

NOMINATION OF GEORGE P. SCHULTZ TO BE SECRETARY OF THE TREASURY

HEARING
BEFORE THE
COMMITTEE ON FINANCE
UNITED STATES SENATE
NINETY-SECOND CONGRESS
SECOND SESSION

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MAY 25, 1972
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NOMINATION OF GEORGE P. SHULTZ TO BE SECRETARY OF THE TREASURY

THURSDAY, MAY 25, 1972

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, D.C.

The committee met, pursuant to notice, at 9:35 a.m., in room 2221, New Senate Office Building, Senator Russell B. Long (chairman) presiding.

Present: Senators Long (presiding), Talmadge, Byrd of Virginia, Nelson, Bennett, Curtis, Jordan of Idaho, Fannin and Hansen.

Also Present: Thomas Vail, Chief Counsel.

The CHAIRMAN. The committee will come to order.

We are pleased this morning to hear Mr. George P. Shultz, who has been nominated by the President to succeed Secretary of the Treasury John B. Connally. Mr. Shultz is no newcomer to the Nixon administration. He has previously served as Secretary of Labor and presently is serving as Director of the Office of Management and Budget.

Mr. Shultz will now be confronted with many new responsibilities, although he has been in contact with these problems of tax reform, inflation, balance of payments, jobs, the budget, the deficit and how to finance it, international monetary reform, international trade. Mr. Shultz's broad background, as well as the confidence of the President in the nominee has been demonstrated repeatedly and we will be pleased to hear from you, Mr. Shultz, and also hope that you might be in a position to respond to such interrogatories that the committee might direct toward you this morning.

At this point, let me insert in the record the nominee's biographical data, the committee's announcement of this hearing and a memorandum prepared by the staff indentifying the special conflicts of interest statutes applicable to the Office of Secretary of the Treasury.

(The material referred to follows:)

[The White House—Office of the White House Press Secretary, June 10, 1970]

GEORGE P. SHULTZ, BIOGRAPHICAL DATA

George P. Shultz was sworn into office as Secretary of Labor by the Chief Justice of the United States at the White House on January 22, 1969.

Prior to becoming the 11th Secretary of Labor, Mr. Shultz was a professor of industrial relations, labor arbitrator, public servant and author in subjects related to the activities of the Department of Labor.

Mr. Shultz was born in New York City on December 13, 1920. He attended elementary school in Englewood, New Jersey, and was graduated from Loomis Institute, Windsor, Connecticut, in 1938.

In 1942, he received a B. A. degree (Cum Laude) in economics from Princeton University, where he played halfback on the football team.

Secretary Shultz served with the U.S. Marine Corps in the Pacific during World War II. He entered the Corps as a private first class in 1942 and was separated from active duty as a Major in 1945.

After World War II, he began his teaching career in economics at the Massachusetts Institute of Technology, where he received his Ph.D. in industrial economics in 1949.

A faculty member at M.I.T. from 1948 to 1957, he interrupted his teaching in 1955-56 to take leave of absence to serve as senior staff economist for the President's Council of Economic Advisers.

In 1957, he became professor of industrial relations at the University of Chicago's Graduate School of Business. He was dean of the School from 1962 until his appointment as Secretary of Labor.

The Secretary has served on arbitration panels for labor-management disputes in such diverse industries as electrical equipment, farm implements, textiles, chemicals, food products and metal fabricating.

Since the mid-1950's, he has served three Presidents and three Secretaries of Labor in a variety of capacities.

He has been a consultant to the President's Advisory Committee on Labor-Management Policy; consultant to the Secretary of Labor; Chairman, Task Force on the U.S. Employment Service; Member, National Manpower Policy Task Force, Labor Department; Member, Steering Committee, Study of Collective Bargaining in the Basic Steel Industry issued by the Labor Department, and Member, Illinois Governor's Committee on Unemployment.

From 1962 until his appointment to the Cabinet, he served as co-chairman of the Automation Fund Committee for Armour & Co., United Packinghouse, Food and Allied Workers and the Amalgamated Meat Cutters and Butcher Workmen.

In 1968, he was president of the Industrial Relations Research Association and a fellow at the Center for Advanced Study in the Behavioral Sciences at Stanford University.

Secretary Shultz has also served as Member, Executive Board, Industrial Relations Research Association; Board of Directors, Borg-Warner Corp.; Board of Directors, J. I. Case; Research Advisory Board, Committee on Economic Development; Board of Directors, Stein, Roe and Farnham, Stock and Balanced Funds; Visiting Committee, Department of Economics, M.I.T.; Board of Visitors, U.S. Naval Academy; Board of Directors, General American Transportation Co.; Board of Directors, Chicago Association of Commerce and Industry.

Secretary Shultz is married to the former Helena M. O'Brien of Nashua, New Hampshire. They have five children.

[Press release, Committee on Finance, U.S. Senate, May 24, 1972]

FINANCE COMMITTEE ANNOUNCES CONFIRMATION HEARING

■ Honorable Russell B. Long (D., La.), Chairman of the Committee on Finance, announced today that on *Thursday, May 25, 1972*, the Committee would hold a one-day hearing on the nomination of Honorable George P. Shultz, of Illinois, to be Secretary of the Treasury. Mr. Shultz has previously served as Secretary of Labor and is presently the Director of the Office of Management and Budget. He will replace the Honorable John B. Connally as Secretary. The hearing will be held in Room 2221, New Senate Office Building, and will begin at 9:30 a.m.

The public hearing will be followed by an executive session in which the Secretary's nomination will be considered, along with the following additional nominations:

Hon. Charls E. Walker, of Connecticut, to be Deputy Secretary of the Treasury;

Hon. Edwin S. Cohen, of Virginia, to be Under Secretary of the Treasury, vice Charls E. Walker, promoted;

Hon. John Michael Hennessy, of Massachusetts, to be an Assistant Secretary of the Treasury, vice John R. Petty, resigned;

Hon. Lee H. Henkel, Jr., of Georgia, to be an Assistant General Counsel in the Department of the Treasury (Chief Counsel of the Internal Revenue Service), vice K. Martin Worthy, resigned;

Hon. William H. Quealy, of Virginia, reappointed to be a Judge of the U.S. Tax Court for a 15-year term;

Hon. Arnold Raum, of Massachusetts, reappointed to be a Judge of the U.S. Tax Court for a 15-year term;

Hon. Irene Feagin Scott, of Alabama, reappointed to be a Judge of the U.S. Tax Court for a 15-year term.

The Chairman stated that the Committee was taking these nominations up at this time at the request of the President. Upon completion of its work on these nominations, the Committee will resume consideration of H.R. 1, the Administration's welfare expansion plan.

CONFLICTS OF INTEREST

[Prepared by the staff of the Committee on Finance]

The general conflicts of interest statutes governing the conduct of federal officials and employees are codified in Title 18 of the United States Code at Chapter 11. These provisions reflect the law as it was amended by Public Law 87-849, 76 Stat 1119, approved October 23, 1962. In addition to these general provisions there are several more specific statutes directed at the office of Secretary of the Treasury.

Summary of General Conflicts of Interest Statutes.—The following is an excerpt from a legal memorandum prepared January 28, 1963, by the Attorney General explaining the conflicts of interest statute:

"SUMMARY OF THE MAIN CONFLICT OF INTEREST PROVISIONS OF PUBLIC LAW 87-849

"A regular officer or employee of the Government—that is, one appointed or employed to serve more than 130 days in any period of 365 days—is in general subject to the following major prohibitions (the citations are to the new sections of Title 18):

"1. He may not, except in the discharge of his official duties, represent anyone else before a court or Government agency in a manner in which the United States is a party or has an interest. This prohibition applies both to paid and unpaid representation of another (18 U.S.C. 203 and 205).

"2. He may not participate in his governmental capacity in any matter in which he, his spouse, minor child, outside business associate or person with whom he is negotiating for employment has a financial interest (18 U.S.C. 208).

"3. He may not, after his Government employment has ended, represent anyone other than the United States in connection with a matter in which the United States is a party or has an interest and in which he participated personally and substantially for the Government (18 U.S.C. 207(a)).

"4. He may not, for 1 year after his Government employment has ended, represent anyone other than the United States in connection with a matter in which the United States is a party or has an interest and which was within the boundaries of his official responsibilities during the last year of his Government service (18 U.S.C. 207(b)). This temporary restraint of course gives way to the permanent restraint described in paragraph 3 if the matter is one in which he participated personally and substantially.

"5. He may not receive any salary, or supplementation of his Government salary, from a private source as compensation for his services to the Government (18 U.S.C. 209)."

Title 18 U.S.C., Sec. 219.—Subsequent to the enactment of the foregoing provisions, a new Sec. 219 was added to the conflict of interest statutes. This new section makes it unlawful for any officer or employee of the United States (or of the District of Columbia) to act as an agent of a foreign principal required to register under the Foreign Agents Registration Act of 1938 as amended.

Summary of Conflicts of Interests Statutes Directed to Officers and Employers of the Treasury Department

Title 5 U.S.C., Sec. 243; Title 31 U.S.C., Sec. 1003.—These provisions are identical. They make it unlawful for the Secretary of the Treasury to—

- (a) carry on the business of trade or commerce;
- (b) be owner in whole or in part of any sea vessel;
- (c) purchase by himself (or by another in trust for him) any public lands or any public property;
- (d) be concerned at the purchase or disposal of any public securities of any State or of the United States; and
- (e) take any emolument or gain for negotiating or transacting any business in the Treasury Department, other than what shall be allowed by law.

Title 18 U.S.C., Sec. 1901.—This provision makes it unlawful for an officer of the United States concerned in the collection or disbursement of the revenues thereof to carry on any trade or business in the funds or debts of the United States, or of any State, or in any public property of either.

Title 26 U.S.C., Sec. 7214 (b).—This provision requires the dismissal from office and the imposition of a fine on any Internal Revenue officer or employee interested, directly or indirectly, in the manufacture of tobacco, snuff, or cigarettes, or in the production, rectification, or redistillation of distilled spirits.

Text of General Conflicts of Interest Statutes.—The following text reflects the principal substance of the statute involved. Subsequent portions of these statutes may make the offense inapplicable in certain specifically described situations.

SEC. 203. "COMPENSATION TO MEMBERS OF CONGRESS, OFFICERS, AND OTHERS IN MATTERS AFFECTING THE GOVERNMENT.

"(a) Whoever, otherwise than as provided by law for the proper discharge of official duties, directly or indirectly receives or agrees to receive, or asks, demands, solicits, or seeks, any compensation for any services rendered or to be rendered either by himself or another—

* * * * *

"(2) at a time when he is an officer or employee of the United States in the executive, legislative, or judicial branch of the Government, or in any agency of the United States, including the District of Columbia, in relation to any proceeding, application, request for a ruling or other determination, contract, claim, controversy, charge accusation, arrest, or other particular matter in which the United States is a party or has a direct and substantial interest, before any department, agency, court-martial, officer, or any civil, military, or naval commission, or

"(b) Whoever, knowingly, otherwise than as provided by law for the proper discharge of official duties, directly or indirectly gives, promises, or offers any compensation for any such services rendered or to be rendered at a time when the person to whom the compensation is given, promised, or offered, is or was such a Member, Commissioner, officer, or employee—

"Shall be fined not more than \$10,000 or imprisoned for not more than two years, or both; and shall be incapable of holding any office of honor, trust, or profit under the United States."

SEC. 205. "ACTIVITIES OF OFFICERS AND EMPLOYEES IN CLAIMS AGAINST AND OTHER MATTERS AFFECTING THE GOVERNMENT.

"Whoever, being an officer or employee of the United States in the executive, legislative, or judicial branch of the Government or in any agency of the United States, including the District of Columbia, otherwise than in the proper discharge of his official duties—

"(1) acts as agent or attorney for prosecuting any claim against the United States, or receives any gratuity, or any share of or interest in any such claim in consideration of assistance in the prosecution of such claim, or

"(2) acts as agent or attorney for anyone before any department, agency, court, court-martial, officer, or any civil, military, or naval commission in connection with any proceeding, application, request for a ruling or other determination, contract, claim, controversy, charge, accusation, arrest, or other particular matter in which the United States is a party or has a direct and substantial interest—

"Shall be fined not more than \$10,000 or imprisoned for not more than two years, or both."

SEC. 208. "ACTS AFFECTING A PERSONAL FINANCIAL INTEREST.

"(a) Except as permitted by subsection (b) hereof, whoever, being an officer or employee of the executive branch of the United States Government, or any independent agency of the United States, or of the District of Columbia, including a special Government employee, participates personally and substantially as a Government officer or employee through decision, approval, disapproval, recommendation, the rendering of advice, investigation, or otherwise, in a judicial or other proceeding, application, request for a ruling or other determination, contract, claim, controversy, charge, accusation, arrest, or other particular matter in which, to his knowledge, he, his spouse, minor child, partner, organization in which he is serving as officer, director, trustee, partner or employee, or any person or organization with whom he is negotiating or has any arrangement concerning prospective employment, has a financial interest—

"Shall be fined not more than \$10,000, or imprisoned not more than two years, or both."

(Subsection (b) makes the preceding provision inapplicable if the officer involved has received in advance a written determination made by the Government official responsible for the appointment to his position that the interest is not so substantial as to be determined likely to affect the integrity of the services which the Government may expect from such officer or employee.)

SEC. 209. SALARY OF GOVERNMENT OFFICIALS AND EMPLOYEES PAYABLE ONLY BY UNITED STATES.

"(a) Whoever receives any salary, or any contribution to or supplementation of salary, as compensation for his services as an officer or employee of the executive branch of the United States Government, of any independent agency of the United States, or of the District of Columbia, from any source other than the Government of the United States, except as may be contributed out of the treasury of any State, county, or municipality; or

"Whoever, whether an individual, partnership, association, corporation, or other organization pays, or makes any contribution to, or in any way supplements the salary of, any such officer or employee under circumstances which would make its receipt a violation of this subsection—

"Shall be fined not more than \$5,000 or imprisoned not more than one year, or both."

SEC. 211. "ACCEPTANCE OR SOLICITATION TO OBTAIN APPOINTIVE PUBLIC OFFICE.

"Whoever, solicits or receives, either as a political contribution, or for personal emolument, any money or thing of value, in consideration of the promise of support or use of influence in obtaining for any person any appointive office or place under the United States, shall be fined not more than \$1,000 or imprisoned not more than one year, or both.

"Whoever solicits or receives any thing of value in consideration of aiding a person to obtain employment under the United States either by referring his name to an executive department or agency of the United States or by requiring the payment of a fee because such person has secured such employment shall be fined not more than \$1,000, or imprisoned not more than one year, or both. This section shall not apply to such services rendered by an employment agency pursuant to the written request of an executive department or agency of the United States."

SEC. 219. "OFFICERS AND EMPLOYEES ACTING AS AGENTS OF FOREIGN PRINCIPALS.

"Whoever, being an officer or employee of the United States in the executive, legislative, or judicial branch of the Government or in any agency of the United States, including the District of Columbia, is or acts as an agent of a foreign principal required to register under the Foreign Agents Registration Act of 1938, as amended, shall be fined not more than \$10,000 or imprisoned for not more than two years, or both."

Text of Conflicts of Interests Statutes Directed to Officers and Employers of the Treasury Department

Title 5 U.S.C., Sec. 243; Title 31 U.S.C., Sec. 1003.—"No person appointed to the office of Secretary of the Treasury, or Treasurer shall directly or indirectly be concerned or interested in carrying on the business of trade or commerce, or be owner in whole or in part of any sea vessel, or purchase by himself or another in trust for him, any public lands or other public property, or be concerned in the purchase or disposal of any public securities of any State, or of the United States, or take or apply to his own use any emolument or gain for negotiating or transacting any business in the Treasury Department, other than what shall be allowed by law; and every person who offends against any of the prohibitions of this section shall be deemed guilty of a high misdemeanor and forfeit to the United States the penalty of three thousand dollars, and shall upon conviction be removed from office, and forever thereafter be incapable of holding any office under the United States; and if any other person than a public prosecutor shall give information of any such offense, upon which a prosecution and conviction shall be had, one-half the aforesaid penalty of three thousand dollars, when recovered, shall be for the use of the person giving such information."

Title 18 U.S.C., Sec. 1901.—"Collecting or Disbursing Officer Trading in Public Property.

"Whoever, being an officer of the United States concerned in the collection or the disbursement of the revenues thereof, carries on any trade or business in the funds or debts of the United States, or of any State, or in any public property of either, shall be fined not more than \$3,000 or imprisoned not more than one year,

or both; and shall be removed from office, and be incapable of holding any office under the United States."

Title 26 U.S.C., Sec. 7214(b).—"Interest of Internal Revenue Officer or Employee in Tobacco or Liquor Production.—"

"Any internal revenue officer or employee interested, directly or indirectly, in the manufacture of tobacco, snuff, or cigarettes, or in the production, rectification, or redistillation of distilled spirits, shall be dismissed from office; and each such officer or employee so interested in any such manufacture or production, rectification, or redistillation or production of fermented liquors shall be fined not more than \$5,000."

[From the United States Code, Title 5.—Executive Departments—Officers—Employees]

§ 242. General duties of Secretary of Treasury.

The Secretary of the Treasury shall, from time to time, digest and prepare plans for the improvement and management of the revenue, and for the support of the public credit; shall superintend the collection of the revenue; shall, from time to time, prescribe the forms of keeping and rendering all public accounts and making returns; shall grant, under the limitations herein established or to be provided, all warrants for moneys to be issued from the Treasury in pursuance of appropriations by law; shall make report and give information to either branch of the legislature in person or in writing, as may be required, respecting all matters referred to him by the Senate or House of Representatives, or which shall appertain to his office; and generally shall perform all such services relative to the finances as he shall be directed to perform. (R.S. § 248.)

§ 243. Restrictions upon Secretary of Treasury.

No person appointed to the office of Secretary of the Treasury, or Treasurer shall directly or indirectly be concerned or interested in carrying on the business of trade or commerce, or be owner in whole or in part of any sea vessel, or purchase by himself, or another in trust for him, any public lands or other public property, or be concerned in the purchase or disposal of any public securities of any State, or of the United States, or take or apply to his own use any emolument or gain for negotiating or transacting any business in the Treasury Department, other than what shall be allowed by law; and every person who offends against any of the prohibitions of this section shall be deemed guilty of a high misdemeanor and forfeit to the United States the penalty of three thousand dollars, and shall upon conviction be removed from office, and forever thereafter be incapable of holding any office under the United States; and if any other person than a public prosecutor shall give information of any such offense, upon which a prosecution and conviction shall be had, one-half the aforesaid penalty of three thousand dollars, when recovered, shall be for the use of the person giving such information, (R.S. § 243; 1940 Reorg. Plan No. III, § 1 (a), (1), (4), eff. June 30, 1940, 5 FR. 2107, 54 Stat. 1231.)

The CHAIRMAN. Mr. Shultz, you are recognized.

STATEMENT OF HON. GEORGE P. SHULTZ, NOMINEE, TO BE SECRETARY OF THE TREASURY

Mr. SHULTZ. Thank you very much, Mr. Chairman, and members of this distinguished committee. It has been my privilege to appear before you on a variety of matters in the past 3 years. I am here today, as you said, as the President's nominee for the post of Secretary of the Treasury.

In accordance with your procedures, I have provided the committee with a biographical statement as well as with a copy of the blind trust agreement under which my financial assets are managed. Since becoming a member of President Nixon's cabinet, I have not occupied any business position.

As the biographical statement will show, I was born in New York City and attended schools in New Jersey and Connecticut. I received

a B.A. degree from Princeton University in 1942 and a Ph. D. from the Massachusetts Institute of Technology in 1949.

In 1955-56 I served as senior staff economist for the President's Council of Economic Advisers.

Following service in the U.S. Marine Corps, I served on the faculties of MIT and the Graduate School of Business at the University of Chicago.

I served as Secretary of Labor from January 20, 1969, until July 1, 1970, when I assumed my present post as Director of the Office of Management and Budget.

As both Secretary of Labor and Director of the Office of Management and Budget, I have been privileged to work with your committee and I have benefited greatly from the exchange of views with you, both as a committee and on an individual basis.

I want to express, Mr. Chairman, my intention as Secretary of the Treasury to continue to work closely with you, your committee and your colleagues.

I stand ready to respond to any questions you may have.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Mr. Secretary.

You are familiar, of course, with the various conflict of interest aspects of the job of Secretary of the Treasury and, I take it, that you are satisfied you have complied with all that.

Mr. SHULTZ. Mr. Chairman, I have filed a statement with the committee and I believe that is all in order. The trust agreement that I had as Secretary of Labor and Director of OMB has been amended by letter to take care of the special additional restrictions that apply to a Secretary of the Treasury.

The CHAIRMAN. If the staff or any one of the committee finds any reason to differ with you on that—why we will advise you of it.

Mr. Secretary, much of the legislative oversight work in Congress is performed by and with the cooperation of the General Accounting Office. It is somewhat alarming to read in the newspapers that the Treasury Department has taken the position—and this is not you; it is your predecessors to this moment—that the General Accounting Office may not inquire into the activities of the Lockheed Loan Guarantee Board. I am advised that the Treasury Department takes the position in general that the General Accounting Office is not to be allowed to review any of the programs and activities carried on by the Treasury Department.

Here in this committee we look upon the General Accounting Office as an arm of Congress, and it strikes me as a very serious matter when the executive department holds itself out as immune from a General Accounting Office inquiry.

What is your attitude concerning the right of the General Accounting Office to inquire into any matter in any executive department or governmental board concerning the disbursement of public funds?

Mr. SHULTZ. The Office of Management and Budget, was created, at least in its Bureau of the Budget incarnation, along with the General Accounting Office, and I have complete respect and acceptance of what the General Accounting Office does.

As I understand the problem, and I am not completely familiar with it, nor am I here to speak as an attorney, which I am not—as I

understand the problem, all of the records submitted to the board are open to the General Accounting Office. Material about Lockheed—Lockheed's books are available to the General Accounting Office. There will be a complete report as a first annual report of the board to the Congress on the actions of the board, I believe, in March sometime. The only thing that is in dispute is, you might say, the internal decisionmaking processes of the board; and there, I think, just as, for example, the internal discussions between the President and the advisers have not been subject to GAO review, this, as I understand it, is put forward on a similar basis. But it is a legal, I think, and highly technical point. It is something that certainly I want to look into and judge for myself that that is the way I understand the problem.

The CHAIRMAN. Well, I am not disputing and to me it is not material what the GAO purpose is, what conversations take place inside a board room in arriving at a decision.

It does seem to me, however, that the General Accounting Office has both the duty and the responsibility to examine the books, see if there are any irregularities, if there is anything about the transactions of the Lockheed Corp. that relate to this loan which would appear to be irregular in any fashion; and I do not see any power in the executive branch to foreclose the General Accounting Office from having access to the books and the records of all the transactions, do you? I am not—as I understand the problem, all of the records submitted to the board are open to the General Accounting Office. Lockheed's books are available to the General Accounting Office. There will be a complete report in the form of a first annual report of the board to the Congress on the actions of the board. The only thing that is in dispute, you might say, is the internal decisionmaking processes of the board. For example, the internal discussions between the President and the advisers have not been subject to GAO review, has not been thought to be a subject of review. But it is a legal and highly technical point. It is something that certainly I want to look into and judge for myself, but that is the way I understand the problem.

The CHAIRMAN. Well, I am not disputing and to me it is not material what the GAO purpose is, what conversations take place inside a board room in arriving at a decision.

It does seem to me, however, that the General Accounting Office has both the duty and the responsibility to examine the books, see if there are any irregularities, if there is anything about the transactions of the Lockheed Corp. that relate to this loan which would appear to be irregular in any fashion; and I do not see any power in the executive branch to foreclose the General Accounting Office from having access to the books and the records of all the transactions, do you?

Mr. SHULTZ. As I understand it, the material that would be submitted to the board by Lockheed is all available. All of Lockheed's books are available and, of course, the actions of the board are known and, in the annual report, the reasons will be set forth. What is not available is the internal analytical material and exchange of views within the board as they have judged the information that has been provided to them.

So there is no restriction at all on what the facts are, and so on.

The CHAIRMAN. Why shouldn't even that information be available to the General Accounting Office? In other words, any facts that are

known to any member of the board—it would seem to me—should be available to the GAO? Why should they be withheld?

Mr. SHULTZ. I think all those facts are available.

The CHAIRMAN. If I understand your position—

Mr. SHULTZ. There is nothing that Lockheed, as I understand it—there is nothing that Lockheed has submitted to the board that is being kept away from the General Accounting Office.

The CHAIRMAN. Well, as I understand it, it is the activities of the board that are being withheld; is that correct?

Mr. SHULTZ. The internal decisionmaking processes of the board.

The CHAIRMAN. Well, why should any of the information that is available to the board, even in connection with its internal operations, be withheld from the General Accounting Office?

Mr. SHULTZ. Well, the information that is available is not being withheld, that is, if there is any question about a fact with regard to the cash flow or the assets or what not of Lockheed that come to the board as a matter of information, either as a regular proposition or upon request, that is all available. There is no unavailability of that.

But as to the internal discussions, as I understand it, Mr. Chairman, and I don't pretend as I said, to be knowledgeable about what the board's internal work has been, and I haven't had that available to me as it has not been to others; but as I understand it, it is that internal discussion that is in dispute and there the board has been advised by the general counsel of the board that they are on proper legal grounds, and I will have to explore with him what those are.

The CHAIRMAN. Let me just read from the letter from the Comptroller General to the Secretary of the Treasury. It is the language which, in his language, seems to paraphrase the statute. It says "Board actions required prior to approving the loan guarantee."

Mr. SHULTZ. Excuse me, this is a letter from the Secretary?

The CHAIRMAN. This is a letter from the Comptroller General.

Mr. SHULTZ. To the Secretary?

The CHAIRMAN. To the Secretary of the Treasury, Mr. Connally. I read from the letter:

"The board must find that (a) a loan to the applicant is needed and that failure to meet this need would adversely and seriously affect the economy, (b) credit to the applicant is not otherwise available, and (c) prospective earning power of the applicant and value of security pledged gives reasonable protection to the United States.

"In this connection the board must receive (a) a certification from the lender that it would not make a loan without such a guarantee, (b) audited financial statements from the applicant, and (c) full and unrestricted access to the applicant's books and other documents.

"GAO's review of the activities of the board would include an examination into (a) the basis or rationale for its various determinations, (b) the documents it should have received from the borrower and the lender, and (c) whether the board's actions comply with the spirit and intent of the act.

"The board must satisfy itself that the underlying loan agreement on which the guarantee is sought contains all appropriate affirmative and negative covenants and provides for the board's approval of any amendment. In addition, the board plan on how and when funds advanced are to be used, and subsequently report any deviations from the plan.

"Concerning the borrower's plan for applying advances under the guaranteed loan, GAO should consider whether the funds advanced were applied solely for the purposes stated by the borrower in its application for each advance.

"We believe a review of the activities of the board is a vital part of the overall examination, since all of the authority contained in the act is vested in the board. While the Emergency Loan Guarantee Act does not provide for GAO review of the activities of the board, in our opinion, such a review is authorized under the general authority granted the General Accounting Office by the Congress to review the records of agencies of the executive branch of the Government."

It goes on to say:

"The chairman of the board, however, informed us that the board does not believe the Congress intended that the General Accounting Office review its decisions. Unless the board can be prevailed upon to change its position, we will be unable to carry out our responsibilities as we view them."

Now, he then cites the statute to us, and it does appear that, to me, there is considerable support for his position in the statute. Now, Mr. Staats seems to feel that if the General Accounting Office is precluded from looking into matters of this sort, that that is a serious limitation that he does not feel that the Congress intended with regard to his function.

Now, I would concede it is perhaps a little unfair to ask you to enter into a debate—before you ever have the job—that seems to be going on between the Secretary of the Treasury and the General Accounting Office, but it seems to me we should be able to clear this matter up.

Can you more completely inform us about your view on this matter, Mr. Secretary? What is it that is being denied the General Accounting Office which the General Accounting Office feels should be available?

Mr. SHULTZ. Well, as to the legal, technical aspects of it, Mr. Chairman, that is something that I believe I should discuss carefully with the general counsel of the board, and in light of a study of the legal aspects of it, come to a judgment on that basis, and I am not prepared to make that kind of a judgment right now.

As a general proposition it is inescapable that the GAO should have access to the information that the board has access to and, as I understand it, that is provided.

Now, I do think that—I don't know whether this is precisely the issue or not—but I think that it is difficult to draw any distinction between the executive branch and the legislative branch if there is no privacy whatever as to the ins and outs of the decisionmaking process. So I think that internal conversations between a Secretary and his advisers or a President and his advisers are not in the same category as the flow of information is, which seems to me should be generally available; GAO should see it, and if they feel that the judgments rendered were wrong they can say so. They can have a different analysis, a different view, and people do differ in their judgments on the same set of facts.

That may very well happen but, certainly, Mr. Chairman, I will look into it and try to judge it afresh in my own way.

The CHAIRMAN. Now, Mr. Secretary, it has been directed to my attention that the General Accounting Office sought to look into ac-

tivities of the Treasury with regard to countervailing duties and here is a letter from Mr. Rossides, speaking for the position of the Treasury, declining to cooperate in that matter; and it prompts me to ask is the Treasury seeking, or under your leadership, would the Treasury seek to maintain the view that it is immune from investigation by the General Accounting Office?

Mr. SHULTZ. No, sir.

The CHAIRMAN. I believe I had asked someone to inform you I was going to ask about this matter. Might I just pass this letter along to you and ask you to take a look at it and tell me what is your judgment about that matter?

(Senator Proxmire's request of GAO, GAO's request of Treasury, and the Treasury response follow:)

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS,
Washington, D.C., October 4, 1971.

B-145797.

HON. ELMER STAATS,
Comptroller General,
General Accounting Office, Washington, D.C.

DEAR ELMER: Periodically, over the past few years, I've been in touch with the Treasury Department regarding our government's refusal to implement 19 U.S.C. 1303 which instructs the Secretary of the Treasury to apply countervailing duties on imports "whenever any country . . . shall pay or bestow, directly or indirectly, any bounty or grant upon the manufacture or production or export" of such merchandise.

To be more specific, as early as 1968, the Department of Agriculture, in the March issue of Dairy Situation, complained of dairy export subsidies by common market countries in these words: "A major factor in the deterioration of world dairy product prices is the subsidization of dairy product exports by European countries in an effort to reduce internal stocks of dairy products."

The Treasury Department has consistently failed to enforce this legislation with respect to dairy products and, in fact, to the best of my knowledge, has not applied the law to imports of any product whatsoever.

Consequently, I would like your office to look into this matter to see if the law is being violated in its non-application. I'd be particularly interested in learning the balance of payment losses our country has suffered because of our failure to exercise this statutory right over the past few years, specifically with regard to dairy products and generally with regard to subsidized imports.

I look forward to hearing from you with regard to such a study at your earliest convenience.

Sincerely,

WILLIAM PROXMIRE.

COMPTROLLER GENERAL OF THE UNITED STATES,
Washington, D.C., April 7, 1972.

B-145797.

The Honorable the SECRETARY OF THE TREASURY.

DEAR MR. SECRETARY: Senator Proxmire has requested the General Accounting Office to review the Department of the Treasury's administration of section 303 of the Tariff Act of 1930 (19 U.S.C. 1303), which requires the Secretary of the Treasury to levy a countervailing duty on any dutiable product imported into the United States for which the producing nation has provided a production or export grant or bounty.

We have made several attempts in discussions with officials of the Bureau of Customs and the Department to obtain complete access to the Bureau and Department records pertaining to the administration of this law, but access to such records has been denied. Mr. Donald L. E. Ritger, Assistant General Counsel of the Department, advised us that administrative decisions regarding the imposition of countervailing duties were beyond the purview of our Office and documents relating to the decisional process would not be made available.

Our staff had been previously advised by officials of the Bureau of Customs that we would be granted access to only published information such as Treasury decisions and rates where countervailing duties were imposed. We were further advised that we would not be granted access to the files dealing with complaints or investigations which did not result in the imposition of a countervailing duty or were still under consideration and probably would not be granted access to all the information in the files pertaining to countervailing duties that were imposed. With these restrictions, we obviously could not perform a review which would enable us to comply with Senator Proxmire's request.

One of the most important duties of the General Accounting Office is to make independent reviews of agency programs and to report to the Congress on the manner in which Federal departments and agencies carry out the laws enacted by the Congress. Our responsibilities are not limited to financial transactions but cover both the efficiency and effectiveness of agency programs. The most recent enacted legislation on this point is the Legislative Reorganization Act of 1970 which provides that "The Comptroller General shall review and analyze the results of Government program and activities carried on under existing law * * *." (31 U.S.C. 1154)

The Congress had earlier recognized that the General Accounting Office would need to have complete access to the records of the Federal agencies and provided the basic authority in section 313 of the Budget and Accounting Act, 1921 (31 U.S.C. 54) as follows:

"All departments and establishments shall furnish to the Comptroller General such information regarding the powers, duties, activities, organization, financial transactions, and methods of business of their respective offices as he may from time to time require of them; and the Comptroller General or any of his assistants or employees, when duly authorized by him, shall, for the purpose of securing such information, have access to and the right to examine any books, documents, papers, or records of any such department or establishment."

I believe that the law clearly authorizes complete access by our Office to the Department of the Treasury's records pertaining to the administration of the law on countervailing duties and request that you advise the Department and Bureau officials concerned to afford us such access.

Sincerely yours,

ELMER B. STAATS,
Comptroller General of the United States.

THE DEPARTMENT OF THE TREASURY,
Washington, D.C., May 12, 1972.

HON. ELMER B. STAATS,
Comptroller General of the United States,
Washington, D.C.

DEAR MR. STAATS: Your letter of April 7, 1972, in which you request complete access to records of the Bureau of Customs and the Department of Treasury pertaining to the administration of Section 303 of the Tariff Act of 1930 has been referred to me for reply.

We are, of course, aware of the general statutes regarding your review and reporting functions that you cite in your letter. Our reasons for denying access to the records in question, other than those available pursuant to the Freedom of Information Act and the pertinent regulations, were explained in detail to your representatives from a legal and policy point of view.

The Treasury regards participation by your office in the areas of our substantive statutory responsibilities under the Tariff Act of 1930 as inappropriate. It is the Treasury's responsibility to inform the Congress, including the appropriate committees such as the Committee on Ways and Means of the House and the Committee on Finance of the Senate, of our approach to substantive matters and we shall continue to do so as the need arises.

While the Treasury Department wishes to cooperate with your Office in any way consistent with our statutory responsibilities so that you may carry out your audit functions and advise Congress of our financial transactions, we cannot grant your request.

Sincerely yours,

EUGENE T. ROSSIDES.

Mr. SHULTZ. Mr. Chairman, I would say in general I would expect the Treasury would be subject to the same reviews as my other branch of the Government by the GAO. There is nothing different about the Treasury except insofar as there are particularly sensitive matters that are matters of executive decision, and so you have an interplay among the people who are supposed to give a judgment and that interplay is part of the executive branch's operations. The information is available; it is available to anybody.

The CHAIRMAN. It would seem to me that—

Mr. SHULTZ. Well, I am not familiar with this particular issue. I am not even as familiar with this as I am with the Lockheed Loan Board.

The CHAIRMAN. Well, the point I would submit, Mr. Secretary, is it seems to me that with regard to a countervailing duty action, for example, that a department of Government ought to act one way or the other and ought to be in position to explain just exactly why it did what it did do or why it didn't, and the General Accounting Office should have the power to inquire into everything about it and either recommend anything it wants to to the Congress as sort of an oversight function of the Congress for which the General Accounting Office was established.

Mr. SHULTZ. Mr. Chairman, I believe in the Lockheed case that the board is prepared to furnish the GAO with the information that has been supplied to it about Lockheed. There is no boundary on that and the board in its annual report will set forward the reasons to support the decisions that it has made. So it will be completely responsive to the Congress in setting forth what it has decided and why.

The CHAIRMAN. I hope we can clear this matter up, Mr. Secretary.

Here is a press clipping about the General Accounting Office—Sam Pierce of the Treasury suggesting that the General Accounting Office was trying to bully or harass the Treasury with regard to this matter; and I think it ought to be cleared up one way or the other. In other words, offhand, I just don't understand why this conflict should develop, but it seems to me as though it is part of our job to clear it up one way or the other and I would hope that you will look at and give this matter your prompt attention.

Mr. SHULTZ. I certainly will.

The CHAIRMAN. And maybe we can work this matter out.
(The article follows:)

[From the Washington Post May 4, 1972]

TREASURY DENIES VEIL ON LOCKHEED

(By Robert J. Samuelson)

The Treasury Department yesterday vigorously denied that it has illegally withheld information about the Lockheed Aircraft Corp. from the General Accounting Office.

At a specially called press conference, Samuel R. Pierce Jr., the Treasury's general counsel, accused the GAO of trying to "bully" and "harass" the three-member Emergency Board that oversees the \$250 million federal loan guarantee to Lockheed.

Under the Congressional legislation authorizing the loan guarantee, the GAO is entitled to investigate all of Lockheed's own financial data, but is not empowered to review the internal studies and memoranda of the Loan Guarantee Board, Pierce said.

Pierce is executive director of the Loan Guarantee Board, whose members are Treasury Secretary John B. Connally, Federal Reserve Board chairman Aurthur

Burns, and Security and Exchange Commission chairman William Casey. Lockheed needed the \$250 million loan guarantee to provide the money for completion of the development of its TriStar jumbo jet.

Pierce's press conference, however, failed to persuade either Comptroller General Elmer B. Staats or Sen. William Proxmire (D-Wis.).

Staats said he remains puzzled by the Treasury's refusal, because the request for internal information is exactly the same that GAO makes of almost all other parts of government.

Both Proxmire and Staats repeatedly contended that Lockheed's financial data alone is insufficient for the GAO, because the official audit—which, Staats said, is expected at the end of June—would have to determine not only Lockheed's financial condition, but also whether or not the Emergency Board had adequate information to make its decision.

So far, the Emergency Board has allowed Lockheed to use \$100 million of the \$250 million loan.

The CHAIRMAN. Senator Bennett?

Senator BENNETT. Thank you, Mr. Chairman.

As I listen to this discussion, I wonder if this is not a matter of timing. The General Accounting Office is an auditing agency, as I view it, but it could be that under the present circumstances they want to sit in and look over the shoulders of the men who are making the decisions while they are being made, instead of after they are made, which is the true function of an auditor. And in view of the tremendous pressure that has been developed in the last few months, which has even touched this committee, to prevent or to insist that people who carry responsibility should do it in the presence of the public, that there should be no secrets, that there should be no confidential operations, I wonder if the General Accounting Office isn't trying to get into the act too soon.

Now, as I understand it, you are going to make an annual report, and I would assume that once that has been made the General Accounting Office would be in a position to audit all of the matters that go into that report; but as I understand the problem they almost want to sit in and look over the shoulders of the committee as it makes its decisions and this, I think, they should probably be denied.

Do you have any comment on that?

Mr. SHULTZ. I think that is very well put, and if the Congress had wanted Mr. Staats to be a member of the board it could have made him a member of the board.

Senator BENNETT. That is the way I appraise it and I hope that it can be worked so that the information will be available at the right and proper time. I don't think the executive department should operate in a cloak of secrecy that continues, but I realize that during the actual operation of a program there must be an opportunity for the men carrying executive responsibility to develop their solutions.

A member of this committee has asked the committee to change its rules and eliminate its executive sessions and operate always in the presence of the public, which the committee has rightfully declined to do; and I, of course, am not a member of the committee but I imagine that this is the essence of the problem, the question of time at which General Accounting should move in, and I think, as an auditor, it moves in after the fact and not during the process of decisionmaking.

I have a couple of other questions I would like to ask, Mr. Chairman.

As you know, as Secretary of the Treasury you will be following a man who has taken a relatively hard line in our international monetary

regulations. Have you made up your mind as to whether or not you are preparing to follow that basic approach and concept? And do you believe that hard bargaining may be necessary in this area?

Mr. SHULTZ. I am quite sure that hard bargaining is necessary in this area. I might say, since you brought up my predecessor, that I didn't know him when he came to Washington, but I had the privilege of working closely with him on a great many things over his entire tenure here, and I have developed the greatest admiration for him and I believe that he has contributed tremendously to many aspects of our economy, including the international economic arena.

Senator BENNETT. Mr. Secretary, yesterday the Senate passed an education bill which is in the minds of those of us who had to vote on it as a result of the Serrano case in California—it is my understanding that State governments are going to find it more difficult to finance local education out of property taxes and are beginning to look to the Federal Government and the Treasury as the source of revenue to replace this potential loss.

Do you believe the Federal Government will have to make sizable contributions to the State education equalization loan programs for public education, and do you think that some of those funds should be given to parents whose children are going to private schools on the theory that in this way the public school system is being relieved of part of its burden?

Could you comment on this overall problem for us?

Mr. SHULTZ. I would be glad to do that.

Of course, we don't know what the outcome of the Serrano and other cases will finally be.

However, if those cases are upheld then we have a really double-barreled major change in the sources of revenues and the size of revenues needed to support the public school system.

The property tax, which has seemed to have gone about as far as it can go in many areas, in any case, will recede as a method of financing public education; and there is a large sum of money involved there varying with the State.

In addition to that, in the Serrano decision there is the call for equalization.

We have made some studies in the Office of Management and Budget to make the following calculations: to take each State by itself and look at the variation in per pupil expenditure from public funds and say to yourself, "I am going to strike an average in that State," and then just bring those who are below the average up to the average, and then do that in every State. That, we estimate, would cost on the order of \$9 billion. That calculation does not set up a standard of equality; it just brings the lower half up to the earlier average, and that is not as ambitious a standard as the Serrano case seems to imply.

So there is an amount of money that financing will have to be found for.

I think it is an open question and we should debate it, as the President indicated in the state of the Union message very strongly, as to where that money should come from, what type of tax, what level of government, what interrelations between type of tax and level of government it should come from. Those are good, open questions; it may be that the Federal contribution should increase. It may be that

this is something that the States should handle. But that is the sort of thing, it seems to me, we should be studying and working on very hard.

We have been—as you know, the President has asked the Advisory Committee on Intergovernmental Relations to review this matter.

Now, as to the question of the flow of funds to students attending private schools. I should think that if there is a major Federal flow that some way should be devised to treat individuals equitably, whatever school they choose to go to; and so that type of approach, I think, is something that should be very much in our minds.

Senator BENNETT. In the last analysis, however, that problem is the responsibility of the Congress, isn't it, to determine the extent to which or the pattern on which Federal funds will go to private—to support private students?

Mr. SHULTZ. The Congress will make the laws and we will hope to help you in doing that.

Senator BENNETT. You will hope to have the money on hand to pay for it?

Mr. SHULTZ. We will only have the money if the Congress provides it in the form of taxes.

Senator BENNETT. Mr. Secretary, as a result of the wage freeze and the following programs, internal revenue agents have been used as a means of enforcing the price control measures, and there is some feeling that as a result of this there will be fewer returns examined and probably more difficulties in that area.

Would you be inclined to increase the level of enforcement or to return the level of the enforcement of tax laws back to what it was before the wage-price control responsibilities were placed on the agents?

Mr. SHULTZ. Well, I think it is very important to maintain and enhance the ability of the Internal Revenue Service to administer the tax laws fairly and firmly; this is as important an aspect of faith in our tax system as anything.

Now, I suppose one would have to say it is a tribute to the quality of the Internal Revenue Service that the Service was turned to when it came to the question of enforcement of the wage and price control system. It is a tribute to the Internal Revenue Service that they are turned to on matters of crime and on drugs and so on, and they have been; but I agree with the implication of your question that we have to be very concerned and cognizant of the prime objective of the Internal Revenue Service to see that it is able to carry out those functions fully and fairly and firmly.

Senator BENNETT. Thank you. No other questions, Mr. Chairman.

The CHAIRMAN. Senator Jordan?

Senator JORDAN. Thank you, Mr. Chairman.

Mr. Shultz, as Secretary of the Treasury, you will participate in policymaking decisions affecting budget balances and the need for Federal borrowing. Since June 30, 1969, Federal borrowings have increased \$60 billion. We face the extension of the borrowing limit before June 30 of this year to higher levels; and let me ask you, to what extent do you think such Federal borrowing are inflationary insofar as they compete with other public and private borrowers for available loan funds? Do you think—and, secondly, do you think it is

good policy to continue to borrow money and run Federal deficits in this kind of financial climate?

Mr. SHULTZ. I think that the borrowing, of course, is a derivative of the deficit; once you have had the deficit you have to borrow and that affects the debt ceiling, so I think the thing to focus on is the deficit, as your question suggested.

There, it seems to me, we have a question of timing. When the economy is operating below its potential, the Government budget can be a proper stimulative force, as I believe it has been, in helping the economy to start an expansion and maintain that expansion.

On the other hand, as the economy moves up and approaches full employment, then a deficit by the Federal Government will, in effect, have the Federal Government demanding more resources of the economy than it takes out in the form of taxes and, thereby, constitute an inflational force. Therefore, I think it is very important now, as the economy is expanding—there is no doubt about that fact—that having talked about the need for fiscal stimulus we turn that coin over and we say its counterpart is the exercise of discipline as the economy expands. We must be able to hold our outlays within the framework of the tax system so that when we get to a full employment situation we can bring the budget into balance, and it seems to me we really must be emphasizing very much now the need for discipline on budgetary matters.

Senator JORDAN. I am glad to hear you say that because I do agree with you very sincerely; I think we have to. Accepting as I do the general concept of a full employment budget, I wonder what tolerable limits we can put on that concept and still remain solvent as a Nation?

Mr. SHULTZ. Well, I think the testing time is here; it is right now. We have had the deficits and now the economy is moving up and the question is, can we maintain discipline over outlays.

Senator JORDAN. Yes; many indicators do point now to a spreading business recovery. Should steps be taken now to prevent an inflationary overheading such as we have had in prior years—in some prior years?

Mr. SHULTZ. Well, I think that we have a lot of room for further expansion. We want the expansion and we need the expansion. But I think it is very important now to be very careful about our outlays, to compare them with the yield of the tax system at full employment, so that as our economy moves up, as this expansion takes hold and flourishes and we get back toward full employment we will automatically see the deficit shrink, we will see the budget come into balance and we will withdraw, in effect, the stimulus of the Federal Government as the private sector picks up and as the expansion continues.

I think that is the way it is supposed to work and if we will put our backs into it and exercise discipline, that is the way it can work.

Senator JORDAN. Do you have a target date in mind when we might achieve full employment?

Mr. SHULTZ. Well, I don't have a target date in mind, but I think that if things continue the way they are, by the time we get into fiscal 1974 we should certainly be very much in that range, if not during fiscal 1973.

We have many strong indicators now about the economy.

Senator JORDAN. When do you think we might expect to do away with wage and price controls?

Mr. SHULTZ. It is very hard, in my judgment, to try to pin down any time on that. I think the controls are having an impact, that we should administer them as firmly and strongly and fairly as we can and make them work. Then as soon as they have helped to do the job, get rid of them. But just when that will be, I find it hard to estimate and I also have the feeling that it is a mistake to try to lay down some end point date because the existence of a date in people's minds tends to build up an anticipation and to affect your ability to operate the system on a current basis.

Senator JORDAN. Are you satisfied with the acceleration of capital investment which we intended to help through some of the legislation we have passed?

Mr. SHULTZ. Well, it has been very encouraging; yes. I think it has been one of the high points, and I should think while it is always difficult to disentangle what caused what, it seems to me the members of this committee who supported changes in that regard have a right to feel pretty good about it.

Senator JORDAN. Is the industrial plant of the Nation being used at reasonably full capacity now, or has it flexibility for the expansion at the present level?

Mr. SHULTZ. I think it has considerable flexibility for expansion. The estimates of utilization of capacity show that there is a considerable gap there. At the same time, it is always a question of whether or not the unused capacity is efficient enough capacity to warrant its use. In other words, much of it may be there but not be efficient enough so that it will actually come into use, but certainly in our plant capacity, in our labor force, we have room for expansion and we need an expansion.

Senator JORDAN. Thank you.

The CHAIRMAN. Senator Fannin?

Senator FANNIN. Thank you, Mr. Chairman.

Mr. Secretary, you have been sort of a triple threat man in the administration—Secretary of Labor and Counsel to the President, and Director of OMB, and now nominated to be Secretary of the Treasury. Given your widely varying experience over the past few years, what do you think is the most pressing economic need facing this country?

Mr. SHULTZ. Well, it is hard to rank things one, two, and three, because I think there are a number of things all of which are important and which tend to fit together. As a matter of fact, thinking aback to the President's August 15 decisions, I think the key thing about those was the interrelation of the elements of those decisions.

First of all, of course, is the importance of continuing the expansion that has gone on now and, at the same time, to be continuing to work to control the rate of inflation. Here, as a practical and operating consideration, in my book, anyway, a very key element is the question of our control over the budget. I think that is going to be related to how well we do in trying to combine these twin objectives of very high employment and reasonably stable prices.

We also have real problems in the international economic area and these are certainly interrelated with our domestic problems. For

example, in 1971, in the second quarter of the year, I think it became particularly noticeable we had a strong expansion of demand in this country, but we had a sort of hemorrhage of that demand to the purchase of foreign products and our whole balance of trade and balance-of-payments situation turned around. In effect, the expansion that was starting then was, in effect, hemorrhaged out in that form and we had a dramatic illustration of the connection between international economic developments and domestic economic developments.

So I think that in terms of the problems that we referred to earlier here—of working hard to see that our people are treated fairly in terms of trade arrangements, both in terms of domestic products and our role in world markets—it is very important to continue to work aggressively on that and at the same time to work with other nations cooperatively and seek a rearrangement of the international monetary system that everyone can feel is mutually advantageous.

Senator FANNIN. Do you think the Europeans will be willing to accept those reforms to the international monetary system under which all adjustments for balance-of-payments deficits and surpluses will fall on the exchange rates; exchange rate changes would become more frequent and smaller for both surplus and deficit countries?

Mr. SHULTZ. Well, I think there is a general recognition that whatever system emerges should certainly have a great deal more flexibility in it than the system that we had prior to August 15. Just what the balance out of the burden of carrying adjustments by the exchange rate system should be, I think remains to be seen and, at least in my judgment, there are a lot of matters having to do with trade restrictions that need to be brought into the picture.

We had a dramatic example here at the time of the Smithsonian agreement when, as you know, the exchange rates were changed. That made American products cheaper abroad so they would be more salable, that automatically with the exchange rate change the European variable levies on agricultural products were raised and, in effect, canceled the exchange rate change. So there was a trade step that, so to speak, canceled out the exchange rate step. That is an example of why it is artificial to look only at one side of the coin. We have to proceed and look at both of these things.

Senator FANNIN. I certainly agree with you. The illustration we have from the standpoint of the 17-percent turnaround with Japan hasn't been of very much consequence as far as the percentage change in imports. Their imports to us seem to continue to increase. I don't know what the imbalance of trade will be with Japan this year as compared with last year. Last year we had an approximate \$4 billion or so imbalance of trade and it would appear to be greater this year. I think it is something to be vitally concerned about, and I did agree with you that these items are necessarily interrelated with inflation. Most of the articles we read and the majority of press coverage blame the Federal Government for inflation because of the increase in expenditures.

I have had a little experience with you as far as trying to get some projects financed, and I know your feeling in this regard. But I am vitally concerned about whether or not we are going to continue being as tough, as you say in dealing with these other countries and insisting on *quid pro quo*.

Just to use an illustration, again, Japan, because these I feel we are probably in more jeopardy than we are with most any other countries as far as our ability to compete. That difficulty is due to their system of government. I don't know whether you agree with my designation of Japan as a tough bargainer but I know we are aware of the problems; I don't know whether we can afford to continue to accept their nontariff barriers or inequities.

I have never been able to understand why we tolerate such inequities. I am not going to take the time today to find out from you why we now let their automobiles come into our country with a 3 percent tariff; in 1965 the rate was 10 percent. We have tariff and nontariff barriers in Japan that run all the way from 35 percent to 60 percent, depending on the size of the car. When we began trading automobiles, they came down with their nontariff barriers. Now they are sky high. It seems to me, when we talk about them being bargain-ers, we are the country furnishing the market and we should be the country that controls that tough bargaining; I don't think we have done enough yet.

I do commend the administration for doing a great deal more in countervailing duties and antidumping than had been done in many years; but do you feel that we can gain greater control of this situation so we can put the brakes on this trend of a gross imbalance of payments?

Mr. SHULTZ. I think it is obviously a problem to be worked at aggressively. I think it is early to evaluate the impact of the moves that have been made and it is too early to try to answer the question of the impact of the Smithsonian agreement and whether or not that will result in a shift in the trade flows around the world and between the United States and the rest of the world.

I would have to say that the first quarter results this year are, while explainable and people offered many reasons why they are the way they are, nevertheless disappointing and we would hope that they will turn around. Clearly this is an area that deserves a lot of attention and aggressive work.

Senator FANNIN. Well, there are many questions I would like to ask you, Mr. Shultz, regarding foreign trade and our balance of payments, but I know we do not have the time.

I am not fully in agreement with this article but, Mr. Secretary, there is a very perceptive article by Alfred L. Malabre, Jr., the economic editor of the Wall Street Journal, which I will ask to be placed in the record, which shows quite clearly that Europe's current favorable position vis-a-vis the United States does not necessarily reflect a superior state of economic virtue.

For example, the United States has actually experienced less inflation than most other major non-Communist countries, whether one views the immediate past or goes back almost a decade. The same is true with our money supply which has grown more slowly than other countries.

On the other hand, even taking into account the December devaluation of the dollar, the record shows that the dollar has actually appreciated in value over the postwar period because of foreign devaluations. According to this article, this makes our exports more expensive and our imports less expensive.

Mr. Secretary, what is your view on the causes of the persistent deficit in the U.S. balance of payments? I think you covered part of it but do you feel that one of the great problems is our wage rates which have increased so rapidly over productivity so as to make us noncompetitive in many instances?

Mr. SHULTZ. Well, I certainly think that the question of productivity is an important one for us. Partly for reasons that are typically associated with movements of the business cycle, but also perhaps because of some other factors we have had a less than satisfactory productivity performance in the last 2 years. It is welcome to see the productivity performance picking up now and I think we can look for it to continue to pick up.

But still it seems to me things like the job development tax credit that you worked on last year, the depreciation reforms that you worked on last year, the attention to incentives for investment and for research and development that tend to yield productivity gains, are very important things for us to keep working on.

Senator FANNIN. Yes.

Mr. SHULTZ. Now, I wouldn't put the whole burden on this or on wage rates. I think that through the post-World War II period we essentially evolved a monetary system and a set of trading arrangements that reflected essentially the relative economic strength of different countries in the immediate postwar period which became increasingly out of date. I think we have sort of seen a recognition of that fact, certainly here, I know, in this committee, and we are trying, and I think Secretary Connally tried hard, and I believe he has succeeded in dramatizing that fact to people around the world. Now we will have to build on that and try to reconstruct an international monetary and set of trading arrangements that will be workable for, we hope, the next 10 or 20 years or so.

Senator FANNIN. Well, I certainly wish you well in that regard and I know the administration has been working very hard to try to bring this about, but can we accomplish these objectives without the cooperation of union officials who seem to be putting stumbling blocks in our path? I personally believe that IRS could be very much involved in perhaps neutralizing the unions' ability to retain all this power and I will talk to you later on that because I really feel it is important and because I do have legislation with that objective.

I personally believe that we must have the cooperation of all segments of our society if we are going to overcome this tremendous imbalance we have with some other countries as far as wage rates and productivity are concerned.

But I wish you well in meeting some of the goals that you expressed this morning because certainly they are common goals as far as this committee is concerned.

Thank you.

(Clipping dated Friday, May 19, 1972, follows:)

MONETARY ILLS: DON'T BLAME THE U.S.

(By Alfred L. Malabre Jr.)

Foreign views of America in recent years have often been unflattering. The criticism has covered a wide range of U.S. activities, from the handling of the Vietnam war to the management of urban problems to the conduct of economic policy.

Some of the criticism no doubt is justified. Certainly, no one can say that U.S. actions in Vietnam over the years, however well intentioned, have been judicious. In at least one area, however, the view from abroad seems glaringly unjustified. It is the idea that U.S. economic policy has somehow been recklessly profligate, and that this profligacy has caused the recent breakdown of the international monetary system.

The complaint is surely familiar to anyone who has conversed much with Swiss bankers or French government officials or West German industrialists. The U.S. has been reluctant to deal sternly with its domestic inflation and therefore with its balance-of-payments deficit, the argument usually runs, and so now international monetary arrangements are in a mess.

Such contentions simply aren't backed up by facts.

As the table below shows, the U.S. has actually experienced less inflation than most other major non-Communist lands—whether one views the immediate past or goes back almost a decade. The statistics, compiled by the International Monetary Fund, show the average rise in consumer prices in a recent 12-month period, and since 1963. In both instances, the record indicates, the U.S. price climb has been relatively mild.

(In percent)

	Latest 12 months	Since 1963
United States.....	3.7	33.1
United Kingdom.....	8.1	51.7
France.....	5.7	38.7
West Germany.....	5.7	27.9
Italy.....	4.6	33.7
Netherlands.....	7.6	53.9
Sweden.....	6.0	46.0
Japan.....	4.6	55.9

Other statistics indicate that U.S. economic policy over the years has by no coincidence been less inflationary in character than most policies elsewhere. For instance, the U.S. has experienced a relatively modest rate of monetary growth. Such growth, in the view of many economists, is a prime indication of how inflationary, or noninflationary, a country's economic planning has been. The figures below, again from the IMF, show money-supply increases in the latest 12 months and since 1963.

(In percent)

	Latest 12 months	Since 1963
United States.....	7	39
United Kingdom.....	11	57
France.....	14	57
West Germany.....	13	78
Italy.....	18	137
Netherlands.....	16	109
Sweden.....	14	38
Japan.....	30	260

Still other statistics suggest that U.S. policy makers have kept economic activity at a relatively noninflationary tempo. A recent report by the Chicago Federal Reserve Bank notes that unemployment rates in key nations abroad remain generally far below the latest U.S. level of 5.9%. The rates mentioned include 3.8% in the Netherlands, 1.7% in West Germany and 4.4% in the United Kingdom.

The U.S. level of plant operations also remains well under foreign levels, according to estimates by the University of Pennsylvania's Wharton School. Factory operations recently amounted to 92.9% of capacity in Belgium, 96.0% in France, 93.1% in West Germany, 93.6% in the Netherlands and 93.4% in the

United Kingdom. Only Italy, where factories are running at about 80% of capacity, has roughly as much idle capacity on hand as the U.S.

Indeed, it can be said that the U.S. is the only major nation that has recently endured a full-fledged business recession, in the name of trying to keep down inflationary pressures. The recession began, as a result of deliberate, highly restrictive economic policies, in November 1969, and it persisted for a full year, according to estimates by the nonprofit National Bureau of Economic Research, the official arbiter in such matters.

A widely held view among U.S. economists is that the relatively mild rate of inflation in the U.S. today is a direct consequence of this induced recession. Paradoxically, it should be added, the much-publicized wage-price controls program of the Nixon administration is given, at the most, only marginal credit for curbing inflation. Rather, the program is viewed as a largely political ploy by Mr. Nixon to silence opponents in Congress and elsewhere by adopting tactics they have long advocated.

How, in the face of such facts, did the U.S. come to be regarded by so many abroad as a profligate nation? How did the dollar come to be so badly overvalued that it had to be devalued in terms of other major currencies last December?

In large part, the trouble seems to reside within the very nature of the international monetary system that a "profligate" Uncle Sam is supposed to have wrecked. The dollar was picked to be the cornerstone of the system, which was set up during an international meeting of financial experts at Bretton Woods, N.H., in 1944. Things were arranged so that the dollar had a fixed worth in terms of gold, and other major currencies had a fixed worth in terms of the dollar. Thus, the dollar became the means by which other currencies could be interchanged at fixed, predetermined rates.

In practice, the arrangement left foreign nations free to devalue their currencies against the gold-linked dollar, and this is precisely what many did periodically over the post-World War II years. Indeed, if one reviews the entire postwar era it becomes apparent that the dollar's value in terms of most major currencies as actually increased, rather than declined. The table below, prepared for this paper by IMF statisticians, shows the number of Belgian francs, British pounds, or whatever that were needed to buy a dollar in the early postwar period (in most instances 1946) and now, taking last December's devaluation into account. In five of the seven cases below, the dollar has appreciated in value because of foreign devaluations.

	Early postwar	1972
Belgian francs.....	43.74	44.81
French francs.....	1.19	5.11
German marks.....	4.19	3.22
Swedish kroner.....	3.81	4.81
Dutch guilders.....	2.66	3.24
Swiss francs.....	4.28	3.87
British pounds.....	.24	.38

The U.S. price record might have been even more exemplary, and the dollar's recent troubles less severe, were it not for the fact that Uncle Sam has had the unenviable role of military guardian of the non-Communist world in the postwar years. With the U.S. maintaining the necessary military muscle, most other non-Communist lands have been able to go merrily along devoting very little of their economic resources to defense. Such outlays, most economists agree, tend to be exceptionally inflation-producing.

Take, for instance, the case of a defense-industry worker. Though he gets paid like everyone else, he doesn't normally produce goods or services that fill a consumer need. The defense worker must buy appliances and food and clothing like his neighbors, but unlike his neighbors he doesn't help to increase the supply of such items. This is a highly inflationary situation, in the view of most analysts.

The table below, based on data assembled by the London-based International Institute for Strategic Studies, shows defense spending as a percentage of gross

national product in various countries. Generally, the figures are for 1970, though the pattern below has prevailed for many years and continues today.

	<i>Defense as percent GNP</i>
United States.....	7.8
United Kingdom.....	4.9
France.....	4.0
West Germany.....	3.3
Italy.....	2.8
Netherlands.....	3.5
Sweden.....	3.7
Japan.....	0.8

Admittedly, such statistics in no way absolve the U.S. price record. Among other things, they suggest that the U.S. economy may be somewhat more inflation-prone than that, say, in Japan. And they indicate that American policy makers have perhaps been under a greater onus than officials elsewhere to keep inflationary pressures from ever developing. This is a price of seeking to hold a defense umbrella over half the world and, at the same time, to maintain the cornerstone currency in an international monetary system of fixed exchange rates.

But the record does not substantiate the idea that Uncle Sam has acted in a dangerously profligate manner over the years, and that this is why the monetary system and the dollar are in trouble. The trouble clearly has other roots. One hopes that this fact will be kept firmly in mind in the months ahead as U.S. planners undertake with officials in Europe and Japan the great task of rebuilding the shattered monetary system of the nonCommunist world.

The CHAIRMAN. Senator Byrd?

Senator BYRD of Virginia. Thank you, Mr. Chairman.

Mr. Shultz, I am pleased to support your confirmation to the very important position of Secretary of the Treasury.

Mr. SHULTZ. Thank you, Senator.

Senator BYRD. I want to say for the record that which I have said to you privately, that I have very high regard for you. Of course, we have not agreed on everything, such as the expansionist budget and the full employment budget concept but I want to say that has not lessened in any way my high regard for George Shultz. I do not envy you your new job. Senator Fannin brought up the question of the most pressing economic problem in our Nation today. I would put the most pressing problem, as I see it, the need for the Government to put its own financial house in order, and the new Secretary of the Treasury, as I see it, must play a very important role, if, in fact, that is to be done.

First, let me say I think you have a very able team working with you in the Treasury and I am pleased that Charles E. Walker will be your deputy. I am also pleased that Edwin S. Cohen, of Virginia, has been nominated as Under Secretary. He is—he impresses me as being an unusually able individual, a technician in the field of taxation, certainly a man like yourself that we need in government.

In that connection, could I ask, to follow up on Senator Bennett's question in regard to the Internal Revenue Service, will that operate directly under the Deputy Secretary under the new setup or will it operate under one of the Under Secretaries?

Mr. SHULTZ. Well, I can't claim to have really thought through how at least I would see all of the reporting relationships within the Department, but I would expect to work closely across the board with the Deputy Secretary, but would certainly want to be heavily involved myself with the Commissioner of Internal Revenue and

be well abreast of their problems and be as helpful and supportive as I can in helping them to work through those problems.

Senator BYRD. It is such an important service that I sort of hate to see it being used for purposes other than its main purpose.

Mr. SHULTZ. As I said earlier, it is a tribute to the service.

Senator BYRD. Yes.

Mr. SHULTZ. But, at the same time, it constitutes a problem, I think that in working with it, in considering the budget and so on, we do have to keep right in the front of our minds that its main purpose is the administration of the tax system. We must be sure that there it is not diluted in its ability to carry that purpose through.

Senator BYRD. Yes. By and large, it seems to me it does a very good job, and I think it speaks well for the American people when you consider that, really, 98 percent of the taxes, I guess, are paid voluntarily—you might say voluntarily. [Laughter.]

Mr. SHULTZ. Speak for yourself, Senator. [Laughter.]

Senator BYRD. Some coercion—but I would say, basically, the American people are pretty honest in what they pay.

Senator BENNETT. Senator, may I quote you a statement attributed to Brigham Young who, when he was asked by the Mormon people why they went West, said: "They went willingly because they had to." [Laughter.]

Senator BENNETT. I think that explains the taxpayers' situation.

Senator BYRD. Very good, Senator Bennett.

Mr. SECRETARY, let me get a few figures in my mind, if I may.

The 1971 deficit on a unified basis was \$23 billion, as I recall?

Mr. SHULTZ. I think that is about right. I don't have all these figures in mind.

Senator BYRD. And on a Federal-funds basis it was \$30 billion. I think what we need today is an updating for the fiscal 1972 deficit. As I understand it from reading the papers, the deficit for this current year, current fiscal year, will not be as great as had been anticipated, one reason being there has been an overwithholding of taxes, and the other being that so-called revenue sharing which has been included as a part of expenditures will not take place during this fiscal year; so what do you predict the 1972 deficit to be on a unified basis?

Mr. SHULTZ. Well, we are working very hard in trying to put together all our information on it in the OMB and in the Treasury. We expect to make a report to the Congress by the end of this month or certainly in early June updating the 1972 budget and also updating the 1973 budget, as we now see it.

But, as you suggest, it is clear that the deficit in the unified budget and also in the Federal funds budget—the change is almost exclusively in the Federal funds budget—will be quite substantially less than we anticipated last January. Partly, it is the overwithholding problem that we have all become too familiar with; partly, it is a somewhat lesser rate of spending and that, as you suggest, is largely attributable to the fact that Congress has not acted as yet on some of the President's proposals.

But, also, I think, in looking at the expenditure side and at the revenue side, it reflects a somewhat better economy, probably in 1971, and certainly in 1972, than was anticipated so that the revenue collections seem to be a little higher, payments for unemployment com-

compensation a little lower, and various things like that are contributing to it. The net of it all will be quite a substantially lesser deficit than was forecast.

Now, I might just follow that by saying that I hope this good news, so to speak, does not lull us into thinking that somehow or other the need for discipline over the budget is receding. I think it should be quite the reverse, for as we get into the range of higher and higher employment levels and higher and higher utilization of capacity, that is just the time when we must exercise the firmest kind of discipline on the Federal budget, and try to keep outlays within the framework of our tax system. Otherwise we will not be able to hold back the forces of inflation.

Senator BYRD. So while the deficit for 1972—fiscal 1972 will be down, the deficit for fiscal 1973 is certain to be up; is it not?

Mr. SHULTZ. Well, some of the reasons why the 1972 deficit is down are just mirror images of things that will affect the 1973 budget. For example, if Congress passes the revenue-sharing bill in the form suggested by the President and reported out by Ways and Means retroactive to January 1, it is clearly too late for that to show up in an outlay of 1972. The last 6 months of the fiscal year payment would show up as an outlay of 1973, so it would swell that outlay total. By the same token, the overwithholding that affects revenues in fiscal 1972 will result in a rebate in fiscal 1973. So you are perfectly right, the two will be offsetting. But that is not entirely the case. Some of the reasons for the improvement are not offsetting.

Senator BYRD. But if you take the 2 years together, and you are so familiar with this—your judgment would be if you take the 2 years together they will add up to about what had been estimated previously?

Mr. SHULTZ. No. I think if you took the 2 years together in the January estimates then I believe that when we have completed our work we will be showing a total for the 2 years that will be less than the total deficit shown last January.

Senator BYRD. But in any case—

Mr. SHULTZ. But nevertheless the distribution is unfortunate. It is better to have the stimulus now and less stimulus as we go along, so I think we are having a reverse result here.

Senator BYRD. But in any case the deficits will be very substantial?

Mr. SHULTZ. Yes, they will.

Senator BYRD. They will be very substantial.

I noted in the press today that an independent group has predicted—they had a very pessimistic report and predicted that new or additional taxes must be levied in the next year, 1973, and I assume you would agree with that report*

Mr. SHULTZ. Well, sir, I have not had any access to the report. I have not seen a copy of it. Like you, I noticed the stories in the paper this morning and that is all that I know about it.

However, I am sure that the report is going to be well worth reading; I look forward to reading it. It has been done in Brookings which is a highly professional organization by Charles Schultze, who, I gather, is the principal author, and other than the fact that he doesn't know how to spell his last name. [Laughter.]

I have the very highest regard for his work and will look at it with interest.

*See p. 36.

I think, just judging from the newspaper reports, that much of what the report draws attention to is what we tried to draw attention to in the President's budget and in our testimony here on that budget and on the debt ceiling. We do have a real fiscal problem. I think we called attention to the fact that the days of the fiscal dividend have passed, that we have no elbow room in the out years in the budget, and so we must exercise real discipline. My feeling is that before we have anything to say about the possibility of higher taxes, that first we do everything we can to keep those outlays under control. If we are determined about it, and when I say "we," I mean you in the Congress as well as those involved in the executive branch, we can do it, but it is going to be a very hard job to do.

Senator BYRD. I think you are so right in saying "we" because, as I see it, if we are going to put our financial house in order it has got to be done by—jointly and with full cooperation between the legislative branch and the executive branch.

The legislative branch can't say, "Well, we are going to act irresponsibly and let the executive branch work it out." But by the same token, the executive branch can't act irresponsibly and say, "Well, let the legislative branch work it out." So we have to work it out together and if we do work together perhaps it can be worked out. But I think we are in the worst shape financially this country has been in perhaps than any previous time, and I, like you, I will read that study with a great deal of interest. But, frankly, it doesn't take a study to indicate to me that this country is in pretty bad shape financially.

I want to read into the record from page 31 of the hearings before the Committee on Finance, September 28 to February 2 of 1971—that was over a year ago—when Secretary Connally came before the committee and I find that in my colloquy with him I said this:

So my judgment is, if you are Secretary of the Treasury two years from today and I hope you will be, if you are my guess is you, or your associates will come in here with a request for a tremendous tax increase. I don't see how we are going to finance all these new programs.

And I see no reason to change my mind today. I think you or whoever might be Secretary of the Treasury will be coming in here and asking for a tremendous tax increase or the levying of new taxes. Whether the people are going to be inclined to support a heavy tax increase to take care of these smashing spending programs, frankly, I don't know and, as one legislator, one vote in the Senate, I don't feel any obligation to vote new taxes.

I am not going to make any decision today but I voted against many of these huge spending programs; I voted against reducing taxes by \$15 billion this year when we were running a deficit of \$30 to \$40 billion. I think the report has just reason to be pessimistic about our financial situation which, as I mentioned earlier, I think is the most pressing problem facing our Nation.

I am glad to hear your comments in reply to Senator Jordan and Senator Fannin, and I certainly want to cooperate with you and with other members of the executive branch in trying to hold down the tremendous increase in the cost of government. If we don't, I think the people themselves are going to be in a very bad situation.

When we analyze it, you know so much better than I do, but as I understand it, the bulk of the taxes in this country, the bulk of the taxes are being paid by the people in the middle economic group—those \$7,000, \$8,000 up to, say \$20,000—isn't that about right, where the bulk of the taxes come from?

Mr. SHULTZ. I think that is right. At the same time, I think it is quite revealing to see the impact on individual tax liabilities of the 1969 and 1971 tax actions. You mentioned a few moments ago the high quality of the work of Mr. Cohen. He gave a speech not long ago, April 29, which I am sure you have a copy of.

Senator BYRD. I sent for it and read it carefully.

Mr. SHULTZ. And in it he has a very revealing table on the impact of those tax changes according to income class and it is quite apparent that the individual income tax changes were extremely helpful in the low-income classes and less and less so as the income rose.

Senator BYRD. The significant part of that speech, or one significant part, I felt, was that \$15 billion tax reduction this year—\$15 billion—at a time when we are running a deficit of \$30 to \$40 billion. The individual got very little out of that, really, and yet the Government lost tremendously by it. That is water over the dam, of course, and we have to go on from here.

I am mighty glad to be able to support your confirmation. I wish you the best of luck in a difficult job, Mr. Secretary.

Mr. SHULTZ. Thank you, Senator.

Senator TALMADGE (presiding). Mr. Secretary, as you know, the Congress last year enacted important amendments proposed to improve the work incentive program. As of today, the request for funds to implement the Talmadge amendment is still bottled up in the Office of Management and Budget, though it was submitted to you by the Labor Department months ago.

I recall that when the work incentive program was enacted by the Congress and signed into law by the President in January 1968, the Budget Bureau also held up a request for funds and later the administration excused the slow start of the work incentive program by blaming the Congress for failing to appropriate funds promptly.

When you were Secretary of Labor, I am sure you were aware that the WIN program as administered was a miserable failure.

When do you plan to send up a budget request so that progress can be made in making the WIN program work?

Mr. SHULTZ. Well, we certainly want to see that program work. I don't have right in my mind the answer to your question but I will check on it and see. I am just not—

Senator TALMADGE. Will you please look into it and report to the committee promptly, in writing, Mr. Secretary?

Mr. SHULTZ. I will do that.

(Mr. Shultz subsequently informed the committee that they were planning to send up a budget amendment for the work incentive program by July 1.)

Senator TALMADGE. The Canadian Auto Agreement is one of the most unreciprocal trade agreements that this country has ever entered into. It has resulted in a growing deficit in our trade balance with Canada.

Do you intend to continue pressing the Canadians to remove the duties on American automobiles so that this agreement can be truly a reciprocal free-trade arrangement?

Mr. SHULTZ. I certainly intend to continue pressing in this area; I do indeed.

Senator TALMADGE. Do you favor expanding the use of flexible exchange rates for international currency?

Mr. SHULTZ. Yes, sir.

Senator TALMADGE. Do you believe that the bands now provided for flexibility will have to be widened?

Mr. SHULTZ. Well, I think that and many associated questions are the sort of things that have to be worked out in trying to develop a permanent system, a new system of international monetary arrangements. I wouldn't want to jump at an answer on a specific item, but certainly I think that the direction of greater flexibility is the right direction to go.

Senator TALMADGE. Does an interest in flexible exchange rates mean that you think it is not possible to persuade other countries to remove most of the trade restrictions they have built into their economics?

Mr. SHULTZ. No, but I know that the process of negotiating trade rearrangements is a tough process. As I said earlier, I think the two have to be seen as related to each other and that we should press hard, as you suggested, in the Canadian case for a removal of barriers that have worked unfairly as far as we are concerned.

Senator TALMADGE. On the subject of tax reform, I understand you submitted a memorandum to the President in 1970 warning of the frustrations of blue-collar workers.

Could you tell us what were these complaints of blue-collar workers that you referred to and what you would propose to do about them?

Mr. SHULTZ. Well, I think that the report was reflecting a sense of frustration that many middle-income people in America have felt for a great variety of causes, some having to do with the tax system, some having to do with the great attention paid—and I personally believe that we should pay attention—to those who have the lowest incomes. Then, beyond that, I think when you look at what has happened to the real earnings of the typical production worker and see that from around 1965 to around 1970 in spite of large money-wage increases real spendable earnings didn't increase at all—they were more or less on a plateau—you can see how people could generate a sense of frustration, a sense of spinning their wheels.

That sort of thing was the background of that report. I did not try there to put forward a definitive program for doing something about it, but really sought only to call attention to the problem and to start some thinking on it.

I am glad to say that real, spendable earnings have now been moving up since the end of 1970 and are now at their highest level in the history of the country. I think that is one of the very positive notes about the economy, that it is very important to keep in mind.

Senator TALMADGE. If there is no objection, I will ask that we insert in the record a New York Times story dated May 21, 1972, upon which that question was predicated. It is the "Washington Report" by Edwin L. Dale, Jr., New York Times.

Without objection, it will be inserted at this point.
(Clipping from New York Times dated May 21, 1972, follows:)

[From the New York Times, May 21, 1972]

BUDGET MAN AT TREASURY

(By Edwin L. Dale Jr.)

WASHINGTON.—Four things can be said with some certainty about George P. Shultz, who is about to become Secretary of the Treasury:

¶His record as a forecaster of the economy since he has been in public office is miserable. He has company. To avoid needless agony, one citation will be enough. From April, 1970: "By the end of the year we will all be happier about wages and prices. Labor output per manhour will be up."

¶His record as a mediator, including retaining the respect of an extraordinary variety of those involved, is excellent. He still gets along well with George Meany, for example.

¶He is ideologically a "free market" man and leans toward such things as flexible exchange rates among currencies and the importance of the money supply as a determinant of economic activity—and against such things as wage and price controls.

¶By far the most important, he has the confidence and respect of the President. The appointment of Mr. Shultz to the Treasury post to replace John B. Connally is most unlikely to "change" the domestic or international economic policies of the United States Government. The reason is so simple as to be overlooked by sophisticates from Capitol Hill to Brussels, from Wall Street to Cambridge, Mass.: the President is the same President, and he makes the decisions.

President Nixon has sometimes overruled Mr. Connally and Mr. Shultz on strongly held positions—a good example being Mr. Connally's view that the devaluation of the dollar's exchange rate against other currencies should not include a "meaningless" increase in the price of gold.

Mr. Shultz can be expected to be overruled, too. Both men know this to be the way of life with a strong President, but somehow outsiders always think the influence runs the other way—that the President bends inevitably to the opinions of his advisers.

At about 2 P.M. last Monday (before Gov. George C. Wallace of Alabama was shot) Mr. Shultz was asked—more accurately, he was told—by the President to take the job of Secretary of the Treasury. The offer came after a remarkable array of matters in which the two men had been involved over more than three years—from murder and politics in the United Mineworkers Union to building the Federal budget; from race relations in the construction industry to welfare reform; from postal and railroad strikes to the presumed waywardness of the Federal Reserve Board; from oil imports to wage and price controls.

It was from that long experience of the two men—not from any inherent desirability—that it came to pass that the almost 200-year-old Office of Secretary of the United States Treasury will be occupied for the first time by, of all things, an economist.

While recently he has not been dealing much in theoretical matters, there should be no mistaking that Mr. Shultz is, in fact, an economist. He can talk "least squares" and "regression equations" with the rest of that often-benighted breed. He was a Ph.D. in the subject, and has taught it. In that respect, a background respect, he is a world of difference from Mr. Connally. But the difference should not be exaggerated.

The President, whose relationship with Mr. Connally was very special, disclosed on Tuesday how Mr. Shultz came to be offered the job of Secretary. After telling a group of Treasury officials that he and Mr. Connally had decided "several weeks ago" that, as originally agreed, Mr. Connally would leave about now, the President continued:

"We agreed the man best qualified to step into these very big shoes is George Shultz. He has a background in Government and a background in economics, and also he happens to believe in the same things we do.

"This is important. There will be a changing of the guard but no change of the rules. I mean whether it is in the field of international economics, the fight against inflation, or the need for fiscal integrity, George Shultz, John Connally and I see the situation the same way."

The fact remains, however, that Presidential advisers do count, and that Mr. Shultz and Mr. Connally are not peas from the same pod. Four items should be mentioned:

THE BUDGET

Mr. Shultz, unless the records are mistaken, is the first modern Secretary of the Treasury to have come to the job with a genuinely intimate knowledge of the Federal Budget process and is therefore somewhat pessimistic about its controllability. He is no less worried than Mr. Connally about the upward surge of Federal spending. Conceivably, he could bring to bear from the Treasury Building the most sophisticated attack on Federal spending programs ever.

TAX REFORM

In this key area Mr. Shultz's views are not well-known. However, he submitted a memorandum to the President in 1970 specifically warning of the frustrations of blue-collar workers and warning that they were susceptible to appeals from politicians such as Governor Wallace. While the memo did not concentrate on tax complaints of the blue-collar workers, these have since come to the fore. It is a fair guess that Mr. Shultz would be less hostile than Mr. Connally to tax changes whose impact would be heavier taxation of some wealthy persons, but he undoubtedly shares the Administration's general skepticism that massive new revenues can be raised by "reform."

CONTROLS

Mr. Shultz and Mr. Connally share the same general philosophy, but Mr. Shultz is more committed from his intellectual background to the view that sustained controls are likely to be a failure. He is doubtful that permanent controls are required on the grounds that "monopoly power" in the economy, either in labor or in "concentration" of industry, has increased much. He believes it has not. He has often said that, apart from emergencies, controls "cannot work for long."

INTERNATIONAL

Here lies the most fruitful ground for speculation, but not much more. Mr. Connally was and is a nationalist—not a protectionist. This led him into a whole series of clashes with the "conventional wisdom" over such matters as the possible desirability of trading blocs in the world, enforcement of antidumping laws and open criticism of foreign countries. Mr. Shultz by his nature is less likely to ruffle feathers and is also likely to seek more avidly than Mr. Connally the economist's natural vision of the best monetary and trading world—one that is not divided into blocs and whose entire aim is to reduce barriers of all kinds, regardless of temporary strains on the balance of payments.

Mr. Shultz is known to believe, for example, that the imposition of controls, now five years old, on United States corporate direct investment abroad was a bad mistake. He is attracted by floating exchange rates. He is about as antiprotectionist on trade matters as anyone can be.

And yet, as a loyal servant of the Administration, he testified in Connally-like terms to the Senate Finance Committee in May a year ago that the United States should get back to its tradition of being "Yankee traders" and stop taking bad bargains from other countries.

Embassies here will undoubtedly be overloading diplomatic pouches with estimates of the meaning of the appointment of the new Secretary of the Treasury. Any sensible dispatch should begin and end with a single sentence: Richard Nixon is still President.

Senator TALMADGE. What do you believe the view of the country is on the topic of tax reform, Mr. Secretary?

Mr. SHULTZ. Well, I think that people want a system that is equitable and fair; they want a system that is certainly simpler than the one that we seem to have right now. I think that there is a great deal of interest in this. Certainly the President has been interested right from the beginning in seeking a fair and equitable tax system, there has been a lot of activity in this administration on that.

I don't see a great deal of evidence, frankly, that the people feel that we in Government are doing such a good job spending the money

that is generated by the taxes we now have or that they think that the taxes should be raised to support additional spending. That observation in my own thinking, anyway lies behind the responses I have given to some of the other questions and why it seems to me before we start talking about ways to raise more revenue we should work very hard to try to keep outlays under control.

Senator TALMADGE. I certainly concur in that.

Mr. SHULTZ. And I know you would prefer that route.

Senator TALMADGE. Do you think the question of tax reform ought to be very high on our agenda next year?

Mr. SHULTZ. Yes, sir; I think that it is a topic that we ought to work on continually and perhaps especially next year.

Senator TALMADGE. Do you believe that we can raise substantial revenue from tax reforms or only redistribute the tax burden in a fairer way?

Mr. SHULTZ. Of course, we have to say what we mean by tax reform. Depending upon how you classify it, it can yield you only minimal amounts of revenue, although it may contribute to a greater feeling of fairness in the system. Certain types of reform yield only a small amount of revenue while other proposed reforms, changes in the structure of the tax system, can yield very large sums of money, particularly over a period of time.

So I think it is a question of what you define as tax reform.

Senator TALMADGE. How would the level of economic activity be affected by these choices?

Mr. SHULTZ. Well, we had a major effort of tax reform in 1969 and your committee played a key role in it. Most of the issues that people talk about when they talk about tax reform were talked about then; you debated them; you considered them; you investigated them.

At this point in time we have yet to complete, in the Treasury, publishing the implementing regulations on those 1969 tax reforms. Most of them have been completed but not all.

We do not have sufficient experience with those reforms to know what their impact is. I do think that if you are constantly in the process of talking about making drastic changes in the nature of the tax system, it can create a kind of uncertainty that can be bad for the economy.

Senator TALMADGE. Thank you, Mr. Secretary.

Senator Hansen?

Senator HANSEN. Thank you, Mr. Chairman.

Mr. Secretary, I am pleased to see you here before this committee in the role that you come this morning. Will you be Chairman of the Cost of Living Council and the chief economic spokesman for the administration, as your immediate predecessor is generally assumed to have been?

Mr. SHULTZ. Yes. The President has asked me to be the Chairman of the Cost of Living Council, and to play a leading role in developing our economic policies.

Senator HANSEN. With respect to the balance-of-payments situation that exists in the country at the present time, I would like to ask some questions about your attitude on the natural resources development in this country, and in oil imports.

Some few years ago a cabinet task force on oil import controls recommended a tariff scheme to replace the quota program.

Do you have any feelings different with respect to the recommendations of the task force than were expressed at that time?

Mr. SHULTZ. Well, I would have to say, first, that since the completion of that work I haven't been particularly involved in that subject so that it isn't one that I have had in front of my mind. But if you say everything else is equal, assuming that you are going to have some kind of a restrictive procedure for national security purposes on the importation of oil, would a tariff system or a quota system be preferable, I think on the whole my preference is for a tariff system rather than a quota system.

There are, I think, things that could be said on both sides, but as an economic proposition, I think, on the whole, you can achieve the same result and it can be done in a more efficient way with a tariff. But it is not a big matter.

Senator HANSEN. Having in mind the recent actions in the last few years by the oil producing and exporting countries, and the price rises which have followed their collective actions, is it your opinion that a tariff could be imposed on imports and produce a substantial amount of revenue for the Treasury on oil and gas imports?

Mr. SHULTZ. Well, of course, the further the prices rise—the world price rises toward the internal U.S. price—the less of a problem you have. I would say insofar as our oil task force is concerned we recommended, and I think everybody was agreeable to this, the setting up of an executive branch committee to keep track of the subject closely. We recommended certain initial moves and then posited any additional moves on the collection of information and seeing what happened.

Now, one of the things that we felt at the time was that we would be seeing a large flow of oil and gas from Alaska and from the Canadian Arctic to the United States. I think, we expected to see a pipeline there and to see this flow. Well, it hasn't come to pass and so that is a change.

Speaking for myself, I would say that it seemed to me unlikely, with the many different countries involved in the production of oil outside the United States, that they would be able to form a cartel against us. I have been surprised that they have been able to do that so effectively. So that is a development that was not there then that seems to me we must take into account as we form our policies in the future.

Senator HANSEN. You speak of the—you phrased your last response, I take it, initially by noting among other things as the world price approaches the domestic price here. With respect to natural gas, it is my opinion that indeed the world price not only approaches it but has exceeded it; is that correct?

Mr. SHULTZ. Far in excess, yes, it is; and my personal belief is that our natural gas is way underpriced—the reason for some of our problems.

Senator HANSEN. I am pleased to hear your observation. I share your feeling.

A number of competent witnesses have appeared relating essentially the same story, that in their opinions there are enormous undiscovered resources within the continental United States, Alaska, and within the Continental Shelf of untapped oil and gas.

Would you favor, having in mind the security of our country and the dependency that comes from a domestically produced source of

energy, that it would seem indicated to give further encouragement than is presently the case to the industry to search out and to explore for and to bring in to production more domestic production than that within the Continental Shelf?

Mr. SHULTZ. Well, I think that partly, of course, the expression that I think the price of natural gas is lower than it ought to be is part of the answer to that question. I think, however, that a large part of our problem is that, recognizing the importance of environmental concerns as we engage in the process of finding and producing these sources of energy, we must learn how to meet legitimate concerns and, at the same time, get access to that energy. I think we are searching to find a way to do that; and that is not so much a question of giving an incentive to the industry for exploration as it is finding ways that are, so to speak, environmentally secure, more environmentally secure, than the past ways have been, to get this energy from the continental United States, Alaska, and from the Continental Shelf.

Senator HANSEN. Well, the information I have is that within the last few decades that there have been 10 times as much pollution occurring from shipping or from accidents that occur in unloading barges, and so forth—there have been 10 times as much pollution of the ocean along the coastal areas of our country from that source than have resulted from spills from wells on the Continental Shelf.

If you would be willing to accept my statement as somewhat accurate, is it your feeling that both of these methods of supplying our needs should be viewed critically or—I am not sure that I follow you exactly when you speak about our environmental concerns. If we don't produce this oil and gas within the continental United States, on land area and, of course, that would include Alaska and—

Mr. SCHULTZ. And the Continental Shelf?

Senator HANSEN. Yes, as part of the United States, if we don't produce it that way, is it your feeling that we would run a lesser risk of oil pollution by shipping it in or how do you propose that we get it?

Mr. SHULTZ. I don't want to pose as knowledgeable, technically, about the environmental problems caused by the movement of oil by tanker and barge and so forth as distinct from offshore drilling. I am just not that technically proficient on that, and I would accept your judgment on it.

But we have had problems in both. Whether a 10-to-1 ratio is the right ratio or not, I think the fact is that both ways of gaining access to oil supplies in this country have given us some problems. We need to work at those problems and try to solve them and, at the same time, I think, we have to work at it with enough imagination and energy that we don't deny ourselves the energy that we need.

Senator HANSEN. There has been great concern expressed over the environment and I am sure it must be shared to some degree by every American, but from some of the things I have read, and I have in mind particularly a rather long statement of concern by Peter Drucker, and he expresses the feeling and the belief that now is not the appropriate time to cut back on development of additional energy supplies and the use of additional energy if we are to get on with the job of cleaning up the environment, adequately treating the sewage that oftentimes goes virtually untreated into the rivers and estuaries around the country, that it will take much more rather than less

energy, and that if we are to bring about an abatement of the pollution coming from automobile exhausts that that, too, will require more, not less, energy in order to bring into being mass transit systems which hopefully could be operated electrically.

Senator HANSEN. Do you think there is merit in his feeling to clean up the environment, the water and the air, it will require more rather than less energy?

Mr. SHULTZ. I think that is probably right. Certainly it requires resources to do it and this gets back to something we talked about a little earlier in this hearing, namely, the importance of improving our productivity. This is really the source of additional resources for whatever it is we want to do with them and cleaning up the environment certainly is one of the prime objectives that we have as a country. But we can't do it in such a way that in effect we turn around and prevent ourselves from doing the very things that will allow us to do it.

I think you are pointing out the sort of a circular situation or possibility, and I think that is a very legitimate concern.

Senator HANSEN. Just one further question, Mr. Secretary.

For a long time, I think, it was the belief and the demonstrated ability, as a matter of fact, of this country, to compete with practically any other nation in the world. Now, with the activities of a number of multinational corporations, with a rather widespread determined effort among most of the nations to seek to lower barriers to trade, this seems to no longer be the advantage of the possession of technology remaining exclusively in the hands of American production. I think it has been demonstrated that many countries have access to information, and to all of the secrets that we once had almost exclusively as our own, so that the differential in wages becomes the prime factor.

There are a number of countries where a competent work force can be assembled and is willing to work for, say, one-tenth or upward to one-fourth of what is paid American labor.

Is it your feeling that we can continue to compete successfully, we can continue to provide the jobs we would hope we might have in this country without any protection or changes in our tariff policies, in our import programs?

Mr. SHULTZ. Well, of course, we have made changes, particularly within the last year, in our international economic arrangements, and I am sure that further changes are needed, so it isn't as though we have the perfect situation right now. Far from it; we don't.

We have a lot of work to do in this area. But, at the same time, it seems to me important to keep reminding ourselves that, while we have a problem, we continue to compete effectively in many areas, in many markets. The United States is by no means getting run out of the world, so to speak. Of course, trade fundamentally will not take place unless there is a mutually advantageous exchange.

So, in the long run, if you are going to export, you have to import.

Senator HANSEN. I assume it is your intention in a general way at least to pursue these policies which have characterized this country's program in the area of international trading in the past couple of years; am I right about that?

Mr. SHULTZ. Yes, sir.

Senator HANSEN. I have no further questions, Mr. Chairman.

Senator TALMADGE. Senator Nelson?

Senator NELSON. I have no questions.

Senator TALMADGE. Thank you very much, Mr. Secretary.

The other witnesses are Mr. Walker and Mr. Cohen and they are well known to every member of the committee.

If it is agreeable, we will ask both of them to come to the table jointly.

Does any member of the committee have any questions for either Dr. Walker or Mr. Cohen?

(No response.)

If not, we will go into executive session.

(Whereupon, at 11:20 a.m., the hearing in open session on this matter was completed and the committee proceeded to executive session.)

[From the Washington Post, May 25, 1972]

BROOKINGS SEES FEDERAL TAX RISE NO MATTER WHO WINS PRESIDENCY

(By Peter Millus)

The Brookings Institution is publishing a study today indicating that a federal tax increase is highly likely in the next four years, no matter who is elected President in November.

The study says that the federal cupboard is bare, that the "peace dividend" is gone, and that existing federal taxes will not even pay the cost for the next four years of the programs already on the books or proposed.

If the newly elected President wants to start any big new programs, the authors say, he will have only two choices: cutting back old programs or raising taxes.

The authors are pessimistic, on the basis of past performance, about the prospects for any big cutback of old programs.

They suggest it is equally unlikely that the new President will be able to resist endorsing new ones.

"Several new or sharply expanded federal programs are now under serious political discussion," they note.

"The replacement of local property taxes devoted to schools by federal financing would cost approximately \$12 billion.

"Equalization of expenditures per pupil within states would require an additional \$9 billion, part of which would probably have to come from the federal government.

"The pending House and Senate water pollution control bills would add about \$3 billion to \$4 billion a year . . ."

In addition, they say, pending proposals for federal support of day care could cost between \$5 billion and \$12 billion a year; the proposed national health insurance program could cost many more billions than projected; and the administration's revenue-sharing bill will not permanently solve the fiscal problems of the nation's cities.

The study was prepared by Charles L. Schultze, former director of the old Bureau of the Budget; Edward R. Fried, former senior staff member of the National Security Council; Alice M. Rivlin, former assistant health, education and welfare secretary; and Nancy H. Teeters, a former fiscal economist for the Budget Bureau.

It is the third annual review of the President's budget that Brookings has published.

The study makes the point that the kind of budgetary problem that the government is facing today is relatively new in American history. For most of the past the fiscal problem has been surplus revenues.

A director of the Budget Bureau in the 1920s, the authors note, was complaining because, "Despite persistent efforts to reduce revenue by cutting taxes . . . we seem helpless in the face of the country's continuing prosperity. . . . At the end of each year we are called upon to determine what to do with surplus millions."

The problem was the same—a prospective revenue surplus—in the late 1950s and early 1960s, the study says. What happened then, however, was that the government over-reacted.

Though no one seems to pay much attention to the fact, federal taxes have been cut substantially over the last 10 years. Excluding Social Security taxes, the present tax laws will produce about \$45 billion less in revenue in fiscal 1973 than the rates in effect in 1963 would have.

At the same time, federal spending has gone up with budget-straining speed—and not as many people think primarily because of the war in Vietnam. The biggest spending increases have been on the civilian side—in the government's basic "income-maintenance" programs such as Social Security, and in what the study describes as the "major Great Society programs," the legacy of Lyndon Johnson.

Spending on these Great Society and other civilian programs, moreover, has increased even faster under Richard Nixon than it did under his predecessor.

Defense-related expenditures made up 53 per cent of the budget in Fiscal 1963. They were down to 44 per cent in Fiscal 1970. They are down to 34 per cent in the proposed budget for Fiscal 1973. "Most of the budgetary savings from Vietnam have already been realized," the Brookings study says.

The study identifies three basic ways of raising federal taxes "that seem worthy of serious consideration." One is tax reform, the alternative being advocated by the leading Democratic presidential candidates. The second is a value-added tax, a kind of national sales tax, which the administration has suggested as a possibility. The third is a simple increase in or surcharge on the present tax rates.

The study says that a flat, across-the-board increase of 1.8 percentage points in all the federal income tax rates would produce an additional \$12 billion. An 8.5 per cent tax surcharge would produce the same result. To raise the same illustrative amount with a value-added tax would take a 4.3 per cent rate, assuming some form of protection for the poor.

The study said that tax reform or a tax surcharge would be the most progressive of the various alternatives. It did not explicitly endorse any of the possibilities, however. Nor did the book endorse any of the looming expenditures it discussed.

The lengthiest discussion of possible cutbacks in the budget was on the defense side. The defense budget went up only marginally in Fiscal 1973, but the authors noted that implicit in the budget is an increase of about \$10 billion by Fiscal 1977.

The cutbacks they suggested ranged up to \$13 billion a year.

The authors noted that there are particularly difficult problems associated with the current effort to find some new way to finance public education. The biggest of these, they said, is that there are several conflicting objectives to be met. People want to increase school revenues and equalize school expenditures at the same time that they want to reduce property tax rates. There isn't enough money in sight to do it all.

There are similar contradictory objectives to be met in other programs, they said, health insurance, for example, where the problem is to make more care available without at the same time driving up its cost.