half over, however, the opportunities to affect 1977 economic performance further through changes in this year's budget are quite limited. Monetary policy, discussed later in this Chapter, can have a more important impact.

Real GNP growth of 6 percent for 1977 and a reduction in the unemployment rate to 6.5 percent by the end of the calendar year remain desirable goals. The present course of fiscal policy appears likely to leave the economy somewhat short of these goals, but every effort should be made through monetary policy and other available policy tools to come as close as possible to achieving them.

Fiscal policy can still have a major impact on economic performance in 1978 and the establishment of appropriate goals should be the first step in deliberations on the Budget Resolution for that year.

Real GNP growth of 6 percent and a reduction in the unemployment rate to between 5½ and 6 percent by the end of the calendar year are realistic goals for 1978. Fiscal and monetary policy should be designed to achieve these objectives.

As discussed in Chapter V, achieving such a large reduction in unemployment will require a combination of overall economic stimulus and direct job creation programs.

The rate of inflation, as measured by the Consumer Price Index, declined for the second year in 1976 from its alarming rate of 1974. As noted in Chapter II, however, the reduction in 1976 owed much to that year's stable food prices, which may not continue to the same extent in 1977, particularly if dry conditions persist in important agricultural areas of the Midwest and Far West. Moreover, fuel prices probably will rise at a higher rate than in 1976, because the rollback in crude oil prices in early 1976 will not be repeated and because prices for natural gas will rise even faster than their 1976 rate of nearly 25 percent.

While food and fuel prices may be somewhat volatile, it is reasonable in setting an inflation control objective for 1977 to strive for continuing stabilization of prices for domestic goods and services other than food and fuel. This category contains mainly manufactured goods and a wide variety of services. Domestic nonfarm prices went up by 9.9 percent in 1975 and by 5.3 percent in 1976. It would be reasonable to strive in 1977 to hold the rise in this index to somewhat less than 5.3 percent.

Such an achievement will require a firmer price-wage policy by the new Administration than its predecessor was willing to implement. We are pleased to see that such a policy is under serious consideration.

Success also will require greater pricing moderation and restraint on the part of producers of industrial commodities, prices of which rose at an 8-percent annual rates in the latter half of last year; and on the part of health care providers.

Progress toward price stability also will require restraint in wage negotiations. It is to be hoped that the inflation premium and the catchup component embodied in wage settlements will continue to decline as it has done over the past year.

Medium-Term Employment Goals

The 1977 Annual Report of the Council of Economic Advisers raises anew the related questions of defining full employment and measuring the potential growth rate of the U.S. economy. These questions are fundamental to the proper design and execution of economic policy. The Joint Economic Committee intends to undertake intensive study of these questions during the coming year. This discussion attempts to establish perspective on this issue by setting forth the main points of agreement and disagreement.

In general, there is widespread agreement on the long-term goal of providing jobs at fair compensation to all who seek to work and of doing so in ways that are consistent with reasonable price stability and also with the preservation of vigorous private enterprise and individual freedom of choice of occupations and careers.

The present Secretary of the Treasury expressed this objective in his testimony before this Committee as follows:

> We will always have some frictional unemployment and some people moving from one job into another. However, as long as there are people who are willing and able to work and who can't find work in this country—one of the richest in the world—I can't accept any level of unemployment.

We are very heartened to see that public service and public works jobs programs are now being substantially expanded as an important step toward bringing closer the time at which actual full employment can be reached.

There is also general agreement that unemployment is presently far too high and that strong output growth and rapid reduction of unemployment are appropriate goals for 1977 and 1978.

Where the consensus breaks down is with respect to medium-term goals for economic performance. The "interim" target of 4-percent unemployment, established by the Council of Economic Advisers in 1962, presently is rejected by many public officials and perhaps by the majority of private economists as no longer representing an appropriate medium-term objective. In the view of these observers, major shifts in the structure of the labor force have occurred that render a 4-percent unemployment rate inconsistent with reasonable price stability.

In the view of this Committee, the above conclusion has been reached on the basis of highly fragmentary evidence. Far too much emphasis has been placed on changes in the age and sex composition of the labor force during the past two decades. Other equally important changes have been all but ignored. These changes include dramatic shifts in the occupational distribution of employment, a rise in the average educa-

tional level of the labor force, and major shifts in social attitudes which influence work habits and career aspirations.

This analysis has been developed quite extensively with respect to the demographic composition of the labor force. It has been pointed out repeatedly that women and young people have comprised a rapidly rising share of the total labor force over the past two decades and that, since these two groups historically have higher unemployment rates than adult men, constant unemployment rates for each group would produce a rising overall unemployment rate. However, if in 1976 each of the three major demographic groups (teenagers, adult men and adult women) had had the same unemployment rate as in 1956, the overall unemployment rate would have been only 0.3 percentage points higher than it was in 1956.[1] By itself, this would not appear to necessitate any very great shift in the medium-term employment target.

It also has been pointed out that the differences among the unemployment rates for the various age-sex groups have widened over the past two decades. For example, in 1956 the unemployment rate for teenagers was 3.3 times the adult male rate; by 1973 it was 4.5 times as high. This suggests that the difficulty of reducing the unemployment rate for teenagers to an acceptable level without creating a very tight, highly inflationary labor market for adult males has increased by more than the simple application of 1976 labor market weights to 1956 unemployment rates would indicate.

The above analysis is instructive, but it needs to be incorporated into a more complete framework encompassing as many as possible of the important changes in the nature of both the demand for and the supply of labor during the past twenty years. One way of looking at the demand for labor is to analyze the shifts in the occupational structure of employment.

As shown in Table IV–1, white-collar workers made up only 41 percent of the labor force in 1959. By 1976, they constituted 48 percent.[2] White-collar workers traditionally have much lower unemployment rates than blue collar workers. Thus, in contrast to the effect of the age-sex shift, it is the occupational groups with the low unemployment rates which have been growing most rapidly. Furthermore, again in contrast to the age-sex shift, the differential between white-collar and blue-collar unemployment rates has been narrowing rather than widening. In 1959, the blue-collar rate was about three times the white-collar rate. By 1972—a year with a similar total unemployment rate—it was only 1.9 times as high. Even in 1976, despite the severe impact of the recession on blue-collar workers it was only twice as high. If the unemployment rate for each major occupational group had been the same in 1976 as it was in 1959, the overall unemployment rate would have been 5.7 percent, or little different from 1959's 5.5 percent, despite the sharp rise in the number of new entrants having no work experience. Thus, when the labor market is examined from the viewpoint of the

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[1] The mid-1950s were a period of reasonable price stability and relatively low unemployment and have thus come to be regarded as a period during which labor markets were in balance. Thus the unemployment rates which existed at that time for various subgroups of the labor force are considered by many to serve as appropriate guides to what may be reasonable to achieve with respect to these groups in the future.

[2] 1959 is used as a base year because data is not available for 1956 and prior years. 1972 has been included in the table to permit comparison of two years in which the overall unemployment rate was approximately the same.

demand for labor, broken down by broad occupational category, there is no readily apparent reason to conclude that the unemployment rate associated with full employment has undergone any major shift.

TABLE IV-1.—CIVILIAN LABOR FORCE AND UNEMPLOYMENT BY OCCUPATION: 1959, 1972, AND 1976

	Civilian labor force [1] (percent distribution)			Unemployment rate [2]		
	1959	1972	1976	1959	1972	1976
Total	100.0	100.0	100.0	5.5	5.6	7.7
White collar	41.4	46.7	48.3	2.6	3.4	4.6
Blue collar	38.0	35.3	33.7	7.6	6.5	9.4
Service workers	12.0	13.5	13.9	6.1	6.3	8.7
Farmworkers	8.0	3.6	3.1	2.6	2.6	4.5
No work experience	.6	.8	.9			

[1] Civilian labor force in each group equals employed in that group plus unemployed whose last job was in that occupation.
[2] Percent of labor force within group, by occupation of last job.

Source: Bureau of Labor Statistics.

Another factor which receives less attention than it deserves is the progression into older age groups of the labor-force "bulge" stemming from high birth rates in the 1940s and early 1950s. As shown in Chart IV–1, the most rapidly growing segment of the labor force is no longer the teenagers or even the young adults of ages 20 to 24, but rather the adults between the ages of 25 and 34. Thus, the supply of workers in what should be one of the most productive and steadily employed age groups is expanding very rapidly. By the 1980–85 period, the number of labor force participants under age 25 actually will be declining, and the total labor force will be growing much more slowly than in the recent past. With a more slowly growing labor force, full employment not only should become easier to achieve but also a more vital social goal than ever. By the mid-1980s, we may very well face a situation of labor shortage rather than labor surplus.

Percent Change in Civilian Labor Force Over 5 Year Periods, by Age Group; 1960-1990

	1960-1965	1965-1970	1970-1975	1975-1980*	1980-1985*	1985-1990*
Total Civilian Labor Force	6.9	11.1	12.0	9.8	6.8	4.8
16-24 years old	22.7	25.8	24.9	9.0	-4.9	-9.2
25-34 years old	-1.0	19.5	31.2	20.0	13.0	4.6
35 years old & older	5.4	4.0	0.3	5.4	9.2	10.8

* Projected
Source: Bureau of Labor Statistics.

Only when these and other changes have been more carefully analyzed for their impact on the relationship between inflation and unemployment will a theoretical foundation for establishing a new interim goal for unemployment have been laid. This Committee intends to examine these economic changes and urges others to undertake similar investigations. Pending conclusion of such studies, we decline to join the chorus of those who have concluded that the "full employment" rate of unemployment is necessarily higher than it was 10 to 20 years ago.

As this Committee has emphasized before, 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 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 humane society.

This objective will require nothing less than fundamental reform of the institutions and policies we employ for making national economic policy. As the Committee stated one year ago in the 1976 Joint Economic Report, new initiatives needed to achieve full employment include 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;
>
> The establishment of supplementary employment policies to close the gap, if one should exist, between employment levels achieved 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.[3]

Potential GNP

A separate but related question concerns the rate of growth of potential gross national product (GNP). Potential GNP represents

[3] The 1976 "Joint Economic Report," March 10, 1976, pp. 10–11.

the volume of goods and services which would be produced at a sustained high level of resource utilization.

Traditionally, potential GNP estimates have been based on the level of resource utilization associated with a 4-percent unemployment rate. In its 1977 Report, the Council of Economic Advisers suggested a new base associated in 1976 with a 4.9-percent unemployment rate and a manufacturing capacity utilization rate, as measured by the Department of Commerce index, of 86 percent. As noted above, this Committee is not prepared to accept this proposed redefinition of "full employment." However, the question of the rate at which potential output grows each year can be examined separately from the question of the level of resource utilization which represents an appropriate medium-term objective.

Growth of potential GNP results from growth in the number of work hours estimated to be available at a constant level of resource utilization and from growth in the average output produced per hour worked. These in turn depend on growth of the working age population changes in labor force participation rates, changes in the average number of hours worked per week, and changes in the factors which determine "productivity" (output per hour worked).

It is of the greatest importance to have accurate estimates of the potential GNP growth rate, because such estimates are necessary to determine how fast the economy must actually grow in order to achieve a given reduction in the unemployment rate. For example, if the potential growth rate is 4 percent per year and if an additional 3-percent real GNP growth is necessary to bring the unemployment rate down by one percentage point, then a 7-percent per year real GNP growth rate will achieve a one percentage point per year reduction in the unemployment rate. If, however, as estimated by the outgoing Council of Economic Advisers, the potential GNP growth rate is 3.5 percent and 2.7 percent additional GNP growth will bring unemployment down by one percentage point, then GNP growth of 6.2 percent per year will suffice to reduce the unemployment rate by one percentage point per year.

These differences may sound minor, but cumulated over time they become important. If, for example, a policy objective of reducing the unemployment rate to 4 percent in 1980 were adopted, the first set of numbers postulated above would require about $65 billion more cumulative growth of real GNP (in 1976 prices) than the second. Expressed another way, a 26 percent total growth of real output during the next four years would reduce unemployment to 4 percent in 1980 if the second set of estimates is correct, but only to about 5.0 percent if the first is correct.

Because the economy has been so very far from fully employed during the past two years, it is exceptionally difficult to estimate what the trend of potential GNP has been. The outgoing Council of Economic Advisers is to be congratulated for addressing itself to this question in a scholarly way. However, the Council itself states that the estimates presented in its 1977 Annual Report are "experimental." We would agree that great uncertainty attaches to these estimates, especially because of the difficulties of measuring trend productivity gains after a period when actual productivity advances have been so badly hampered by the 1970–71 and 1973–75 recessions.

Publication of an official statistical series on GNP potential recently has been discontinued pending satisfactory revision of the series. Lack of such a series is a great handicap for economic analysis.

The unemployment projections for 1977 and 1978 contained elsewhere in this report are based on the assumption that the potential growth rate for GNP in 1977 and 1978 will be about 3.7 percent and that an additional 3 percent real GNP growth per year is required to bring the unemployment rate down by 1 percentage point per year. These are our best estimates at this time, and we think they are reasonable. Further examination of this question is of great importance.

The Council of Economic Advisers, in cooperation with other appropriate government agencies, should undertake promptly further studies of potential GNP with the objectives of revising and resuming publication of an official historical series and of providing the best possible estimates of potential GNP growth over the next decade.

The Joint Economic Committee plans to hold hearings on this subject during the course of this year and to work in close cooperation with other interested congressional committees and with the Council of Economic Advisers. It is hoped that regular publications of potential GNP estimates can be resumed before the end of the year.

V. ECONOMIC POLICY IN 1977 AND 1978

In this Chapter, we discuss the fiscal, monetary, housing, employment, and price-incomes policies which will be needed this year and next of the goals advocated in the previous Chapter are to be achieved. It is important that these policies be considered not only in relation to the needs of the U.S. economy, but in the context of a world economy which continues to experience difficulties in recovering from the strains placed on it in 1974 and 1975. The international economic situation and the need to coordinate our policies with those of other major countries are also discussed in this Chapter.

Budget Policy for 1977 and 1978

The program of stimulative tax and spending measures for 1977–78 recommended by the Administration and now under consideration by the Congress constitutes a necessary and desirable shift in the direction of fiscal policy. As noted in the previous Chapter, 1977 economic performance probably still will fall short of what this Committee would have desired, but it will be much better than it would have been without this policy shift.

Size and Composition of the Stimulative Program

Decisions on the overall size of the stimulative program during its first year are reflected in the recently enacted Third Concurrent Resolution on the Budget for Fiscal Year 1977. This Resolution provides for total outlays of $417.5 billion, receipts of $347.7 billion and a resultant deficit of $69.8 billion. Within these totals, the stimulative program accounts for $3.6 billion to be spent on job creating programs and $13.8 billion in tax reductions and related special transfer payments, for a total budgetary impact of $17.4 billion.

The composition of the stimulative program also now appears fairly well determined, although legislative action has not been completed. The program will include a personal tax rebate and related transfer payments totaling approximately $11.4 billion, permanent tax cuts for low and middle-income individuals of $5 billion per year,[1] and enlarged spending on public works, employment and training programs and counter-cyclical aid to State and local governments of $3.6 billion in fiscal year 1977 and perhaps $8 billion in fiscal year 1978.

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[1] The permanent tax cut will be achieved by replacing the present minimum and maximum standard deductions with a single standard deduction, which as presently proposed by the Ways and Means Committee would be $2400 for single persons and $3000 for joint returns. The budgetary impact, as projected by the Joint Committee on Internal Revenue Taxation would be $1.8 billion in fiscal year 1977, $6.7 billion in fiscal year 1978, and about $5.2 billion per year thereafter. The fiscal 1978 amount is affected by an expected overwithholding attributable to rates based on the old law.

Business Tax Reduction

The one element of the stimulative program which remains undecided is the nature of the business tax component. The Administration has recommended that businesses be given a choice between an enlarged investment credit (12 percent compared to the present 10 percent) or an income tax credit equal to 4 percent of payroll taxes paid. An alternative approved by the House Ways and Means Committee would allow businessmen instead to take a tax credit based on the increase in employment above the 1976 average.

Witnesses testifying before the Joint Economic Committee during its Annual Hearings were unanimous in their opposition to this latter approach, pointing out that it would represent a windfall to strong firms which were increasing their employment anyway and would discriminate against weak firms within any given industry as well as against whole industries or regions of the country in which employment is not growing or is growing relatively slowly. They also emphasized that such a provision would be difficult to administer accurately.

For several years, this Committee has been advocating the use of income tax credits to offset partially the rising burden of the social security payroll tax. As the Committee often has discussed, action of this type, by lowering employment costs, should both stimulate employment and help to limit the rate of price increase. The Administration proposal is in line with our past recommendations. Since the current proposal is of quite modest size, dramatic results are not to be expected. However, it is important to establish the principle of utilizing the tax system to control costs and to stimulate employment.

> **The proposal to give business firms the choice of an income tax credit against social security taxes or a larger investment tax credit would introduce into the tax law a constructive method of offsetting the undesirable economic effects of rising payroll taxes, and we support this proposal. While we also support further efforts to develop an employment tax credit which will help to moderate cyclical fluctuations in employment and/or to encourage hiring of the disadvantaged, we do not believe that time permits adequate consideration of such a proposal for inclusion in the program of temporary stimulative measures currently under consideration.**[2] [3]

Housing

A serious omission in the Administration's fiscal stimulus program is its failure to include a housing component. Over the past three years, the Nation has fallen well behind its housing goals. Despite the im-

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[2] Senator Bentsen states: "I disagree. An effective employment tax credit could be enacted as part of the economic stimulus package, and there is time to do it. For the last two years, in supplemental views to the JEC's Annual Report, I have recommended that an employment tax credit be adopted to stimulate job creation in the private sector. Last year, the Subcommittee on Economic Growth, which I chair, published a study analyzing how a variable-based employment tax credit could prove an effective part of an economic stimulus program: 'Employment Tax Credits as a Fiscal Policy Tool.'"

"I think we have studied this potentially excellent job creation measure enough. There is no better way to discover how well it could work than to give it a try. Congress should enact an employment tax credit as an option to increase investment tax credit."

[3] Senator Proxmire states: "I do not favor a credit against social security taxes."

provement in housing starts in the latter part of 1976, the housing industry remains depressed and the unemployment rate in the construction trades is still 15 percent. Federal stimulation of the housing industry through selective subsidies would have the further merit of creating jobs in the private sector at costs to the taxpayer well below those required for public service employment.

Public funds to stimulate the housing industry already are available. Some $1.8 billion in "tandem" plan funds (funds used to subsidize mortgage interest payments) already have been made available by Department of Housing and Urban Development but not yet used by the housing industry. An additional $5 billion in "tandem" plan funds have been authorized but not yet appropriated by the Congress. However, the Second Concurrent Budget Resolution was adjusted upward to allow $2 billion of these funds to be appropriated and spent during the present fiscal year, and this provision was maintained in the Third Resolution. A substantial amount of money also is available for direct home owner mortgage subsidies (Section 235).

In the past, "tandem" plan financing has been criticized for subsidizing the construction of housing units that would have been built in any case. By targeting the funds to lower income families in areas with low vacancy rates, high unemployment and a deteriorating housing stock, use of "tandem" plan funds would be more likely to result in net additions to construction activity. If all housing construction done under "tandem" plan financing were units that would not otherwise have been built, the use of already appropriated or otherwise budgeted funds could result in as many as 100,000 new housing starts and 200,000 additional jobs. Because actual budget outlays on the program would total less than $400 million, Federal expenditures per job could be as low as $2,000. A deepening of the interest subsidy and further increase in the mortgage limit for the direct homeowners' mortgage subsidy might add another 25,000 housing units and about 50,000 more jobs.

Jobs for Youth

One of the most distressing problems facing the American economy continues to be high unemployment among young people, and we are pleased that the stimulative program makes a start on attacking this problem. But more needs to be done, and done rapidly.

Teenagers and young adults suffer from higher unemployment rates than any other group of workers. During 1976, the unemployment rate for teenagers 16 to 19 years old averaged 19 percent, and for young adults 20 to 24 years old it was more than 12 percent. Black teenagers, the hardest hit, experienced monthly unemployment rates during 1976 of between 35 and 40 percent, and in many of our major cities unemployment among black teenagers far exceeded even this official figure.

The number of teenagers and young adults who were unemployed during 1976 averaged almost 3.5 million, nearly half the toal number of jobless Americans. In addition, there were more than 350,000 youths who would have been looking for work if it had been available but who were not counted in the unemployment statistics.

Although the 1974–75 recession increased the youth unemployment rate from 14.3 percent during the fourth quarter of 1973 to 20.5 per-

cent during the second quarter of 1975—where it has hovered since—youth unemployment is not just a cyclical problem. During the postwar period, except for the three Korean War years, the unemployment rate for 16- to 19-year-old youths has averaged more than 14 percent and his ranged from 2.5 to 3.5 times the national unemployment rate. Economic recovery alone will not reduce youth unemployment to acceptable levels.

High unemployment rates among youths result from a variety of social and economic factors: residence in depressed inner cities or rural areas, elimination of low-skilled jobs by changes in technology and industry structure and by the decline in small neighborhood businesses and family farms, lack of work experience and skills, poor educational backgrounds, and inadequate job counseling.

A fundamental cause of high youth unemployment in recent years has been the rapid influx into the labor force of those born during the postwar baby boom. As shown in Chart IV–I, the number of labor force participants of ages 16 through 24 grew 23 percent from 1960 to 1965 and a further 26 percent from 1965 to 1970. The trend is shifting rapidly, however, and as also shown in Chart IV–I, the size of this segment of the labor force is actually expected to decline during the 1980s.

The problem of youth unemployment thus is an immediate, not a future, problem and should be tackled immediately. If we fail to come to grips with this problem during the next three years, we will face by the 1980s not just a need to provide jobs for young people, but a need to rehabilitate middle-aged adults who drifted through the 1960s and 1970s without ever acquiring adequate work experience.

The job needs of youths vary widely. Almost one million unemployed youths, mostly in school, seek only part-time work or summer employment. Most are teenagers 17 to 18 years old, who need simple, easily learned jobs. By contrast, older youths who are beginning to make career decisions and assume family responsibilities require more sophisticated jobs and training that lead to career positions. Some youths, particularly those who have failed in or been failed by the educational system, need extended comprehensive assistance to become job-ready, while other youths may need little more than good job counseling and information.

Last year this Committee recommended that Congress give high priority to developing a comprehensive program targeted specifically at the employment needs of young people. As part of such an effort, we recommended that Congress consider a program of community service jobs for youths plus a substantial expansion of job information and counseling services.

We are pleased to note that this recommendation has received serious consideration, from Members of Congress as well as from the new President. Major youth employment bills have been introduced in both Houses of Congress this year, while the President has proposed to expand existing employment and training programs and to establish a Conservation Corps as part of his economic stimulus program.

The Third Concurrent Resolution on the Fiscal 1977 Budget recommends $1.5 billion in additional budget authority and $600 million in additional outlays for youth employment programs. This funding level could create a significant youth employment program.

Young Americans 16 to 24 years old suffer from higher unemployment rates than any other group of workers. Much youth unemployment is due to the basic structure of the economy and the society and would not be alleviated by a return to prosperity and full employment in the economy at large. The severity of this problem requires the enactment of specially targeted training, employment and counseling programs for youths. To address the variety of problems faced by unemployed youths, the following components should be included: (1) A program of youth jobs on projects which provide needed services to local communities or the Nation; (2) a conservation corps which provides jobs in the National Forests and Wildernesses; (3) a program to develop private sector jobs for youths and an increase in on-the-job training; (4) an expansion of work-study programs to integrate the processes of education and work; (5) an expansion of the Job Corps; and (6) an upgraded information counseling, and placement service for youths.

A Job Fund for 1978

The two-year nature of the stimulative program indicates a commitment to a sustained period of strong growth and provides a stable framework for private decisionmaking. However, some enlargement of the spending elements of the program and/or some further tax reduction are likely to be required if the 1978 growth targets we have recommended are to be achieved.

It is not possible to decide at this time precisely how much additional stimulus, if any, may be needed in 1978 or which specific programs can be further expanded most effectively. Therefore, it is important to incorporate an added measure of flexibility into the First Concurrent Resolution on the Budget for Fiscal Year 1978. This can be done by the inclusion of an unallocated "jobs fund."

In addition to the countercyclical spending increases recommended by the Administration, the First Concurrent Resolution on the Budget for Fiscal Year 1978 should contain an unallocated "jobs fund" of $5 billion. At the time of the Second Concurrent Resolution on the 1978 Budget in September 1977, such part of this fund as appears needed can be allocated to those countercyclical programs which are proving most effective and most suitable to expansion. Any unneeded portion of the jobs fund can be eliminated from the budget.[4]

An objection might be made that such an unallocated fund will present a temptation to enlarge spending unnecessarily and will provide a built-in bias toward bigger budgets. If it is made clear, however, that this fund is available only for countercyclical programs and only if it clearly is needed to meet growth and employment targets already agreed upon, we do not believe that the use of the fund will be abused. In terms of the congressional budget process, it is easier to

[4] Senator Proxmire states: "I oppose the $5 billion unallocated job fund. I think that funds should go either to housing or tax cuts. Housing, especially, can provide more stimulus in a prompter fashion for less cost per job than any other program."

reduce the outlay total at the time of the Second Concurrent Resolution than to increase it.

Tax Policy for 1978

If the Administration's recommendations are accepted, total personal income taxes paid during 1977 will be reduced by the amount of the tax rebate. This reduction will be in addition to certain temporary provisions placed in the tax law in 1975 and since extended through 1977: the personal tax credit of the greater of $35 per person or 2 percent of the first $9,000 of taxable income and the earned income credit for low-income working families with children.

Together these three provisions will reduce fiscal year 1977 personal tax receipts by about $18 billion below what would have been collected under the permanent tax code ($8.3 billion due to the tax rebate and $9.5 billion due to the extension of the temporary tax credits). Associated transfer payments will amount to about $4 billion.[5] Congressional action may alter these totals somewhat, but the fact remains that, due to temporary provisions, personal tax payments in 1977 will be significantly below the trend implied by the permanent tax law. They will comprise about 8.1 percent of GNP. Under current law, this ratio would rise to an estimated 9.1 percent in fiscal year 1978 because the temporary provisions are scheduled to lapse.

Such a sharp rise in the effective tax rate would seriously erode the growth of consumers' real after-tax incomes and restrict the growth of the private economy. Recognizing this, the Administration has recommended that the personal tax credit and the earned income credit be extended through 1978. Since no repeat of the tax rebate is contemplated, however, the ratio of personal income taxes to GNP nonetheless would come to 8.8 percent, a substantial rise from this year's level.

This rising ratio of taxes to GNP will hamper the rapid growth of private demand which is needed in 1978. When the drag on the economy caused by rising effective tax rates is recognized, there could be, as in 1977, strong pressure to enact further temporary tax measures.

Most of us have supported the tax rebate this year for lack of a better alternative to stimulate the economy quickly. But, we do not wish to see the rebate repeated in 1978. Tax rebates have the disadvantage that a lower proportion tends to be spent than would occur if the tax change were permanent. A related defect is that rebates have little secondary effect on business investment because businessmen are aware that the rebate-induced rise in consumer spending is only temporary. Furthermore, until the tax forms are redesigned to yield the needed information, it is impossible to distribute the rebate entirely fairly; some families receive double payments and others none at all.

In recommending that the temporary tax credits be extended for one more year, the Administration has stated that permanent tax reform proposals will be submitted this fall for inclusion in the 1979 budget. We applaud the dedication of the Administration to meaningful reform of the personal income tax system, and we agree that these proposals should be thoroughly debated in the Congress. However, if this is to be the timetable for tax reform, some further provi-

[5] This includes $0.9 billion for payments in excess of tax liability to earned income credit recipients under present law and $3.2 billion for $50 payments to social security, SSI and earned income credit recipients in conjunction with the proposed tax rebates.

sion for temporary tax reduction will be needed in 1978 to sustain strong growth of the private economy.

The large increase in the share of personal income taxes in GNP which would occur under the Administration's proposed budget for fiscal year 1978 should be avoided. This will require a tax reduction somewhat larger than just the extension of the present personal tax credits. In the First Concurrent Resolution on the Budget for Fiscal Year 1978 Congress should make provision for this larger personal tax reduction.

This tax reduction could be achieved by temporarily lowering tax rates, by enlarging the personal credit, or in other ways. In designing the specifics of the tax reduction, every effort should be made to ensure that it meets distributional objectives as well as fiscal policy requirements and that it does not introduce any new obstacles to tax reform in 1979.

Budget Totals for 1978

The budget recommended by the Carter Administration for fiscal year 1978 provides for outlays of $459.4 billion, receipts of $401.6 billion and a deficit of $57.7 billion. If both the jobs fund and the additional tax reduction we have suggested were to be enacted, this would add $5 billion to spending and might reduce tax receipts by $6 billion ($8 billion for calendar 1978), bringing the deficit to perhaps $69 billion.[6] [7] However, precise estimation of the deficit this far in advance is quite difficult. As previously discussed, actual spending fell short of congressional intent in 1976 and appears quite likely to do so again this year. If this tendency continues, the deficits for both 1977 and 1978 could be below current estimates.

Naturally, we do not welcome the continuation of such large deficits. The alternative is worse, however, since it implies sluggish growth and continued high unemployment, with all their attendant social evils. We do not believe that this deficit will be inflationary, nor will it crowd private borrowers out of credit markets or reduce private economic activity, given the present underutilization of the Nation's labor resources and private plant capacity. Also, we would point out that our recommendations contain considerable flexibility. Should the economy perform better than we expect during the rest of this year, the jobs fund can be cut back or eliminated, or part of the tax reduction postponed.

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[6] Senator Bentsen states: "I think it would be a mistake for the Committee to recommend measures that will add $11 billion to the fiscal 1978 deficit. President Carter has recommended a two-year package of economic stimulus measures and Congress has just passed a Third Concurrent Resolution on the Budget which should be given time to affect the economy before we recommended additional stimulus that will swell an already overbloated deficit. By the time Congress considers the Second Concurrent Resolution on the fiscal 1978 Budget in September, we will be in a much better position than we are now to determine what will have to be done to keep the economy healthy and growing in 1978. It may well be that nothing will have to be done. If more stimulus is needed, we should consider it then. Therefore, I disassociate myself from this part of the report and, in particular, from the two recommendations which would add this $11 billion to the deficit."

[7] Senator Proxmire states: "I do not agree with the $11 billion increase in the deficit for fiscal year 1978. The estimated deficit is already too large and should be reduced through cuts in both military and civilian spending."

The Full-Employment Budget

One helpful way of looking at the economic impact of the Federal budget is to look at how the surplus (or deficit) would be changing if the economy operated continuously at a constant level of resource utilization. Traditionally, this analysis has been done in terms of the resource utilization level associated with a 4-percent unemployment rate, and in this report we maintain that definition as an analytic convenience.

Had the economy operated at a 4-percent rate of unemployment in 1976, the budget would have been approximately in balance. In 1977, this will shift to a deficit of about $15 billion due primarily to the tax reductions which are part of the stimulative program.

In 1978, however, the swing will be in the other direction, with the full employment budget moving from deficit into surplus and the total shift about $15 to $20 billion from the final quarter of fiscal year 1977 to the final quarter of fiscal year 1978. This shift is due to the absence of a tax rebate in 1978, combined with the revenue generating effect of continuing inflation.

To permit a budget shift of this magnitude to occur would have an unwanted restrictive effect on the economy. Analysis of the full employment budget thus reinforces the conclusion reached above that additional tax and spending measures are required if strong growth is to continue in 1978. The tax and spending changes we are recommending would eliminate about two-thirds of the restrictive swing in the full employment budget.

Monetary Policy

In the months ahead, monetary policy will play a key role in determining whether or not the U.S. economy moves toward steady growth and lower unemployment. By helping to bring currently idle plant and equipment back into production, monetary policy can also spur the productivity growth needed to reduce the rate of inflation. Monetary policy will be particularly important in three key areas.

First, the policies of the Federal Reserve Board will have a substantial influence on the impact of the Administration's fiscal stimulus package. A larger Federal deficit will put some upward pressure on interest rates, and the tax rebate will cause a sharp short-term increase in the money supply. Failure by the Federal Reserve to accommodate the larger Federal deficit or action to offset a rise in the money supply would force interest rates up and work to curb the beneficial effects that the Administration's program seeks to achieve.

Second, accommodative monetary policy may be needed to help the economy to absorb any inflationary shocks that may come from either domestic or international shortages. Restricting the growth of the money supply can be relatively effective in situations where domestic demand is simply too high, but it is not efficient in dealing with rising prices caused by foreign cartels or natural disasters. The unusual weather in early 1977 threatens to reduce harvests seriously in the South, Mid-West and West. If the Federal Reserve reacts to resulting higher food prices by restricting the money supply, the action will be futile, but the entire economy will suffer.

Third, in addition to fostering sufficient growth in the money supply not only to accommodate but actually to complement the Administration's efforts to spur economic growth, the Federal Reserve can act directly to help keep long-term interest rates from rising. In 1976, there was a modest lengthening of the maturity of the Federal Reserve's securities portfolio. By continuing this policy, the Federal Reserve can help to offset upward pressure on long-term interest rates.

The behavior of long-term interest rates is of special concern for two reasons. First, any increase in long-term interest rates would tend to exacerbate the present weakness of business investment. Second, home mortgage rates need to be reduced from present levels if there is to be a sustained recovery in the housing industry.

Last month 31 Democratic members of the House Committee on Banking, Finance and Urban Affairs wrote to the Federal Reserve Board of Governors and the Federal Open Market Committee to stress the need for a monetary policy consistent with the fiscal stimulus program. We, too, wish to stress the importance of pursuing a monetary policy which fully complements fiscal policy. The historical record gives some grounds for concern.

In 1975 Congress adopted a fiscal stimulus program that included tax rebates and payments to social security recipients. Shortly after the rebates were in the hands of taxpayers, the money supply started to grow rapidly. The Federal Reserve reacted by tightening money growth, thereby negating part of the fiscal stimulus.

This year's adverse weather conditions may cause sudden increases in the price of fuel and food. Several times in the past, the Federal Reserve has treated a sharp rise in prices as if it were due to excessive demand even when this was not the case. Such a misapplication of monetary policy took place in 1958 and, especially, during the 1973–74 rise in oil prices.

Economic indicators do not suggest that there is currently any excess demand in the economy. The demand for business loans is still low as is actual investment in plant and equipment. The utilization of industrial capacity is well below an inflationary level, and unemployment remains high. The type of inflation we are likely to experience this year will not be a type to be dealt with by any tightening of monetary policy.

Recently, the Federal Reserve Board announced monetary targets for the period ending with the fourth quarter of 1977. The target for the narrowly defined money supply (M1) is to be held at its previous range of 4½ to 6½-percent annual growth. However, the lower limit of the ranges for M2 (which includes savings deposits at commercial banks) and M3 (which includes, in addition, deposits at thrift institutions) was lowered by one-half percentage point. The new ranges are 7 to 10 percent for M2 and 8½ to 11½ percent for M3. In explanation, in addition to technical considerations, the Federal Reserve stressed the importance of gradually reducing monetary expansion so as ultimately to attain general price stability.

The 11 to 12-percent money GNP growth projected for 1977 may put some pressure on the targets envisioned by the Federal Reserve. Even if M1 grows at the upper limit of its targeted range, the rate of growth in the velocity of money would have to be about 5 percent to accommodate the expected increase in money GNP. This high rate of velocity growth is possible, but very far from assured. Unless the Federal

Reserve Board remains flexible with regard to the upper limits of its targeted ranges, continued economic recovery could be thwarted.

During the course of the current recovery, interest rates have fallen. In part this reflects lenders' expectations that inflation will not return to double digit figures. In setting its monetary policy, the Federal Reserve has continued to stress the impact that policy can have on the expected rate of inflation and on the psychology of consumers and investors. But too often the Federal Reserve appears to minimize the impact restrictive policies have on consumer and investor confidence.

The conduct of monetary policy in 1977 should be consistent with the need for real economic growth and stability. Monetary policy should not only accommodate but actively complement the efforts of the Congress and the Administration to spur economic activity. Efforts should be made to keep short-term interest rates low and to reduce long-term rates further to facilitate a continued recovery in residential construction and an upswing in business investment. The Federal Reserve should not attempt to offset short-term increases in the money supply caused by the fiscal stimulus program nor tighten money in response to price increases caused by shortages of individual commodities. A posture of flexibility should be adopted toward the targeted ranges for the monetary aggregates. Given the uncertainty about the year-to-year needs of the economy and the changing technical relationships among components of the money supply, a one-percentage-point addition to the upper limit of the target ranges for the monetary aggregates would be prudent.

Policies To Counter Inflation

Even when the economy is operating below capacity, inflationary pressures can be created by "structural" problems in the public or private sectors. On the government side, spending programs, regulations, subsidies and other activities can cause prices to rise. On the private side, excessive demands for higher wages or prices in the noncompetitive industries can have the same result. Supply shortages, whether due to market failures, weather conditions, industry bottlenecks, or artificial constraints imposed by domestic firms or international cartels can also force prices up.

Because fiscal and monetary policies cannot by themselves solve these kinds of problems, the Federal Government has over the years instituted a number of actions intended to moderate price increases, strengthen competition and remove the structural barriers that prevent the market system from operating freely. Possible government actions include improved regulatory and procurement procedures, enforcement of antitrust laws, Presidential "jawboning," wage and price guidelines and wage and price controls. At present, the principal government agency with responsibilities for analyzing structural inflation problems is the Council on Wage and Price Stability (CWPS), created by Congress in 1974 as a successor to the Cost of Living Council (COLC). The main difference between the two agencies is that COLC had mandatory wage and price control powers; CWPS has no such authority.

The purpose of CWPS is to monitor and analyze inflationary activities throughout the economy. It reviews government policies, programs, and regulations under its statutory authority and, together with the Office of Management and Budget, reviews the "inflation impact" analyses prepared by government agencies pursuant to an Executive Order signed by President Ford in 1974.[8] In the private sector, the Council is supposed to conduct comprehensive studies of certain major industries and investigate specific price and wage increases. It can present its views concerning new regulations before regulatory authorities and it can hold public hearings on price and wage increase. It has subpoena power to obtain information. It does not have the power to delay, modify, or disapprove any government or private action.

Inflation Impact Statements

The Council has had only limited success in achieving its objectives and there is little likelihood that it will have a significant influence on wage and price increases under present circumstances. Experience with the inflation impact analyses has been disppointing. There are several problems in this area. First, government agencies have been slow to implement the program. Two agencies, the Agriculture Department and the Federal Energy Administration, have advised the Council that they do not believe the inflation impact statements should be continued and the Defense Department has asked to be exempted from the program.

Second, those agencies that have attempted to perform inflation impact studies have typically performed them in an unsatisfactory manner or, with respect to new regulations, after the proposals have been published and too late to influence the decisions. Third, OMB, which is responsible for reviewing inflation impact statements concerning new legislation, has done little to hold agencies accountable for competent analyses and seems uninterested in the program. Even the CWPS appears to have given it less than full support. A report prepared jointly by its staff and the Office of Management and Budget concludes, "The types of enforcement which now exists places considerable reliance on OMB and CWPS, neither of whose performance has been completely satisfactory."[9]

The essential problem with respect to the quality of the inflation impact analyses is that government agencies are not inclined to produce analyses of their own proposals which demonstrate adverse economic effects if the proposals are carried out. Once an agency endorses a new program or regulation it is motivated to defend that decision against criticism rather than to encourage or support criticism. In addition, agency heads must respond to a variety of pressures for resources, and compliance with the inflation impact statement program is not likely to be given much weight. As the CWPS–OMB report puts it, "Given the natural proclivity of agencies to respond to what they perceive as

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[8] Executive Order 81811 was extended to Dec. 31, 1977, by Executive Order 11949. The new order changed the title from "Inflation Impact Statements" to "Economic Impact Statements."

[9] "An Evaluation of the Inflation Impact Statement Program," prepared for the Economic Policy Board by the staff of the Council on Wage and Price Stability and the Office of Management and Budget, Dec. 7, 1976, p. IV.

their constituency, analysis of economic effects of major decisions tends to be viewed as a fairly low priority." [10]

The built-in conflict that exists in agencies which are asked to analyze their own programs predates the President's 1974 Executive order concerning inflationary impact statements. Efforts to establish the Planning Programming and Budgeting Systems (PPBS) several years ago were unsuccessful and there have been persistent problems in obtaining adequate program analyses including benefit-cost analyses from government agencies.[11] Moreover, any such analysis produced by an agency can be subjected to the criticism that it is self-serving. A number of Environmental Impact Statements prepared by government agencies have been criticized for this reason.

The lack of enthusiasm among the Executive agencies for engaging in self-criticism and the unsatisfactory results produced to date make it unrealistic to expect much from this approach. Yet there is a need for such analyses, as the potential benefits are great. A more feasible approach would be to place the responsibility for economic impact analysis of selective proposals in a single agency which has no vested interest in any particular program or constituency. The responsibility should be assigned through legislation rather than an Executive order to make it clear that, as a matter of public policy, agencies will be held accountable for the economic consequences of their actions.

Monitoring Private Wage and Price Setting

In the area of wage and price increases in the private sector the Council, despite a few exceptions due to its own commendable efforts, has not been an effective moderating force. Its studies and hearings concerning capacity needs in certain industries have been helpful in identifying potential bottlenecks. Its analysis of rising prices for health care, coal, steel and other industries and its studies of collective bargaining have also been illuminating.

Unfortunately, the Council's excellent work has been rendered largely ineffective by the lack of attention and support given to it by the previous Administration and by its limited authority and resources. Since private firms are not required to provide advance notice of planned price increases, most of the Council's analyses are made after the increases are put into effect. Its small staff (less than fifty) must divide its efforts between the regulatory agencies and the private sector and is stretched too thin to gather and analyze information adequately for more than a handful of industries.

Part of the problem lies in the structure of the Council. The staff is headed by a Director who reports to a council of Cabinet-level officials. It is thus under a Cabinet committee and suffers from the liabilities traditionally associated with Cabinet committees. Cabinet members are too busy with their primary responsibilities to devote sufficient time to such groups. Furthermore some Cabinet members in the previous Administration were not in sympathy with the efforts of the Council, and at least one member virtually boycotted its meetings.

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[10] Ibid., p. VIII.

[11] For a discussion of PPBS see "Economic Analysis and the Efficiency of Government," Report of the Subcommittee on Economy in Government of the Joint Economic Committee, February 9, 1970. For studies of benefit-cost see "Benefit-Cost Analyses of Federal Programs," a compendium of papers submitted to the Subcommittee on Priorities and Economy in Government of the Joint Economic Committee. January 2, 1973.

The attitude of the previous Administration is illustrated by the fact that the activities and findings of the CWPS were not discussed in the Economic Report of the President and the Council of Economic Advisers in 1975 or 1976. Two persons have served as "acting" directors of the CWPS since the resignation of the Director in May 1976. Up to now the approach to the work of the Council has been one of studied neglect.

Much the same can be said for price-incomes policy generally. While the reduced rate of inflation in 1976 was welcome, prices are likely to rise in 1977 at least at the 1976 rate and probably somewhat faster. The signs that inflation will persist include the enormous recent increase in the Federal price ceiling on interstate natural gas, the expected increase in food prices and the fact that a number of major collective bargaining agreements will be negotiated this year.

Under these circumstances, it would be foolhardy to believe that wage and price stabilization can be achieved without concerted efforts by the Government. Too often those who fear the imposition of government controls have counseled a course of action that amounts to complacency. As a result, we find ourselves without a well thought out stabilization policy. But it is not necessary to choose between comprehensive controls and nothing. There is a middle course that can and ought to be taken now.

The first step toward an effective stabilization policy is to authorize the Council on Wage and Price Stability to require prenotification of price increases from selected industries and to delay for modest periods wage or price increases that could have serious inflationary effects on the economy.[12] The second step is for the President to place the full weight of his office behind the Council.

Prenotification and delay would permit the Council to investigate and hold hearings into the planned increases, allow the President to call public attention to them, and provide an opportunity for discussions among the Government, business and labor before they go into effect. The public is entitled to know the facts about and the consequences of wage or price increases, especially whether they can be justified on economic grounds. The Government's responsibility is to make known the facts and the possible consequences.

In addition, the Executive agencies must do a better job of managing their procurements. Wastefulness, carelessness, and permissiveness have become the hallmarks of government purchasing practices in both the defense and civilian agencies. The Defense Department has a major responsibility in this area because its procurements comprise such a large proportion of overall Federal procurements.

Finally, Congress must share the responsibility for controlling inflation. One step Congress could take would be to adopt procedures for

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[12] Senator Kennedy states: "The Council on Wage and Price Stability should be the cornerstone of an effective price-wage policy and the front line of defense against inflation. But I do not agree that the prenotification and delay procedure should be the first step in the development of the new stabilization policy. In moving from the essentially hands-off, do-nothing policy of the previous Administration to a more active incomes policy for price and wage restraint, Congress and the Administration have the opportunity to develop a broad range of new and essentially voluntary cooperative arrangements among business, labor and Government, short of mandatory steps such as prenotification and delay. I believe the Administration, with the vigorous encouragement of Congress, should be given the opportunity to do so. I also believe that a major increase in the manpower and other resources of the Council will be necessary to achieve the goals of stabilization policy. To me the first step by Congress should be to give the Council the resources it needs."

assessing the economic effects of major legislative proposals before they are acted upon. Another would be for Congress to develop its own fact-finding capabilities with respect to wage and price increases in the private sector.

Legislation should be enacted authorizing the Council on Wage and Price Stability to require prenotification of planned price increases from selected industries and to delay for modest periods wage or price increases which could have serious inflationary effects on the economy.

Legislation should be enacted extending the Economic Impact Statements program now covered by an Executive Order to encompass all Federal agencies and departments and to require the agencies and departments to prepare Economic Impact Statements in all instances where proposed programs, procurement actions and regulations will have significant economic impact. An agency such as the Council on Wage and Price Stability or the General Accounting Office should be equipped with sufficient staff to enable it to assess the Economic Impact Statements and to make independent studies of the economic effects of new proposals on a selected basis. The Economic Impact Statements and the assessments of the Statements should be performed in a timely manner and before the new proposals are adopted.

The President should support the efforts of the Council on Wage and Price Stability by directing all government agencies to cooperate with it and to make available such information and assistance as the Council may require. The President should also be prepared to help make available to the public the facts, findings and recommendations developed by the Council.

Congress should develop its own capabilities for assessing the economic effects of legislative proposals before they are acted upon.[13]

Coordinating Economic Policy Among Countries

Sluggish economic growth and stubborn payments disequilibria continue to dominate economic relations among industrial and developing countries. Both of these difficulties stem to a considerable extent from the four-fold increase in oil prices that occurred in 1973. Recovery from the 1974–75 recession has now been underway in the leading

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[13] Senator Bentsen states: "There are excellent recommendations here, but the Committee made a mistake in recommending that the Council on Wage and Price Stability be given the power to delay selected wage or price increases. I must disassociate myself from this particular recommendation."

"First, if the CWPS is given the power to delay wage or price increases, some industries will be selected out to bear the full brunt of their powers while others will go unscathed. Those industries which are most visible or most politically vulnerable will be most affected. Second, if delays are applied to all industries, this simply becomes a system of temporary wage and price controls. In the long run, as we have learned, the economy will pay through a misallocation of resources and inefficient production.

"I would have preferred for the Committee to have developed a more positive set of recommendations, focusing on how to increase competition through development of new businesses, how to expand supplies of potentially scarce materials, how to improve technology, and how to induce business to invest in more productive machinery and equipment."

industrial countries for two years, but its pace in the latter half of 1976 was far from satisfactory. In the United States, the Government is taking expansionary fiscal measures designed to step up the pace of recovery. Similar expansionary action is desirable in other countries.

The United States should encourage Japan and Germany to stimulate their economies and let their exchange rates appreciate.

Sluggish growth has resulted in continuing high unemployment and a growing risk that governments will accede to the demands of protectionists. In addition lagging growth in the industrial world has resulted in weak demand for imports from developing countries. The latter, consequently, also have been forced to contend with high unemployment and have been obliged to borrow heavily abroad to finance imports of high-priced oil, food, capital goods, and essential intermediate products.

Even with reasonable growth during 1977 on the part of the major industrial countries, the total current account deficit of the non-oil-producing developing countries with the rest of the world will be little changed from 1976. The primary international impact of growth will be to increase the total OPEC surplus and the deficit of the industrial nations. The subsidiary effect of growth will be to stimulate industrial country demand for exports from developing nations and limit the total deficit of the latter. But under any circumstances the deficits of the non-oil-producing developing world will persist at a high level (see Table V–1).

TABLE V–1.—CURRENT ACCOUNT BALANCES FOR OECD, OPEC, AND OTHER COUNTRIES, 1973–77

[In billions of U.S. dollars]

Group of countries	1973	1974	1975	1976	1977
OECD	2.5	−33.0	−6.5	−23	−25
OPEC	3.5	70.5	39.5	41	45
Nonoil developing countries	−2.5	−21.0	−29.5	−20	−22
Other countries	−4.0	−9.5	−15.5	−12	−14
Unexplained discrepancy	.5	−7.0	12.0	14	16

Source: Council of Economic Advisers.

To bring these deficits within a range that can be financed on a sustained basis, both steady expansion in the industrial world at a reasonably high level and the adoption of measures by the developing countries themselves to curb deficits are essential. The shift in the external current account position of the United States from a nearly $12 billion surplus in 1975 to a deficit during 1976 of slightly over $1 billion has been extremely helpful in assisting the efforts of other countries to curtail their deficits. In 1977 the U.S. trade deficit will be even larger and, again, this will be of help to other countries in strengthening their current account balances.

The United States has made and is making its contribution to a sustained global recovery from the 1974–75 recession and to the redistribution of payments deficits in a way that will ease the problems of developing and weaker industrial countries. To insure the success of these efforts and to avoid a surge of protectionist sentiment, the other

leading industrial countries—Japan and Germany particularly—should join in this effort.

The Japanese Government intends to adopt a budget for fiscal 1977 (which begins on April 1, 1977, and ends March 30, 1978) that is designed to raise the real economic growth rate by 1 percentage point over fiscal 1976 or to about 6.7 percent. Japanese planners hope that their policies will be consistent with a drop in the rate of inflation as measured by the consumer price index of nearly a percentage point to about 7.7 percent. If the growth target is achieved—and any prospect of a shortfall should bring forth immediately an additional stimulus—unemployment should be reduced modestly and the external current account should, according to Japanese Government planners, swing from a surplus in 1976 of about $2 billion to a small deficit in fiscal year 1977. The Japan Economic Research Council, a private body, is less sanguine. It projects a 5.9 percent real growth rate and a significant current account surplus in fiscal year 1977.

As of late 1976 industrial production in Japan was still below the previous peak attained in 1973. By contrast, industrial output in both the United States and Germany has reached or exceeded prerecession highs. Therefore in Japan there is ample room for the application of additional stimulus without raising the threat of worsened inflation. A program at least as stimulative as that the government has proposed is essential. If the real growth and current account targets specified by the government seem unlikely to be achieved as 1977 progresses, policies should be changed to insure that these goals are reached.

On the basis of policies being pursued in Germany at the close of 1976, the Organization for Economic Cooperation and Development (OECD) projected for 1977 a drop in the real growth rate from about 5.5 percent to 3.5 percent. The rate of inflation would remain stable at about 3.5 or 4 percent, and unemployment would rise by about 1 percentage point. Moreover, the OECD projected that Germany's external current account surplus would increase from about $4 billion in 1976 to $5 billion in 1977. The German Government, however, expects a growth rtae of 5 percent in 1977, leading to reduction in unemployment and the current account surplus. Since both the present high unemployment rate and the current account surplus are inappropriate, Germany will be a prime candidate for the application of expansionary measures if events during the next few months suggest that the government's projection will not be realized.

Especially in Germany, and to some extent in Japan as well, suggestions from the United States that each country should stimulate its economy have been greeted by objections to the effect that additional stimulus would accelerate inflation. Any significant rise in the rate of inflation would require subsequent restrictive measures and produce adverse consequences. Inflationary fears are probably exaggerated ,but to the extent that they are not a remedy is readily available. Permitting the external value of the mark and the yen to rise in response to market pressures would both help to curb domestic inflation and to enable Germany and Japan, in addition to the United States, to absorb an increased portion of the oil-consuming worlds' deficit with OPEC. During 1976, both Germany and Japan at times resisted market pressures tending to push the external value of their currencies higher. In general, such pressures should not be resisted but

should be viewed as a desirable means of achieving both domestic and global economic objectives.

To carry its fair share of the global oil payments burden and to prevent an unreasonable portion of that burden from being imposed on weaker industrial and developing countries, each of the three lead-industrial countries should be running a current account deficit rather than a surplus. The United States, Japan and Germany have strong economies and are far better qualified than other countries to borrow from the oil producers to finance oil imports. These three countries are more capable than others of servicing such loans. Therefore, the leading industrial countries should be running current-account deficits and borrowing from the oil producers to cover these deficits. Global redistribution of payments imbalances would thus be facilitated.

Japan and Germany should not rely primarily on export-led growth to bolster their own economies but instead should themselves provide an impetus for growth to the rest of the world. Obviously the structure of these two economices cannot be modified overnight, but dependence upon export markets as a generator of growth should be reduced gradually and domestic public works, environmental restoration and consumer demand should be fostered.

VI. MEETING THE GOALS OF BUDGET POLICY IN THE LONGER RUN

The Challenge of Funding New Programs

The early months of the Carter Administration have witnessed a new spirit of cooperation between the President and the Congress. This has increased the hopes of many for improvements, reform and innovations in Federal programs. Expansions and improvements in Federal programs, however, are usually accompanied by increased Federal expenditures. At the same time, the new President is committed to achieving full employment and a balanced Federal budget within his first term of office. For Congress and the President to deliver on the triple promise of full employment, new Federal programs and a balanced budget, very astute management of Federal resources will be required.

The budget planning process employed by the Office of Management and Budget (OMB) and the Congressional Budget Office (CBO) involves projecting the future real growth of the economy, the rate of inflation, and the unemployment rate. Using this assumed course of economic development, the tax revenues which would be collected are estimated. Then these receipts are compared to the costs of honoring current legal commitments and continuing present Federal program levels. This comparison is referred to as the "current services" or "current policy budget."

As inflation and real growth push individuals into higher tax brackets, and as the costs of unemployment insurance decline with the unemployment rate, a handsome budget surplus is projected to emerge, reaching the range of $60 to $80 billion by 1982. These resources would be ample to finance most of the social programs now being discussed with the notable exception of a national health program.

Projections such as these, however, are very sensitive to the underlying economic assumptions. For example, our progressive personal income tax is such that inflation causes receipts to increase faster than expenditures. Table VI–1 illustrates how the budget might look under alternative inflation assumptions. The upper panel presents inflation assumptions from CBO staff documents prepared for consideration of the First Concurrent Resolution on the Fiscal Year 1978 Budget. Under these assumptions, the surplus available by 1982 would exceed $60 billion. If future inflation rates, on the other hand, revert to levels closer to our long-term historical experience, the budget surplus available for new programs will shrink sharply (see lower panel of table).

TABLE VI-1.—PROJECTIONS OF FEDERAL BUDGET TOTALS WITH ALTERNATIVE INFLATION ASSUMPTIONS

[In fiscal years; billions of dollars]

	1977[1]	1978	1979	1980	1981	1982
Congressional Budget Office projections:						
Inflation rate	5.0	5.5	5.4	5.1	5.0	5.3
Total receipts	348	400	457	520	590	660
Total outlays	418	460	493	523	560	598
Surplus (+), deficit (−)	−70	−60	−36	−03	+30	+62
Projection assuming less inflation:						
Inflation rate	5.0	4.5	4.0	3.5	3.0	3.0
Total receipts	348	391	434	473	511	545
Total outlays	418	453	477	497	518	538
Surplus (+), deficit (−)	−70	−62	−45	−24	−07	+07

[1] Levels set in the 3d concurrent resolution on the fiscal year 1977 budget.

Source: Congressional Budget Office staff odcuments prepared for consideration of 1st concurrent resolution on the fiscal year 1978 budget and the Joint Economic Committee staff.

Another problem with these projections is that they examine the impact of economic growth on the budget but not the impact of the budget on growth. In fact, of course, the Federal budget also has a substantial influence on the economy. This one-way mode of analysis leads to a serious inconsistency between the size of the deficit and the level of private demand.

Analysts agree that the budget will move toward surplus as unemployment falls if tax and spending policies are held constant. Once the feedback link is made between the rising surplus and private demand, however, it becomes clear that the growing restrictiveness of budget policy may curb private activity and prevent the unemployment rate from continuing to fall. Our analysis indicates that full employment will not be restored within the next five years without substantial tax reduction or spending increases relative to current policy levels, but these budget changes could cause the projected budget surplus to disappear.

In its recent report, *Budget Options for Fiscal Year 1978*, the CBO tries to correct this inconsistency. In that document, CBO analyzes the tax and spending policies necessary to achieve a stipulated economic growth path under various assumptions about the strength of non-Federal demand. This analysis assumes that the non-Federal sector makes an autonomous contribution to total aggregate demand, given current policy concerning Federal expenditures and revenues. This autonomous contribution is characterized as strong, moderate, or weak. If the resulting growth in non-Federal demand combined with the current policy level of Federal purchases is inadequate to reach the CBO's target economic growth path, taxes are reduced until sufficient fiscal stimulus is provided to reach the target growth path. The conclusion of this analysis is that our goals of low unemployment and balanced growth may not be attainable within a reasonable time unless private demand is unusually strong.

During the past 20 years, Congress has enacted periodic tax reductions which, on the average, have served to hold the ratio of personal income taxes to gross national product to about 8¼ percent. If present tax laws are maintained over the next five years, however, personal income taxes would rise to about 11 percent of GNP by 1982. Not only

would this increased tax burden weigh heavily on the taxpayers, but the resulting Federal surplus could prevent the unemployment rate from falling to desired levels. The political improbability of such a sharp rise in the effective tax rate on personal income is obvious. Should Congress and the Administration decide that a return to full employment requires keeping personal income tax collections at approximately 8½ percent of GNP—the level that prevailed from 1957 to 1972—the budget surplus projected in Table VI–1 for 1982 would vanish. Table VI–2, reproduced from a Joint Economic Committee staff report published last year, illustrates this point.

It is true, of course, that tax reductions are not the only way to provide the economic stimulus necessary for real income growth. Spending on the new programs could provide needed stimulus while simultaneously meeting national objectives. The crucial question about this approach is how quickly the programs contemplated by Congress and the Administration can be designed, adopted and brought into operation.

TABLE VI–2.—TAX RECEIPTS AND DEFICIT WITH VARYING ASSUMPTIONS [1]

[In billions of dollars]

	Individual tax receipts (current service)	Individual tax receipts (8.5 percent of GNP)	Difference	Budget surplus or deficit (assuming taxes are a constant share of GNP [2]
Calendar year:				
1977	168.3	160.2	8.1	−57.1
1978	195.8	177.2	18.6	−55.6
1979	228.0	195.9	32.1	−41.1
1980	265.0	216.5	48.5	−28.0
1981	306.5	238.7	67.8	−12.8
1982	350.6	263.7	86.9	0

[1] Calculations are made using CBO's baseline economic assumptions as published in "Five-Year Budget Projections: 1978–1982, Technical Background," December 1976.
[2] This calculation assumes a level of expenditures adequate to continue current services.

Source: Congressional Budget Office and Joint Economic Committee.

Congress and the Administration must be fully cognizant of the timetable associated with the new congressional budget process in considering the adoption of new program initiatives. The long lead time necessary for budget planning and approval does not allow enough time to get new programs incorporated into the First Concurrent Resolution on the 1978 Budget, which must be agreed to by May 15. This has made the deferral of most new programs until 1979 inevitable. Given the protracted period of congressional study and debate which will—and should—precede adoption of such major initiatives as welfare reform, tax reform or national health insurance, the extent to which major spending programs can begin even in fiscal year 1979 remains open to question. Furthermore, actual outlays on even the biggest new programs typically are rather modest in the first year or two of operation.

Thus, we cannot expect permanent new programs to provide much stimulus to the economy in 1978 or even in 1979. Every present indication is that such stimulus will continue to be needed if the commitment to full employment is to be realized. This has been recognized in President Carter's two-year fiscal program, the spending component of

which falls largely in 1978. Should additional economic stimulus be required, tax reductions again would prove to be the most rapid way to implement it.

By submitting a program of economic stimulus composed largely of temporary measures, President Carter has demonstrated his awareness of the difficulties of funding major new programs out of the projected budget surplus. Congress also must be aware that, if the budget margin is spent on tax reductions, it cannot be spent a second time on new programs. Neither can tax reductions intended to stimulate the economy be spent a second time to "sweeten" a tax reform package. This implies that the permanent tax reductions which are enacted will have to do double duty, achieving both stimulus and reform. It also indicates that existing programs will feel intense pressure from the financing needs of new programs. To give the economy the stimulus it needs, tax and spending measures will have to be skillfully combined, and temporary spending programs will have to be carefully phased out as permanent ones are introduced.

Improving the Policymaking Process

Fiscal year 1977, which runs from October 1976 through September 1977, is the first year in which the provisions of the Congressional Budget Act of 1974 are legally binding. This Act revolutionized congressional budgeting procedures, giving Congress for the first time a systematic process for looking at the budget simultaneously as an instrument of economic policy and as a blueprint for meeting public needs.

The recent need for a Third Resolution on this year's budget to counteract an unexpected weakening of the economy has provided an opportunity to test the short-run flexibility of the budget process. This test has demonstrated that the budget process is capable of responding to changed economic circumstances. The legislation needed to amend this year's budget has proceeded rapidly. Although decisions by at least eight separate congressional committees are required, these decisions have been considered as components of an overall program, and the total impact on the budget and on the economy has been analyzed and debated. As discussed above, enactment of these budget amendments has significantly improved the 1977–78 outlook for production and employment.

At the same time, experience during this first year of the new budget process has uncovered problems which need to be resolved. The discussion below identifies possibilities for improving the usefulness of the budget as an instrument of economic policy. This use of the budget is the particular concern of the Joint Economic Committee pursuant to the Employment Act of 1946, and our concentration on this aspect of budget policy is not meant to downplay the importance of strengthening further the procedures by which spending allocations within the budget are determined.

Three important questions of fiscal management have emerged during this first year of the new budget process. First, how can actual budget outlays be effectively monitored and kept on the track intended in the Budget Resolution? Second, what action should be taken when outlays do depart markedly from the budget plan? Third, what types

of actions are appropriate when economic conditions depart from expectations and the budget plan itself must be altered during the course of the year?

Controlling Budget Outlays

The appropriations which Congress enacts provide budget authority. These totals are binding and cannot legally be exceeded. However, these funds are not necessarily expended within the budget year in which they are appropriated. Actual spending or budget outlays draw in part on balances remaining from prior year's budget authority and in part on current authority. The predicted outlay total for the current or future years is necessarily an estimate based on judgments about how rapidly appropriated funds will be spent.

Estimation of outlays is quite difficult. This was illustrated dramatically in fiscal year 1976 and the transition quarter when actual outlays fell $16 billion short of their amounts set in the Budget Resolution.

Since actual outlays, not budget authority, determine the economic impact of the budget, careful estimation and control of outlays is essential to the successful use of the budget as an instrument of economic policy. There were numerous reasons for the weakening of the economy state expected outlays to avoid the administrative difficulties inherent factor and one which lies within the control of the Federal Government.

Before control of outlays can be improved, monitoring procedures must be strengthened so that departures of actual from intended spending are recognized before it is too late to take corrective action. Outlay projections are derived by the OMB from information supplied by the individual agencies. There is a natural tendency for agencies to overstate expected outlays to avoid the admiinstrative difficulties inherent in working within a tight spending ceiling. It is the responsibility of OMB to scrutinize these estimates and to make necessary adjustments to eliminate any bias. It is also the responsibility of OMB to provide Congress with information on the expected outlay path within the budget year so that departures from the planned totals can be quickly identified.

OMB and CBO should undertake a systematic program of assisting individual agencies in making accurate outlay estimates and scrutinizing agency estimates to eliminate any remaining bias. At the beginning of each budget year, OMB should publish an expected quarterly outlay path for the year (on a unified budget basis) so that actual spending each quarter can be measured against expectations.

Once deviations from the expected outlay path are identified, the question remains as to what, if any, offsetting adjustments should be made. Spending shortfalls themselves often are highly desirable. Lower interest costs due to a drop in interest rates, higher receipts than expected from offshore oil leases, or savings due to improved program management surely are to be welcomed. At the same time, large deviations from expected outlays can have undesired effects on the economy.

Some small range of error in outlay estimates is inevitable and should be expected. For example, spending shortfalls totaling, say, $4 billion would represent less than one percent of overall Federal

spending and only 0.2 percent of total GNP. Its economic impact would be barely discernible.

The economic impact of a spending shortfall also varies with the cause of the shortfall. For example, increased receipts from offshore oil leases would not have the negative impact on employment which would result from a delay in paying out the same amount of money on a public works project.

The Budget Committees and the Joint Economic Committee should work together to develop answers to the following questions:

(a) What size and kinds of departures from planned outlays require corrective action?

(*b*) What type of corrective action is appropriate?

(*c*) What authority, if any, should Congress give to the Executive Branch to adjust either taxes or discretionary spending temporarily in amounts necessary to carry out the intent of the Congressional Budget Resolution? [1]

Adjusting to Changing Economic Conditions

The problem in 1976 was a failure to keep outlays on the planned path. In 1977 a different problem has arisen. Economic growth has been weaker than anticipated, and this has necessitated a change in the budget plan itself. Obviously, similar sitautions economy proves either stronger or weaker than anticipated. While action on a Third Concurrent Resolution, as indicated earlier, was accomplished swiftly and successfully this year, it would be desirable nonetheless to establish ground rules for the future on the types of policy changes which are appropriate for midyear corrections of economic policy. In general, we would argue that permanent tax changes and permanent spending programs seldom can be adequately debated in the context of amendments to the current year's budget policy.

As in 1977, economic developments will at times depart from expectations, necessitating amendments to the Budget Resolution. In anticipation of such occurrences, Congress should develop a list of agreed policy tools for achieving short-run and temporary changes in fiscal policy. Such a list might include:

(*a*) Variations in countercyclical spending programs, such as countercyclical aid to State and local governments; and

(*b*) Temporary tax changes, including tax rebates.

[1] Senator Bentsen states: "The suggestion that Congress might give the President authority to alter tax or spending decisions previously made by the Congress is a bad one. We have just gotten over a long battle with one President who persisted in thwarting the desires of Congress by impounding funds authorized and appropriated for specific purposes by the elected representatives of the people, and I do not want to give another President any discretion that may lead to the same result."

"In 1974, Congress created a new budget process that has worked very well. We have seen, with the passage of the Third Concurrent Resolution on the Fiscal Year 1977 budget, that the process is flexible enough to respond to changes in economic conditions. I think the Committee's recommendation that a process be established to keep better track of spending and taxes will be sufficient to assure that the goals of the Budget resolution are carried out."

Fundamental changes in the tax structure or in permanent spending programs should be decided on their own merits rather than as part of an adjustment in fiscal policy for a year already underway.

This is an area in which the Budget Committees and the Joint Economic Committee should cooperate in developing more specific recommendations.

Maintaining a Comprehensive Federal Budget

For various reasons many federally owned and controlled agencies have been excluded by law from the annual Federal budget. These agencies include the Postal Service Fund, the U.S. Railway Association, the Federal Financing Bank, and the Exchange Stabilization Fund, and the Federal Reserve System Board of Governors, among others. Certain other government-sponsored institutions such as the Federal land banks and the Federal home loan banks also are excluded from the budget.

When this practice was begun, the funds involved were small and of relatively little importance. For recent years, however, these activities have expanded substantially. In fiscal year 1978, outlays for these agencies are estimated at $8½ billion. As this spending has grown, the comprehensiveness of the conventional Federal budget has diminished, making it less useful as a tool and a measure of fiscal policy. Excluding these agencies from the budget also may have reduced the effectiveness of congressional review.

Each of the "off-budget" agencies should be carefully reviewed. Unless there are strong reasons for not doing so, they could be incorporated as part of the regular Federal budget.

Minority Views on the 1977 Economic Report of the President

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SUMMARY OF RECOMMENDATIONS

Fiscal Policy

1. The Minority prefers a fiscal policy of permanent tax reduction, rather than tax rebates, to generate rewards to those who labor and save. Such a policy will produce a smooth expansion of productive capacity, jobs, and real GNP, thus increasing supplies and reducing inflation.

2. Congress should examine the tax system annually to determine the effect of inflation on revenues, marginal tax rates, and incentives. Whether Congress decides to adjust tax rates for inflation automatically, or by deliberate annual review, it is clear that Congress must never again allow inflation to create an unintentional tax increase.

3. The Minority Members express concern over the low rate of economic growth, even in good years, which is implied by the low percentage of GNP devoted to saving and investment.

Monetary Policy

4. The moderate policies of the Federal Reserve have contributed to the economic expansion, the tapering off of inflation and interest rates, and the revival of homebuilding and construction in the past year. It would be disastrous to throw all this over for a sharp increase in the money supply and a very brief dip in short-term interest rates, followed by renewed inflation.

Employment

5. A disaggregated view of the unemployed is important for formulating effective targeted manpower programs and reducing the unemployment rate on a permanent basis. The wide variation in unemployment among geographical regions in the United States, as well as within poverty and nonpoverty areas in and out of metropolitan districts, suggests where the highest priorities for targeted unemployment programs lie.

6. Better vocational links between schooling and apprenticeship programs could be extremely useful in reducing teenage unemployment. On the other hand, manpower programs for adults should utilize different methods, such as retraining and relocation allowances.

7. Current definitions of unemployment do not provide the best possible measure of either labor force potential or economic hardship. The Joint Economic Committee should explore the existing problems in the use of unemployment and employment statistics in such present legislation as CETA, Public Works and Revenue Sharing. In addition, the National Commission on Unemployment Statistics should be pushed into action.

Business Capital Spending

8. The Minority Members express great concern over the sluggish rate of business capital spending. Factors contributing to the condition include the recession, the fear of wage and price controls, the low utilization of manufacturing plant capacity, the decline in the ratio of market value to replacement cost of assets, heavy-handed government regulation, and a cloudy outlook for profitability. In the long run, we need massive capital outlays in the private sector to increase productivity, achieve greater energy independence and raise our standard of living.

9. The following should be prime candidates for a package to expand business investment:

(1) Place depreciation on a current dollar basis to reflect replacement costs;

(2) Reduce corporate income tax rates;

(3) Integrate corporate and personal income taxes to eliminate the double tax on corporate income, and eliminate the tax bias against equity financing versus less stable debt financing; and

(4) Expand and make permanent the investment tax credit.

Social Security

10. Minority Members strongly urge the Congress to expedite a full-scale review of the Social Security System.

Government Regulation

11. The public must be informed as to the full cost of government regulation.

12. Congress must be more specific in the authority it grants regulatory agencies, and more stringent in its supervision.

13. The most fundamental type of regulatory reform lies in simplification of the Internal Revenue Code. We urge that a major aspect of the Administration's proposed tax reform package be tax simplification, especially for individuals and firms in the lower income brackets.

14. The Federal Government should better coordinate its gathering and publication of statistical information.

People's Capitalism

15. The Minority Members believe that we must construct effective mechanisms for broadening the base of ownership of American capital.

16. Labor-management committees, on both the firm and community levels, can have a positive effect on worker productivity and on the quality of life within the firm and the community, and should be encouraged.

Business Ethics

17. Inflation, shortages, and the disclosure of illegal payments by American firms to foreign government officials have strained the credibility of industry in the eyes of the public. Certain businesses must explain their price and distribution decisionmaking processes to the public to enable it to understand the process and to satisfy itself that

the process reflects genuine market forces. These corporations must begin to accept the responsibility of providing more complete information concerning distribution and price decisions, in order to avoid almost certain government intervention.

Boom and Bust in Public Works Funding

18. The funding of public works programs must be reorganized so that these programs will affect the economy in a truly countercyclical manner. The Government must arrange to raise money during economic expansions to fund useful public works programs during recessions, rather than raising these funds through higher taxes or by borrowing and crowding out private spending in a recession. By urging states and localities to set aside money out of each year's public works budget in special accounts, to be used in the event of a recession, public works funding could be put on a truly countercyclical basis.

Welfare

19. The Minority supports the continued improvement in the administrative efficiency of the welfare system.

20. Welfare reform will be costly. The Minority believes that the important question of finance becomes critical to the issue and that financing problems should be solved before serious discussion of implementation takes place.

21. The Minority supports continued efforts to explore the feasibility of the Negative Income Tax.

I. INTRODUCTION AND MACRO-POLICIES

Introduction

Some major themes dominate the Minority views, and are worth emphasizing at the outset. They turn basically upon our understanding of the U.S. economic system and upon the key role played by private enterprise in that system. Our emphasis on private enterprise is not a matter of ideology; it is a matter of realism. For, we believe that economic policy must be guided by how people work and how businesses invest, hire, and produce.

For this reason, we have emphasized recommendations which encourage effort, saving, investment, and the kind of economic growth in which the private sector plays a dominant part. Collaterally, we have taken notice of the fact that labor does not work, business does not invest, and people do not save, unless the returns on labor and investment and saving warrant their actions; the curtailment of these returns by high taxation and inflation can lead to erosion of confidence in the future and drying up of supply and demand, causing recessions or even depressions.

We believe it is necessary to underscore the role of the private sector for two major reasons. First, our economic success is basically the success of private enterprise. Second, we take strong issue with those who see government intervention as the solution for and determinant of our economic problems.

Those who argue this latter course preach a deceptively simple message; that primary reliance on direct government spending can create jobs, increase purchasing power and thus provide the basis for economic growth. The argument is simplistic because in the short run it is a fact that jobs and purchasing power can actually be created by direct government intervention; but this intervention will simply result in a substitution of public for private activity with less real output, job creation and business expansion, and be more and more completely dependent on increased government intervention which will trasform our society and jeopardize our freedoms.

Thus, while we agree with the Majority that an economic stimulus program is necessary, we differ substantially on the content of that program; our recommendation for permanent tax reduction addresses directly what is needed for increased incentives to work, save and invest. While we agree with the Majority on the need for an "appropriate" monetary policy to accompany an economic stimulus program, our view of what is appropriate is based on what will motivate business and labor to maintain work effort and investment without the gains from these activities being eroded by inflation. Finally, while we agree with the Majority as to the need for increased business investment, we disagree with the implication that increased demand alone will bring this about; such a view pays little heed to the need to assure workers an adequate wage and investors an adequate return.

Like it or not, prices, profits and take-home pay are key issues in how well the private sector works, since they determine for a worker or investor whether his or her effort is worth the sacrifice. The promise of reward is, in fact, what spurs business and labor to operate efficiently; there is no comparable motive spurring the public sector. Complaints about "high business profits" or "exorbitant wage demands" without an understanding of the factors necessary to maintain the quality of working life, productivity, and efficient production and distribution in a particular trade or industry, are premature—in our view.

Indiscriminate critics of business deserve to know more about how our economic system works, and this we point out in our section on "Business Ethics." However, the same critics only jeopardize the standard of living of workers and consumers when they advocate legislation which serves to abort and not to encourage private sector growth. History is replete with economic failures caused by the assumption that Government can effectively replace the decisionmaking which is best suited to the extraordinary complexity of the private sector market.

In this report, the Minority Members of the Joint Economic Committee comment on several major economic issues. We are concerned about the strength and continuance of the expansion; the soundness of our fiscal and monetary policies; employment; the sluggish rate of business capital spending; the procyclical effects of public works spending; the integrity of the Social Security System; the heavy hand of Federal regulation; business ethics; the cost-effectiveness of our welfare system; and worker participation in our private capitalistic economy.

We have some strong views on all of these issues. But, since the past is prologue, we first would like to review, very briefly, developments in 1976 before turning to the above issues.

The U.S. economic recovery from the 1974–75 recession will be two years old this May. In 1976, the quarterly pattern of gross national product (GNP) growth was uneven but the overall figure advanced by 11.5 percent, 6.1 percent in real terms. The apparent hesitation of the economy in the last two quarters of 1976 can be attributed, at least in part, to the doubts which always surround a Presidential election. The closeness of that decision in 1976 only served to emphasize the popular uncertainty. But, despite this pause, the real GNP increase for the year was the fastest rise in 21 years, and double the annual postwar average. This, indeed, was a good performance.

Inflation abated somewhat in 1976. The GNP deflator rose by 5.1 percent, down from 9.3 percent in 1975 and 10 percent in 1974. The rise in 1977 could be in the range of 5½ to 6 percent, due in part to higher food costs as a result of weather-induced shortages and drought.

Employment increased by 3 percent, 2.7 million persons, last year; total employment is at an all-time high. Due to secular and cyclical increases in labor force participation rates and growth in the working age population, the labor force grew by 2.3 percent, or 2.2 million persons, in 1976. Thus, despite the very healthy growth in employment, the unemployment rate only dropped by 1 percentage point in 1976. There is much to be done in the area of structural unemployment, and Chapter II of our report addresses this issue.

The employment policies outlined in Chapter II are aimed primarily at the next few years. If we hope to accommodate the tremendous growth of new workers in the labor force in the long term, improve real incomes, and enhance our general standard of living, business investment increases must create additional capacity. Business capital spending, addressed in Chapter III, so far has not signaled a strong upsurge.

On balance, 1976 requires no apologies. While much remains to be done, 1976 laid a good foundation for sustainable economic gains in 1977 and beyond. Whether or not the Nation can build successfully on this foundation depends on whether the Congress can shake off its habit of addressing long-term economic problems with short-term political remedies.

We are about to enter the third year of the current cyclical upturn. Historically, such periods have been marked by the easing of growth rates toward sustainable long-term levels from the more rapid growth rates characteristic of rebounds from recession lows. At such times, economic policy normally must begin to concern itself less with the past and more with the future, and must deal with problems of sustaining the expansion over the long term while avoiding renewed inflation. This is the basic theme of the Minority report.

This year the economy faces a particularly rough transition from recovery to long-run expansion. The current transition must occur at a time of unusually sluggish business investment and a persistently high rate of underlying inflation, both of which depress the rate of economic growth.

A fiscal policy which insists that pumped up demand is sufficient to produce continued real growth will fail.

> **A fiscal policy which fritters away Federal revenues in "pep pill" rebates while it denies the need for permanent incentives, and maintains tax rates and the Federal share of GNP at wartime levels, will set the stage for a reduction in real growth rates and an increase in inflation by mid-1978.**

Employment may well fail to respond to the rebate as inflation raises tax rates on income, reducing demand and inducing leisure. Inflation takes a large bite out of savings and interest, so that such goals as home ownership seem out of reach for the typical family, further discouraging work effort and labor force participation.

Businesses may well be unable to expand profitably beyond current levels of production and employment if they continue to face government competition in the capital markets, government bureaucracy in the conduct of business, government intervention in raw material markets, and high government taxes on wages, on earnings and double taxation on dividends.

> **The Minority prefers a fiscal policy which. reduces tax rates to generate rewards to those who labor and save. Such a policy will produce a smoother expansion of productive capacity, jobs, and real GNP, increasing supplies and reducing inflation.**

We need this latter course now.

We need growth in real ouput to reduce the pressure on prices. We need lower tax rates to encourage this growth in our capacity to pro-

duce real goods and services, to create jobs, and to induce people to take those risks and fill those jobs. We need steady long-term growth in productivity, the labor force participation rate, and the supply of skilled labor, to provide for an increasing ratio of retirees to the working age population and maintain the necessary integrity of the Social Security System.

The steps we take this year will determine whether the economy will continue to expand in 1978 toward the achievement of our long-term goals, or be faced with a third major economic setback in this decade.

Fiscal Policies for Achieving Forecast Goals

Demand or Supply?

The Minority Members wish to take issue with the recurring refrain, sung by the Majority at every opportunity, that if only demand can be inflated to the proper level, employment and investment will follow as a matter of course in perfect harmony and all will be well with the world.

We have had nearly $250 billion in deficits to stimulate demand over the last seven years, and the economic results have been less than perfect. What has been stimulated instead is inflation. In fact, each dose of ill-timed government stimulation to fine tune the economy has only created more inflation, more recession, and more stimulation, in a vicious circle.

Professor Martin Feldstein has submitted to the House Budget Committee a paper entitled "Unemployment Policy After the Recession," prepared for the Lehrman Institute's Economic Policy Roundtable. In it he states that the cause of today's "high rate of unemployment is not insufficient demand. As a result, the traditional Keynesian policies of increasing demand would not only fail to achieve a sustained reduction in unemployment, but would again ignite an inflationary chain reaction."

Clearly, we must look for other causes of unemployment. Two spring immediately to mind—rising tax rates which actively discourage business and labor from producing, and our continuing failure to deal with the problem of structural unemployment. (Structural unemployment is discussed in Chapter II of the Minority Report.)

The current impression that demand is deficient and in need of stimulation was fostered by an inventory adjustment during the summer of 1976 which made GNP appear to be faltering. In fact, the underlying figures showed that final sales (GNP minus volatile inventory changes) were rising at an accelerating rate throughout 1976, according to the Department of Commerce. At the same time, Bureau of Labor Statistics figures clearly indicated a lack of investment in the plant and equipment needed for the formation of new jobs, the maintenance of productivity, and the generation of increases in real wages. Tables I–1 and I–2 illustrate these points.

Taken together, these tables indicate the need to focus on problems of supply. Failure to do so will lead to an early renewal of inflation, as expanded demand for an inelastic supply drives prices higher. Unfortunately, the President's tax package is largely demand oriented, favoring temporary tax rebates instead of permanent tax rate reduction.

Temporary Tax Rebate

A temporary tax rebate is assumed to be a moderate stimulator of demand. It is designed to put money into people's hands to produce spending, which is supposed to generate its own supply as firms rush to fill orders. There are many problems with this approach.

(1) *Most of a temporary rebate will not be spent.* It will simply go into savings. Indeed, this is especially likely to occur in a year in which savings have been depleted by high energy and food prices brought on by severe weather.

TABLE I-1.—*Rates of increase in GNP, final sales—1972 dollars*

	Percent
1976:	
1st quarter	3.7
2d quarter	4.2
3d quarter	4.3
4th quarter	5.5

Source: Department of Commerce.

TABLE I-2.—PRODUCTIVITY AND UNIT LABOR COSTS

	Quarterly percent changes in—	
	Productivity	Unit labor costs
1976:		
1st quarter	7.3	3.2
2d quarter	3.2	3.5
3d quarter	2.9	4.5
4th quarter	1.5	7.3

Source: Bureau of Labor Statistics.

The Permanent Income Hypothesis, which seeks to predict changes in consumption as incomes change, is a respected model of consumer behavior. It states that consumers adjust their spending habits to conform to their long-run income prospects, with saving acting as a residual. Far more than half of windfall income is banked, as opposed to only 5 to 10 percent of ordinary income.

We have empirical confirmation of this view. Professor Franco Modigliani testified before this Committee on February 7, 1977, that the tax rebate of 1975 was almost entirely saved, and had no impact on final demand for at least a year.

(2) Even if we assume that the recipients of the tax rebate will spend it, we cannot predict an upsurge in demand.

The Department of the Treasury has no great cash surplus to disburse. When it sends out checks for the rebate, it will do so after borrowing the money by floating Government bonds.

If these bonds are bought by the public, then the purchasers will have that much less to spend, or to lend to private borrowers to spend. One group of citizens will cut spending as another increases it.

If the Federal Reserve buys the bonds, we will get an increase in the money supply, because the Federal Reserve will give the Government new money for the bonds. However, we have no reason to expect this increase in the money supply to call forth additional supplies of goods. We have ample evidence that it will simply raise prices and, as a consequence, raise interest rates.

We should have learned by now that interest rates rise and fall with inflation, as investors seek to maintain the real rate of return on their assets. (See section on Monetary Policy.) Investment will be displaced by the government spending. Consumption will be reduced as people anticipate higher future taxes to pay interest and principal on the expanded government debt, and as they are forced to increase savings to maintain the real value of savings accounts being eroded by inflation.

(3) If temporary rebates do little to increase demand, they do even less to stimulate supply. For example, the profitability of an investment depends on the level of future after-tax earnings from that investment. Since a rebate does nothing to change tax rates on future income, no investment that was not already profitable is made so by a rebate. A rebate does little to add to investment.

Similarly, a rebate on last year's income does nothing to reduce taxes on this year's labor. It does not leave workers more of their income from an hour of work. It does nothing to encourage more overtime, longer hours for professionals, or increased labor force participation by those not now looking for work.

Permanent Tax Rate Reduction

Unlike a rebate, a permanent tax rate reduction stimulates the economy in three ways:

(1) It stimulates spending by increasing the after-tax income of consumers on a permanent basis, causing them to change their spending habits.

(2) It increases the incentives to work and to hire. Greater take home pay and after-tax income make an hour of labor more rewarding, relative to leisure, than previously. Overtime is more readily accepted. Professionals and the self-employed are encouraged to produce more and vacation less.

Tax rate reduction also stimulates hiring directly. The cost of labor to the firm includes payroll and withholding taxes, while take home pay is exclusive of both. Every tax rate reduction permits a simultaneous reduction in the cost of labor and an increase in take home pay. This causes firms to demand more labor, and makes labor more eager to work, and more willing to moderate its wage demands. (That is why tax cuts are part of Britain's efforts at a new social compact to fight inflation and unemployment.)

(3) Tax rate reduction increases savings and investment, thereby accelerating job formation and economic growth.

By leaving a saver more of his interest, after taxes, tax rate reduction encourages savings. It is savings which are translated into new homes, factories, and equipment to provide more jobs and higher wages.

Tax rate reduction encourages investment. Suppose there exists a range of investment opportunities yielding returns of zero to 25 percent per year. Suppose that investors demand a 5 percent real return after taxes and inflation. If taxes are zero, and if inflation is 5 percent, then only those projects yielding 10 percent or more will be undertaken. If we now impose a 50 percent tax rate on corporate income, projects yielding 10 percent to 20 percent will be abandoned. Lowering the tax on investment income would reinstate such projects, with all the output and job creation associated with them.

All told, the increased work effort, savings, and investment resulting from the supply effects listed in (2) and (3) above have a large impact on real output. Setting new employees to work increasing supplies of vitally needed products helps to stabilize prices. It also increases the tax base.

Keynesians who consider only the demand effects predict that tax cuts, while bringing in less revenue per dollar of GNP, will stimulate GNP by enough to recoup much of the tax cut (about two-thirds of it). Taking into account the incentive effects on supply, there is reason to believe that all of the cut may be recovered as the tax base rises. If we also consider that unemployment compensation will be less as unemployment falls, it is clear that the Federal deficit will probably not be made worse, and may even be reduced. This apparently happened with the Kennedy tax cut, and in the 1920's several times.

The Treasury Department feared that the large tax rate reductions of the Kennedy tax cut (which amounted to tax reductions equivalent to $34 billion in today's economy) would reduce government revenues by $89 billion over six years. However, revenues rose by $54 billion over that period.

TABLE I-3.—EFFECT OF 1962-64 TAX CUTS ON REVENUES 1963-68

[In billions of dollars]

	1963	1964	1965	1966	1967	1968	Total
Revenue losses estimated in 1963 by U.S. Treasury	2.4	5.2	13.3	20	23.7	24.4	89
Actual revenue gains	7.0	6.0	4.0	14	19.0	4.0	54
Difference in estimates	9.4	11.2	17.3	34	42.7	28.4	143

Source: U.S. Department of the Treasury.

As the House Budget Committee Minority Members state in their views on the Third Concurrent Resolution on the Budget, "Clearly, then, it can be observed that reduction in the marginal tax rates do not result in higher deficits, but rather they expand the tax base, increase revenues, boost GNP and increase employment."

Professor Walter Heller, even though a supporter of the rebate, admitted before the Joint Economic Committee on February 7, 1977, that Federal revenues were restored to their pre-tax cut levels within a year of the Kennedy tax cut, saying, "Did it pay for itself in increased revenues? I think the evidence is very strong that it did."

Mr. Bert Lance, Director, Office of Management and Budget, testifying before this Committee on February 24, 1977, agreed with Dr. Hellers' view that permanent tax cuts have paid for themselves:

> I would say to you that, given the time to propose a stimulus package other than in the first two weeks of a new Administration, that I think we could make a strong case for permanent tax reduction. * * * We didn't have that time. * * * My personal observation is that as you go through the process of permanent tax reduction, there is an awfully good argument to be made that the revenues of the Government actually increase at a given time. I think that has been proven in pre-

vious circumstances. * * * I would personally come down on the side of permanent tax reduction as opposed to something less than permanent tax reduction.

The House Budget Committee Minority goes on to observe, "The tax cuts enacted during the Collidge administration were also very effective. At that time, the Secretary of the Treasury advocated large tax rate reductions from the high level that had been imposed to finance World War I. It was his belief that when a person's initiative is crippled by legislation or by a tax system which denies him the right to receive a reasonable share of his earnings, then he will no longer exert himself, and the country will be deprived of the energy on which its continued greatness depends." In 1924, Coolidge endorsed, and the Congress enacted, the Treasury Secretary's proposal to cut the personal income surtax from 50 to 25 percent.

In studying the effects of the cuts, Jude Wanniski, in an article for the National Observer dated March 6, 1976, wrote:

> The low tax rates not only produced an enormous expansion of the economy, with real per capita income increases approaching 4 percent a year, but they also produced sufficient revenue to pay off almost a third of the national debt, slicing it back to $17 billion by 1928. In eight years, American productivity—output per man-hour—increased by 30 percent.

The power of tax rate reductions to create jobs still exists, as Table I–4 shows, and should be considered by the Congress.

TABLE I–4.—*Effects of a $19 billion reduction in personal income tax* [1]

[Impact of proposed tax reduction during 1977, 4th quarter. In billions of dollars.]

GNP	+42
Personal income	+23
Disposable personal income	+56
Consumption	+34
Fixed investment	+ 7
New jobs created	790, 000

[1] Congressional Budget Office study, dated Feb. 3, 1977, of a reduction in each tax bracket's rate by 5 percentage points.

Inflation and the Tax System

A further justification for tax rate reduction is the fact that tax rates have been creeping up for several years. Each year, inflation pushes taxpayers of all income levels into higher tax brackets, even if their incomes have only risen to keep pace with prices. Since 1972, for example, several million factory workers have been propelled from the 19 percent bracket to the 22 percent bracket with little or no increase in real income.

As this phenomenon continues, wage demands increase to offset higher withholding. Since taxes rise 1.2 percent for every 1 percent increase in wages and prices, workers must have a "cost of living" increase in excess of the rate of inflation just to maintain the value of their take home pay. This helps to build inflation into wage demands.

While the Government has granted periodic tax reductions to keep average tax rates roughly stable, it has done so at irregular intervals. Furthermore, while maintaining average tax rates, it continues to

allow marginal rates to rise, producing the disincentives to labor and saving described above.

Testimony before this Committee branded the $30 billion increase in real Federal taxes due to inflation between 1972 and 1974 as one of the causes of the 1974 recession, which surely cost the Government far more than $30 billion in lost revenue and increased unemployment compensation. The social loss, of course, was even greater. In the year following the tax cut of 1975, inflation raised the real tax burden by more than $5 billion, contributing to the disappointing rate of growth (less than 5 percent) of final sales and GNP in 1976.

In a paper prepared for the Joint Economic Committee, Professor Thomas Dernberg warned that unlegislated, inflation-induced tax increases in the first year of the 1974 recession undoubtedly worsened the downturn. He concluded that the Tax Code should be adjusted (indexed) automatically for inflation, to keep tax rates from rising without an open debate and vote by the Congress. He suggests that, "An indexed personal income tax would have helped to avert the collapse of 1974, that it would tend to stabilize the level of economic activity, that there is little presumption that it would contribute to inflation, and that it might, indeed, do the opposite if it relieved cost and supply pressure."

Congress should examine the tax system annually to determine the effect of inflation on revenues, marginal tax rates, and incentives. Under a provision of the Tax Reform Act of 1976, the Joint Committee on Internal Revenue Taxation will shortly be conducting a study on indexing. In the meantime, the Act urges the Council of Economic Advisers to publish an annual announcement of the amounts by which inflation has increased taxes and tax rates. We hope that the Council will cooperate in this matter.

When Congress decides to adjust tax rates for inflation automatically, or by deliberate annual review, it is clear that Congress must never again allow inflation to create unnoticed an unhealthy, pro-cyclical tax increase going into recession.

The Need for Growth

It is the view of the Minority Members that permanent tax rate reductions should play a major role in any stimulus package adopted this year. We note the recommendation of the Senate Republican Economic Package for $17.3 billion in rate reductions on personal income tax for low and middle income taxpayers by the end of 1978. Other Members of the Minority have urged reductions in tax rates in each bracket of from 10 to 22 percent. As we note above, the historical evidence is overwhelming that this type of tax reduction will be more effective at job creation, and less inflationary, than a tax rebate.

In addition to personal income tax rate reductions, the Senate Republican Economic Package recommends a tax rate reduction for small business. An increased dividend exclusion for small investors, and an interest exemption for small savers, are included in an effort to increase savings and investment beyond the effect of lower tax rates.

These attempts to stimulate business, savings, and investment directly reflect the concern of the Minority over the low rate of economic growth, even in good years, which is implied by the low percentage

of GNP devoted to saving and investment. We have the worst record in this regard of all major Western Nations. It has adversely affected our unemployment rate, and our rate of increase of real wages.

Wages are determined, in large part, by the capital-labor ratio. Countries with a high stock of tools and equipment per worker have high wages. Countries with a growing stock of tools and equipment per worker have growing wages. If we want more jobs and higher wages, tax rates must come down so that investment in tools and equipment can increase.

TABLE I-5.—WAGE INCREASES AND INVESTMENT

	1965–75 percent change in real wages and fringe benefits [1]	Investment as percent of GNP averages, 1960–73	
		Total	Total minus home building
United States	15.7	17.5	13.6
Canada	48.5	21.8	17.4
Japan	137.9	35.0	29.6
Belgium	103.8	NA	NA
France	77.4	24.5	18.2
Germany	78.1	25.8	20.0
Italy	116.4	20.5	14.4
Sweden	68.8	NA	NA
United Kingdom	53.9	18.5	15.2
Switzerland	55.1	NA	NA

[1] Includes pension programs and other fringe benefits.
NA—Not available.

Source: Bureau of Labor Statistics.

In 1950, the United States had twice the per capita income of Sweden or Switzerland. In 1974, these countries surpassed the United States in per capita income, and several others are close at hand. This rapid progress of our trading partners was aided by availability of tools and equipment per worker. We should do the same.

The real need for increased capital formation is discussed in detail in Chapter III, under the section entitled Business Capital Spending of the Minority views.

The consequences for the Social Security System of failure to increase the rate of capital formation and economic growth in the United States are analyzed in Chapter III under the section entitled Social Security. Briefly, current law provides for pension benefits far in excess of those which the economy will be capable of providing at expected rates of growth of productivity and population. If we are not to reduce benefits, we must provide incentives for increased savings and investment, or face the necessity of levying taxes approaching 30 percent of taxable payroll. Funding of the current social security deficit out of general revenue will not be an easy way out of this dilemma, since the amounts involved are on the order of $35 billion per year over the next 75 years. This is roughly 15 percent of general revenues, which are already hard-pressed to keep up with the demands of other programs.

If we are to be able to fund our pension health care, and defense needs in future years, and to provide a rising standard of living for our population, a determined effort to increase economic growth must be made. Incentives to work, save, and invest must be strengthened through the reduction of marginal tax rates, removal of regulatory

roadblocks and redtape, and the elimination of educational deficiencies which prevent many thousands of our citizens from becoming productive, self-supporting workers.

Monetary Policy

The Federal Reserve has been walking a fine line between a restrictive monetary policy which could stifle the economic recovery, and an overly expansive policy which could rekindle inflation. In our view, this effort has been successful.

Over the past year, the Federal Reserve set growth targets for the monetary aggregates. M1 (cash and checking accounts) was to grow by between 4½ and 6½ percent, and M2 (which includes consumer time deposits at commercial banks) by between 7½ and 10 percent. The target for M1 was achieved with a growth rate of 5.5 percent, while M2 rose 10.9 percent. A broader measure, M3 (which includes deposits at savings institutions) was to have grown by between 9 and 11½ percent, but in fact rose 12.8 percent. Monetary growth in the last quarter of 1976 was even faster than for the years as a whole; 6.3 percent for M1, and 12.3 percent for M2, at annual rates.

All of these growth figures are high by historical standards, and all exceed levels which are compatible with stable prices. It is the announced intention of the Federal Reserve gradually to reduce these rates of increase to more reasonable levels. However, this will be done slowly so as not to restrain the recovery.

There are those who call for further increases in the rate of growth of the monetary aggregates, "to lower interest rates and get the economy moving." The aim is admirable, but the method is madness.

Long-term interest rates, the ones which determine the cost of major investments in houses, factories, and equipment, cannot be forced down by easing money. Risk factors aside, these rates (i) are the sums of the real returns demanded by investors (r), and inflation premiums (p) equal to the expected rate of price increases over the period of the loan. In other words, $i = r + p$.

Interest rates equal real rates of return plus inflation. Interest rates rise and fall with inflation.

In 1962, when inflation was 2 percent, one could get a mortgage in this country for 5 percent. In 1976, inflation was 6 percent and mortgages were 9 percent.

The same relationship holds across countries. In the early 1960's, Germany and Switzerland had the world's tightest money, lowest rates of inflation, and lowest interest rates. Some Latin American nations had printing press money, 100 percent inflation, and 105 percent interest rates. Today, Britain and Italy have the highest rates of money creation, inflation, and interest rates in the developed world.

As paradoxical as it may seem, the way to reduce interest rates over the long-term is to pursue tight money. It is the real interest rate (r) that affects a country's rate of growth. The lower "r" is, the higher is the number of investment projects which can be funded, since even projects with a low real rate of return become profitable at a low real interest rate. The way to lower real interest rates is to reduce taxes on savings to increase the savings rate. (See the section entitled Fiscal policies for Achieving Forecast Goals.) Inflation and nominal rates

should be kept low too, however, to avoid high nominal payments for non-business borrowers who may have liquidity or cash flow worries, such as young home buyers.

The moderate policies of the Federal Reserve have contributed to the economic expansion, the tapering off of inflation and interest rates, and the revival of homebuilding and construction in the past year. It would be disastrous to throw all this over for a sharp increase in the money supply and a very brief dip in short-term interest rates, followed by renewed inflation.

The announced targets for M1, and M2, and M3 for the coming years are little different from those of 1976. (The bottoms of the ranges for M2 and M3 have been reduced one-half percent.) Since the velocity of money usually increases during recoveries, there is ample room for economic growth to occur under anticipated increases in the aggregates. At the same time, the Fed is carefully montoring the disappointing productivity and unit labor cost figures of 1976, and the higher rates of growth of wholesale prices in the last quarter of 1976, for signs of renewed inflation.

Meanwhile, mortgage credit is plentiful and rates are declining. Firms have rebuilt their cash positions and face little difficulty in raising funds in the bond markets.

One cloud on the monetary horizon is the possibility of a heavy Treasury note issue to fund the tax rebates and other programs proposed by President Carter. If the Federal Reserve is bullied into buying these notes, either directly or by purchasing outstanding paper, the money supply will take a giant leap upward. If this generates inflationary fears, long-term interest rates would be likely to rise, and the recovery could suffer.

It is appropriate at this point to mention the recommendations of Professor Robert Mundell on how to break free of the Phillips curve to reach low unemployment with low inflation. A liberal fiscal policy of low tax rates must be used to reduce unemployment, while a tight money policy (gradually arrived at) must be used to lower inflation and interest rates. It is to be hoped that the Federal Reserve can pursue its part of this course in peace.

II. EMPLOYMENT

The Structural Element in Unemployment

Over the last two decades, the marked changes in the composition of and worker participation in the labor force have blunted much of the expected result of policies for achieving full employment. A direct challenge to the present orthodoxy of the "correct" target for full employment was issued by the outgoing Council of Economic Advisers. They determined that the theoretical unemployment rate at full employment is now 4.9 percent rather than the former 4 percent of the mid-1950's. While this announcement was greeted with considerable criticism, most economists have acknowledged that labor force changes will force the evolution of a more realistic assessment of the limitations of macroeconomic policy.

The following are the main reasons given for the Council's reassessment of the definition of full employment. Because a larger proportion of job seekers now come from outside the labor force (women and teenage new entrants and re-entrants), job introduction periods and job turnover rates are much higher. All things being equal, the proportion of youths in the labor force (accompanied by higher turnover rates and longer search periods) necessarily produces a rise in the total unemployment rate.

Higher participation rates of teenagers and women in the labor force does not signal a permanent shift in the composition of the labor force. For example, the shift of the teenage population through the ranks of adult workers as the baby boom passes will mean that the unemployment rate at full employment could be revised downwards substantially.

While the debate on the correct estimate of the full employment rate will continue for some time, an understanding of the structural impediments and natural frictions inherent in the labor force is critical for the formulation of economic policy. Some period of job search is inevitable and desirable; the worker has a chance to test out several job opportunities. On the other hand, there could be a considerable mismatch of job skills and available jobs in a particular locality. This frictional type of unemployment is usually short-lived, but more permanent structural biases, such as institutional barriers to hiring women, minorities, etc., may extend the period of joblessness. The Council of Economic Advisers introduced a new terminology, "induced unemployment", to explain the unemployment that comes about as

a result of income maintenance programs that actually blunt work incentive and lengthen the average duration of unemployment.[1]

While the concept of frictional unemployment is fairly straightforward, its quantitative evaluation is extremely difficult. As might be expected, frictional unemployment will form a smaller part of total unemployment during the contractionary phase of the business cycle, and a larger proportion of total unemployment in the cycle's expansionary phase.

For example, in 1969, when the aggregate unemployment rate was only 3.5 percent, frictional unemployment could have accounted for 60 to 80 percent of the country's unemployment; on the other hand, in the recession year of 1975 frictional unemployment probably caused only 30 to 45 percent of total unemployment.

Utilizing the Department of Labor's classification of types of unemployment, frictional unemployment would include reentrants, new entrants, job leavers and some proportion of job losers. A certain amount of job losses will be related to "normal" conditions such as the end of seasonal work, factory closings, etc.

Has Employment Reached Its Expansionary Phase?

The January establishment survey showed an increase of 4.1 million persons in nonfarm payroll employment since its June 1975 trough. The household survey indicates similar impressive improvement. Although this indicates the economy has been enormously successful in providing private sector jobs, employment activity, measured against the November 1973 economic peak, does not compare as favorably. Close examination of the employment statistics reveals that only certain sectors have been responsible for the employment gains, and while the disparity between sectors is closing slowly, great unevenness remains. Payroll employment has increased substantially in such non-manufacturing activities as services, State and local government, finance, insurance and real estate. Smaller employment gains have occurred in wholesale and retail trade. In the goods producing industries, however, only mining has exhibited tremendous growth. Employment in manufacturing (both durable and nondurable), transportation, public utilities, and contract construction has remained severely depressed below 1973 peak levels. As Table II–1 shows, employment in many industries only recently has expanded beyond its previous peak. This expansion may be sharply curtailed by the recent impact of severe weather.

[1] Representative Clarence Brown adds: "I feel that government income maintenance programs are a very important reason for raising the definitional level of 'full employment.' In a volume of studies issued by the Joint Economic Committee in 1974. 'How Income Supplements Can Affect Work Behavior,' several analysts concluded that. 'income transfer programs will induce program beneficiaries to work less,' and further, 'one cost of transfer programs is a reduction in labor supply.' It is relatively easy to see how this can happen. When one adds up unemployment compensation (which is not subject to payroll or income taxes); food stamps; housing subsidies; other general assistance programs; and the savings in transportation, clothing and other work-related costs, the difference between the after-tax compensation of workers and the government-provided income of non-workers is often very small. Add to this the utility of leisure and a strong case exists for lengthening one's duration of unemployment. In turn, the unemployment rate will rise; and, accordingly the irreducible minimum level of 'full employment' must rise."

TABLE II-1.—SOURCES OF EMPLOYMENT RECOVERY

Employment category	Employment as percent of total employment	Percent change in employment from previous peak in employment [1]
Goods producing	29.2	
Mining	1.0	22.4
Contract construction	4.3	−14.0
Manufacturing	24.0	−5.8
Durable	13.9	−7.2
Nondurable	10.0	−3.7
Service producing	70.8	
Transportation and public utilities	5.6	−3.6
Trade	22.2	4.8
Finance, insurance, real estate [2]	5.5	6.6
Services [2]	18.6	12.9
Government [2]	19.0	8.3

[1] As of January 1977.
[2] Employment not subject to cyclical decline. Standard reference dates used, i.e., peak at November 1973.

Source: Bureau of Labor Statistics and Joint Economic Committee.

A Disaggregated View of the Unemployed

After an initially promising drop in the first five months of 1976, the unemployment rate climbed back to an average 7.9 percent rate in the last quarter of 1976. The drop in January of this year to 7.3 percent suggested renewed economic strength, but February's rate rose to 7.5, reflecting the massive layoffs from the winter weather conditions. By the end of this year, unemployment probably will drop only between 6 and 6½ percent. This range is still unacceptably high, but macroeconomic policy can do little more within this year's time span. Further longer-term reductions must be accomplished by carefully constructing programs targeted toward specific groups such as the hard-core unemployed and minority youth.

The need for specific programs is illustrated by a disaggregated view of the statistics. As Table II–2 shows, aggregate unemployment rates throughout 1974–76 mask a near doubling in adult male unemployment, while during the same period, teenage unemployment averaged nearly 20 percent.

By way of contrast, the unemployment rates in 1973—a period of relatively high employment—were 4.9 percent for total unemployment, 14.5 percent for teengers, 3.2 percent for adult males, and 4.8 percent for adult females.

TABLE II.—UNEMPLOYMENT RATE PERCENTAGES

[Seasonally adjusted, quarterly average]

	1974				1975				1976			
	I	II	III	IV	I	II	III	IV	I	II	III	IV
Unemployment rate:												
All civilian workers [1]	5.0	5.1	5.6	6.7	8.1	8.7	8.6	8.5	7.6	7.4	7.8	8.0
Adult males [2]	3.4	3.4	3.8	4.9	6.2	7.0	7.0	7.0	5.7	5.7	6.0	6.3
Adult females [2]	5.0	5.0	5.5	6.5	8.0	8.4	7.9	7.9	7.4	7.1	7.6	7.6
Teenagers [3]	14.8	15.2	16.3	17.6	19.8	20.2	20.2	19.5	19.4	18.7	18.8	19.0

[1] Unemployment as a percent of civilian labor force.
[2] 20 yr and older.
[3] 16–19 yr.

Source: Bureau of Labor Statistics.

The reasons for unemployment are different for age and sex categories. For example, new entrants comprise the lowest type of unemployment for adult males but new entry is the most frequent cause associated with teenage unemployment. Seventy percent of adult male unemployment stems from job loss, but job loss in responsible for only about 23 percent of teenage unemployment. See Table II–3.

These data suggest that the most direct methods for reducing teenage unemployment would be counseling and on-the-job training, to ease the transition from school to work. For adult males, the help would best come from some other types of programs such as income maintenance (designed to give workers time to find a new job), a local job bank or subsidized transportation to allow a search for a more distant job.

In the last few years of high joblessness there has been a considerable amount of dissatisfaction in some quarters with the official definition of unemployment. Critics object that it does not include among the unemployed those discouraged workers who have dropped out of the labor force. On the other hand, there has been criticism that the unemployment rate encompasses students (who should not be considered as serious full-time job seekers), workers who are only conducting a desultory job search, or others who should not be considered part of the labor force. A newly published series by the Department of Labor gives measures of various concepts of unemployment ranging from the long-term unemployed (15 weeks or more) to short-term/part-time job seekers. As shown in Table II–4, the unemployment rate ranges anywhere from under 3 percent to nearly 11 percent for the fourth quarter of 1976, depending on where one stops on the definitional scale.

TABLE II-3.—1976 PERCENT DISTRIBUTION

	Adult males	Adult females	Teen-agers
Job losers	70.1	43.5	22.6
Job leavers	10.4	16.5	8.9
Reentrants	16.8	35.2	28.8
New entrants	2.7	4.8	39.7

Source: Bureau of Labor Statistics.

TABLE II–4.—RANGE OF UNEMPLOYMENT MEASURES

[Seasonally adjusted, quarterly averages]

	1975	1976			
	IV	I	II	III	IV
U–1	3.1	2.7	2.2	2.4	2.6
U–2	4.6	3.8	3.7	3.9	3.9
U–3	5.8	5.0	4.9	5.3	5.3
U–4	8.1	7.1	7.0	7.4	7.5
U–5	8.4	7.6	7.4	7.8	7.9
U–6	10.2	9.3	9.1	9.5	9.7
U–7	11.2	10.2	10.0	10.3	10.7

NOTES

U–1—Persons unemployed 15 weeks or longer as a percent of the civilian labor force.
U–2—Job losers as a percent of the civilian labor force.
U–3—Unemployed household heads as a percent of the household head labor force.
U–4—Unemployed full-time jobseekers as a percent of the full-time labor force.
U–5—Total unemployed as a percent of the civilian labor force (official measure).
U–6—Total full-time jobseekers plus ½ part-time jobseekers plus ½ total on part time for economic reasons as a percent of the civilian labor force less ½ of the part-time labor force.
U–7—Total full-time jobseekers plus ½ part time for economic reasons plus discouraged workers as a percent of the civilian labor force plus discouraged workers less ½ of the part-time labor force.

Unfortunately, this broad array of definitions does not provide the best possible measure of either labor force potential or economic hardship. Even U–7 does not measure workers who, in addition to discouraged workers, could be drawn into the labor force if economic conditions were better. In addition, while U–1 recognizes some notion of hardship from people unemployed 15 weeks and over, we would need more information such as in-kind income, level of savings, etc., in order to make a true assessment of the economic hardship. The same principle holds true for U–3, which deals with unemployed household heads.

Examination of discouraged workers (as used in U–7) sharply focuses on the personal degree of job confidence and individual assessment of the job market. In the fourth quarter of 1976, a total of 1.3 million youths, aged 16–19, desired a job but did not consider themselves in the labor force. Of the reasonss given, 89,000 youths thought they could not get a job and, thus, were not conducting any type of job search. Of the 2.6 million unemployed adult workers in the 25–29 age bracket, 511,000 also did not believe they could get a job. Lack of education and training was the most significant of the personal factors cited for both groups. Most of the youths said that of the two job market factors listed, inability to find a job was a larger factor than the lack of jobs per se. However, the adult group was split almost equally between the inability to find a job and the belief that no job was available.

The teenage group's attitude that lack of training or education is a greater handicap than age and their belief that jobs were present suggests that a better vocational link such as apprenticeship programs or work-study programs during high school, could be extremely useful. On the other hand, retraining for job skills different from previous work experience seems necessary for adults. Most of these programs for adults probably could utilize skills already learned without the necessity of teaching work discipline.

The disproportionate burden of unemployment falls upon certain geographical regions in the United States, as well as causing sharp differentiation within poverty and non-poverty areas in and out of metropolitan areas. In metropolitan poverty areas, the unemployment rate for youth 16–19 years of age was 32.4 percent in the fourth quarter of 1976, but for black youths, the figure was an astounding 44 percent. In non-poverty areas, the comparable figures were 18.1 and 33.8 percent. In non-Metropolitan poverty areas, the youth unemployment rate was 17.6 percent; for black teenagers, 27.3 percent. In non-poverty areas, the unemployment rates were 16.4 percent and 32.9 percent respectively for total youth and for black teenagers. These figures do not include discouraged youths who have already dropped out of the labor force. In addition, most black youths, if employed, are in dead-end jobs with no hope of advancement. These widely varied figures suggest where the highest priorities for targeted unemployment programs lie.

Regional Unemployment Statistical Problems

The above figures on the metropolitan and non-metropolitan areas represent the best estimates of the Labor Department, but the Department readily acknowledges that the finer the disaggregation, the

greater unrelibility of the figures. These problems occur with regard to determining the full unemployment rate not just in poverty areas, but in other small geographic areas, such as cities and counties. The acuteness of this problem is dramatized by the flow of Federal funds sent to areas of high unemployment. Beginning with the Comprehensive Employment and Training Act of 1973, Congress has enacted a series of bills which tie program funding to local area unemployment. For example, the Public Works and Employment Act of 1976 makes over 35,000 local governmental units potentially eligible for funds, based on local area unemployment rates. An inaccurate unemployment rate can often mean the difference between the diversion or the continuation of vital funding in a severely depressed area. As the Bureau of Labor Statistics pointed out in hearings before the Joint Economic Committee, improvement in techniques unfortunately will not be solved solely through increased expenditures for employment surveys. Several reasons have been given: (1) The underlying criteria (primarily people drawing unemployment insurance) cover only a portion of the labor force and differ from state to state; and (2) independent estimates are not obtainable from the national Current Population Survey to correct any systematic errors in the small area estimates. Moreover, many of the legislated areas do not match up with the traditional labor market areas. Consequently, varying degrees of confidence can be attached to the estimates from a high rate of confidence in states and larger labor market areas to a fairly low rate for smaller cities and counties.

The Bureau of Labor Statistics and the various State employment agencies are working together for improvement of these statistics. However, it could be several years before the appropriate techniques are tried, checked and modified. In part, the resulting controversy from the use of these numbers comes from imperfect legislative understanding as to what data are available and what limitations the data have. The Joint Economic Committee could serve as a valuable educational forum to explore the existing problems in the use of unemployment and employment statistics in such present legislation such as CETA, public works, and revenue sharing. Alternative suggestions and methodology to remedy the practical difficulties also could be explored.

In addition to the suggested action by the Joint Economic Committee, the Minority Members strongly recommend that the National Commission on Unemployment Statistics created by Public Law 94-444, the Emergency Jobs Programs Extension Act of 1976, be pushed into action. The President must appoint nine members with the consent of the Senate. Seven of these members are to be chosen on the basis of their expertise in employment and unemployment statistics. Its mandate, patterned after the respected "Gordon Committee", is very broad: It includes responsibility to examine the concepts, methods, and procedures involved in collecting, analyzing, and presenting employment and unemployment statistics and to suggest improvements. Since the Commission has 18 months to compose its report and additional time afterwards for review and implementation procedures, this will be a long-term undertaking. However, it is important that the Commission's work begin as soon as possible.

In an alternative economic stimulus package to the Administration's program, the Senate Republican Policy Committee proposed several

measures aimed at the unemployment problem. The first was the creation of a new title in the Comprehensive Training and Employment Act specifically for on-the-job training, work experience, and public sector jobs for unemployed youth. The proposal calls for $1 billion in budget outlays for fiscal year 1977 and $2.1 billion for fiscal year 1978. Expected jobs and training slots were estimated at 450,000 and 700,000 in fiscal year 1977 and fiscal year 1978, respectively.

The second proposal concerned a wage subsidy for the "hard-core" unemployed worker, i.e., unemployed 26 weeks or longer. The subsidy would consist of $1.00 per hour for the first six months and $.50 per hour for the next six months. It was believed that this type of incentive to encourage the hiring of the long-term unemployed would provide on-the-job training in the private sector. While a "maintenance of employment" provision would be expected to forestall the possibility of potential abuse, for example, hiring minimum wage teenagers in fast-food operations, several members of the Joint Economic Committee are exploring additional remedies for this problem. Other wage subsidy proposals would include all persons ineligible to receive unemployment compensation. This would add new entrants (especially youths and women re-entering the labor force) to those eligible for subsidy.

During the annual hearings, a large retailer indicated that because of its unusually high proportion of part-time employed workers, it would be virtually impossible to establish a reasonable base period to determine "maintenance of employment." However, several witnesses demonstrated a willingness to participate in the formation of either a wage or training subsidy for youth and other disadvantaged workers. Indeed, the witnesses felt that their input could improve substantially the success of these types of measures. The Minority believes that these approaches represent an effective and innovative approach towards alleviating structural unemployment.

As we imply above, it is the structural unemployment issue which must be met before we can honestly claim to have solved the problem of unemployment in the United States.

III. LONGER TERM ISSUES

Business Capital Spending

The economic recovery is being slowed by sluggish business capital spending. Business fixed investment, adjusted for inflation, increased only 3.8 percent in 1976. While this might be considered an adequate rise in other settings, it is slower than normal for this stage of an economic recovery, and it is causing concern in many quarters, public and private.

Expenditures for new plant and equipment totaled $121.2 billion in 1976, a 7.5 percent current dollar increase over both 1975 and 1974 (there was virtually no rise in such spending in 1975). As noted above, in real terms the 1976 rise was only half that amount.

Expenditure estimates show a slowing of the pace in recent months. According to a survey conducted in late October and November, 1976, by the Commerce Department, Bureau of Economic Analysis, business planned to increase capital spending by 4.3 percent in the fourth quarter of 1976, 1.2 percent in the first quarter of 1977 and 1.5 percent in the second quarter of 1977.

In the 1976 *Economic Report of the President*, the Ford Administration suggested that business fixed investment would have to account for about 12 percent of gross national product (GNP) during the 1976–1980 period to achieve full employment by 1980 and to meet environmental and energy independence objectives. However, the ratio of business investment to GNP was only 9.1 percent in 1976. (See Table III–1.) Even with the improvement in real business fixed investment anticipated for 1977, the ratio will still be below 10 percent. Thus the ratios would have to be considerably above 12 percent over the next four years to put enough capital in place by the end of 1980 to meet the specified goals.

TABLE III-1.—MARKET VALUE AND REPLACEMENT COST OF NET ASSETS OF NONFINANCIAL CORPORATIONS, 1960–75

Year	Market value (billions)	Replacement cost (billions)	Ratio of market value to replacement cost of net assets	Ratio of real business fixed investment to real GNP
1960	$436	$427	1.020	0.090
1962	504	461	1.093	.089
1964	657	507	1.295	.093
1966	713	591	1.207	.108
1968	893	711	1.256	.103
1970	787	858	.917	.102
1972	1,093	1,003	1.090	.100
1974	1,107	1,320	.838	.106
1976	1,326	1,601	.828	.091

Source: 1977 Economic Report of the President, p. 29.

Factors Slowing Fixed Business Investment

A number of factors have contributed to the recent slowdown in investment spending:

(1) The recession, of course, has had a major impact; real GNP dropped 1.7 percent in 1974 and 1.8 percent in 1975; unemployment rose to 9 percent in early 1975. This can discourage businessmen from investing.

(2) Business confidence was thoroughly shaken by the threat of wage and price controls last Fall by candidate Carter. While denials have since been made, fears of reacceleration of inflation and possible government reaction remain prime causes of concern.

(3) Low utilization of manufacturing plant capacity has been an investment deterrent the past two years. Some analysts suggest that this is the main cause of lagging invesment, but this is a narrow view. The massive inventory reduction of 1974 precipitated the drop in utilization ratios, but that inventory liquidation is over and capacity utilization has been rising steadily since the first quarter of 1975 when the ratio reached a trough of 70.9 percent. It currently stands 10 percentage points above that, at 80.5 percent, and is still rising as consumer demands and further inventory needs prompt plant use.

(4) The decline in the ratio of market value (historical cost of assets) to replacement cost of assets for nonfinancial corporations has lowered the ability to fund investment projects. Table III-1 illustrates this.

The implications of the trends in the foregoing table are discussed further in factor (6) below dealing with corporate profits.

(5) A factor which cuts both ways is regulation, particularly changes in laws and regulations designed to protect the environment. These can be a drag on investment—and this negative influence has been the most potent the past two or three years. Such regulations can have an adverse impact on production costs, and can cause uncertainties in making long-run cost and profit calculations. For instance, a change in environmental laws, rulings or regulations may affect the operations of a new plant; the risk associated with building a plant is correspondingly increased.

A frustrating example is the effort by Public Service Company, New Hampshire, to build two nuclear power plants at a site called Seabrook to meet New England's future energy needs.[1] After two year's delay, the company had the go-ahead last summer from the Nuclear Regulatory Commission to proceed with a design that pumps sea water into the cooling system and discharges it back into the ocean, using a tunnel connection between the plant and the sea. The Regional Administrator of the Environmental Protection Agency had made an "initial determination" that the plant met EPA requirements. However, last November the regional EPA administrator reversed himself—claiming crab larvae might be affected. So now, after spending $140 million already, and every month adding $15 million more to costs, PSC is faced with complete uncertainty while two con-

[1] Please note that this Public Service Company example is not to be interpreted as endorsing nuclear energy per se, nor as taking the company's position in the matter. The example is used simply to illustrate in a concise way some of the follies of government regulation.

flicting Federal agencies try to decide whether the company will be permitted to proceed with its ocean piping system or will be required to construct cooling towers, which, in turn, may require a new site for the plant. If the company can proceed with the ocean cooling tunnels, already in the works, New England will have some new power by 1981. If PSC must build cooling towers, and possibly relocate, the new energy will be delayed further. In fact, PSC may have to forget the whole project and try to recover what it can of its sunk costs. (See Minority section entitled Cost of Government Regulation.)

On the investment stimulus side is the need to adjust plants to meet government environmental regulations, necessitating increased investment spending. For example, Table III-2 shows expenditures by business (all industries) for air, water and solid waste abatement from 1973 to 1976 and the ratio of these expenditures to total plant and equipment spending. Such ratios have risen from 4.9 percent in 1973 to 5 percent in 1974, to 5.8 percent in 1975, and 6.1 percent in 1976. In some industries such investment is rising more rapidly than overall investment. Incidentally, while an improved environment increases our standard of living, measured GNP does not reflect these improvements.

(6) Finally, and most importantly, business investment depends on profitability. For the last three years, corporate profits appear to have been rising sharply. For 1976, nonfinancial corporations reported record-breaking after-tax earnings. Yet, many businessmen feel that profits remain inadequate to justify major capital expenditure programs. Why? The reason is that "profits, adjusted for inflation on inventories and depreciation," give a far different picture than mere "reported profits." "Inflation-adjusted" profits actually fell sharply in 1974 when corporations were reporting record earnings to shareholders and the Government. In 1976, adjusted after-tax earnings may barely exceed levels achieved a decade ago. The Mellon Bank, in its December 3, 1976, "Economic Comment," says that low current and projected earnings on investment "go a long way toward explaining the disappointing performance of plant and equipment spending during the current recovery."

The sharp inflation of the recent past distorts profits by generating windfall gains on inventories and by causing depreciation schedules, based on historical cost, to fall below the level needed to replace existing plant and equipment.

TABLE III-2.—CAPITAL EXPENDITURES BY BUSINESS (ALL INDUSTRIES) FOR AIR, WATER, AND SOLID WASTE ABATEMENT, 1973-76

[Dollar amounts in billions]

	1973	1974	1975	1976
Total plant and equipment spending	$99.7	$112.4	$112.8	[1] $121.2
Pollution control spending	$4.9	$5.6	$6.5	[1] $7.4
Pollution control as a percent of total P. & E. spending	4.9	5.0	5.8	6.1

[1] 1976 estimates based on latest Department of Commerce survey, October-December 1976.

Source: Survey of Current Business, July 1974; Economic Indicators, January 1977.

In 1974, when inflation reached double-digit levels, inventory profits accounted for nearly 40 percent of corporate earnings. Changes in accounting methods and a halving of inflation rates have combined to reduce inventory gains the past year, but they will still cause an upward bias in 1976 earnings. On the other hand, neither a reduction in the inflation rate nor a change in accounting practices will relieve or eliminate the distortion caused by inadequate depreciation schedules in the near future, since price increases over the last several years are already built into the replacement cost of plant and equipment.

The cutting edge of inflation comes in the return on specific fixed investments. If capital stock is revalued at replacement cost, adjusted pre-tax returns on investment were about 9½ percent last year compared to a 16 percent average during the 1960's. The small margin between that return and long-term borrowing costs is no doubt a factor in the disappointing trend of capital spending. And, we all know that capital spending has been the major missing ingredient in the current recovery. This suggests that the Congress and the Administration, in looking for ways to stimulate the economy, would do well to consider corporate tax measures aimed at raising projected rates of return on investment projects. This would encourage a more vigorous pace of plant and equipment spending, which, in turn, would translate directly into economic growth and jobs. Some alternatives for meeting this goal are listed in the latter part of this chapter.

The Need for Increased Business Investment

A higher rate of investment is necessary in the short-run to bolster our economic expansion. But in the long-run, we need massive capital outlays. Various studies in recent years have pointed to the huge volume of capital investment needed over the next decade—trillions of dollars—to expand, replace and modernize our production facilities to accommodate economic growth, to help us reach full employment, to implement mandated anti-pollution and OSHA programs, to achieve greater energy independence, and, in general, to raise our standard of living.

In this connection, we need a sensible energy program, bolstered by major increases in capital spending for exploration, research, and development. To be sound, such an energy policy must rely primarily on the efficiencies and incentives of the free maketplace. The Minority made some strong statements on this in its 1976 Midyear Review of the Economy and we still stand by those comments.

Even for those who advocate "zero economic growth" as a way of enriching our overall quality of life, huge amounts of capital formation are still essential in order to develop and use new products, new processes of production, and to meet lifestyles that are more economical in their use of resources, and do less damage to the environment. But, with all due respect to the "zero economic growth" advocates, a rising GNP is crucial to economic advancement. In turn, increasing productivity is a key to economic growth.

Productivity—Key to the Future

An economy can grow through increases in factors of production such as the development of new lands for agricultural production or

an increase in human labor resources through population growth, a longer work week or a higher labor force participation rate by our population. But for a variety of reasons, except for an increase in labor participation rates, which may already have run its course, none of these sources of GNP growth has risen much in the past few decades, nor is there potential for much acceleration in the future.

Thus, the real key to economic growth and enlarged job opportunities is through increased productivity (output per unit of input, usually in terms of labor input). Over the past 25 years, improvement in labor productivity has accounted for more than two-thirds of the growth in the real gross national product.

Unfortunately, over the past decade productivity growth has shown a marked decline, even after adjusting for cyclical effects. Productivity growth in the private sector averaged 3.3 percent per year between 1948 and 1966. However, between 1966 and 1973, the rate was only 2.1 percent per year, below the long-run trend, and about one-third lower than the rate of the 1950's and early 1960's.

Productivity depends on: (1) Increases in the amount of physical capital per worker; (2) technological innovation that brings more output from each unit of resources, capital or labor; (3) qualitative improvements in the labor force through better education and manpower training; (4) improved mobility of labor and capital, permitting resources to shift from low productivity sectors to high productivity sectors; and (5) management innovation to improve the way labor and capital are used.

Of the factors listed, increased and improved capital per worker is the most potent force for productivity and economic growth. The most energetic and skillful shoemaker, working long hours under the able supervision of an effective manager, but using hand tools of a century ago, could not remotely approach the productivity of a less skilled operator working with the aid of modern computer driven machinery.

The decrease in the ratio of capital-to-labor the past decade is at the root of our recent slowed rate of productivity. Between 1948 and 1966, capital per labor hour in the private sector grew by 3.1 percent per year; during the 1966–73 period, this growth fell to 2.8 percent per year; and since 1973, the growth of capital per labor hour has fallen to about 1.7 percent, after adjustment for cyclical factors. The decline in this ratio is due to a faster rate of growth of the labor force since the midsixties (as a result of the postwar baby boom and an increased percentage of women in the work force), not matched by corresponding increases in the total capital stock. The decline in capital per worker accounts for a large part of the decline in the productivity rate and real wage growth since 1966.

We must turn our productivity trends around, and to do this will require large-scale investment in new business plant and equipment.

How Can Fixed Business Investment Be Expanded?

Keynesians argue that the low recent rate of capital formation is due to insufficient total spending (consumer, business and government). Softness in the economy, and resulting excess capacity make it unwise for business to make extensive capital investments, so the argument goes. Based on this philosophy, and in an effort to stimulate

demand, we have generated nearly $250 billion in Federal deficits over the seven years 1971–77. Yet business capital investment spending is still lagging.

Chase Econometric studies show that less than one-half and perhaps no more than one-third of total capital spending goes for the expansion of output capacity. More than one-half of total capital spending is for modernization—capital expenditures for increasing efficiency and cutting costs. Thus, much more capital investment would occur if high tax rates were reduced to improve after-tax rates of return, even during periods of excess capacity.

Moreover, current manufacturing capacity utilization of 81 percent (Federal Reserve Series) is not all that low. It is incorrect to argue that 81 percent of capacity utilization means that we have 19 percentage points to go before we reach full capacity. All plants in all industries are never going to operate at 100 percent capacity at the same time. A more accurate measure of full utilization would be the maximum level reached under normal peacetime conditions, and that would be the 88 percent in 1973. Yet that was a year of considerable and widespread bottlenecks, shortages and strong price inflation pressures. There was an even higher 92 percent capacity utilization ratio in 1966, but that was during the height of the Vietnam War, and is not a standard for peacetime.

There is no reason to believe that prevailing capacity utilization rates and insufficient total spending in the economy are the critical determinant of long-run growth of capital spending.

For long-run capital formation, it is time we took a different approach—direct stimulus to increase the after-tax return to investment. Only this, plus measures to reduce the risks associated with the regulatory climate, can really promote expansion of business plant and equipment spending. As noted earlier in the factors weighing on business investment, inadequate corporate profits (adjusted for inflation) is the key problem. We must bolster after-tax real returns.

There are various ways to do this. The Minority is not wedded to any particular tool, but the following should be prime candidates for such a package:

(1) Place depreciation on a current dollar basis, to reflect replacement costs;

(2) Reduce corporate income tax rates;

(3) Integrate corporate and personal income taxes to eliminate the double tax on corporate income, and eliminate the tax bias against equity financing versus less stable debt financing; and

(4) Expand and make permanent the investment tax credit.

There are major advantages and disadvantages to each approach. However, our main concern is that something be done, and soon. Only by increasing the after-tax return to business can we promote vigorous growth of capital investment. We need a shift in incentives that would promote investment by the use of internal funds. The course taken should be simple, unbiased and permanent (our aim is long-run steady growth, not a short-lived shot in the arm).

In the last analysis, Government does not create wealth—people do. Growth in our type of society must come from the private sector under the twin incentives of adequate profits and adequate wages, which in turn give rise to savings for investment, as free as possible from the damaging effects of inflation.

Social Security

The current condition of the Social Security System has important implications for economic growth, job creation, real wage increases, tax policy, and our ability to fund future spending programs, as well as for the level and security of benefits for both current and future retirees.

The System's short-run funding problems (the trust funds will be depleted by the early 1980's) can be solved with minor adjustments of tax rates. However, long-run imbalances in the System require the immediate attention of the Congress.

The Effects of Social Security on Savings and Growth

The Social Security System is regarded as a pension plan or retirement program by its participants. In reality, it is a system of transfer payments from workers to retirees. Under private pension plans, and (in part) under Sweden's compulsory pension system, each group of workers saves during its working life for its own retirement. The savings are invested to expand real output in the economy, and, upon retirement, the workers live on the accumulated principal and interest which is their share of that expansion. In the United States, workers and employers pay a social security tax which is not saved and invested. It is transferred to retirees for immediate consumption.

Insofar as Americans feel they can rely on social security payments for retirement income, they feel they can afford to save less during their working years. Professor Martin Feldstein has stated, "The implication that social security halves the rate of personal saving is startling but not unreasonable. For middle- and low-income families, social security is a complete substitute for a substantial rate of private saving." (Journal of Political Economy, Vol. 82, September–October 1974). Unlike Sweden, the United States does not make up for the lowered savings rate with government savings (surpluses used to build up the social security trust fund, or to keep the Government from running deficits and borrowing what would otherwise be private investment capital). The low savings rate is one of the reasons for the low rate of investment, economic growth, and real wage increases in the United States compared to those of other Western nations (See Table I–5). This in turn means a slow rate of growth in the social security tax base, which necessitates higher tax rates. These further discourage hiring and work effort, compounding the problem.

One immediate recommendation that results from this analysis is that steps should be taken to increase the U.S. savings rate. This could be accomplished by lowering marginal tax rates across the board.

Lowering marginal tax rates would allow each saver to keep more of any interest earned, increasing the relative attractiveness of saving over consumption. It would also increase the reward to labor as opposed to leisure. All told, tax rate reduction would lower real interest rates and increase investment, real wages, employment, and, as a consequence, the social security tax base.

Demographics, Inflation, and Social Security

Even if the U.S. growth rate is increased through proper fiscal policy, the social security tax base will be inadequate to meet currently scheduled benefits at currently scheduled tax rates. Dr. Alice Rivlin, Director of the Congressional Budget Office, testified before this Committee on May 27, 1976, on the two major reasons for this problem:

"The Demographic Shift. Those born during the postwar baby boom of 1947 to 1954 would be retiring in about 2012 to 2020. * * * Continuation of the decline in the birth rate following the baby boom * * * would bring about the lowest ratio of working age population to retired population that the system has ever experienced. The ratio will shift from 30 beneficiaries per 100 workers in 1975 to 50 beneficiaries per 100 workers in 2030. To fund the additional beneficiaries with the smaller ratio of taxpayers would require an increase of about 20 percent over scheduled tax rates for each worker.

"The Benefit Computation Formula. The social security benefit computation formula is simply an equation to determine how much of the earnings that were lost by retirement, death, or disability will be replaced by the benefit. The summary equation is:

average lifetime wages
×
wage replacement factor
=
benefit amount

"The wage replacement factor is the percent of average monthly wage to be replaced by benefits. It is not a single value. It is graduated into different values over dollar-range brackets so that persons with lower wages get a higher percentage of their former earnings replaced."

That portion of the 1972 Social Security Amendments which provides for cost of living increases for retirees receiving social security benefits is working accurately and well. However, that part of the Act which adjusts the initial benefits which will be received by people not yet retired is seriously defective.

Under current law, the wage replacement factor is increased to compensate fully for inflation. According to Dr. Rivlin, "This adjustment or indexing overlooked the fact that average lifetime wages of the future retirees are also rising and, therefore, the benefit formula is actually overadjusted."

The following is a simplified illustration of the problem:

TABLE III-3.—OVERADJUSTMENT IN THE SOCIAL SECURITY FORMULA FOR A WORKER CALCULATING THE INITIAL BENEFIT LEVEL HE WILL RECEIVE UPON RETIREMENT

If his average monthly wage is:	and the wage replacement factor is:	then the resulting initial benefit will be:
$300	x 70 percent	= $210
If prices rise 10 percent, the worker's projected initial benefit ought to rise to		$231
If wages rise 10%:	and the wage replacement is unchanged:	then benefits do rise 10 percent:
$330	x 70 percent	= $231
But if wages rise 10 percent:	and the wage replacement factor also rises 10 percent:	then benefits are overadjusted:
$330	x 77 percent	= $254

The average monthly wage is calculated by averaging earnings from 1951 to date, until 1995, when the base year will move forward to maintain a 45 year average. Until 1995, the average monthly wage will not quite keep pace with inflation because no old years will be dropped out of the average as new years are added. Therefore, part of the adjustment now being handled by replacement factor changes is needed at present. Dr. Rivlin points out that, "As a result, simply eliminating the indexing of the wage replacement factor (commonly known as 'decoupling') would, if no other adjustment is provided, decrease the ratio of retirement benefits to final wages."

If social security tax rates are increased gradually as needed to meet annual expenses, rates will reach the levels displayed in the annual adjustment section of the following table. Alternatively, rates could be raised at once to the one-time adjustment levels for the whole period.

About half of the tax increases shown are due to the overindexation of benefits. Even assuming the correction of the indexation problem, tax rates will have to rise to the neighborhood of 19 percent of taxable payroll.

Professor Martin Feldstein of Harvard told this Committee, on May 27, 1976:

> That the current method of indexing should be corrected. I cannot stress too strongly that this error must be corrected before people come to believe that they are entitled to these impossible benefits. In my subsequent comments, I will assume that the current double indexing is corrected. The recent demographic swing from baby boom to baby slump will eventually require a very large increase in the social security tax rate if the current relative benefit structure is to be maintained.
>
> As a minimum, such a tax increase would prevent raising other tax revenue for important purposes. And, added to the current marginal tax rates of more than 30 percent already paid by families earning $10,000 to $15,000, this extra tax would have substantial disincentive effects.
>
> Although there has been much concern about the social security program's unfunded liability of more than $2 trillion (without decoupling, $4 trillion) there is no economic reason why social security should ever be bankrupt. Current beneficiaries and covered workers are expected to receive over $2 trillion in benefits more than they are expected to pay in fu-

ture taxes. If social security were a private pension program it would require current assets of more than $2 trillion to be financially solvent, i.e., to guarantee its ability to meet its future obligations. Since the social security program has a trust fund of only $44 billion, or some 2 percent of its obligations, social security is bankrupt by the conventional standards used to determine the actuarial soundness of private pension programs. This analogy of social security to private pension programs is, however, misleading. A private pension program must have sufficient assets to meet all prior commitments because it cannot be certain that any future contributions will be made. In contrast, the government can continue to compel future generations of workers to pay social security taxes. The future tax rates can be set so that tax revenues are sufficient to meet the claims of the beneficiaries. The government's power to tax is its power to meet the obligations of social security to future beneficiaries.

As long as the voters support the Social Security System, it will be able to pay the benefits that it promises. It is therefore very important to prevent an increase in the tax rate or other changes that will undermine public support of social security's primary purpose: providing basic income-related annuities that individuals otherwise could not or would not buy for themselves.

The current working population has some serious thinking to do about its provisions for retirement. Its savings rate is low. Its investment in physical capital is low. Nor is it investing in a large generation to succeed it. At the same time, it is promising itself major increases in retirement benefits, to be paid for by the next generation.

TABLE III-4.—CURRENT AND NECESSARY TAX RATES AS A PERCENT OF TAXABLE PAYROLL[1]

	Tax rates in current law			Necessary revisions		
	ASI	DI	Total	OASI	DI	Total
Annual adjustment:						
1975 (calendar year)	8.75	1.15	9.90	9.29	1.36	10.65
2050 (calendar year)	10.20	1.70	11.90	23.72	4.87	28.59
1-time adjustment	9.43	1.54	10.97	15.42	3.51	18.93

[1] 1976 trustees report—"intermediate" assumptions.

Note: OASI=Old age and survivors insurance. DI=Disability insurance.

One of three things must occur:

(1) The current working population will choose to rely on the willingness of the next generation to pay taxes at a rate not yet experienced in the Nation's history.

(2) Drastic steps will be taken to increase the growth rate of the U.S. economy by increasing the profitability of work, saving, and investment compared to the rewards of idleness and consumption.

(3) The benefit formula will be revised.

The Minority Members strongly urge the Congress to expedite the full-scale review of the Social Security System recommended by

Dr. Rivlin, and indeed by all other experts on the subject. The House Ways and Means Committee currently is struggling with this very technical problem, and is deserving of the support of the rest of the Congress in its efforts to find a solution. Congress should prepare itself to act promptly on the Committee's report. If changes are to be made in the benefit formulas, those who are to be affected must be warned early in their careers, so that they may plan for retirement with an accurate view of the benefits they can expect.[2]

Costs of Governmental Regulation

Few subjects these days are of so much controversy as the issue of government regulation. The bigness of government, the need to simplify its procedures, became issues in the recent Presidential campaign and many of the congressional campaigns. Notwithstanding the general consensus that there is a lot of government regulation, there seems to be a significant divergence of opinion as to the need for such regulation and its effectiveness. A recent study by the Senate Government Operations Committee, for example, has concluded that "on the whole, our Federal regulatory system is fundamentally sound." Although it recommends certain changes in specific fields, it makes the point that "by and large, it appears that the vast majority of Federal regulatory programs are well conceived, meet legitimate needs, and provide the public with benefits which amply justify their existence." The Senate Report points to meat and poultry inspection, child labor laws and government regulation of aviation safety, highway safety and patent medicines as examples of successful government regulation which we now take for granted.

Other parties conclude that the Government does not regulate enough. Labor interests point out that only 1½ percent of all businesses were inspected for occupational safety and health last year, thus assuring that most employers would never feel the pressure to improve the safety of working conditions. According to a recent Washington Post article, 13 of the 17 regulations on toxic substances issued by the Occupational Safety and Health Administration came only after the agency was compelled to do so by lawsuits.

According to the "public interest" theory of regulation expounded by political scientists, most government regulation is an honest response to real needs in society which have reached the point where legislation—and regulation—become necessary. Those who support this view assert that such regulation is simply the cost of doing business in a free, modern society.

Contrasted with this view is the "self interest" theory; which says that regulation only comes about when the regulated industry becomes powerful enough to seek protection from its competitors and to ask the Government to ensure a profit. Regulation opponents point to many incidents to demonstrate this point of view. When Interstate

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[2] Mr. Rousselot states: "It has long been my opinion that participation in the Social Security system should be made voluntary. Under a voluntary program, the option would be provided to the workers of this country to invest their social security withholding payments, together with their employers' matching payments, in a private sector insurance program. Such a system would be a welcome alternative to the bleak future which the present system faces and would offer to the individual participant both higher interest and greater freedom regarding the use of his payments. Many teachers, city and country civil servants, firemen and policemen, and Members of Congress now enjoy this free choice option."

Commerce Commission (ICC) regulations were removed from frozen vegetables in the 1950's, for example, shipping rates dropped 20 percent. When the Supreme Court held that fresh-dressed poultry was not subject to ICC regulation, the average rate for shipping it fell by 33 percent. Federal regulation of air fares means that the consumer often pays twice the rate for an interstate trip than for an intrastate trip of the same length; the $38 price tag on the 230 mile flight from New York to Washington, D.C., compared with the $25.50 charge for the 340 mile flight from Los Angeles to San Francisco, is the most commonly cited example.

Critics of Federal regulation cite the growing power, influence and cost of an allegedly faceless and unsupervised fourth branch of government. The image which these critics paint is of overzealous bureaucrats issuing arbitrary, conflicting regulations and administering laws whose language is often replete with the vagueness born of congressional compromise. They point to the fact that the Code of Federal Regulations constitutes a stack of books 15 feet high containing 60,000 pages; that in 1975 the Federal Government proposed or adopted more than 10,000 rules and regulations, filling more than 60,000 pages in the Federal Register.

The enormous cost and excessive burden of complying with Federal regulation cannot help but impair the ability of business to produce inexpensive products and meet consumer demand. Among small firms especially, government regulation is said to reduce profit margins, discourage innovation, hinder growth and expansion, and impair the ability of such firms to compete with larger ones for government contracts. Estimates vary, but the paperwork burden alone is said to cost business and taxpayers together $40 billion per year. The average cost of simply filling out forms is estimated at almost $6,000 a year per firm, a fact which cannot help but be a substantial burden on smaller businesses. Although some of the most articulate opposition to such regulation has come from the largest firms and the most prominent business leaders in this country, the fact is, they charge, that critics of big business often pass laws and encourage regulations which permit only the largest businesses to survive.

Although the regulatory framework of American Government is different today than it was many decades ago, the fact is that the argument over the degree of government regulation is not new. The Emperor Diocletian attempted to solve the problems of inflation in the Roman Empire with comprehensive—and unsuccessful—price regulation, in which both the purchaser and seller of overpriced goods were subject to capital punishment. The Magna Carta itself was a reaction by early England's feudal lords against the excessive regulatory practices of King John. Our own Declaration of Independence, in listing the complaints of American Colonists against King George III, stated that, "He has erected a multitude of new offices, and sent hither swarms of officers to harass our people, and eat out their substance."

In the final ananlysis, one's view of government regulation is likely to depend on one's view of Government. Notwithstanding this controversy, there are certain findings which we believe can be safely made, and certain areas for improvement which we as Minority Members believe come directly from these findings.

First, there is no doubt in our minds that government regulation is a significant cost in our society. Congress has not done an adequate job of determining the cost impact in advance. The evidence is flooding in to suggest that increased regulation also constitutes a significant extra cost of doing business. To dramatize this phenomenon, we believe that government regulation can aptly be called the "new cost-push" affecting consumer prices. A 1975 study by Arthur D. Little, Inc., indicates that 8 to 10 percent will be added to the cost of iron and steel simply to comply with pollution control regulations; this translates into an increase of approximately $25 to $30 per ton in steel costs. In a May, 1976, speech, the vice president of the Goodyear Tire and Rubber Company indicated that Goodyear's regulatory costs were projected at $38 million last year, compared with $27 million in 1975. A recent study by General Motors concluded that government regulation cost that company more than $1.3 billion in 1974, and consumed the time of more than 25,000 employees. This translates into more than $250 per car. In testimony before the House Appropriations Subcommittee on Interior last year, EXXON (Exxon Company U.S.A.) testified that in mid-1975, it was filing 409 reports to 45 different Federal agencies; the filing of these reports alone consumed approximately 112 person-years, and cost the company more than $3½ million.

The cost of such regulation is passed on to the consumer directly. The consumer also pays because of the diversion of funds which might have gone into capital expansion. In the Arthur D. Little study cited above, for example, it is estimated that investment in pollution control equipment alone in the years 1977 through 1983 will total more than one-quarter of all capital investment in the iron and steel industry. This very large figure will have an effect on the ability of the industry to replace and expand its existing plant.

Second, we also find that both Congress and the regulators sometimes impose conflicting, arbitrary and picayune laws and rules for doing business. Examples of such regulations are legion and cannot be documented in full here. In milk producing plants, for example, the Occupational Safety and Health Administration (OSHA) requires sound absorbent tile to reduce noise level, but the Federal Drug Administration (FDA) requires ceramic tile for sanitary reasons. The 1963 proposal by the Rock Island Railroad to merge with other mail carriers in the interest of efficiency took 11 years to go through the ICC; by that time the Rock Island Railroad was bankrupt. These regulatory situations are examples of agencies following congressional mandates and delegations of authority contained in legislation enacted by the Congress.

Third, notwithstanding the publicity given to legislation such as the Occupational Safety and Health Act, the Clean Air Act, the Employee Retirement Income Security Act, etc., we find the bulk of complaints about government regulation concern the complexity of our tax laws. An entry in the August 1, 1975, Congressional Record points out that a small family store grossing less than $30.000 a year must fill out, on the average, 52 tax forms each year. The Office of Management and Budget estimates that tax reporting represents approximately 35 to 40 percent of the reporting burden for most firms, especially smaller firms. General Motors, in its study of the impact of government regulations on the 1974 calendar year, estimated the cost

of filling out tax forms alone at $12 million, entailing 400 people-years.

Fourth, another major identifiable issue with respect to government regulation is that a significant amount of the cost of complying with government requests is a matter of supplying the Government with statistics. The Goodyear study cited above estimated the cost of this kind of compliance at $2 million. Many such reports are duplicative, with some requiring different accounting procedures to produce the same kind of information. This is said to be true, for example, in the oil industry, where the Federal Energy Administration (FEA), the Federal Power Commission (FPC), and the Federal Trade Commission (FTC) all require parallel, but differently constituted, financial reports.

Fifth, it is clear to us that there must be reform of the government regulatory process as part of our national policy to promote and preserve smaller businesses. Many of the "horror stories" of government regulation concern the extent to which smaller firms must comply with rules—and fill out forms—adapted to larger firms. In an age where modern information-gathering machinery such as computers often distinguish the smaller firm and the larger one, the larger firm now has an additional competitive advantage. In this way the Government only reinforces the old adage that "bigness begets bigness."

Several areas for improvement in regulatory policies and practices follow from the findings which we have discussed above.

First, it is essential that the public know the full cost of regulation. Many of the aims served by regulation are legitimate and achievable goals of modern society, but the American people deserve to know the price tag on achieving these goals. In enacting major legislation, Congress should not attempt to curry political favor by promising salvation without finding out what "salvation" is going to cost. The "new cost-push" must be brought out into the open. Unfortunately, most of the information we have received on the cost of regulation is after-the-fact. To compound this problem, estimating techniques for identifying the costs of proposed rules and laws are, in our opinion, inadequate. Inflation impact statements written by Congress are simplistic and often misleading, according to critics. After-the-fact information, while useful, is in short supply, and the techniques for gaining this information are not yet fully developed. Furthermore, we face the irony of requiring more reports and more forms if we are to make any comprehensive review of the costs of government regulation. However, we applaud the efforts being made by business leaders to publicize costs, and we hope that in the aggregate these surveys will allow us to identify more precisely the cost-push affecting American business.

Second, Congress must be more specific in the authority it grants regulatory agencies, and more stringent in its supervision. The case law regarding delegations of congressional authority allows as a practical matter very vague guidelines as to the intent of Congress. This accords with traditional congressional practice of drafting legislative guidelines often in general, compromise-laden language. The recent Senate Government Operations Committee report on Federal regulation points out, for example, that the usefulness of agency reports to Congress depends on the detail with which the reporting re-

quirements are spelled out in the enabling legislation. At the same time, the report criticizes the low priority given by most Members of Congress to oversight activities. The Minority Members, therefore, endorse the concept of "sunset" legislation which would subject the existence of Government agencies to systematic mandatory review, as we believe this is an effective means for sharpening the congressional intent and delegation of authority in the enabling legislation.

Third, probably the most fundamental type of regulatory reform lies in simplification of the Internal Revenue Code. We would urge that a major aspect of the Administration's proposed tax reform package be tax simplification, especially for individuals and firms in the lower income brackets. In this regard, we look with some interest at the tax simplification aspects of proposals to consolidate individual and corporate income taxes.[3]

Fourth, it is clear that the Federal Government needs the facility to coordinate the gathering and publication of statistical information. The coordination of statistics should be housed in a single agency, which would, in addition, be required to approve any Federal form being sent to an individual or firm. Experience with such statistical agencies has proved successful, notably in Germany.

Finally, we believe that this Committee can make its own contribution to cutting through the Federal regulatory jungle. This would require an emphasis on regulatory reform as a part of all Committee hearings being held this year. We assume that the forthcoming hearings on problems of small business will zero in on this area. With its position of prestige as the "think" committee of Congress, the Joint Economic Committee can make a substantial contribution to publicizing the need for regulatory reform.

As stated above, one's view of government regulation often depends on one's view of government. Nevertheless, advocates of big and small government alike can agree on many facets of the dilemma proposed by Federal regulation. At the least, Federal regulation is a significant factor in the complexity and cost of providing jobs and operating business, particularly small business, imparting a new cost-push which the consumer eventually has to bear. At the most, excessive Federal regulation could be a significant force toward the concentration of American industry in ever larger units and the removal of economic decisionmaking more and more from the individual and reposing it in big business and impersonal government.

People's Capitalism

Perhaps the most far-reaching development in the economic history of our country has been the change in the purchasing power of the average American. This change has had substantial social implications. Home ownership, the leisure goods boom, the vast growth in the tour-

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[3] Mr. Rousselot states: "I believe that the best possible reform of the Internal Revenue Code would be accomplished through the abolishment of the personal income tax—the tax which most severely restricts individual and economic freedom by redirecting vast sums of citizen's earnings into the Federal bureaucracy. H.J. Res. 23, which I introduced with Congressman Symms and McDonald on the opening day of the 95th Congress, and which I have introduced in past Congresses, would accomplish this reform. In addition to restructuring the tax system, this legislation would also prohibit the United States Government from engaging in any business or enterprise except as specified in the Constitution, and it would require in a three-year period that the government divest itself of all business ventures which tend to compete with the private sector."

ism industry, are all components, causes and results of our increased affluence.

However, a recent staff study psblished by the Joint Economic Committee, "Broadening the Ownership of New Capital: ESOPS and Other Alternatives," makes the disturbing point that, despite our national wealth, the ownership of individual wealth is still extraordinarily concentrated. According to that study, the top 1 percent of our population owns almost one-quarter of the personal wealth. Nor have income-supporting transfer programs been able to change the basic structure of income distribution which has existed since World War II.

Coupled with this trend, or lack of trend, is the dramatic growth of control by institutional investors of corporate stock. In 1900, 96.6 percent of U.S. corporate stock was held by individuals; by 1975, this figure was reduced to 64.7 percent. The study points out that in the last 18 years individuals have been selling off stock on a net basis at the rate of approximately $5 billion a year. In other words, decisions regarding capital investment have become increasingly the province of a professional class which, as a practical matter, has favored the better-established, non-risk firms at the expense of innovative, small and growing ones. The Joint Economic Committee Study cited above sums it up this way:

> . . . (I)nstitutions, tend to buy and sell large blocks of stock, concentrating their activity on a relatively small number of large issues. Also, since the asset managers have access to the same information and closely follow each others' assessments and actions, they are often on the same side of the market. This is beneficial in that it leads to more prompt and accurate adjustment to information, but it could also lead to greater price volitility, which increases the risk of investing in stock and hence the cost of equity capital. Institutions can also penalize new ventures by depressing the prices of their issues through diverting funds that would have otherwise been invested in small and risk issues.

This section, then, takes a look at several concepts for broadening the ownership of wealth. Tying these concepts together is the principle that people should have "a piece of the action" in both their government and in their form of economic organization. In part, this discussion reflects a point made in the section on government regulation, above, that we should avoid creating an economic system which tends to force decisionmaking in economic and public affairs into higher levels of corporate and government organization. Implicit in our discussion is the strong belief that we must construct effective mechanisms for broadening the base of ownership of American capital.

The Joint Economic Committee staff study described numerous ways for achieving the goal of broadening the ownership of wealth. Basically they consist of methods for increasing employee ownership of corporate stock (as, for example, stock purchase plans financed in part by the investment tax credit provisions of the Tax Reform Act of 1975) or of methods for increasing the ownership of stock by the general population. This second category would encompass proposals to eliminate the double taxation of dividends, which discourages equity financing by business, or to institute a tax deduction for stock purchases:

some have even urged a so-called financed capitalist plan, wherein households participating in the plan purchase stocks from eligible corporations by means of loans guaranteed by the Federal Government.

Substantial differences distinguish the individual proposals in each of these categories, and some of the proposals are already in existence in this country and abroad. Conventional and employee stock ownership plans, which at the present time are in place at an estimated 200 to 500 firms, utilize tax credits or interest free loans for the purchase of a company's stock by its employees. Many European companies, on the other hand, have established so-called wage earners' investment funds. Some such funds are centralized (i.e., cover many participating corporations) and others are decentralized to the point where the fund can only hold stock in the immediate firm. Under a recent proposal in Denmark, every public and private sector employee would contribute to a central wage earners' fund, which is turn would invest approximately one-third of the contributions outside the company of origin.

While we express no preference at the present time for a particular plan, we do believe the following considerations are important:

(1) It is important, in our view, that any plan for broadened stock ownership entail the purchase of voting shares rather than non-voting shares. This is consistent with our view that ownership of wealth is futile unless there is some control over its disposition. Thus, we agree with the recommendations in the Joint Economic Committee staff study that employee stock ownership trusts should have voting rights which, in the case of publicly held corporations, would be passed through to the employees.

(2) We favor the trend, apparent in this country, of individual employee stock ownership plans, rather than the European practice of wage earners investment funds. By being confined to a single firm, each plan is more likely to motivate employees to maximize company profits and, thus, the value of the company's stock. Although this system has some disadvantages (e.g., employees risk substantial losses in the event of the company's failure) these weaknesses could be compenated for by allowing a certain portion of the plan to be placed in diversified investments.

(3) We also believe serious consideration must be given to innovative financing schemes, especially in the area of real estate. Proposals for a home buyers trust account, and for combination mortgage-equity instruments to finance larger developments, should be scrutinized carefully to ensure that present laws encourage this kind of innovative practice.

As we have implied above, the concept of ownership is inextricably tied to decisionmaking within the firm or other enterprise. Because of this, we have recommended that voting stock be the subject of employee stock ownership trusts. However, equally important in or view is the need to encourage greater employee participation in the decisionmaking of firms, especially larger firms. We do not believe that this poses a threat to individual corporations or the capitalist system as such. On the contrary, we believe the capitalist system can be strengthened. Experience with labor-management committees, on both the firm basis and the community-wide basis, support the view that the mutual trust which is gained and the cooperation which is enlisted has a positive effect on worker productivity and on the quality

of life within the firm. Documented cases include marked decreases in absenteeism and increases in output per worker. On a community-wide basis, the institution of effective labor-management committees has brought in new business and prevented older businesses from leaving.

To date, the Federal Governments' role in this endeavor has been minor. The National Center for Productivity and Quality of Working Life, while working for this goal, is seriously under-financed.

Business Ethics

The economy is affected by social as well as economic matters. One problem faced by the business community is the maintenance of society's faith in the ethical behavior of the seller or businessman. This problem arises because the goal of the free market system is, simply, profits, and because the links between profits, efficiency and maximum production of needed goods and services are not obvious to the public.

Society today is reaching a new level of discussion concerning business ethics—a level where business is harder pressed to defend itelf. There have been recent occurrences that have brought this about and are the basis of antagonistic feelings toward business.

The payment of large sums of money by American corporations to foreign government officials is particularly upsetting to Americans. Perhaps more distasteful is the justification by some firms that making such payments is the way to do business in those countries. In other words, in some cases sales and profits appear to have determined business response above and beyond a concern for conventional ethical standards. There is little public acceptance for the argument that competition justified illegal acts in the past. There is substantial experience of successful international business to the contrary.

Inflation and shortages have also led to friction between business and the public. Regardless of what the economic reasons might be, the substantially higher prices that the American consumers have been forced to pay as a result of inflation for necessities during the past few years has no doubt led to resentment of business. There is a limit to the amount of price increases—whatever the cause—that a consumer can withstand before he begins to resent the seller.

Profits serve a vital role in our free enterprise system. They, along with prices, help to allocate resources, stimulate investment and economic growth to benefit the whole society. However, the few businesses that have billion dollar profit quarters or multi-billion dollar profit years, have the difficult task of reconciling its level of profits with the social wants.[4] The inconsistencies of the situation invite criticism and require an earnest effort to communicate, and educate the public.

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[4] Mr. Rousselot states: "After-tax profits adjusted for inflation have not been excessive in recent years. As has been stated earlier in this report, inflation-adjusted profits actually fell sharply in 1974 when corporations were reporting record earnings to shareholders and the government. In 1975, the top 500 manufacturing companies in the United States earned less than 4 cents net profit on each dollar of sales—the thinnest profit in 17 years.

"While profits have been growing in recent months, the growth has not been adequate to modernize and expand industry sufficiently to provide jobs for the 20 million men and women expected to join the labor force over the next 10 years. Most economists agree that $4 to $4½ trillion in investment must be found to expand capacity in order to create these jobs.

"The way to alleviate unemployment and its attendant social problems in this country is not to spurn big business and profits. On the contrary, these problems will only be solved as business and the private sector are permitted to expand and grow. To castigate business profits in the name of 'wanting social conditions' is to castigate the very means whereby such social ills may ultimately be cured."

Business must understand that its economic world is a mystery to most Americans even though they work, live and deal with business daily. Therefore, business must truly make an effort to answer the most pressing questions, and explain the functional capabilities of business in solving economic problems in a free society. Business does not convince the Government or public that its needs are just when it answers questions of unemployment solely with a discussion of capital investment.

There is strong belief in the free market system because it is an unbiased arbitrator of conflicting consumer demands for scarce resources and an efficient vehicle for maximizing output and minimizing waste. However, the public now questions whether the market controls business, or whether select businesses control the market. In other words, some critics believe that the market is no longer free but is tilted toward business. Consumers seek protection by forming consumer unions, or more prevalently, they turn to the Government for protection through regulation of businesses. But, it is ironic in some cases that government regulation of business turns into government protection (see Chapter on Government Regulation).

Government and business have had a more "off" and "on" relationship in the recent past. One major problem in government regulation of business is that it is done sometimes at the behest of the voters and sometimes at the behest of agency bureaucrats. Equally unsettling is the fact that Government and business have become competitors in the labor and money markets. This competition not only has an effect on the roles and relationships between Government and business, but also affects the consumer. The Minority Members feel that nothing is more absurd than a democratic government acting as a competitor rather than an ally toward any legitimate group in its own society. However, since the Government and people of this country demand business must do so.

What must business do to fulfill its part in the business-consumer relationship in such a manner that confidence in the free market may be preserved and strengthened?

Simply, business must open its price and distribution decisionmaking process to enable the public to understand the process and to satisfy itself that the process reflects genuine market forces. We believe that business would not be made less competitive under this process.

It would not be necessary for all businesses to engage in this "sunshine" process. Only those businesses which have a major impact within an industry or the country as a whole will need this sort of public relations program. The free market system generally controls smaller businesses through price competition and the laws of supply and demand. The large corporation, especially one that controls a "necessity" (oil, utilities, autos, etc.) is not subject, in the short-run, to price elasticities. Corporations which can, because of market share and capital size, sustain price increases during a time of heavily falling sales must begin to accept the responsibility of providing more or complete information concerning distribution and price decisions. The answers by such business giants to these questions will help the public better understand and appreciate those companies whose industries are more competitive and whose prices are determined by a freer and more competitive market.

We are confident that business can develop "sunshine" procedures on a self-enforcing basis. We are not advocating that the Government issue more forms or more reporting requirements. What we are basically talking about is a communications crisis facing American business today. What we are talking about is expanded press releases announcing corporate policy, increased accessibility of business leaders to the press and other procedures for educating the public about the complicated dynamics of business decisionmaking. It must be understood that the "sunshine" procedures do not imply that all activities of business should be in full view of the public. Nor at any time need a business be placed in a less competitive position than it maintains now.

The Minority believes that the question of business ethics may have reached a crisis stage because the Government might step in with its heavy hand of regulation if business does not solve its communication problems.

Boom and Bust in Public Works Funding

One of the most difficult tasks that policymakers face is to gauge in advance all the repercussions of a given spending program. One of the most frequently overlooked aspects of countercyclical spending programs is the need to fund them, and the effect of that funding on the economy. A countercyclical spending program is not effective in stimulating economic activity if it simultaneously increases tax burdens on producers and workers to such an extent that as much private sector employment is lost as is created by the spending program.

This section suggests a new method of funding public works programs, so that these programs will affect the economy in a truly countercyclical manner. This section does not go into the pros and cons of public works per se. It simply sets forth a far more effective way of managing this type of program than is currently being employed.

Professor Arthur B. Laffer illustrates the problem in the following manner in a *Wall Street Journal* article of July 28, 1976:

> * * * Firms worry about the total wages they have to pay, while employees are concerned with the wages they receive. The difference between the wages firms pay and the wages employees receive is called the "wedge."
>
> If the "wedge" is increased, wages paid by firms must rise. Firms will hire fewer workers. Wages received by employees will fall. Employees will be less willing to work.
>
> Let us imagine an economy that produces 1,000 real units of output and has government spending of 500 real units. While producers and workers are paid 1,000 units, they receive only 500 units and therefore have a "wedge" of 50 percent. For every two units someone produces, he gets to keep only one.
>
> Viewing the current U.S. economy in this manner, let us see what happens if, for whatever reason, there is a shortfall of income or output down from the 1,000 level to, say, 900 real units. In our economy, as output and employment fall, government spending rises, here almost entirely as a result of increased transfer payments. Let's imagine government spending rises by 40 real units.

> Therefore, while output falls from 1,000 to 900, government spending rises from 500 to 540. The "wedge" in the economy rises from 50 percent to 60 percent. Now producers and workers receive only four-fifths of one unit for every two they produce, as opposed to receiving the one unit for every two produced previously.
>
> By increasing spending during a recession, the Government reduces the incentives to produce and work. Far from stabilizing the economy, such countercyclical spending, will, in fact, accentuate the cyclical aspects of the economy.

Clearly the net impact of a countercyclical spending program on employment and spending may be zero or even negative. Such programs share many of the same problems as were discussed in connection with tax rebates.

If a program is funded by a tax increase, it is obvious that the private sector will contract as the public sector expands. This is widely understood. No one recommends tax increases in recessions. However, other funding methods currently used have the same effect.

If the program is funded by government bond sales to the public, the supply of loanable funds to the private sector is reduced, interest rates rise, and other borrowers cut back on their own spending. The public anticipates higher future taxes to pay interest on the expanded debt, and curbs its spending and its work effort.

If the Government sells bonds to an accommodating Federal Reserve, new money is issued in exchange for the bonds. The tax increase in this case takes the form of inflation, which is a tax on cash, bank accounts, and fixed incomes. Inflation cuts down the wealth and spending ability of the public. It increases interest rates and restricts private borrowing. It increases tax rates, and decreases incentives to work, save, and invest.

These problems can be avoided. To do so, the Government must arrange to raise money during economic expansions to fund useful public works programs during recessions. In this way, the funding becomes just as countercyclical as the spending.

Sweden has developed this sort of countercyclical policy in conjunction with the private sector. Each year, Swedish firms are permitted to set aside a portion of their pre-tax profits in special restricted accounts for the accumulation of funds for capital investment. The firms pay no tax on profits so deposited if the money remains in the account until a period of recession. At such a time, the government releases the money, still untaxed, for investment by the firm. Firms may withdraw money from these accounts during expansions, but taxes and a penalty fee must then be paid. In this way, Sweden tries to even out investment spending over the business cycle.

A similar policy could be instituted for public works. During economic expansions, the Government could set aside tax receipts in special National Development Accounts. During recessions, localities could draw on the accounts to finance public works projects which had been postponed in good years in order to take advantage of Federal aid from the accounts in recessions.

To ensure that the public works projects being funded were projects of value which localities really intended to undertake, the special accounts should be set up on a matching basis. Each locality would be permitted to set aside a portion of its annual public works budget

in its own special account. The Federal Government would match this deposit, as it occurred, with a contribution to the locality's account equal to some percent of the locality's deposit. (This percent could vary among localities according to their needs, their average unemployment rates over the business cycle, inversely according to their per capita incomes, etc.) The locality could withdraw its funds during expansions. However, if it did not wait until the Federal Government decided to release the funds, it would lose the Federal matching funds, which would be returned to the Treasury.

In this way, localities would be encouraged to even out national construction activity by shifting their public works projects to times of slack in the construction industry.

Note that the localities' special accounts should simply be held as special deposits at commercial banks. Keeping the funds in the banking system would ensure that their use in a recession would simply result in the transfer of the money from the special accounts to the accounts of the contractors and workers hired to do the construction. The reserves of the banking system would be unchanged. Total credit would be unchanged. The entire impact of the program would be delivered through a countercyclical increase in the turnover (velocity) of the existing money supply. No increase in inflation, in the tax burden, or in interest rates would occur to close off private spending. No sudden surge of bank reserves or the money supply would occur to confuse Federal Reserve policy. (If the Federal money were kept in a government account at the Federal Reserve, the transfer of the funds to commercial banks would cause a jump in reserves which could obscure the underlying monetary situation.)

If, instead, the National Development Accounts program established its own fund and "invested" the municipal and Federal tax receipts in government bonds, then it would have to sell the bonds to raise cash for projects in a recession. This would be equivalent to an increase in government borrowing, and would result in the very procyclical funding we are trying to avoid.

A National Development Accounts Program, set up as described, could accomplish several important reforms:

(1) It would replace hastily drawn up countercyclical programs currently rendered partially or totally ineffective by pro-cyclical funding.

(2) It would ensure that valuable public works projects would be favored over projects undertaken solely to use up Federal grants.

(3) It would avoid, through prior funding, the enormous waste of resources when half-completed projects are abandoned by financially strapped localities in recessions.

(4) It would help to smooth out activity in the severely pro-cyclical, recession-prone construction industry.

Welfare

Reform of the welfare system finally may have received the necessary political attention and priority to allow first steps to be taken during 1977. This reform is long overdue.

The economic inefficiency and social burden have been painfully obvious for a long time. We spend $60 billion a year on income maintenance, and yet the working poor still face the dilemma of choosing not to work in order to better support their families. We have increased the aid to lower income citizens by 2,300 percent since 1960, and yet the majority of our poor still live a demeaning existence. However, the greatest failure of the present system is that it has divided the country rather than having provided a focal point for human unity and pride.

The crimes of the welfare system against the poor and the taxpayer have left the public distrustful of the system and of proposed solutions. The validity of a complete reform is checked by the cynicism of the American people. There have been, however, recent developments that may begin to provide the public with hope concerning reform of the welfare system.

A major improvement in the welfare system has been better administrative efficiency with special concern for payment errors (overpayments, underpayments and fraudulent payments). Since 1973, the Department of Health, Education, and Welfare has forcefully sought to tighten its supervision of payments. The results have been impressive.

The percentage of overpayment cases is down from the 1973 level of 22.8 percent to 13.9 percent, underpayments from 8.1 percent to 5.2 percent and fraudulent cases from 10.2 percent to 5.5 percent. Though any waste of welfare money is harmful to the taxpayer and even more so to the truly needy recipient, the importance of these first steps in the HEW effort is evident. The need to continue this administrative tightening is equally obvious, because the waste is still present and therefore too high. Continued supervision of the three largest welfare programs—Food Stamps, Medicaid and Aid to Families with Dependent Children—should be top priority; improper payments for these programs still run about $2.7 billion.

In a statistical development concerning the welfare system this past year, the Congressional Budget Office (CBO) has helped determine the effectiveness of the welfare system by measuring the number and percentage of families and individuals below the poverty standard ($5,500 a year). The CBO estimates were about one-half of earlier Census Bureau data because the CBO included some "in kind" benefits as part of a person's or family's income. The CBO found that 7.4 million families and individuals, or 9.3 percent of the population were under the poverty level (this excludes the Medicare and Medicaid programs which, if included as "in kind" benefits, would have lowered the estimates to 5.4 million families and individuals or 6.9 percent of the population). This is a drop of approximately 32.5 million from the poverty status since 1960. It is therefore fair to conclude that the welfare system, along with the general growth of the economy has been successful in reducing poverty for many of our citizens.

However, while the welfare system has expanded rapidly, there has been little change in the distribution of income according to the CBO report. That report shows that with the inclusion of all transfer payments, the poorest 20 percent of the population has 7.2 percent of all income, while the richest 20 percent of the population has 41.3 percent of all income.

Though the atmosphere surrounding the welfare system has cleared somewhat by the administrative improvements and reduction of numbers below the poverty level, it is still difficult to decide which reform program is optimum. Various reforms would change the entire system, while other reforms would make adjustments, but keep the present structure intact.

One reform option that has received increasing support is the negative income tax (NIT). Those who support the NIT suggest that an advantage of the system would be lower administrative costs because the entire welfare system would be linked to the tax system, thereby eliminating some of the 140,000 positions now required to administer the various local, State and Federal welfare programs. In addition, by linking welfare to the tax system, there would be a closer coordination by various administrative and governmental agencies in considering policies that involve taxes and welfare. Under the NIT, to raise welfare benefits would plainly mean increasing taxes or increasing the deficit, a simple point that is often ignored by too many legislators.

Another advantage under the NIT is that all benefits would be in cash so that welfare recipients could spend their income as they choose. Income levels would be set on a national basis, thereby eliminating the wide variation in State welfare payments. Also, by rolling welfare programs into one cash payment, the welfare system would be greatly simplified because most "in kind" programs, which provide much of the opportunity for fraud, would be eliminated.

Critics of the NIT would question the supposed lessening of costs and increase in efficiency of the new system and the basic philosophy of the guaranteed income.

The cost of the NIT (or other plans of federalization) could be substantial, depending on the level of the "break-even" incomes for the different demographic groups. With a deficit estimated at $60 billion for fiscal year 1977, the important question of finance becomes critical to the issue. The Minority Members feel that the simple addition to the deficit of the net cost is unacceptable. The suggestion that taxes be raised for the financing of the new system also does not seem logical.

The American taxpayer is already overburdened. The middle income group in this country is in the worst position. To increase the taxes on this group is unthinkable. Those who suggest that the upper income groups be taxed to pay the cost of the new system would be placing a heavy burden on relatively few taxpayers. If the NIT's net cost were $15 billion, the approximately 6.25 million taxpayers with adjusted gross income of $25,000 or more would have to pay 31 percent more in taxes than they do now. Without doubt, financing is possible through manipulation of the Tax Code, but it is questionable whether the extreme alteration is beneficial to the society as a whole.

Of special concern to the Minority is that Congress in its anxiety to end the nightmare may relegate the cost issue to a secondary status. Cost of the NIT is a top priority problem that must be solved before serious discussion of implementation takes place.

A long-held criticism of the NIT is that it would guarantee an income to all people and would therefore be a work disincentive for

the working and non-working poor. However, studies in New Jersey, Iowa, and North Carolina, which placed controlled groups under an NIT, may make this criticism less valid.

These studies, though they cannot determine the effect of a national NIT, show that under the NIT work efforts were reduced only modestly, partly because of a reduction in overtime and the dropping of second jobs. In addition, there were many positive effects on the people in the control group, such as, an increase in the purchases of appliances, improvement in housing situations, greater use of medical services, and improvements in nutrition, schooling, and school performance.

The results are not a definitive statement on the NIT's effects on work habits, and further testing (already in progress) is needed, but they do provide evidence that a traditional and important criticism of the NIT may be unfounded.

The need for welfare reform has long been present, and demands top priority from the new Administration and Congress.

JACOB K. JAVITS,
Ranking Minority Member.

ADDITIONAL VIEWS OF SENATOR WILLIAM V. ROTH, JR.

I concur in large part with the views expressed by the Minority. There are several points, however, which deserve further emphasis.

For the first time since the "Great Depression" the American middle-income taxpayer faces the prospect of downward mobility. The Minority Report correctly illustrates that the Administration's economic stimulus package, consisting principally of $50 rebates and more public service jobs, will do little to restore middle-income confidence and to spur the long-term economic growth so critically needed. The middle-income taxpayer is the driving force in the expansion and health of this Nation's economy. Small businessmen, senior citizens, parents, teachers, and blue and white collar workers have all invested their lives and talent in America as a society that maximizes the potential of each citizen. These people, those who are carrying the burden of our many Federal spending programs, must remain confident that with prudence and hard work they and their families will prosper.

The Minority Views of the Joint Economic Committee have pointed out two important ways that we can reinforce the participation and confidence of our middle-class. One is to proceed with the development and implementation of a deregulation package that will reduce the cost of doing business—and therefore the cost to the Nation's consumers. In developing a deregulation policy, care should be taken to eliminate conflicting regulations and to simplify the time-consuming and expensive reporting requirements of small businesses. Moreover, where regulation is desirable, people should be explicitly aware of the cost in terms of the increased prices of consumer items, facilities and services. To ensure that this occurs, I specifically concur in the suggestion that Congress be more precise in the authority it grants regulatory agencies and more stringent in its supervision.

The Minority Views also endorse the need for a permanent reduction in Federal income taxes, a move which would provide tax relief to the working middle-class, the most ignored men and women in America.

For too long, Congress has consistently ignored the millions of middle-income taxpayers in this country, and the tax bill presently working its way through Congress is another slap in the face to people who pay most of the taxes.

The proposed increased standard deduction provides no tax relief to any single person earning more than $12,500, and virtually no tax relief for a married couple earning more than $15,000 a year. Under this provision, a married couple earning $17,500 will receive a tax cut of only $6 a year, or a little less than $.25 a paycheck.

Taxpayers who itemize their deductions, such as those who own a home, have large medical expenses, or make charitable and religious contributions, would receive no tax relief at all from this provision.

Approximately 78 percent of total individual income taxes are paid by people earning more than $15,000 a year, yet this Congress continues to deny these taxpayers any real tax relief. Middle-income people at these levels, particularly the growing number of families where both the husband and the wife work, deserve and need tax relief.

The regulations, controls, and tax burdens of big government are choking the private initiative and economic growth needed for upward mobility. This represents a threat to our present middle-class citizens, and it especially threatens minorities, the poor, women, and young people who expect upward mobility in the future.

The choice facing this Nation is clear: Are we going to permit America to move, like Great Britain, to an equalitarian society where there is less for all? Or are we going to build a society in which performance and ability is rewarded?

Our Nation was built on the premise of excellence, of performance, of productivity. We cannot permit it to drift into a rut of mediocrity, no-growth, and equalitarianism.

That is why I believe it is so important to reject the easy solutions of big government, and take steps to enact permanent tax cuts for working Americans and reduce government regulations and red tape. These steps will restore the Nation's confidence in the economy and the future, and stimulate the long-term economic expansion needed to assure upward mobility for all Americans.

WILLIAM V. ROTH.

ADDITIONAL VIEWS OF REPRESENTATIVE JOHN H. ROUSSELOT

The views expressed in the Minority section of the Annual Report of the Joint Economic Committee basically are consistent with my position. There are several items, however, which I feel deserve special attention.

FISCAL POLICY

It was disappointing to receive the Administration's budget revisions for 1978. The new figures, revised from the previous Administration's January budget recommendations, recommended Federal outlays of $459.4 billion, Federal revenues of $401.6 billion, with a deficit of $57.7 billion—an increase of nearly $11 billion from the recommendations of the previous Administration. I firmly object to this unnecessary increase in government spending and corresponding boost in the Federal deficit.

It is my opinion that government spending could, and should, be maintained at the present 1977 levels. Such an action would not require any drastic cuts or rescissions, but would merely require a determination on the part of the Congress to put a ceiling on new increases. By simply holding the line on outlays, we could limit the presence of the Federal Government in the private borrowing markets, free up desperately needed funds for private sector expansion, and significantly reduce the inflationary pressures in the economy which are created by deficit financing.

ECONOMIC STIMULUS

The Minority Report deals effectively with the need for a permanent tax rate reduction to stimulate the economy. I totally concur with the Report's findings and recommendations for permanent tax cuts, as opposed to temporary tax rebates and increased deficit spending, as a formula for creating long-lasting jobs for the unemployed and generally stimulating economic activity.

During consideration by the House of Representatives of the Third Concurrent Budget Resolution for Fiscal Year 1977 (H. Con. Res. 110) I presented the Minority substitute resolution to the Majority economic stimulus package (H. Con. Res. 122) which implemented the Minority's recommendations for tax rate reductions. Our proposal was for a $19 billion permanent across-the-board personal income tax reduction for the 88 million working people of this country. According to findings of the Congressional Budget Office, such a tax cut would have boosted the GNP to $42 billion over the next six months, increased employment by 790,000 jobs and greatly stimulated economic activity in the area of housing, investment, construction, etc., (see Table I-4 in the Minority Report). Additionally, a permanent tax cut would restore to the American taxpayer a large

measure of economic freedom and permit him—instead of the Federal bureaucracy—to make his own decisions regarding the use of his hard-earned wages.

A $19 billion reduction in personal income taxes could take the form of a 22 percent reduction in the personal income tax rate or a five point reduction in each personal income tax bracket. Table A–1 shows the effects of those reductions on family incomes ranging from $6,100 to $61,905.

TABLE A–1.—EFFECT OF PERMANENT TAX RATE REDUCTION

Family of 4 standard deductions, or 16 percent itemized	Taxable income	Now (percent)	New tax rate (percent)		Tax savings	
			After 5-point cut	After 22-percent cut	5-point cut	22 percent rate cut
$6,100	$1,000	14.0	9.0	10.9	$50	$31
$7,100	2,000	14.5	9.5	11.3	100	64
$9,100	4,000	15.5	10.5	12.1	200	136
$13,100	8,000	17.3	12.3	13.5	400	304
$17,857	12,000	18.8	13.8	14.7	600	498
$22,619	16,000	20.4	15.4	15.9	800	717
$27,381	20,000	21.9	16.9	17.1	1,000	964
$32,143	24,000	23.6	18.6	18.4	1,200	1,245
$36,905	28,000	25.4	20.4	19.8	1,400	1,562
$46,429	36,000	28.7	23.7	22.4	1,800	2,275
$61,905	52,000	34.7	29.7	27.1	2,600	3,973

As the Minority Report indicates, evidence exists, both historical and current, which illustrates that permanent tax cuts are the most effective and least expensive way to stimulate the economy. One hundred-forty eight Members of Congress agreed with this position when the vote was taken on the Minority substitute to the Third Concurrent Budget Resolution for Fiscal Year 1977; it is hoped that the rest of Congress will learn from history and facts and join us in supporting permanent tax cuts—and greater personal and economic freedom—when the opportunity again comes before the House.

Employment

The growth of employment in the United States is today at historically high levels. In fact, total employment in the United States has grown about twice as fast as the population. Table A–2 shows the relationship between growth in jobs and population.

The present unemployment level of 7.3 percent is still, however, a disappointing figure. We must continue to work creatively towards finding jobs for those who are without work and without pay checks but wish to be in productive jobs.

As the Minority Report correctly pointed out, the unemployment rate has little, if anything, to do with the lack of aggregate demand in the United States. Rather, it is basically caused by two factors.

TABLE A-2.—EMPLOYMENT/POPULATION RATIO, 1966-76

Year	Population	Employment
1966	196, 560, 000	72, 895, 000
1967	198, 712, 000	74, 372, 000
1968	200, 706, 000	75, 920, 000
1969	202, 677, 000	77, 902, 000
1970	204, 878, 000	78, 627, 000
1971	207, 053, 000	79, 120, 000
1972	208, 846, 000	81, 702, 000
1973	210, 410, 000	84, 409, 000
1974	211, 901, 000	84, 936, 000
1975	213, 540, 000	83, 783, 000
1976	215, 355, 000	88, 352, 000

Source: Bureau of Labor Statistics.

The first is that the labor force is growing at a faster rate than that at which the economy is adding to the stock of modern plant and equipment. In other words, investment and capital formation, because of high marginal tax rates, are not adequate to meet the growth of labor force participation.

The second significant factor is that disincentives to work have been created because of unemployment compensation laws which make it, in some cases, more profitable for the unemployed to stay home and collect unemployment checks rather than find a new job. The length of time (up to 65 weeks) of unemployment compensaiton also becomes a factor. One commentator, Charlton Ogburn, has noted that the Federal Government, through such unemployment compensation programs, has become "a prime promoter of unemployment." Moreover, the statistics which are generally relied upon to provide a reliable indication of the severity of unemployment can often be misleading because they include hundreds of thousands of students, housewives, and others who are voluntarily unemployed. By their own admission, many of these people are capable of working and probably would find jobs if overly generous assistance programs had not deprived or discouraged them of their incentive to work.

In a study submitted to the House Budget Commitee, Professor Martin Feldstein, Harvard University, estimated that the small gap betwen after-tax take-home pay and the level of unemployment compensation benefits has the effect of raising the measured rate of unemployment by 1.25 percent. I clearly agree with the recommendations of Dr. Arthur Burns, Federal Reserve Board, that we should take a careful look at the disincentive effects of our rapidly expanding unemployment compensation system.

JOHN H. ROUSSELOT.

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 19, 1976. 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

Jobs and Prices in the West Coast Region

The fourth in a series of regional hearings on jobs and prices was held in Los Angeles in early January. The hearing devoted special attention to the problems of rapid population growth, ethnic and racial diversity, migration of workers across national boundaries, and the orientation toward trade with Asia which creates unique economic problems for the Western States.

The Committee heard from the State's Lt. Governor; the Mayor of the City of Los Angeles; the Mayor of Compton, California, representatives from the office of the Mayor of San Francisco and the Los Angeles Board of Supervisors; the Executive Secretary-Treasurer of the California Labor Federation; the Director of the California Department of Industrial Relations; and industry representation. Spokesmen from academia, labor, environmental and technology groups, and several unemployed testified.

1976 Joint Economic Report

The Committee conducted 11 days of hearings during January, February, and March 1976, in its annual review of the President's Budget and Economic Report.

Testimony was received from labor and management, the academic community, local government spokesmen from various areas, and Administration spokesmen, including the Chairman and Members of the Council of Economic Advisers; the Departments of Treasury, Agriculture, Commerce, and Health, Education and Welfare; and the Office of Management and Budget. A panel of experts presented testimony on the social costs of unemployment and another on the economic outlook based on alternative policy assumptions. The Committee also heard from members of minority groups and private forecasters.

International aspects of the President's Report were discussed by the Secretary of the Treasury in February.

The Annual Report of the Joint Economic Committee was filed with the Congress on March 10, 1976 (Senate Report 94–690). The Minority Members of the Committee released to the press separately the Minority views to the Committee's Report.

The fourth and final volume of the printed hearings on the President's Economic Report contained invited comments from leaders of banking, labor, environment, and private research groups.

Jobs and Prices in Fall River and Boston, Massachusetts

The fifth and sixth in the series of regional hearings were held in mid-February in Fall River and Boston, Massachusetts.

The focus of these hearings was the current unemployment and inflation outlook in the New England region, considering the fact that that area had been particularly hard hit by the recession. The Committee heard from representatives of State and local governments, labor, small business, and the academic community.

National Conference on Full Employment

In mid-March the Committee held a National Conference on Full Employment as the culmination of its series of regional hearings and commemorating the thirtieth anniversary of the Employment Act of 1946.

The conference focused on four subjects: the nature and costs of unemployment and inflation; a review of the Nation's economic policy record under the Employment Act of 1946; an examination of the economic goals and priorities needed for the next decade; and a discussion of the policies needed for achieving full employment.

The Committee received testimony from leaders of national, State and local governments; the academic community; small business, labor, and community groups; and private citizens.

The Economics of Solar Energy

In early April the Committee heard testimony from experts and businessmen involved with solar energy. The hearing focused on the economic outlook for solar energy and the extent to which an acceleration in Federal efforts can lower its costs.

Public Service Employment Programs Financed Under the Comprehensive Employment and Training Act (CETA)

Misinformation about the effectiveness of the CETA program led the Committee in early May to hold a hearing to give Congress a direct, concrete picture of the jobs, people, and accomplishments of the program. Testimony was received from the Mayor of Baltimore and two CETA administrators as well as from several enrollees in the program.

Social Security System Hearings

In late May the Committee held two days of hearings on the financial soundness of the Social Security System, focusing on the projected receipts and expenditures of the social security trust fund, problems encountered by the system in recent years, prospects for the future, and the relationship between the social security system and other government programs. Testimony was received from the present and the former Commissioners of the Social Security Administration,

representatives of senior citizens' and retired persons' associations, and the academic community.

Allocation of Resources in the Soviet Union and China—1976

In hearings in May and June, in an Executive Session before the Subcommittee, the Directors of the Central Intelligence Agency and the Defense Intelligence Agency testified. This was the latest in the Joint Economic Committee's continuing study of economic conditions and resource allocations in the Soviet Union and China.

The 1976 Midyear Review of the Economic Situation and Outlook

In June the Committee held four days of hearings on its midyear review of the economy. Distinguished private economists and Administration officials discussed the policies needed to support continuing recovery, with particular emphasis on monetary and fiscal policy.

The Midyear Report on the Economy was issued in September as a result of these hearings (accompanied by a separate release of minority views).

Capital Formation Needs in U.S. Industry

The Committee held a hearing in early June on the prospect of capital shortages in important industries and the possible implications for sustained recovery with price stability. Testimony was received from spokesmen from steel and electric power companies as well as independent economists and a representative of the banking industry.

Youth Unemployment

Early in September the Committee held a hearing on the causes and effects of high unemployment among youth and the problems youths face in the transition from school to work. Testimony was heard from representatives of State and local government, the academic community, and labor and community groups.

Canadian Oil Policies and Northern Tier Energy Alternatives

The Committee in early September held a hearing in Minnesota on the energy outlook for that area and the availability, especially from Canada, of natural gas for the Northern Tier. Witnesses included representatives of national, State, and regional government, and several energy suppliers.

Current Economic Situation and Outlook

In late September the Committee held a hearing to put in perspective recent economic developments and to explore the outlook for future economic recovery. Testimony was received from business, academic, and forecasting representatives.

Federal Housing Policies

The Committee held a hearing in late September focusing on the pace of the housing recovery and the effectiveness of Federal housing policies. Witnesses included the Secretary of Housing and Urban Development, and labor and academic leaders.

Long-Term Economic Growth

During the middle of November the Committee held six days of hearings discussing alternative paths to achieve long-term economic

growth. In preparation for these sessions the Committee had commissioned 43 papers on 29 issues related to future growth. Testimony was received from representatives of business; national, State and local government; and the academic community.

Current Services Budget Analysis

In early December the Committee held two days of hearings on the estimates of the Office of Management and Budget of the Federal Budget for 1978, assuming no policy changes were made. Testimony was received from the Office of Management and Budget, the Congressional Budget Office, and representatives of the business and academic communities.

An Economic Evaluation of the Current Services Budget, Fiscal Year 1978

A staff report analyzing the fiscal 1978 budget outlook and presenting estimates of budget receipts and outlays on a current service basis for the next five years was released late in 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.

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 January 9, February 6, March 5, April 2, May 7, August 6, September 3, November 5, and December 3. On June 4 and July 2 the Deputy Commissioner, Office of Data Analysis, testified in place of the Commissioner.

Special Studies

The Fast Breeder Reactor Decision: An Analysis of Limits and the Limits of Analysis

The Committee released a study on the Fast Breeder Reactor on April 16 which concluded that cost-benefit studies justifying the breeder project must be fundamentally revised and that these appraisals grossly understate potential U.S. uranium resources. The study was prepared for the use of the Committee by a physicist-economist at Resources for the Future.

Changing Conditions in the Market for State and Local Government Debt

A study describing recent developments in the municipal bond market and analyzing policies designed to reduce State and local government borrowing costs was released by the Committee in late April. Two changes were recommended by the study, the first involving greater limitations on the use of the tax-exempt market. The second is the adoption of a taxable bond option so that State and local bonds would be more attractive to a broader group of investors.

A Review and Update of the Cost-Benefit Analysis for the Liquid Metal Fast Breeder Reactor (LMFBR)

A study released in early June, done at the request of several Minority Members of the Committee, updated ERDA's cost-benefit justification for the Liquid Metal Fast Breeder Reactor.

Broadening the Ownership of New Capital: ESOPs and Other Alternatives

As an outgrowth of full Committee hearings in December 1975, the Committee released in late June a staff study on Employee Stock Ownership Plans. The study contained a detailed analysis of the ESOP as well as alternative methods for broadening the ownership of new capital in the United States.

Achieving the Goals of the Employment Act of 1946—30th Anniversary Review

Beginning in January the Committee released seven studies continuing the comprehensive investigation regarding the ills of the economy, enabling the Committee and the Congress to formulate the new economic policies to fulfill the goals of the Employment Act of 1946. The studies, prepared by the JEC staff, the Library of Congress, and private experts from the United States and abroad, are listed below:

VOLUME 1—EMPLOYMENT

Paper No. 2—The Canadian Job Creation Model and Its Applicability to the United States—January 1976.
Paper No. 3—Job Creation: The Project Approach in New England—August 1976.
Paper No. 4—Estimating Potential Output for the U.S. Economy in a Model Framework—November 1976.
Paper No. 5—Estimating the Social Costs of National Economic Policy: Implication for Mental and Physical Health and Criminal Aggression—October 1976.

VOLUME 3—INFLATION AND MARKET STRUCTURE

Paper No. 1—The Inflationary Impact of Unemployment: Price Markups During Postwar Recessions, 1947–70, November 1976.
Paper No. 2—Antitrust Law and Administration: A Survey of Current Issues—December 1976.

VOLUME 4—ECONOMIC PLANNING

Paper No. 1—Economic Planning in Five Western European Countries: An Overview—December 1976.

U.S. Economic Growth from 1976 to 1986: Prospects, Problems, and Patterns

During the year the Committee released eight volumes of this study series discussing the factors and processes which will be shaping long-run U.S. economic growth. This is the only effort in the Federal Government which is taking a comprehensive and long-run view of our economy from many different perspectives. The volumes released this year include:

Volume 1—Productivity—October 1976.
Volume 2—The Factors and Processes Shaping Long-run Economic Growth—November 1976.
Volume 3—Capital—November 1976.
Volume 4—Resources and Energy—November 1976.

Volume 5—The Steady State Economy—December 1976.
Volume 6—Forecasts of Long-run Economic Growth—December 1976.
Volume 7—The Limits to Growth—December 1976.
Volume 8—Capital Formation: An Alternative View—December 1976.

China and the Chinese

In late November the Committee released a compendium of papers containing an appraisal of Chinese development, recent articles by four scholars, and a report by the Executive Director of the Committee on the first Congressional staff delegation to visit China.

Soviet Economy in a New Perspective

A compendium of papers was presented in October entitled "Soviet Economy in a New Perspective." The study is a compilation of research papers by scholars and experts, prepared at the request of the Committee, and dealing with recent performance in the Soviet economy, its prospects and problems, and their implications for the United States and Western European countries.

Economic Progress Subcommittee

The Subcommittee completed a comprehensive review of the Federal Reserve System that was undertaken by the late Wright Patman, former Chairman of the Joint Economic Committee, and Chairman of the Subcommittee on Economic Progress. The study was released by the Committee early in the new year and is entitled "The Federal Reserve System."

Members of the Subcommittee: Representative Wright Patman, Chairman; Senators William Proxmire, Lloyd Bentsen, Jr., Paul Fannin and Jacob Javits; and Representatives Henry S. Reuss, Lee Hamilton, Gillis Long, Garry Brown and Margaret Heckler.

Priorities and Economy in Government Subcommittee

Abuses of Corporate Power

The effect on the economy of abuses of corporate power was the subject of four days of hearings held by the Subcommittee in mid-January and early March. Testimony was received from representatives of national government, business, and citizens' groups.

Five-Year Budget Projections

Two days of hearings in April marked the seventh annual hearing of the Subcommittee on national priorities. The Subcommittee in these hearings considers the future implications of current budget decisions and tries to anticipate future economic conditions. Such projections and discussion of assumptions were included in the current Administration budget document. One purpose of the hearing was to examine the Administration's analysis to see whether its economic assumptions are reasonable and to understand the priority choices implicit in the Administration's projections. Testifying were the Secretary of the Treasury, the Director of the Congressional Budget Office, and the Director of the Office of Management and Budget.

Economics of Defense Production: Shipbuilding Claims and Economics of Defense Production: The Airlift Mission

The Subcommitee in June held three days of hearings on long-term economic budgetary consequences of current defense procurement policies. Shipbuilding claims against the Navy, the military airlift and other missions and their relationships to defense procurement policies were discussed by the Deputy Secretary of Defense, the Comptroller General of the United States, spokesmen for the Department of the Navy, and a retired Admiral.

Special Studies

Priorities and Efficiency in Federal Research and Development

In early November the Subcommittee released a compendium of five studies identifying serious and startling shortcomings in the way Federal research and development funds are allocated. The studies were prepared at the request of the Subcommittee in cooperation with the Library of Congress, the American Association for the Advancement of Science, and three universities.

Members of the Subcommittee: Senator William Proxmire, Chairman; Senators John Sparkman, Abraham Ribicoff, Hubert H. Humphrey, Edward M. Kennedy, Charles H. Percy and Robert Taft, Jr.; Representatives 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

Two days of hearings in January continued consideration of new Canadian foreign investment screening procedures and the role of foreign investment in the Canadian economy. These hearings were begun in December 1975. Representatives of the academic community and the Department of State testified.

U.S. Economic Relations With Latin America

A comprehensive review and examination of U.S. economic relations with Latin America and Caribbean nations was conducted by the Subcommittee in late June. Representatives of international business, the Department of State, and the academic community discussed these issues.

In early July the Subcommittee held two days of hearings in New Orleans on the problems and prospects of U.S. trade and investment in Latin America. Testifying were international business organizations, the banking and academic communities, and representatives of local government.

In August witnesses testified before the Subcommitte on several of the complex issues surrounding international commodity marketing agreements, particularly as they affect Latin America.

Members of the Subcommittee: Representatives Gillis Long, Acting Chairman; Senators John Sparkman, Lloyd Bentsen, Edward Kennedy, Robert Taft, and Paul Fannin; Representatives Lee Hamilton, Margaret Heckler, and John Rousselot.

International Economics Subcommittee

Guidelines for Exchange Market Intervention

An October hearing elicited testimony from the Undersecretary of Treasury for Monetary Affairs, a banking executive, and a member of the Brookings Institution pertaining to intervention in exchange markets and the content of proposed guidelines pertaining to international monetary reform.

Members of the Subcommittee: Representative Henry Reuss, Chairman; Representatives William Moorhead, Lee Hamilton, Clarence Brown, Garry Brown, and John Rousselot and Senators John Sparkman, Abraham Ribicoff, Hubert Humphrey, Lloyd Bentsen, Jr., Edward Kennedy, Jacob Javits, Charles Percy, and Robert Taft, Jr.

Fiscal Policy Subcommittee

Studies in Fiscal Policy

In August and December the Subcommittee released two volumes of a study series initiated to discuss policies which might be utilized to offset the destabilizing effects of inflation on the budget. The two volumes are:

Paper No. 1—The Economic Impact of Alternative Fiscal Policies—August 1976.

Paper No. 2—Indexing the Individual Income Tax for Inflation: Will This Help to Stabilize the Economy? December 1976.

The Effect of Inflation on Federal Expenditures

In late June the Subcommittee released a study which had been prepared at the request of the Subcommittee by the Congressional Budget Office. In addition to estimating the overall impact of inflation on Federal spending, the study examined the inflation sensitivity of 26 separate categories of spending, ranging from social security to interest on the public debt.

Members of the Subcommittee: Representative Richard Bolling, Chairman; Senators William Proxmire; Lloyd Bentsen, Jr., Robert Taft, Jr. and William Roth, Jr.; Representatives William S. Moorhead, Gillis Long, Lee Hamilton, Clarence Brown, Jr. and John Rousselot.

Urban Affairs Subcommittee

The Future of State and Local Government Finances

As a result of New York City's financial problems, the Subcommittee held two days of hearings in late January to examine in detail the future prospects for State and local government financing and to develop a strategy for dealing with the financial problems of these governments before they occur. Testimony was received from representatives of financial and investment firms, the academic community, and national government.

Regional Economic Problems and National Economic Policies

The Chairman of the Council of Economic Advisers testified at a hearing in early September at which the relationships between re-

gional economic problems and national economic policies were discussed.

Members of the Subcommittee: Representative William Moorhead, Chairman; Representatives Richard Bolling, Gillis Long, Gary Brown, Margaret Heckler, and John Rousselot; Senators Abraham Ribicoff, Hubert Humphrey, Lloyd Bentsen, Edward M. Kennedy, Charles Percy, and Jacob Javits.

Economic Growth Subcommittee

Economic Growth and Total Capital Formation

The Subcommittee released in mid-February a study which made a pioneering attempt to measure total capital formation in the United States from 1929 to 1973.

Employment Tax Credits as a Fiscal Policy Tool

A Subcommittee study released in July concluded that an employment tax credit is a promising new way to both increase the number of jobs and hold down prices, with a minimum of government interference in the economy. Two professors from the University of Iowa prepared the study.

Members of the Subcommittee: Senator Lloyd M. Bentsen, Jr., Chairman; Senators William Proxmire, Abraham Ribicoff, Hubert H. Humphrey, Edward Kennedy, Jacob Javits and Charles Percy; and Representatives William Moorhead, Clarence Brown and Margaret Heckler.

Energy Subcommittee

Energy Conservation

In the spring the Subcommittee held a series of hearings focusing on the opportunities for greater energy efficiency in residential housing, commercial and public office buildings and manufacturing plants, and the role of energy conservation in the program of the Energy Research and Development Administration (ERDA). The Subcommittee heard from the Administrators of ERDA and the Federal Energy Office, regional energy organizations, consumer groups, architectural experts, and private citizens.

Multinational Oil Companies and OPEC: Implications for U.S. Policy

In early June the Subcommittee held three days of hearings to examine the implications for U.S. energy policy of the evolving relationships between multinational petroleum companies and the Organization of Petroleum Exporting Countries. Testimony was received from several oil company executives, energy consultants, a representative from the Justice Department, the Secretary of Commerce, and the Deputy Secretary of State.

Members of the Subcommittee: Senator Edward M. Kennedy, Chairman; Senators Hubert Humphrey, William Proxmire, Abraham Ribicoff, Jacob Javits, Charles Percy, and Robert Taft; Representatives William Moorhead, Lee Hamilton, Gillis Long, Otis Pike, Clarence Brown, Garry Brown, and John 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 the groups in whose activities the staff took part in 1976:

Advisory Committee on National Growth Policy Processes.
AFL-CIO Labor Studies Center.
American Economic Association Convention, New Jersey.
American Enterprise Institute.
American Institute of Certified Public Accountants.
Atlantic Institute Conference on the International Monetary System, Paris.
The Brookings Institution.
Case Western University.
Center for Naval Analysis.
Chase Econometrics Outlook Seminars.
Civil Service Commission, Executive Seminar—Kings Point, N.Y.
Club of Rome Annual Meeting.
Columbia University Business School Energy Conference.
Commission for the Advancement of Public Interest Organization.
Conference Board Conference.
Cornell University.
Council on Foreign Relations.
Full Employment Action Council Conference, Washington, D.C.
Hudson Institute Lecture-Seminar.
National Association of Business Economists.
National Conference on Full Employment.
National Economists Club.
National War College (Industrial College of the Armed Forces).
Princeton Center for Alternative Futures.
Society for International Development: UNCTAD Seminar.
Town Hall of California, Economics Section.
Treasury Conference on Floating Exchange Rates.
United Nations Association.
Wharton Econometric Forecasting Associates Conference on the Economic Outlook.
Woodrow Wilson International Center for Scholars.
World Bank Annual Meeting, Manila.

The Executive Director and other professional staff members addressed or presented papers to the following:

Ad Hoc Interagency Committee on Futures Research.
American Bar Association.
American Society for Public Administrators.
American University Washington Semester.
Battelle Memorial Institute.
Civil Service Commission Executive Training Seminars.
Clearinghouse on Women's Issues.
Institute of Industrial Relations, California.
Keystone Conference, Colorado.
Lintas Seminar, Internaitonal Business Executives.
Meeting of Manpower Program Administrators, California.

National Association of Tax Administrators.
University of North Carolina.
University of Southern California, Washington Campus.

The Executive Director represented the Committee as part of a delegation consisting of House and Senate staff directors and senior counsel to Japan and the People's Republic of China at the invitation of the National Committee on U.S.-China Relations. While enroute, he gave a briefing on the economy to the Mayor and a group of business and government leaders in Anchorage, Alaska. He also conferred with officials of the Japanese Government, and with business representatives.

The Executive Director also participated in the Bicentennial Convention conducted by the American Academy of Political and Social Sciences, and addressed the Savings Bank Association.

A Senior Staff Economist of the Joint Economic Committee spoke for the U.S. Information Agency in London, York, Brussells, and Bonn on the U.S. economic outlook and the congressional budget process.

Changes in Committee Membership

During 1976 Senators Paul J. Fannin and Robert Taft, Jr., left the Committee membership, and Senator William V. Roth, Jr., of Delaware, joined the Committee Membership.

Changes in Committee Staff

Leaving the staff during the year were Louise Greenfield, Executive Secretary, and Loughlin F. McHugh, Senior Economist, who retired; Cheri Boothe, Secretary; Gregory Church, Messenger; Marie Cunningham, Executive Secretary; Jerry J. Jasinowski, Senior Research Economist; Arthur Keeffe, Professional Staff Member; Barbara Levinson, Secretary; Dee Roi B. Stewart, Office Manager; and Larry Yuspeh, Research Assistant.

Additions to the staff were Elaine Allen and Christal Blakely, Secretaries; Richard Boltuck, Research Assistant; Charles H. Bradford, Minority Counsel; G. Thomas Cator, Research Assistant; William Chastka, Messenger; Deborah Dubrule, Secretary; Stephen J. Entin, Minority Economist; Brett Fromson, Research Assisant; Elizabeth P. Gotschall, Receptionist; Kenneth M. Hughes, Assistant Clerk; Ellen Crosby Lessard, Research Assistant; and Mark Policinski, Minority Economist.

Distribution of Committee Publications

In 1976 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 30 committee prints and has published 33 sets of hearings, for a total of 63 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 1976.

In addition, committee prints, released by the Joint Economic Committee, are mailed to over 700 depository libraries through the country by the Government Printing Office.

SUBCOMMITTEE MEMBERSHIP, NINETY-FOURTH CONGRESS, 2D SESSION

CONSUMER ECONOMICS

SENATORS

Hubert H. Humphrey, *Chairman*
William Proxmire
Abraham Ribicoff
Edward M. Kennedy
Jacob K. Javits
Charles H. Percy

REPRESENTATIVES

Richard Bolling
William S. Moorhead
Gillis W. Long
Margaret M. Heckler

ECONOMIC PROGRESS

REPRESENTATIVES

Wright Patman (deceased)[1]
Henry S. Reuss
Lee H. Hamilton
Gillis W. Long
Otis G. Pike
Garry Brown
Margaret M. Heckler

SENATORS

Hubert H. Humphrey, *Chairman*
William Proxmire
Lloyd Bentsen
Jacob K. Javits
Paul J. Fannin (retired)[2]

PRIORITIES AND ECONOMY IN GOVERNMENT

SENATORS

William Proxmire, *Chairman*
John Sparkman
Abraham Ribicoff
Hubert H. Humphrey
Edward M. Kennedy
Charles H. Percy
Robert Taft, Jr.

REPRESENTATIVES

Wright Patman (deceased)[1]
Lee H. Hamilton
Gillis W. Long
Otis G. Pike
Clarence J. Brown
Garry Brown
John H. Rousselot

INTER-AMERICAN ECONOMIC RELATIONSHIPS

SENATORS

John Sparkman
Lloyd Bentsen
Edward M. Kennedy
Robert Taft, Jr.
Paul J. Fannin (retired)[2]

REPRESENTATIVES

Gillies W. Long, *Acting Chairman*
Lee H. Hamilton
Margaret M. Heckler
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[1] See note 1 at end of this section.
[2] See note 2 at end of this section.

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[3] See note 2 at the end of this section.
[4] See note 1 at the end of this section.

NOTES

1. The Honorable Wright Patman (D–Tex), Vice Chairman of the Joint Economic Committee and Chairman of the Subcommittee on Economic Progress, died on March 7, 1976. His seat on the Committee and the Subcommittee was filed by The Honorable Otis G. Pike (D–N.Y.).

2. The Honorable Paul J. Fannin (R–Ariz) retired from the Senate in September 1976. His seat on the Committee was filled by The Honorable William V. Roth, Jr.