

**NOMINATIONS OF WILLIAM E. SIMON AND
DAVID R. MACDONALD**

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

ON

NOMINATIONS OF WILLIAM E. SIMON, OF NEW JERSEY,
TO BE SECRETARY OF THE TREASURY, AND DAVID R.
MACDONALD, OF ILLINOIS, TO BE ASSISTANT SECRETARY
OF THE TREASURY FOR ENFORCEMENT, TARIFF AND
TRADE AFFAIRS, AND OPERATIONS

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NOMINATIONS OF WILLIAM E. SIMON AND DAVID ROBERT MACDONALD

WEDNESDAY, APRIL 24, 1974

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

The committee met, pursuant to notice, at 9:05 a.m. in room 2221, Dirksen Senate Office Building, Senator Russell B. Long (chairman) presiding.

Present: Senators Long, Hartke, Ribicoff, Byrd, Jr., of Virginia, Mondale, Curtis, Fannin, Hansen, Dole, and Packwood.

The CHAIRMAN. In today's hearing, the Committee on Finance will be considering the nominations of Mr. William E. Simon to be Secretary of the Treasury and Mr. David Macdonald to be Assistant Secretary of the Treasury for Enforcement, Tariff and Trade Affairs, and Operations.

Mr. Simon is no stranger to this committee. I believe that the Senator from New Jersey, Mr. Williams, would like to introduce our witness today.

STATEMENT OF HON. HARRISON A. WILLIAMS, JR., A U.S. SENATOR FROM THE STATE OF NEW JERSEY

Senator WILLIAMS. Thank you very much, Mr. Chairman.

It is a pleasure and an honor to be able to present a fellow New Jerseyite to the committee as the nominee for this very important post. While we are all familiar with the contributions Mr. Simon has made, particularly within the last year to the Nation in the energy crisis, we in New Jersey know also of his background and his professional life in the securities industry.

Some might think that this is a bit of a comedown from "czar" to a Cabinet position, Bill, but I know that everybody, particularly here in this committee that has first opportunity to consider this nomination, feel the overriding importance of the Secretary of the Treasury in this time when there are so many foreboding economic indicators. We in New Jersey are, of course, proud of this appointment, and we know that the times will require the best of Mr. Simon. And we know he will give his best as he has in the 1½ years that he has been at the service of the American people in a high appointive position.

Certainly the energy crisis is not over, and it is not solved. But most recently, Mr. Simon brought a cool competence to that critical situa-

tion, and the same cool competence is needed in this important position that you are considering today, Mr. Chairman.

Thank you.

Good luck to you.

Senator FANNIN. Mr. Chairman?

The CHAIRMAN. Senator Fannin?

Senator FANNIN. Mr. Chairman, I would like to have the opportunity of welcoming Mr. Simon to this committee meeting this morning. I am very proud that I have had the opportunity to work with him. And as we all know, after a very brilliant career in private industry, he came to Government, and his performances have been outstanding. And he took on a chore that seemed like an almost impossible task. And although it was a difficult one, he certainly handled it with great expertise, and we are very proud of his position that he consistently took as to the problem that was involved. He faced up to realities, and certainly he brought a great sense of responsibility to that position. So I think we are very fortunate to have Mr. Simon in Government, and I am very pleased, before we proceed with the hearing, to express my great support of him.

The CHAIRMAN. Do you have a statement that you would like to make, Mr. Simon?

STATEMENT OF WILLIAM E. SIMON

Mr. SIMON. I have a brief statement, Mr. Chairman; yes, sir.

The CHAIRMAN. Please proceed.

Mr. SIMON. Mr. Chairman and members of this distinguished committee, less than 1½ years ago, I appeared before you, seeking confirmation to high office. This morning, it is my honor and privilege to come before you again, on this occasion as the President's nominee for Secretary of the Treasury.

You have my biography on file. Also, in accordance with your procedures, I have provided the committee with a statement of my financial assets, which are managed in a blind trust by Morgan Guaranty Trust Co. of New York. I have also supplied the committee with a letter from Edward C. Schmults, General Counsel of the Department of the Treasury, expressing his opinion that my financial arrangements are in conformity with the conflict-of-interest statutes.

Today, we are faced with a broad range of complex economic and financial issues. You are familiar with all of them, since they have been at the forefront of Presidential and congressional attention for some time. These issues include inflation, renewed economic expansion, energy, reform of the international monetary system, trade reform, tax reform, and the restructuring of our financial system. Of all of these issues, the problem of raising prices has been and will continue to be our dominant concern. Inflation has been gathering momentum for almost a decade; it is the most serious and intractable problem faced by the past two administrations. We must devote our strongest efforts to help bring it under control.

Over the past year I have testified on innumerable occasions here in the Senate and in the House. I assure you that I will continue to be readily available to work with the Congress on these and other important issues in the months ahead.

Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Simon, I had prepared a number of questions that I thought about asking you, but after thinking about it, I have concluded that it is not quite fair to put a man on the spot when you think that he is competent for the job, because to do so tends to imply that if he does not answer the question right, you are going to vote against his confirmation. So I think I will preface my statement by simply saying that I am satisfied that you are in all respects qualified and ought to be confirmed to the job.

TIGHT MONEY POLICY AND INFLATION

Having done so, I would like to ask about the tight money policy and the inflation problem. Chairman Burns of the Federal Reserve Board recently stated he believed a tight money policy is necessary to combat inflation, in spite of the effect of such a policy on housing and other critical national priorities. Could you give us your views in that regard?

Mr. SIMON. Chairman Burns' remarks relative to a continued taut posture of the monetary aggregates is consistent with the problem that we have on the inflation front at this point. The chairman is also dedicated not to have a recurrence of the liquidity squeeze or the crunch that we experienced in August of 1966. What we need at this point more than ever is a proper balance between the fiscal and the monetary policies, and a return to the fundamentals to get this inflation dragged back into the cage, Mr. Chairman.

HOUSING PROBLEMS

And as far as housing is concerned—the second portion of your question—there are ways that housing has been helped in the past through the Federal agencies, through tandem plans, and Ginnie Mae and Fannie Mae and the auction purchases, and the home loan purchasing; and we are looking at and studying that right at this minute.

The CHAIRMAN. One thing that gives me cause for concern about our housing problem is that housing credit necessarily has to be long-term credit, and when someone signs up for a 30-year mortgage at a time of very tight money and high interest rates, he spends 30 years carrying the burden of having built a house at a time when the Government's fiscal and monetary policies were oriented against an inflationary spiral. I wonder whether we should not be thinking somewhat in other terms to try to make credit for housing available for people who want to build it on a basis that would not be so cyclical. That way there would be a certain amount of credit available every year, and the interest rates would tend to remain rather level rather than go up and down from 7 percent to 12, and back on down to 6.

Mr. SIMON. I think probably the most difficult task is to remove housing from its contracyclical posture as far as the business cycle is concerned. I worked on it at great length as a banker for many of the housing agencies back in my other world on a variable interest rate mortgage, and I think that is a very promising alternative at this point and would answer that question, sir.

The CHAIRMAN. Senator Fannin?

Senator FANNIN. Well, thank you, Senator.

As I say I have great confidence in you, and as I stated before, I do realize we have some problems that are very serious. And I do not, I certainly do not know the answers. But, as Chairman Long has expressed from the standpoint of his being home last week, I could speak on the same subject because I was contacted by several realtors who were vitally concerned and were giving me examples. For instance, they say that with this long-term payment on a home, they buy a water heater and it lasts for 5 years and they pay for the water heater about 10 times before they get through with the 30-year loan. Do you think that it is possible to keep our housing program going forward with the interest rates that we have facing us today?

Mr. SIMON. Senator Fannin, high interest rates obviously are a deterrent to people purchasing homes, and nothing is as great a concern in our economic discussions at this point. I can say that nothing is of greater concern to our President right now. The economic team met yesterday afternoon for 2½ hours, and housing was the center of the focus of our discussion. The President has directed us to come up with remedial suggestions in this area.

BALANCE OF TRADE

Senator FANNIN. One of the great problems that we have, of course, today is that in our balance of trade, especially with the petroleum products being increased in price, do you feel that we can, through our negotiations in GATT, correct this situation? Here we have the great imbalance and we have cars coming in this country at a 3 percent tariff, and we have a problem of getting our cars into other countries for double that, treble that, and sometimes 10 times that much. The rates and tariffs have been going up to 50 or 60 percent, and is there anything that the Treasury Department can do in that regard?

Mr. SIMON. Yes, sir. And there is also a great deal that the Congress and the Senate, in particular, can do about this problem. We would be extremely optimistic on multilateral trade negotiations, but we need one thing, first, and that is the successful passage of the trade bill to give us the tools to negotiate, Senator.

Senator FANNIN. You feel it is essential, if we are going to have negotiations in GATT, that the trade bill go through?

Mr. SIMON. I most certainly do, sir, with the highest sense of urgency.

OIL COUNTRY MONETARY RESERVES

Senator FANNIN. Are you alarmed at the tremendous amount of reserves, monetary reserves, that will be accumulated by countries, like Saudi Arabia, Iran, and those oil-producing countries?

Mr. SIMON. I think alarm would be a little too strong an adjective. I believe for the foreseeable future, for the next year, that the investment mechanism throughout the world, Europe as well as our markets here, can handle the investment. But, it is going to require other investment opportunities for these nations, as their reserves, indeed, surpass their ability to spend them. The committee of twenty is actively working with the OPEC nations on methods to invest these reserves in the future, and how these reserves will indeed be handled in the context of international monetary reform.

Senator FANNIN. Do you see OECD as a factor involved in what we would be able to do in this regard?

Mr. SIMON. Well, presently, these negotiations are in the Committee of Twenty that are working on international monetary reform, Senator. What the ultimate mechanism would be is unclear at this point.

Senator FANNIN. Well, thank you very much.

Mr. SIMON. Thank you, sir.

The CHAIRMAN. Senator Hartke?

Senator HARTKE. Good morning, Mr. Simon.

Mr. SIMON. Good morning, sir.

TAX CUTS

Senator HARTKE. Do you favor a tax cut at this time?

Mr. SIMON. No, sir, I do not, Senator Hartke.

Senator HARTKE. Would the Administration oppose a tax cut?

Mr. SIMON. Yes, sir, the Administration would oppose a tax cut.

Senator HARTKE. Would they veto a tax cut of any kind?

Mr. SIMON. I would not prejudge what the President may or may not do on a tax cut. That decision has not been made by the President.

Senator HARTKE. If there were a tax cut proposal, would you have any preference of methods employed?

Mr. SIMON. We just feel that a tax cut at this point would be highly inflationary, would stimulate demand that is already excessive. Our problem today in the economy is one of supply, not of demand.

Senator HARTKE. Do you feel that the present inflationary trend is a result of a shortage of goods rather than a situation where you have excessive interest rates and excessive taxation?

Mr. SIMON. I do. I think the excessive interest rates are a result of the inflation. Obviously, they have a casual effect if they get this high, there is no doubt about that. I would say that food and fuel are the major components of our inflation problem. Certainly there are shortages coupled with the high prices that are charged by the OPEC nations.

OIL SUPPLIES

Senator HARTKE. Is there a shortage of fuel at the present time, to the extent that the price is increased as a result of the shortage or has the price increased as a result of the action of the oil companies?

Mr. SIMON. Well, one might say that is one and the same thing, because these shortages have been created by a group of nations that own 67 percent of the world's proven reserves. And for a time they have the ability to raise the price to these clearly unworkable levels.

OIL COMPANY PROFITS

Senator HARTKE. In regard to the high oil prices, is it not true that the profits of the major oil companies have gone up remarkably. Could we characterize them as excessive?

Mr. SIMON. They have gone up remarkably and in one instance, I guess, or in several, perhaps, they could be considered excessive, if allowed to continue.

Senator HARTKE. Do you feel that it is the administration's responsibility to thoroughly investigate why the oil prices have gone up so

high, in view of the fact that the present shortage has been alleviated and Saudi Arabia has indicated that they are going to increase their production. We are not expected to have a shortage for the next 4 or 5 years?

Mr. SIMON. Two things in that respect: Yes, we are investigating and searching out the way they made their profits, No. 1. But, No. 2, the President, in anticipation of these profits, recognizing that they are profits due to the world price explosion in this commodity, requested a windfall profit tax and submitted that proposal which is being marked up in the Ways and Means right now.

Senator HARTKE. Mr. Simon, would that investigation be made available to this committee?

Mr. SIMON. Certainly.

Senator HARTKE. And will you do that?

Mr. SIMON. I certainly will, Senator.

TAX CUTS

Senator HARTKE. I disagree with you on the tax cut issue. The fact is not one of shortage of goods, but an arbitrarily fixed situation on interest rates and taxes. Most of the individuals, especially lower income groups, are finding it difficult to make ends meet. Would it not be preferable at this time to institute the recommendations of the Social Security Advisory Committee and provide for an equalization of the social security tax by providing that one-third be paid by the employee, one-third by the employer and one-third out of the general fund?

Mr. SIMON. There again that just increases our "Federal economy" and neglects the inflationary consequences. Our responsibilities to the future of our country together requires us really not to do that again, however tempting the immediate political or economic benefits. It may be good politics temporarily, but it is lousy economics.

Senator HARTKE. It has been bad economics now throughout the past 8 or 10 years.

Mr. SIMON. Yes, sir.

Senator HARTKE. We continue to have tight money, severe high interest rates, high tax policies, and all this has failed to reduce unemployment or inflation. Why if you have a policy which has failed for 8 to 10 years do you continue to pursue it?

Mr. SIMON. Well, of course, we are paying the price of our past sins that probably go back to 1964, with the commencing of "guns and butter," and the massive Federal deficits. What I am suggesting is that we have a new spirit, a new political will, if you will, Senator Hartke, and have the proper balance of fiscal and monetary policies in this country that will once and for all cure this problem we have got.

Senator HARTKE. You intend to continue this high interest rate, high tax, austerity program—dangerously deflationary program?

Mr. SIMON. That does not imply that. It implies just the opposite, Senator Hartke, that once that we show a resolve to do something about inflation, you will see the immediate response in interest rates.

Senator HARTKE. What do you propose to do about inflation then?

Mr. SIMON. Well, I—

Senator HARTKE. You say it is food and fuel. Food and fuel are not going to be increased as a result of any policy resolve, they are going to be increased by production.

Mr. SIMON. I think that you have seen that we have been addressing the supply problem since 1972. All of the acreage set aside was removed, and agricultural production this year will be at record levels. And we have seen many key agricultural commodity prices decline rather dramatically in the last three months. And so this is solving a problem. It is bringing the problem of supply and demand in balance.

As far as fuel is concerned, that is of a longer term nature because we cannot grow a barrel of oil as fast as we can a bushel of wheat. It is going to take 3 to 5 years before we begin to see the product of the additional oil exploration that is going to be going on in our Outer Continental Shelf and the secondary and tertiary recovery and all of the things that you have heard me talk about so much in the last 5 months.

GAS RATIONING

Senator HARTKE. Let me ask you about another subject.

As Administrator of the Federal Energy Office, did you have rationing stamps printed?

Mr. SIMON. Yes, sir, we did, Senator.

Senator HARTKE. Under what authority?

Mr. SIMON. The authority—and I have testified on this on several occasions with our General Counsel, a very conservative General Counsel, I might add, named William Walker—was in the clear legislative intent involved in many testimonies that we must be prepared to implement it in the event rationing became necessary. Now, printing of the stamps takes 30 to 45 days, and we would not have been prepared, obviously, if we did not physically have the stamps ready to mail out.

Senator HARTKE. Is it not true that there was no authority, that in fact you exercised only anticipatory authority?

Mr. SIMON. There was no statutory authority, Senator Hartke. It was authority that we exercised by the spirit of the law with Congress and by the mandate that we felt we had received in our testimony, so evidenced by a letter that we last submitted to Senator Montoya in hearings.

Senator HARTKE. What was the cost of the rationing stamps?

Mr. SIMON. \$12.7 million.

Senator HARTKE. And that expenditure was made without any legislative authority?

Mr. SIMON. Yes, sir.

Senator HARTKE. Mr. Simon—

Mr. SIMON. I might say, also, although this is a debatable point, that is why we requested statutory authority for rationing. Under the Defense Production Act of 1950, we have the authority to ration and, therefore, to go ahead and print the stamps. But, we felt that that was a moot point, and one for which we should have a statutory base.

OIL COMPANY ANTITRUST CASE

Senator HARTKE. Mr. Simon, the Washington Post reported last year that you directly intervened in an antitrust case in the Federal

Trade Commission on behalf of eight major oil companies who were the object of that case and you were the Deputy Secretary of the Treasury at the time. What comment do you have on that?

Mr. SIMON. I was also at that time, Senator Hartke, Chairman of the Oil Policy Committee and, as such, I was working on stimulating refinery construction and expansion in this country, as well as stimulating exploration and production. And when that FTC complaint was lodged against the oil companies, I wrote the chairman of the FTC a letter outlining what my energy staff in the Treasury had done relative to the problems that that created, and we will have an ability to testify on that. I was not aware at the time that that was a violation, and it was published in the Federal Register and made public.

We changed the mandatory oil import quota policy last April, a year ago, and this was to encourage increased refinery construction in this country, to give people the stability of supply because you cannot finance \$300 million to \$500 million to build a new refinery or expand an existing one if you do not have a source of feedstock. And the independents were going out to build refineries, and we had them come to us and say—

What are you doing in Government? Here you are telling us to go out and build refineries, so we go out and we get our financing and we are going down the road to build or to expand our refineries, and now you tell us that you have to disintegrate, and that you are not going to allow it any more. Now, our banker then comes to us and says: How can we lend you the money if the Government is doing this?

So, this problem was what we pointed out to the FTC.

I am not saying that they should not be disintegrated. I am just pointing out that this is a potential danger, and a deterrent for new refinery construction.

Senator HARTKE. I will yield. Others have questions.

The CHAIRMAN. I would suggest that each Senator limit himself to 8 minutes during the first round of interrogation.

Senator Ribicoff?

TAX REFORM

Senator RIBICOFF. Mr. Simon, what are the major areas of the tax law that you feel should be reformed?

Mr. SIMON. We presented a tax proposal in April of last year, Senator Ribicoff, that pretty well covered the administration's viewpoint on tax reform.

Senator RIBICOFF. Well, would you repeat those for the purpose of the record now?

Mr. SIMON. Perhaps I could submit them all for the record, because I will undoubtedly leave one or two out.

Senator RIBICOFF. Well, would you mention those that you think are the most important, then?

Mr. SIMON. We dealt with runaway plants, and foreign tax incentives for foreign investment. We have proposed the removal of the foreign depletion. We have proposed a change in the treatment of foreign taxes and royalties of the oil companies, as far as their treatment as a tax credit. Those are among the most important, as well as our recent windfall profit tax proposal.

Senator RIBICOFF. What measures do you advocate to bring a halt to the galloping inflation which is affecting our entire economy?

INFLATION CURES

Mr. SIMON. Senator Ribicoff, if I thought that I had a magic solution to cure our inflation problems, that would, indeed, be wonderful. But, unfortunately, there is no fast or easy solution.

I would go back to what I said before, that we have to get back to the fundamentals and work together to curb spending and to bring all of the excesses under control. And then we will see the reasonable interest rates that Senator Hartke spoke of before and that we all want so much.

Senator RIBICOFF. Do you think it can be solved by just that simple statement?

Mr. SIMON. Well, it is not that simple. It has to address ourselves to the supply and capacity problems in this country that are creating the shortages, versus the demand in this country, and we have to be more aware so that we will have an ability to act, rather than to react, when we are having these problems. The two recent examples are, of course, in the food area last year and fuel this year. And what will it be next year?

Well, I hope we have learned our lesson, and that we will put the proper mechanism into place that will study that as well as provide the proper economic climate for savings for the needed investment, for expansion in all business in this country.

ECONOMIC FORECASTS

Senator RIBICOFF. You know, I am somewhat puzzled. I have been sitting on this committee now for 12 years, and during that entire period I have seen a series of outstanding men, men of integrity, men of ability, such as yourself who have come before this committee with their proposals, with their theories, with their objectives and their recommendations. And as my memory goes back over that 12 years, it seems that almost all of you have been consistently wrong in your predictions year after year, Democrats and Republicans alike. And yet, the executive branch, the Congress, the people, the banking community, the business community, depend to a great extent upon the recommendations of the Treasury Department. How can you explain this consistent error or these consistent wrong predictions from the Department of the Treasury?

Mr. SIMON. Well, when you say predictions, predictions are made by many people, primarily the economists, Senator Ribicoff, who are in charge of forecasts and forecasting is a dangerous profession. I do not know anybody who is gifted with the ability to see into the future. It is a natural human propensity to believe that the policies that one puts in are, indeed, the right policies. And so, therefore, things are going to get better. I do not have any locked-in rigidity that my policies, whatever they turn out to be, are going to be at the outset the right ones. What I am interested in is working cooperatively with the Congress in addressing some of these, perhaps in a different way.

Senator RIBICOFF. Well, is there any place in Government that the American people can rely upon for predictions and forecasts, as far as the economy is concerned?

Mr. SIMON. Well, when one talks about predictions and forecasts and confidence in Government, I think you can say that the overall profession of forecasting, whether it be in Government or whether it be in the private sector, errs on many occasions, as all economists erred last year in the food price explosion and in the inflation rate. I am afraid that no one foresaw that. So, I believe that our ability on forecasting in my recent experience in Government, has been relatively as good as anyone else's.

PROPOSALS TO COMBAT INFLATION

Senator RIBICOFF. Then why could not Senator Kennedy's or Senator Mondale's proposals for a tax cut be just as good as your proposals? The Nixon Administration proposals have not worked. Why would your proposals be more sound than the proposals of Senator Kennedy and Senator Mondale?

Mr. SIMON. Well, this is a disagreement on the substance of the issue, Senator Ribicoff. We believe that the fundamentals in our economy are strong and that the weakness, as shown by the recent negative real GNP growth figure, is isolated in areas of our economy that were affected by the energy problems—in the automotive industry and in housing, due to high interest rates, as well as the energy problems. And we see that turning around. We see tremendous plant and equipment spending plans and, if anything, we see them increasing. So, the fundamentals are there and so why stimulate demand that is already there, and pay the piper with a higher inflation rate later?

COMMISSIONER OF INTERNAL REVENUE

Senator RIBICOFF. Mr. Simon, there is one particular man who has served under you who has been doing an outstanding job. That is the Commissioner of the Internal Revenue, Mr. Donald Alexander. Now, I trust that you can assure the committee that you intend to have him to continue to serve in that capacity. Have you made any commitments to anyone concerning Mr. Alexander's continued service or removal as Commissioner of Internal Revenue?

Mr. SIMON. Let me assure you, Senator Ribicoff, in my role as Deputy Secretary of the Treasury actively for almost a year before I moved to the Federal Energy Office, the Commissioner of Internal Revenue reports directly to the Deputy Secretary of the Treasury, and there is no one that I am closer to in the Treasury Department than Don Alexander. And I cannot say that I can make a commitment from him that he is going to stay but, boy, I certainly want him and have told him so, and he has assured me that, indeed, he is going to remain.

Senator RIBICOFF. But, that is not the question.

Have you made any commitment to anyone that you will remove Mr. Alexander?

Mr. SIMON. Absolutely not, sir.

INDEPENDENCE OF INTERNAL REVENUE SERVICE

Senator RIBICOFF. All right, now. Last year the Joint Committee on Internal Revenue Taxation requested its staff to review the activities of the Internal Revenue Service for the purpose of determining whether any person whose name appeared on the so-called White House Enemies List, were singled out for specially harsh or punitive action. This staff study concluded that the Internal Revenue Service had resisted White House efforts to use them for this partisan purpose, and with the backing of Secretary Shultz was able to maintain the independent role intact. I would like you to assure this committee for the record that you will make every effort to maintain the integrity and the independence of the Internal Revenue Service administering the tax laws.

Mr. SIMON. I will guarantee you that I will do that, as I have in the past in my other role, Senator.

Senator RIBICOFF. All right. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Byrd?

Senator DOLE. Mr. Chairman, do you rotate on this committee?

The CHAIRMAN. I am just reading down the list, Senator, and I have Senator Byrd next. If I start from the top he is No. 10, and I have you as number 11.

Senator DOLE. I do not care, but I have to be at another committee.

SECRETARIES OF THE TREASURY AND ENERGY POLICY

Senator BYRD. I will yield to the Senator from Kansas.

The CHAIRMAN. Go ahead.

Senator DOLE. Mr. Simon, do you still have direct control over the Energy Office?

Mr. SIMON. No, Senator Dole. I will not have direct control.

Senator DOLE. Do you have any control at all?

Mr. SIMON. Well, control; no. Energy policy, economic policy, that is a team mechanism. It always has been and always should be, in my judgment. On a day-to-day basis, I do not believe that any outside agency should control anybody.

Senator DOLE. That you will have some input?

Mr. SIMON. Oh, certainly I will have some input in energy policy, because energy policy and economic policy are inextricably integrated. The economic policies in the troika will be integrated to implement Project Independence, and will be involved in the conversations on what directions we are going to be going, so, yes; I will be directly and actively involved in energy in that respect, as well as any other way I can be helpful.

John Sawhill was my Deputy, and as you well know, he is a very competent person and I will help him any and every way I can.

OIL PRODUCTION INCENTIVES

Senator DOLE. Well, I think it is important because I think you have done a good job in that office, and I think there are still problems ahead. I would hope that we would not lose the experience that you

have gained because of a shift in positions. In that same area, we are looking now at the so-called tax reform on the House side and where they are planning on raising about \$16 billion in revenues, as I understand the package, and about \$13 billion of that comes from the domestic oil industry.

Now, one of the causes of inflation, as I understand it, are shortages, and it just seems to me they may, in effect, be driving the independent oil industry out of business with some of the rather drastic steps taken by the House Ways and Means Committee.

How are we going to have production in my State of Kansas and other States of this country, if we take away all of the incentives from the producer?

Mr. SIMON. Senator, I agree with that. We cannot. Sometimes there is a terrible tendency not to understand that the great majority of those people out there in that oil world are independent, and when people talk about the oil companies, they think that covers the entire spectrum of the petroleum industry. They fail to recognize that 75 percent of the new holes that are drilled are those of the independent producer. So, we have to be very careful about punitive legislation that will destroy incentives.

TENDENCY SEEN TO PUNISH THE OIL INDUSTRY

Senator DOLE. I think there is a tendency on the part of some, and some in the Senate, from non-oil-producing States to punish the oil industry. I understand that one of the reasons for the housing crunch is the great increase in the cost of lumber, which is grown in the State of Washington, and there has been a 71-percent increase in that. Now, I have not seen many Senators around saying or suggesting that we rollback the price of lumber.

When they do not produce oil in their States it is pretty easy to rollback the price of oil, like me saying, rollback the price of salmon. We do not have any salmon in Kansas and it is a little distressing to our industry when 100,000 people are working in that industry in the State of Kansas, and another 100,000 are royalty owners, to have the non-oil-producing representatives single out this independent industry. I am not talking about the international oil companies, but about the independents who have a stake in this country, and who need the incentive to produce the oil we have said for the past 6 months is so vitally needed. But there is at stake here, I think, the solution to the energy problem. We are not going to solve it and become independent by 1980 or any other year if we destroy the industry in the process.

Mr. SIMON. I agree with that, Senator.

TAX CUTS

Senator DOLE. Now, with reference to tax cuts, and I know it is very popular, and I am a candidate this year, and no doubt there will be a tax cut passed by the Senate because we pass everything in the Senate. What would be the leadtime, if there were a tax cut, how long would it take to help the economy?

Mr. SIMON. If our projections are correct, and indeed we believe that they are, we have already seen the worst of the slowdown due to

the energy embargo, et cetera. The second quarter of this year will show zero or slight growth, and then, in the second half of this year, it is going to show increased growth, and the tax cut would come just at the wrong time. The impact of the tax cut would, at that point, exacerbate our inflation problems.

Senator DOLE. So, from that standpoint it would not be helpful?

Mr. SIMON. It certainly would not, sir.

Senator DOLE. Well, does it really, do you really produce anything with a tax cut?

Mr. SIMON. You produce more demand, and, as I said before, we have sufficient demand right now. It is the supply that is our problem, the shortages.

SLOWDOWN IN THE GROSS NATIONAL PRODUCT

Senator DOLE. Well, what percentage of the drop of 5.8 percent in the gross national product has been due to a slowdown in auto sales?

Mr. SIMON. The entire decline—and this is the difference in this slowdown—was isolated to the automotive, the housing, and energy-related activities in our economy. It is not a pervasive slowdown that goes across the entire spectrum of the economy. It was specialized.

Senator DOLE. So, there are pockets and it is not a broad, nationwide problem?

Mr. SIMON. No, sir.

Senator DOLE. Well, that is the point that has been made to me a time or two, and it just seems—

Mr. SIMON. Would you not think that the first thing that would happen when automobiles drop as drastically and as quickly as they did, that steel production is going to drop? But steel production is going all out at present and capital spending plans are continuing at record level. We have never seen a pervasive slowdown, or a recession, or any definition that you wish to give during a period where capital spending was at these levels.

Senator DOLE. Is it not true that there is a fairly wide recovery now in the production of automobiles with the medium size?

Mr. SIMON. Exactly. We believe in the third and fourth quarter, when they have been able to retool to the extent that they do, with the demand for smaller automobiles, there will be a significant pickup in automobile sales.

Senator DOLE. Those are the only questions I have, Mr. Chairman.

But, I would underline that I come from a food producing State. We believe in the concept you stated earlier, the one way to relieve this shortage is to provide an incentive. And we will produce the wheat and the corn and, try to find some oil in our State if they do not take away their incentive. But, I think there are some in this body who may want to do that.

Thank you.

The CHAIRMAN. Senator Byrd?

Senator BYRD. Thank you, Mr. Chairman.

Mr. Simon, I want to congratulate you on your appointment to a very important office, and I want to commend the President also for being able to obtain your services. I think that my colleague from

New Jersey Senator Williams, summed it up quite well a little while ago, when he commended the cool competence that you brought to the position that you have held for the last year or so.

GOVERNMENT IN THE MONEY MARKET

May I ask you this: I know that you do not have the information with you, but would you have your office—hopefully, reasonably soon—provide for me information as to the extent to which the Treasury Department or the Government has gone into the money markets for funds for the 4-month period November 1973 to February 1974?

Mr. SIMON. Would you like that in agencies, federally sponsored agencies, as well as Government?

Senator BYRD. Yes. The total Government.

Mr. SIMON. My last memory of it, and I have not looked at these numbers in about 6 months, Senator, it was close to 62 percent of the Government's total involvement in the capital markets, which I think is awful.

Senator BYRD. Thank you.

DEFICIT SPENDING

Now, there have been several questions in regard to inflation and how best to get inflation under control. Would you agree that one way the Government is not likely to bring inflation under control is to continue this tremendous deficit financing which we have been involved with for the past 5 or 6 years?

Mr. SIMON. Yes. Almost 10 years. Yes, sir. I definitely agree with you.

Senator BYRD. So, these continued heavy deficits have not solved our problems at this point; have they? I guess you would agree with that?

Mr. SIMON. Yes, sir.

Senator BYRD. And if you accelerate or increase these deficits by reducing revenues, then does it not tend to stimulate inflation rather than to curb inflation?

Mr. SIMON. It most certainly does, Senator Byrd.

Senator BYRD. Would you agree that we must bring the deficit spending under control, and bring about a balance between fiscal and monetary policy, if we are going to accomplish the objective of reducing inflation?

Mr. SIMON. Yes, sir. We would have to, as I said, go back to the fundamentals and stop attacking the results of the problem, Senator.

INTEREST RATES

Senator BYRD. How do you see interest rates going in the next 4 to 6 months?

Mr. SIMON. Forecasts. I am probably not any better at forecasting than anyone else. But, if indeed we are able to harness the inflation problem over the next 4 to 6 months, we could see a significant reduction in interest rates, although it is going to be counterbalanced by what we believe will be a strong economy in the second half of this year, with a demand for funds, which is offsetting. So, the long rates probably would be able to decline, not as much as the short rates.

The short rates, obviously, are reestablishment of the yield curve, if you will, with short rates down quite significantly.

GOVERNMENT IN THE MONEY MARKET

Senator BYRD. Would it be correct to assume that the more that the Government itself goes into the money market, the more that tends to stimulate high interest rates?

Mr. SIMON. Yes, indeed. Excess demand. But, more important than that, if the number is still approaching that number that I mentioned a few minutes ago of 62 percent as far as the Federal Government's total involvement in the capital market, including Treasury bills and coupon securities as well as federally sponsored agencies, then who is disadvantaged? Who becomes the disadvantaged? Is it the Xeroxes of tomorrow, the State and local government financing? And, obviously, the pool of savings to supply the money is not infinite, and the more we take, obviously the higher rate that people must pay at the bottom end of that ladder.

Senator BYRD. So the more that the Government goes into the money markets, the more money the Government needs, the more money it must borrow, the more competitive, of course, the money market becomes, and the higher the interest rates that everyone has to pay, including the public?

Mr. SIMON. Yes, sir.

Senator BYRD. And the cost to the Government now, as I recall in the present budget, and the new budget, which Congress is working on, is already \$29 billion. There are the interest charges that the American Government pays for the money which it borrows from the public?

Mr. SIMON. That is correct, sir.

Senator BYRD. That figure is a very substantial proportion of our entire Federal fund budget, and it goes only for that one purpose—of paying the interest on this debt. And I assume that you feel that everyone would be better off, including the average citizen, if those interest charges, and the costs to the Government of the interest that it must pay, on the national debt, were not so high?

Mr. SIMON. Indeed we would, sir.

Senator BYRD. Thank you, Mr. Simon.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Packwood?

MONETARY POLICY

Senator PACKWOOD. Bill, I share some of Senator Ribicoff's fears. I have not had his length of experience on this committee and I've been on the Banking Committee for just 5 years. But, for these past 5 years, I have heard all of the defense and well-intentioned testimony, I think, from economists of this country, conservative ones and liberal ones, and I have come to the conclusion that indeed economics is an art; it is not a science.

Prediction is a hazardous business. You have alluded now to the proper balance between fiscal and monetary policy. But, for the life of me, I do not know what that balance is. I am not sure what you mean

by that. I know in the first 2 years I was here, in 1969 and 1970, the Administration talked about high interest rates and, hopefully, an effort toward balancing the budget, and said it would bring interest rates down eventually, and would result in price stability. That did not work, and price instability was not as bad then, but inflation continued and ran around 5 or 6 percent. What does work? What do you mean by a proper balance between monetary and fiscal policy?

Mr. SIMON. Where you are not running massive deficits on a continuing basis, Senator Packwood, and forcing monetary policy to bear the brunt of economic stabilization all alone. That is what is meant.

CAUSES OF INFLATION

But, also, collaterally I mentioned that one must also take a look at what causes inflation and what has caused inflation. We have had shortages in some of our critical commodities—internationally traded raw materials, the food and fuel problems we know so well—and our ability to anticipate this problem has not been very good.

Senator PACKWOOD. But, we did not hit those shortages severely until the summer of 1973 or a bit earlier.

Mr. SIMON. Basically, it started with food in late 1972.

Senator PACKWOOD. Yet, we had a substantial inflation, not 10 percent, but a substantial inflation even before the shortages developed.

Mr. SIMON. This inflation started in the period of the Vietnam buildup, when we were financing massive deficits, and that was the start, and we are still paying the penalties for it.

Senator PACKWOOD. Well, I can hardly defend the Congress' fiscal responsibility, but this administration continually sends us a budget with a \$10 billion to \$20 billion deficit. That's what they start with, and then we get ahold of it and make it worse.

Mr. SIMON. I would hope that the best first step that we have seen is the new budget reform, as far as Congress looking at it as a whole, rather than just on an ad hoc basis, and I think that is a great first step.

FULL EMPLOYMENT BUDGET

Senator PACKWOOD. Do you accept the concept of a full employment budget as being noninflationary?

Mr. SIMON. A full employment budget concept is basically an indicator, and that is what I accept it as. I am not, as you know, Senator Packwood, an economist, so I do not have the rigidity of concepts, if indeed—no, I should not say that because that is calling the economists rigid; and I do not say that. But, I do not have any of these preordained concepts.

Senator PACKWOOD. I have no other questions, Mr. Chairman.

The CHAIRMAN. Senator Mondale?

UNEMPLOYMENT

Senator MONDALE. Thank you, Mr. Chairman.

This week's Newsweek has quite an article about you. You may have read it. It makes three or four points about your position in economics.

No. 1, it says you would be willing to take the chance that unemployment will stop at 6 percent, and you might even permit unemployment to rise to 7 percent, is that correct?

Mr. SIMON. No, sir, it is not.

Senator MONDALE. What is your position on unemployment?

Mr. SIMON. I am as sensitive to the problem of the unemployed in this country as any American would be, and I would be in favor of action to address the problem of unemployment. And there, again, this was a major topic as far as anticipating what an unemployment rate might be, as we looked toward the balance this year with the President yesterday. Senator, I would suggest that I have been accused of lots of things in magazines and newspapers, and it has been a favorite sport of lots of people. But, I have made no comments to newspaper reporters or editorialists or otherwise, on what economic policies I might embrace, because it would be improper until you, Senators, confirm me.

Senator MONDALE. What do you consider to be an acceptable unemployment rate?

Mr. SIMON. Our goal should be the full employment goal that we have embraced which is in the area of 4 percent. We can argue downtown whether 4 percent is outmoded or not. But, that is strictly the direction we must work toward.

Senator MONDALE. In other words, you consider 6 percent unacceptable, and you would move with economic policies to avoid it?

Mr. SIMON. Yes, sir.

Senator MONDALE. And what economic policies would you pursue?

Mr. SIMON. We are looking at a number of alternatives, and I would rather not at this point, Senator Mondale, say that this is the way we would go, or that way.

Senator MONDALE. Well, what are the range of remedies you are considering then?

Mr. SIMON. Well, one can look at public service employment as, perhaps, a way to reduce unemployment.

Senator MONDALE. Do you think that the present budgetary proposals for public service employment, I think of \$350 million, is adequate?

Mr. SIMON. It all depends on what level of unemployment you are looking at and by how much you are attempting to alleviate unemployment.

Senator MONDALE. I am not trying to debate you. We are looking at the current economy and we are looking at inflation. We are looking at the current employment rates and we are looking at economic projections. Do you think in the light of that the current request of \$350 million for public service employment is enough?

Mr. SIMON. If unemployment is to increase, as we believe it will, gradually over the near term 6 percent, probably not, Senator Mondale.

Senator MONDALE. Do you anticipate unemployment around 6 percent?

Mr. SIMON. I do not expect it to get there, personally, no, Senator.

Senator MONDALE. The public service jobs remedy would, in effect,

try to provide public employment for the unemployed, do you have any proposals for heading off unemployment in the private sector?

Mr. SIMON. Not at the present, Senator Mondale, no, sir.

Senator MONDALE. None?

Mr. SIMON. But we are going to be studying these problems and they have started these studies already and will be addressing these in anticipation of something that may indeed not occur.

UNEMPLOYMENT INSURANCE

Senator MONDALE. What about unemployment insurance? What do you think about that?

Mr. SIMON. The President has recommended increased unemployment insurance—benefits, I believe the increase is \$1.1 billion—recognizing that we needed broader coverage due to the energy problem and making people come under this act that heretofore did not, and we would hope that that would receive favorable consideration in the Congress.

Senator MONDALE. This Newsweek article goes on to say that the new Secretary wants to get back to conventional, Republican businessmen's balanced budget economics. He wants to try and bury the full employment budget concept. He would like to move toward a balanced budget. He does not want a housing industry that produces above 2-million units a year. Would you comment on that?

Mr. SIMON. I just do not know where that author got any of those comments.

Senator MONDALE. You think this is sort of a creative novelist that wrote this?

Mr. SIMON. I think that they check around and say, "What does this fellow believe," because, obviously, definitively I would not make statements.

FULL EMPLOYMENT BUDGET CONCEPT

Senator MONDALE. This is a good chance for you to tell us what you believe. Are you against a full employment budget concept?

Mr. SIMON. As I said, I consider the full employment budget concept a good economic indicator basically. I probably could be described as a financial conservative, so I would lean more toward the balanced budget concept on an actual basis. There is no doubt about that. But, I do see the benefit in running deficits during periods of economic malaises, economic slowdowns, to help get the economy out of its slump, but not in respect to what has gone on where we have had 14 budget deficits in the last 15 years, some of them quite massive, that have created this major problem that we have got right now.

Senator MONDALE. I believe a few years ago the President of the United States in the state of the Union message endorsed the concept of a full employment budget, and said that that is a good way to guide the national budget. Do you accept that?

Mr. SIMON. Yes; I do accept that.

HOUSING

Senator MONDALE. All right, now, what about the statement that you would oppose housing starts exceeding 2 million per year?

Mr. SIMON. That is just not correct. Our housing goals have been stated and that is just an absolute untrue statement.

Senator MONDALE. How many housing units do you think we should be producing a year?

Mr. SIMON. I think we can produce in the area, as is the President's goal, of 2,600,000 housing units a year. And there again we have provided many new mechanisms in the last few years that contribute to this problem that Senator Byrd spoke of in our preemption of the capital market and the Fanny Mae, and Ginnie Mae, and tandem programs that assist housing during periods such as this.

WAGE CONTROLS

Senator MONDALE. Now, on the wage front, "Simon agreed with Dunlop that some system of control should continue, even if it is voluntary." Is that accurate?

Mr. SIMON. I say there what the administration suggested, and that was the monitoring techniques of the Cost of Living Council to preach moderation in price and wage increases. I think it is self-defeating to have explosive wage increases this year.

Senator MONDALE. Would you have controls on wages?

Mr. SIMON. Outright controls? I do not favor wage and price controls, no, sir. I would propose just what was proposed, and I endorse that, which is the monitoring system, with the exception, of course, of health care, which was one exception that the President asked for. And also the potential of construction as well.

SPENDING CURBS

Senator MONDALE. All right now.

On two or three occasions in your testimony you said we have to curb spending. By how much and in what sectors?

Mr. SIMON. That is a very difficult question to answer. It is not the finite thing, as Senator Packwood said. In the science, if you wish to call it that, of economics, there is no formula that says if we cut by this much, then we will cut the inflation rate by that much.

Senator MONDALE. Well, I am using your words. You said we should curb spending. What do you mean by "curbing spending?"

Mr. SIMON. Yes. We should not continue to have year after year after year the massive deficits that we have had. And as I said, in 14 of the last 15 years.

Senator MONDALE. And would you curb spending this year? Would you reduce?

Mr. SIMON. At this point in the economy, I think that some stimulation is, indeed, needed, and that our forecasts for fiscal 1974, which is in the area of a \$4½ billion deficit, is about on target.

Senator MONDALE. So, when you say curb spending, you are not referring to this year's budget?

Mr. SIMON. No, sir.

INFLATION CURBS

Senator MONDALE. What would you do about this excessive inflation? What are the elements of assigning a plan to restrain inflation without unemployment?

Mr. SIMON. Here, again, I have no magic solution.

Senator MONDALE. Well, I mean, you must have some ideas? This is the key issue in our country today.

Mr. SIMON. Indeed it is, sir.

Senator MONDALE. And you are going to be the person in charge of it. You must be able to tell us something about what you intend to do to restrain inflation.

Mr. SIMON. There, again, I can go back and stand on my answer earlier of having the fundamentals in place.

Senator MONDALE. What do you mean by fundamentals?

Mr. SIMON. It does not mean that monetary policy has to exert the major portion of the role in our economic stabilization program. We should address the problems of supply, just as we have addressed them in agriculture. We can look forward to the fruits of the decision in the agricultural area, where we are going to produce a record crop this year, and bring on the additional supplies of petroleum in this country, the major components there again being petroleum and food which gave us our problem before.

LOWERING PRICES

Senator MONDALE. You said it would be 3 to 5 years to bring on more petroleum. What would you do to bring down prices now?

Mr. SIMON. Farm prices have already declined. Petroleum will take a little bit longer, there is no doubt about that.

Senator MONDALE. If I can just have one more minute. As I understood, you would not reduce spending, you would not permit unemployment to rise. You are against wage and price controls, but you are going to bring prices down. Now, tell me how are you going to do it?

Mr. SIMON. When you addressed the problem of supply, it is not done instantly, Senator Mondale. That is the problem economics play to a much slower drummer, as they say, and it is going to take us some time to cure these problems. They are not going to be solved this year.

Senator MONDALE. So your answer to inflation rests solely on the supply side?

FISCAL DISCIPLINE SEEN NEEDED

Mr. SIMON. It rests on the supply side and on the fiscal discipline side as exercised by our Government, which requires a political will and a cooperation between the Executive and the legislative in paying attention to the fundamentals. And, as I said—

Senator MONDALE. When you talk about political will, you are not asking us to do anything, so what do you need the political will for?

Mr. SIMON. Well, when you say we are not asking you to do anything, we are asking for all of us to get together and stop this continued increase in spending that we have had for the past 10 years.

Senator MONDALE. You just said that you would not change the budget though. You said the budget is okay.

Mr. SIMON. The budget is okay. The budget is in place for this year, and also, we are required to put a budget into place a great deal in advance, Senator Mondale.

The CHAIRMAN. Now, as a matter of procedure, the Democrats on this committee have something of a problem because the Democratic

caucus is meeting at this very moment. I have received a notice urging that the Democrats attend that caucus. I believe it also well that we on this committee try to conduct ourselves with a sense of urgency in getting on with our business. I would suggest that we simply proceed with this hearing and those who would like to attend the caucus can go ahead and attend the caucus, while our Republican friends can ask their questions.

The Staff can inform any Senator whether the question he had in mind asking the Secretary has already been asked of him, and then we can proceed on with our business. If those who are here have finished their questions prior to 11:30, then I would suggest that we recess until 11:30. Is that all right?

Senator MONDALE. If we can get back, I would like to ask some more questions. Could the nominee return?

The CHAIRMAN. I would suggested that in the event those of us who remain here have concluded the questions that we want to ask Mr. Simon, that the committee at that point simply stand in recess until 11:30. I assume that by that time the Democratic caucus will conclude its business and we can come back.

I would suggest that we continue by our 8-minute rule a while longer because it might help to get on with the business. I would like to ask one or two things of the Secretary about the energy crisis.

ENERGY CRISIS AND OIL COMPANY PROFITS

Now, Mr. Secretary, are you aware that the general public, rightly or wrongly, has the impression that the energy crisis was something that was dreamed up by the oil companies for the purpose of maximizing their profits?

Mr. SIMON. Unfortunately, Mr. Chairman, I think that is probably correct. Yes, sir.

The CHAIRMAN. I come from an oil-producing State, Mr. Secretary, and I believe that this impression is probably the majority view in Louisiana, where we try to produce more oil for the size of the State than any State in the Union. In your judgment, is that correct or not?

Mr. SIMON. Yes, sir, that is. And we have all worked terribly hard to attempt to explain this complicated subject to the American people, and it just—

The CHAIRMAN. Well, now, you said that you think it is correct that people have this impression. But I want to know this: is that impression that they have correct?

Mr. SIMON. It most certainly is not, sir.

REASONS FOR THE ENERGY CRISIS

The CHAIRMAN. How do you believe that this energy crisis came about?

Mr. SIMON. Chairman Long, this energy problem has been coming on this country for a long time. It has been warned about by many experts long before I came to Washington. One can go back to the *Phillips* decision in 1954, to the regulation of natural gas at the well-head and at uneconomic price levels, that was a disincentive to exploration for natural gas in this country. Production peaked in 1970.

Exploration peaked in 1956. All during this period of the past 20 years, the demand has continued to grow between 4 and 5 percent, and today we are producing 11 million barrels a day in this country, and we are consuming over 19 million barrels a day. This shows you the extent of our own imbalance in this country between our supply and demand, and the result is that we have to rely on foreign nations, some of them obviously insecure sources for our supply. We have had a cut-off of this supply four times in the last 25 years. The first three times it did not make any difference because we were in surplus, and finally it took the embargo, when we were no longer in surplus, to focus the attention on this problem here in this country.

The CHAIRMAN. Well, with about half of our energy coming from natural gas, once we had a situation where the producers were required to sell that gas for about one-quarter the price that the other fuels were selling for on a Btu basis. That almost had the effect of dictating that here was going to be a shortage of gas, did it not?

Mr. SIMON. Yes, sir, it most certainly did. It was predicted. We were warned about it continually, and there have been many attempts to de-regulate it. We have a bill up here now to de-regulate natural gas, as you know, Mr. Chairman, that we feel is one of our highest priorities in the energy area.

The CHAIRMAN. In other words, the effect of that decision meant that everybody who could get gas was going to want to get it and change over from oil or coal, while at the same time it reduced the incentive of the producer to provide more gas, did it not?

Mr. SIMON. That is correct, sir.

The CHAIRMAN. So it was just a matter of time before gas was going to be in very short supply—not because of the supply going down, but because of the demand increasing so rapidly?

Mr. SIMON. Yes, sir.

OIL AND FREE TRADE

The CHAIRMAN. I know that a lot of people think that free trade would solve all problems, and I can understand how they sometimes arrive at that conclusion, that there would be Heaven on earth if you had a complete free trade. But from a complete free trade point of view, did it not make sense that this Nation should permit the Near East, where the oil can be produced so much more cheaply, to ship us a great deal of oil rather than produce it here? I mean, strictly from a free trade point of view?

Mr. SIMON. From a free trade point of view, yes. But, one might say if we did not have a quota system, it has been argued that there would be a disincentive for domestic production to go up also, if we allowed all of that cheap oil to come in, so you can argue both sides.

The CHAIRMAN. Well, I think my first economics professor told me that in sophomore economics you are taught to understand how it is supposed to work, and then you spend the rest of your time studying why it does not work that way. In the real world it would be desirable to have less imports, and then have a reliable fuel supply for national security purposes, if you have to anticipate that those other countries, not the companies, but the countries, might proceed to get together to raise the price, and you could be very much disadvantaged. And that is, in effect, what happened to us when these OPEC countries got to-

gether and demanded much higher prices for oil, and also cut off our supply.

Mr. SIMON. That is correct, sir.

OIL COMPANY PROFITS

The CHAIRMAN. Now, do you regard the profits that the oil companies have been making this last year as obscene?

Mr. SIMON. I have said that "obscene" was an adjective that I would not use to describe the profits. We did a study in the Treasury Department of the long-term profitability of the petroleum industry from 1958 through September 1973 as related to other manufacturing industries in this country, and found that they were in the middle range of profitability.

One has to look at a longer period of time before people can believe that, indeed, they are making unreasonably exorbitant or obscene profits. However, there was one area that we felt, with the arbitrary increase in the price of crude made by the OPEC nations, who control 67 percent of the world's reserves, that this represented a per se wind-fall profit, and that is why we recommended to the Congress a wind-fall profit proposal directed at crude oil.

The CHAIRMAN. What percentage of these increased profits have been in the international oil area as compared to the domestic area?

Mr. SIMON. It has been growing each year, and now the major portion of the profitability of the multinational oil corporations are in their foreign investments. But, it is not only their foreign investments. Profits have come from their tanker fleets, exchange rate fluctuations of the dollar last year, and from their refinery and marketing operations. It is not just from the price of crude oil.

The CHAIRMAN. The thing that concerns me is that we hear a scream about the increased profits of the oil companies, and my impression is that at least 75 percent of those increases is in the foreign area or international area—yet when we seek to do something about it, the proposals come through to clobber the domestic producers where less than 25 percent of those profits are. Now, can you give me some enlightenment on that subject?

Mr. SIMON. That is true, Mr. Chairman. I do not know what the exact percentages are for each company. It varies company to company on their international operation and domestic operation. But, there is a propensity at this point to penalize the entire industry, and it falls very heavily on a segment of the industry called the Independents who provide a great competitive function in this oil industry. And I would just hope and pray that the infinite wisdom of Congress is going to take hold finally and that we do not do anything punitive to this industry, which would be terribly counter-productive to our country and our economy.

The CHAIRMAN. Is it true that the only way we are ever going to be able to say grace over our own destiny in this country, where energy is concerned, is to develop our own capacity to produce our energy requirements? It is true that in order to do that you are going to have to permit the domestic producers to make enough profit and have enough incentives to expand and produce a great deal more, unless you want to nationalize the industry and have the Government do it for them?

Mr. SIMON. A reasonable profit, yes, sir. I agree with you.
The CHAIRMAN. Senator Hartke?

INTERNAL REVENUE SERVICE

Senator HARTKE. Mr. Simon, there has been a report that there is an intended change in the operation of the Internal Revenue Service in the offering as to whom the Internal Revenue Director would report to. Would you have him continue to report to the Deputy Secretary or the Secretary?

Mr. SIMON. Basically, on a day-to-day operational basis concerning the problems of the Internal Revenue Service, he would contact the Deputy Secretary, as I say, for the run of the mill things. When there are particular problems that might involve some sensitivity, I would always go to the Secretary. In the case of the relationship between George Shultz and myself, we would go through those problems together during those visits.

Senator HARTKE. I am not speaking now of whether or not you continue the operation with the Secretary or the Deputy Secretary. What I am asking is whether or not you intend or plan to have the Internal Revenue Director report to someone of a lesser stature?

Mr. SIMON. No, sir.

TAX REFORM

Senator HARTKE. Do you have any plans for tax reform whatsoever?

Mr. SIMON. Yes. Our proposal would limit artificial accounting losses which are the basis of tax shelters. It was directed to the petroleum industry, for example, and provides that a person could not get a write-off, a tax accounting write-off, if you will, unless he had income from his investment or it was an actual, not an artificial, loss. It involved petroleum and real estate, both, and is designed as a limitation of the accounting loss.

Senator HARTKE. This deals with the artificial accounting losses. Is that what you are talking about?

Mr. SIMON. Yes, sir.

Senator HARTKE. What about the minimum tax?

Mr. SIMON. Yes. We have a minimum tax proposal. I have been out of the Treasury for 5 months now, and the specifics of the minimum tax proposal, I could supply for the record.

Senator HARTKE. What is your intention in that regard? How much?

Mr. SIMON. How much?

Senator HARTKE. Do you know what the percentage is?

Mr. SIMON. I do not have the percentage, Senator Hartke.

[The Department subsequently supplied the following:]

[From the Treasury Department's "Proposals for Tax Change," Apr. 30, 1973]

EXPLANATION—I. MINIMUM TAXABLE INCOME (MTI)

GENERAL EXPLANATION

1. SUMMARY OF PROPOSAL

The proposal is designed to assure that every individual will pay a reasonable amount of federal income tax relative to the size of his income. This will be accomplished by requiring that every individual's taxable income, to which the

present graduated tax rates are applied, be no less than his "minimum taxable income," which is approximately one-half of his adjusted gross income expanded to include specified tax preferences which represent exclusions from income under present law.

The minimum taxable income will be determined as follows:

(I) By *adding* to present law adjusted gross income the total of percentage depletion in excess of basis, the excluded one-half of net long-term capital gains, exempt earned income from foreign sources, and the nontaxable bargain element in certain stock options to arrive at Expanded Adjusted Gross Income (EAGI);

(II) By *subtracting* from EAGI, the deductions for personal exemptions, a \$10,000 floor, extraordinary medical expenses, extraordinary casualty losses and investment interest (and investment expense) to the extent of investment income to arrive at the MTI Base; and

(III) By *dividing* the resulting MTI Base by two to arrive at "minimum taxable income."

Every individual will be required to pay tax on the greater of his minimum taxable income or his normal taxable income computed in the usual manner.

The specified exclusions¹ and all itemized deductions will be permitted to operate freely within the area of up to one-half of income, but in all events the other one-half of income will be subject to income tax. Because of the \$10,000 floor, the adjustments for extraordinary medical expenses and casualty losses and other reasons, MTI will have little or no impact on taxpayers in income brackets below \$50,000.

MTI is not a form of a "minimum tax" like the provision in present law which imposes a flat 10 percent tax on specified "tax preferences." Instead, MTI will be part of the regular income tax structure in which the rates of tax range from 14 to 70 percent. MTI will be a more effective solution, consistent with our graduated tax rate system, to the problem to which both MTI and the present Minimum Tax are directed.

The proposed MTI provision, in combination with the proposed Limitation on Artificial Accounting Losses (LAL), will be substituted for the present Minimum Tax on individuals.² Under these provisions, the contrast to the present Minimum Tax which treats all tax preferences the same, different types of preferences will be separated and treated differently. LAL will apply to deferrals of tax and MTI will generally apply to exclusions from tax.

Senator HARTKE. May I ask you what is your attitude concerning the Ways and Means decision to remove the percentage depletion?

Mr. SIMON. We have favored the removal of the foreign depletion allowance, and we have opposed the removal of the domestic depletion allowance. We have felt two things about the domestic depletion allowance. One that it was a useful carrot for the independent producer to go out and raise his funds to drill domestically. And, two, the economists have argued quite compellingly that in former years the depletion allowance has resulted in a lower price of gasoline and heating oil to the consumer.

Senator HARTKE. What about the foreign investment tax credit? What is your position on that?

Mr. SIMON. We recommended that the tilt be changed from the incentive for foreign drilling to domestic drilling, Senator Hartke.

Senator HARTKE. Would you follow the provisions of the Burke-Hartke bill, or not? The Burke-Hartke bill, in case you have forgotten—

Mr. SIMON. Yes, sir.

¹ Other exclusions from income which affect primarily lower and middle income taxpayers will not be subject to the MTI limitation. These exclusions from income which will not be affected by MTI include amounts received under health and accident plans, rental value of parsonages, scholarship and fellowship grants, etc.

² The present Minimum Tax on corporations will be retained. The principal application of MTI will be to individuals, but it can readily apply to estates and trusts also.

Senator HARTKE. Provides very simply that the foreign tax credit should be shifted from a credit to a deduction.

Mr. SIMON. We just dealt specifically with the oil companies, Senator Hartke.

Senator HARTKE. Do you intend to apply it to just one segment of industry?

Mr. SIMON. At this point.

Senator HARTKE. You do not believe that that is discriminatory?

Mr. SIMON. Well, we believe—

Senator HARTKE. That is discrimination. It discriminates against the oil companies and it is a favor for the other big international corporations, is it not?

Mr. SIMON. We believe the recent explosion in the tax and royalty payments could not be literally called a tax credit item, and that should be changed.

Senator HARTKE. You do not believe it should be applied to the copper industry, for example, which is in extremely short supply now?

Mr. SIMON. We did not address ourselves to that; no, sir.

OIL COMPANY PROFITS

Senator HARTKE. When Senator Long asked you whether or not you consider the profits of the oil companies obscene, is it not true that Continental reported more than a 100-percent increase in profits, in their first quarter and Occidental over 1,000 percent?

Mr. SIMON. Continental? I do not know whether they did.

Senator HARTKE. And Standard Oil of Indiana a 71-percent increase?

Mr. SIMON. And Exxon 39 percent.

Senator HARTKE. And Exxon is the lowest, is that right?

Mr. SIMON. It is the lowest I have seen recently.

Senator HARTKE. Yes. Most of them average around about 70-percent increase in profits. Do you consider that an unconscionable situation in view of the fact that most people are facing a difficult time making ends meet in this inflation ridden society.

Mr. SIMON. If I believed, Senator Hartke, that this was a situation that was going to continue, yes, I would consider that most exorbitant. Indeed I would.

Senator HARTKE. And would you propose some type of tax on that?

Mr. SIMON. If indeed that was to continue. I consider this a one-time event, looking at the prices in the past year. But, when one talks about, you know, American business, admittedly the oil companies, who operate multinationally, experienced greater profitability but 1973 was a very, very good year for American business. I think I read recently that Alcoa, just a couple of days ago, reported a 126 percent increase in their profits. So, it has been a good year. But there again, we have to look at the overall 10- or 15-year experience and how it relates and what is the average growth rate. I think that you will find that the average annual growth in the petroleum industry has been at the lower level of profitability, and return on equity has been about, I think, 10th or 11th out of 30.

INTEREST RATES

Senator HARTKE. You said you had no idea about how high interest rates would go. Are we going to have a 12 percent prime? Is that not the projection?

Mr. SIMON. I have not seen the forecast of the 12 percent prime, Senator Hartke, and I am not saying that it is impossible. When I said, I believe, that I did not know anything about interest rates, I was questioning my ability or anyone's really to forecast them.

Senator HARTKE. Even with a 10-percent prime rate, is it not true that as far as the general business is concerned, and the stock market specifically, that it increases the price of stocks, and that makes them a less desirable investment than other types of debt instruments?

Mr. SIMON. I think one found that looking back at the history of the 1950's, that a little bit of inflation was considered quite healthy for stocks and, indeed, it increased the price. But, I think the experience in the 1960's and indeed, so far into the 1970's shows that inflation is bearish for stocks, and people are going to commodities.

Senator HARTKE. And high interest rates makes the debt instrument more attractive, is that not true? And, therefore, it makes the investment opportunity less attractive.

Mr. SIMON. The equity market, yes.

Senator HARTKE. My time seems to be up.

Senator HANSEN. Please continue as far as I am concerned, Senator Hartke.

TAX CUTS AND A BALANCED BUDGET

Senator HARTKE. Let me just ask you two more questions quickly. The only time in the recent history in which you have had a substantial improvement in the debt since 1961 was following the tax reduction which we accomplished in 1964. That tax reduction amounted to about \$10 billion, which in comparison to the gross national product was much more than the present \$10 billion which present tax cuts would cost. And the net result of the former tax reductions, Mr. Simon, was that for the first time we had the sharpest reduction in the increase in the national debt. And, a nearly balanced debt, even though we reduced taxes by \$10 billion.

Why, with that positive experience with tax cuts, and the negative experience this country has had with deflationary policies which have not cut inflation, are you not willing to at least examine the merits of a general tax reduction at this time.

Mr. SIMON. Basically, Senator Hartke, it is very attractive to cut taxes, and it is always much easier to cut taxes than it is to raise taxes. And we are not recommending that we should have an increase in taxation in this country. But, looking ahead at the spending needs for this country, and the uncontrollables in our budget, cutting taxes at this point would, in our judgment, just add to obviously the deficit and destroy any ability we had toward moving toward a balanced budget.

Senator HARTKE. I just want to point out for the record that you have asked for an all-time high in budget expenditures for fiscal 1975 of \$304.4 billion.

The Republicans have not had a chance to question our guest. Senator Byrd, I am forced to leave. Would you please assume the chair at this point?

Senator BYRD [now presiding]. Senator Hansen?

OIL COMPANY STOCK PRICES

Senator HANSEN. Thank you very much, Mr. Chairman.

A sense of fairness tells me to speak out for those of us who have Presidential aspirations not present this morning, and I want to call attention to Senator Jackson, because I think he deserves a little action. I note that the Wall Street Journal says in an editorial:

Like Justice Stewart, who knows pornography when he sees it, Senator Jackson knows oil profits are obscene and thus does not have to justify whatever yardstick he is using. In our view profits are not obscene so long as they have redeeming social value.

And I note that the Los Angeles Times for Thursday, April 11, headlines in its business and finance section "Uncertainties Hang Over Industry or Oil Stocks Bob Down Despite Profit Boom." The article goes on to point out that stock in Exxon, the world's biggest oil company, sold for as much as \$103.25 a share late last spring. This week it is selling for \$80 on the New York Stock Exchange. Mobil is down to about \$45 share from a 1973 high of \$75.50, which represent a 40 percent drop. And Texaco is between \$27 and \$28, after selling for as much as \$43.12 last year.

This poses a problem for me to understand when I read about the obscene oil profits that are being made, and when I contemplate, as all of us have from time to time, the needs of this industry, which economists reckon between a low of \$800 billion capital required, new capital if we are to come anywhere near meeting the demands that we will experience by 1985, to as much as \$1½ trillion.

OIL DEPLETION ALLOWANCE

Mr. Secretary, much has been said about the oil depletion allowance. It has been pointed out in this same editorial, to which I referred in the Wall Street Journal, that they join now with those who say, "Let us do away with the depletion allowance" for a somewhat different reason. They say that the depletion allowance tends to subsidize consumption, and with that I agree, because I think that realistically we have to recognize that without the depletion allowance, we would have had fewer oil and gas supplies. Really what the depletion allowance has done is to make available more oil and gas at a lower price than otherwise would have been possible. Do you agree with that?

Mr. SIMON. Yes, sir; I do, Senator.

PETROLEUM PRICES

Senator HANSEN. Do you think that there is some reasonable rationale for permitting prices to rise to achieve two objectives: First, to discourage unnecessary consumption on the one hand and, on the other, to provide the encouragement that the industry will need to amass the capital necessary to get on with the job of assuring that we have adequate supplies to meet our eventual requirements by 1985?

Mr. SIMON. Senator, it is a conscious policy decision to make sure we do two things: That energy in our country be brought on line and at reasonable prices. We are today controlling by law the prices of petroleum in this country. The present price of crude oil at \$5.25, with added incentives for matched barrels and the stripper, as you know, is, indeed, necessary to bring on the additional supplies at much more reasonable levels than we are paying the Arab nations. We can be self-sufficient in this country at levels much below this, and so we should strive for that.

And I also think of Senator Jim Buckley's illustration. I never realized that New York State was a producer State and he talks about the 5,400 wells in his State that are producing an average of a half a barrel a day. And, obviously, to produce a well at a half a barrel a day costs you a lot more money than to produce one that is significantly greater than that. Well, if they cannot get \$9.50 a barrel for their oil, which they probably are, they would have to close down the well, and what is the alternative? To pay the money to the Arab nations with the balance-of-payments consequences and all of the rest of it. Yet, that is useful, and, yes, we ought to do that.

ROLLBACK OF DOMESTIC OIL PRICES

Senator HANSEN. Considering your response to several questions asked by Senator Mondale, with the United States admittedly in a short petroleum supply situation this past year, do you think it makes sense to roll back the prices of domestic oil? Do you think it makes sense to impose greater tax burdens on an industry that we have come to depend so largely on for our very way of life in this country, if we expect to eliminate inflation over the long haul and everything else in balance?

Mr. SIMON. No, sir. Our position is well-known on that. That is the only way we will bring on the additional supplies. There again, it can be done carefully and we believe we are doing it carefully in exercising responsibly the price controls that we have mandated by law in the area of petroleum and making sure that we maintain that fine balance of bringing on the additional supply without having unreasonable prices.

Senator HANSEN. We must admit and many may not agree with me, that the U.S. Congress really has very little to say about the price that the Arabs and the larger bloc of countries, including the OPEC nations, charge for oil, but we can do something about the price domestically, if we choose to continue to dabble or to mess with the laws of supply and demand, and in an earnest endeavor to make people live better, decide that it is in the public interest to roll the price of oil back. Is there anything wrong with the argument that we will leave the foreign price of oil alone, because we really cannot control that, but we can do something about the domestic prices so we will cut the price of that, say, generally in half? Now, that has been proposed, and is being proposed again. Is that a sound argument?

Mr. SIMON. Well, the results of that, Senator Hansen, are predictable. It would just cease the exploration that we have got going on out there in this country right now, because people are not going to invest

their money in this risky business if there is not a reasonable rate of return, and, consequently, it would make us more reliant each year, as our demand grows, on insecure foreign imports at high levels, which subject us to two things: One, a potential cutoff, and we have had four of them in the past 25 years; and, two, threat of a price explosion that can arbitrarily be set by a cartel for a time.

Senator HANSEN. Mr. Chairman, I have used up my time. I have not exhausted my inquiry, but I yield to you, sir.

Senator BYRD. Well, suppose we go to Senator Fannin now and then we will come back to the Senator from Wyoming in a few minutes.

Senator FANNIN. Thank you, Mr. Chairman.

ENERGY COMPANY PROFITS

Just to follow up on what has been said about profits, and the great misunderstanding that exists, Mr. Simon, I do have the current issue of the profit situation from the Chase Manhattan Bank and I feel that they have done a great service over the years and especially since this energy crisis has been upon us in properly placing before the American people the true facts as to just what is involved. In other words, we have much at stake, we have a very dangerous situation.

"The American people are entitled to a much greater insight on the part of their elective and appointed representatives in the Government." And they state, and I think you will agree, "an urgent need to publicize the underlying factors responsible for the unusual level of earnings experienced by the petroleum companies in 1973." And in this particular article it brings out that the brief reports appearing in the business section of the newspaper attract mainly the attention of investors and are ignored by most other readers, and that a combination of abnormal factors in 1973 caused the earnings to be much larger, and that because of the news media and others, focusing attention on these high profits, the public awareness is on that particular phase. Mr. Simon, this could be true of many other industries. Is that not correct that because of the shortage, earnings have gone up, but it is an abnormal situation in many instances, and it will correct itself.

Mr. SIMON. There is no doubt about that, Senator Fannin. There was one other peculiarity that came out in our study running through the years 1959 to 1973. Comparing 1973 to 1972, 1972 was the worst year during that 16-year experience. So, you are comparing a high-profit year caused by a price explosion that came from extraordinary circumstances to the poorest year in the 16 years that we studied. So, that is out of line. Now, this is going to continue because the price explosion did not come until the last half of 1973, and the oil industry is going to be what I would say embarrassed by their profitability, probably through the third quarter of this year, and certainly the second quarter.

Senator FANNIN. Then in this article it says because of abnormal developments cited earlier, nearly three-fourths of the increase in the revenue has occurred outside of the United States. Now, that is not the oil companies' revenues. Now, has that not resulted to a great extent in other governments of the world or other companies and other governments of the world, mostly other governments bidding up the

price of oil? I can recall when France entered into these negotiations with the Arab countries, and the OPEC countries that they bid up the price, for instance, of LNG, and I know Algeria had the same problem. Is it not true that the other countries of the world have perhaps been more to blame for this than the United States?

Mr. SIMON. Well, there were cases where the spot auctions after the embargo was imposed were at what I would call ridiculous levels, that started at \$16 and some odd cents, and went as high, on one or two occasions, to \$25. And I believe that part of our oil industry participated in some of that, too. But, the profitability of their international operations did not just come from the barrel of crude oil. It came from the entire operation of the company. It went through their tanker operations, the exchange rate profitability, through the strengthening of the dollar, and the refineries and the marketing. It was not only just a crude oil price.

Senator FANNIN. I think we have had a discussion of the Federal Power Commission and you have covered it fairly thoroughly many times, and including today, of the difficulties resulting or accruing from the 1954 *Phillips* decision. This has also affected the importation of liquefied natural gas. I am sure that you are aware of some of the problems they had with Algeria and the renegotiation, and, also, in Boston with the attempt to bring LNG in from Algeria. Do you not think that we could better negotiate and handle these affairs if the authority could be under the FEO rather than under the Federal Power Commission?

Mr. SIMON. It would greatly facilitate and expedite the negotiations; yes, sir.

Senator FANNIN. I know that referring to a contract effective in my own State, the El Paso natural gas contract, we were talking to the officials in Algeria, when they said to us that they would renegotiate these contracts upward, because the Federal Power Commission had not acted. They were supposed to have acted in early January, and we were over there in late January, so they said that the price that would be negotiated now would be a much higher price. This is, I think, a very good illustration of the problem that accrues.

Then getting back to the problem we have with the American public and a better understanding, I feel that the American public does want the free enterprise system to prosper, and they are very anxious for the individual to have the freedom of opportunity. And when we are talking about that, the stock of most of the major oil companies, there are very few companies that are not owned by thousands upon thousands of stockholders. Is it not true that very few individuals have any appreciable ownership, of the major oil companies?

Mr. SIMON. Oh, that is correct, sir. I think you will find that in every major corporation in America, it would be impossible really for one individual to have a majority interest.

Senator FANNIN. So, when we are talking about these oil companies, and major oil companies that get all of the criticism, are we not really talking about a controllable situation? There are stockholders and they have a board of directors, and it is all carried on under the laws and regulations of the United States? And I think the best illustration of this misconception is the Rockefeller family. I was in Moscow at

the same time as David Rockefeller of the Chase Manhattan Bank, and he was talking to the Russian officials, and they wanted to discuss the oil situation and petroleum products, they asked David Rockefeller if Rockefeller did not own over 50 percent of Exxon, and his answer was that the Rockefeller family owns less than 1.5 percent of Exxon.

So, I feel if the public really had the proper information that there would be a far different feeling regarding the situation facing this industry today. Do you feel that way?

Mr. SIMON. Yes, sir. I do, Senator Fannin.

Senator FANNIN. Thank you very much. Thank you, Mr. Chairman.

Senator BYRD. I will take just a couple of minutes and then I will yield.

Senator HANSEN. Please do.

STRIVING FOR A BALANCED BUDGET

Senator BYRD. Mr. Simon, I do not want to add to the burdens that you will be carrying as Secretary of the Treasury, but I would hope that you could take the lead in attempting to get this country back on some sort of a sound fiscal basis. I think we are on a very unsound basis. I want to say, frankly, though, that my view is a minority view in the Congress. I might warn you that the word balanced budget is a dirty word in the Congress. But, I believe very strongly that we are not going to get inflation under control until we get these huge Government deficits under control, and it is cause for concern that during the 6-year period, fiscal 1970 through 1975, that we will have added to the national debt \$133 billion, thus, 25 percent of the national debt will have been incurred during that short period of time. I realize that one individual cannot reverse this trend, but I do believe that if the leadership of the Treasury Department is in that direction, in the direction of getting us back to a balanced budget, that would be of tremendous benefit to the Nation.

I do not want you to say anything today that would complicate your situation with my colleagues. But, I would hope that you might be able to work in that direction.

Mr. SIMON. Yes, sir.

TAX CUTS

Senator BYRD. I notice that mention was made of a tax cut in 1964, but no mention was made of a tax cut in December of 1971, when revenues were reduced by \$14 billion at a time when we were running huge deficits. Undoubtedly, that added to the increased inflationary pressures, and I just have the feeling that too many persons in both the administration and the Congress feel that we can get something for nothing, that we can spend all of the money we want, but nobody has to pay for it. I think that that is fundamentally wrong. The people who are being hurt the most by this are those in the lower and the middle economic brackets, and those on fixed incomes. They are paying a heavy tax through inflation. Would you agree that inflation is a hidden tax?

Mr. SIMON. Yes, sir, it is.

Senator BYRD. And that it is a cruel tax?

Mr. SIMON. Yes, sir, it is.

Senator BYRD. And that the tax of inflation, as I visualize it, and I would be glad to get your views, hit hardest those on fixed incomes and those in the lower economic brackets.

Mr. SIMON. That is correct, sir.

Senator BYRD. I doubt that the very wealthy are hurt much by inflation. They might even be helped. But, I think the poor guy is hurt very badly by this inflation that we are experiencing.

Mr. SIMON. I would say the wealthy have a better ability to protect themselves from it.

Senator BYRD. They have means of protecting themselves.

Mr. SIMON. Yes, sir.

CON ED DIVIDEND PICTURE

Senator BYRD. I noticed in the press this morning that Consolidated Edison for the first time since 1885 omitted its dividends for the quarter. Do you happen to have any comment on that, or any particular reason why that should be?

Mr. SIMON. I did not see that this morning, Senator Byrd, but I would believe that would be an outgrowth of the reduction in demand for electricity this past winter and an inability to get rates raised at the same time, or in time to compensate for that. That is a judgment. As I say, I have not read that.

Senator BYRD. In other words, the public is complying with the requests of the Government to reduce energy needs?

Mr. SIMON. Yes, sir; that is correct.

Senator BYRD. Which, of course, we needed to do.

Mr. SIMON. Yes, sir.

GAS RATIONING

Senator BYRD. I might say that the question of rationing stamps was brought up this morning and the majority of my colleagues felt that you should have gone to rationing some months ago and you resisted that. And you have, up to this point, at least, you have certainly turned out to be right.

Mr. SIMON. We just thought it would be absolutely impossible to administer equitably, given our economy and the way we all live today, versus the last experience in World War II. There are almost five times as many automobiles on the road today, and massive suburbia, and no mass transit in areas like Los Angeles and Washington, D.C., et cetera, and it would have been just a bureaucracy of 15,000 or 17,000 people and \$1½ billion of unnecessary expenditure.

Senator BYRD. We have entirely different conditions now than we had during World War II?

Mr. SIMON. Yes, sir.

Senator BYRD. Thank you, Mr. Simon.

I yield the remainder of my time, plus his time, to the Senator from Wyoming.

Senator HANSEN. The Senator from Virginia is most gracious, as we all know.

CON ED DIVIDEND PICTURE

Mr. Simon, I do not think I have many more questions to ask you. Would it not also possibly be a factor in the situation with respect to Consolidated Edison that fuel prices have increased, and the experience of complying with ambient air quality demands has been an added expense?

Mr. SIMON. Yes, sir. Indeed that is a part and parcel, Senator Hansen. Yes, sir.

Senator HANSEN. I have a further question.

FEDERAL OIL AND GAS CORPORATION

It has been proposed by some Members of the Congress that we need a mechanism whereby we can compare the behavior of the free enterprise system in order to know if it is overchanging, if its profits are obscene and what might be done in the way of remedial legislation. Pursuant to that idea legislation has been proposed which would create a governmental entity to be funded by appropriations, and cloaked with the authority and responsibility of going into the drilling business and into the exploration for oil and gas. Some people would give it preferential rights with respect to the exploration of petroleum potential on all publicly owned lands. Would you comment on that proposal?

Mr. SIMON. Well, we have not favored the corporation called FOG. I think that the fellow who made that name up had a good sense of humor.

Senator HANSEN. Would you say that again? I do not think everybody heard you.

Mr. SIMON. FOG, the Federal Oil and Gas Corporation. We just basically do not believe that the Federal Government in this very risky industry can do a better job than our free enterprise system. To give preferential treatment to the Federal Oil and Gas Corporation on Outer Continental Shelf leasing, which potentially holds the vast majority of the future reserves for this country, would create the severest disincentive. The people who would run FOG company could not have been associated with the petroleum industry, and their pay would be rather low. I can just see, as I have said in testimony, the poor fellow going up to the Appropriations Committee asking for a few more billion dollars after his 31st consecutive dry hole. And I just do not believe that this is a governmental role. If anything, that would push us further and further into the arms of other nations as far as our dependency.

Senator HANSEN. Do you see any reason to believe that there are other ways of conducting the essential duties and chores that individuals in private corporations do as you look about the world and see what has been going on in England or in other socialistic countries, despite criticisms of private enterprise. Do they have a better way?

Mr. SIMON. On the contrary. All experience in nationalized industry shows a stifling, a lack of incentive, and a decrease in the productive capacity and productive ability of that country.

Senator HANSEN. In America, where we placed the customer up on the pedestal and industry responds to what the customer wants, is it

not true that we have a greater choice and a greater variety and, indeed, because of those factors a greater freedom than people anywhere else in the world?

Mr. SIMON. We have the greatest standard of living, and the lowest cost and the highest per capita income, and we are the greatest industrialized nation that the world has ever known. And why in the world we would want to continue moving more power to the Federal Government, I do not know for the life of me, and I will resist it.

Senator HANSEN. I cannot think of a better place to recess these hearings than right now. You have brought us out of the fog and into the clear sunlight.

Thank you.

The committee will stand in recess until 11:30 this morning.

[Short recess was taken.]

Mr. SIMON. Mr. Chairman, do not forget that I have my friend, Mr. Macdonald, here. Do you not want to ask him some questions, too?

The CHAIRMAN. Senator Percy wanted to be here to introduce Mr. Macdonald but was unable to make it. We will insert his introductory statement at this point in the record.

STATEMENT OF SENATOR CHARLES H. PERCY, A U.S. SENATOR FROM THE STATE OF ILLINOIS

Mr. Chairman and Members of the Committee, I am pleased to support the nomination of Mr. David R. Macdonald to be Assistant Secretary of the Treasury for Enforcement, Tariff and Trade Affairs, and Operations. Mr. Macdonald has had a distinguished career and he currently is a partner in the firm of Baker & McKenzie in Chicago.

Mr. Macdonald combines great knowledge of the law as well as years of business experience. I think he is an excellent choice for the post for which he has been nominated and I hope the Committee will look favorably upon his nomination.

The CHAIRMAN. We will also insert Mr. Macdonald's prepared statement in the record at this point.

[The statement follows:]

PREPARED STATEMENT OF DAVID R. MACDONALD, ASSISTANT SECRETARY OF THE TREASURY FOR ENFORCEMENT, TARIFF AND TRADE AFFAIRS, AND OPERATIONS (DESIGNATE)

Mr. Chairman and members of this distinguished committee, I am here today as the President's nominee for the post of Assistant Secretary of the Treasury for Enforcement, Tariff and Trade Affairs, and Operations.

As my biographical sketch shows, I was born in Chicago, Illinois, in 1930 and raised in Winnetka, a suburb of Chicago, and I still make my home there.

I attended Cornell University in New York, receiving a B.S. degree in 1952, and in 1955 I received a J.D. from the Michigan Law School in Ann Arbor. After law school I spent two years in the U.S. Army.

Most of my professional career as a lawyer has been with the firm of Baker and McKenzie, in Chicago, where I specialized mainly in corporate law with some involvement in international finance. I have also been a director of the Chicago City Bank and Trust Company, Seaboard Life Insurance Company of America, and Scheer Financial Corporation. I have resigned from the directorships and my resignation from my law firm will become effective upon confirmation.

I am a member of the American, Illinois and Chicago Bar Associations, the Economic and Legal Clubs of Chicago, the Board of Directors of the Chicago Library of International Relations, and the Committee of Visitors of the University of Michigan Law School.

My past experience has not brought me into frequent contact with Congress, and I am, therefore, looking forward to the privilege of working closely not only with the members and staff of this committee, but also with the other committees that are interested in Treasury business.

In accordance with your procedures, I have provided the committee with a biographical statement, as well as a copy of my financial statement, with assets in a blind trust managed by the American National Bank of Chicago, and other information showing what steps I have taken to avoid any possible conflict of interest questions.

I will be happy to answer any questions you may have.

STATEMENT OF DAVID R. MACDONALD

The CHAIRMAN. Mr. Macdonald, do you subscribe to the answers that the Secretary has given to these various issues, or do you find that there is any area in which you want to challenge his statement?

Mr. MACDONALD. I subscribe to them 100 percent, sir.

Mr. SIMON. Sound thinking.

The CHAIRMAN. Well, if Mr. Simon can speak for the two of you, my guess is that we will expedite these hearings to assume that you would agree with what the Secretary says or that you do not dispute it.

Mr. MACDONALD. Exactly.

The CHAIRMAN. I do not think that it would be too good an idea for you at this particular point to be disputing what your potential boss has said here.

Senator Mondale has returned from the Democratic Caucus and I know that he has a number of things he wants to ask about, so I will call upon him.

Senator MONDALE. I am most grateful for your staying around to permit me to ask some questions about what I think you would agree to be the central issue, economic issues, facing America; namely, the distortions that have now developed in the economy as a result of inflation and rising unemployment, and shortages and the rest.

CAUSES OF INFLATION

I would like to go back if I might to your analysis of what is causing the inflation. As I heard your testimony, you are of the solid opinion, that it is all excess demand, that aggregate demand is causing a situation in which too many dollars are chasing too few goods. I am sure you are aware of the fact that Dr. Samuelson from Massachusetts Institute of Technology, Walter Heller, of the University of Minnesota and former Chairman of the CEA, and Arthur Oakum, and others, disagree. They say we are in a situation which is essentially cost-pushed where the inflationary factors that are driving up factors are the result of the commodity price increases that are not going to be responsive to aggregate demand economics, and that to apply a remedy designed to restrict excess demand at a time when that is not the problem can only produce further unemployment, and while at the same time you have inflation. And it seems to me that is exactly where we are today. We have a restrictive budget, and we have the highest interest rates that I can recall. But, we also have the highest inflation since World War II, and we see rising unemployment because, in effect, what we are doing is applying the theory of trying to treat a surplus demand situation.

Now, how do you deal with the argument of Heller and Samuelson and the others? Surely these are respected economists of high stature.

Mr. SIMON. Yes, sir. Senator Mondale, if one looks back over the last year's experience of our inflationary problem, over 60 percent of our inflation problem was due to rising food and fuel prices. And, indeed, one might say that that was a shortage situation. It started with the horrible weather we had here as well as around the world in 1972 and simultaneous boom conditions in all of the countries of the world.

On the petroleum side, the shortage occurred, one might say, artificially through an embargo that was imposed by nations that control 67 percent of the world's reserves. The rise in prices of the internationally traded raw materials came from the boom conditions around the world, pushing world prices up dramatically, so this has been the component, and this is what I spoke of before when I said that we should attempt to anticipate these problems. Indeed, agriculture is a perfect example where the set-aside was removed and the commodity markets have responded in the last 3 months. And we have seen quite a decline in wheat and corn and soybean prices. I believe as the higher crop production is realized, which it is going to be, that you are going to see further declines in response to it.

The response to the world price increases of petroleum has been a significant reduction in demand. I believe this surplus in the world production is going to create downward pressure on these prices.

FINDING CURES FOR INFLATION

Senator MONDALE. Well, I guess I do not quite understand. If you have your cost-push factors in a limited area, or the limited areas of food and fuel, however fundamental that is, how does having a slack economy along with it, a restrictive budget and astonishingly high interest rates and tight credit deal with that problem?

Mr. SIMON. Well, what was the first part of your statement, Senator? I am sorry.

Senator MONDALE. Well, I am trying—in other words, these very respected economists are saying that we are in a recession or heading into one, we are going to have rising unemployment and inflation at the same time, because what we are seeing is a period of cost-push inflation, not excess demand.

Mr. SIMON. That is the part I wanted.

Senator MONDALE. I heard you this morning repeatedly say that the problem is excess demand, so how do you—

Mr. SIMON. Well, I have heard these forecasts before and I can go back and talk about the forecasts that a lot of people made last October and November about the recession and, indeed, the depression that we were going to have come February or March of this year due to the energy problem. Unemployment was going to be at 8, 9, or 10 percent, and they were suggesting dramatic easing of money and fiscal stimulus. We did not believe this. We believed that we could isolate the economic impact of the energy problem, and it has been isolated, so that is why I do not happen to agree with all of these doomsday forecasts that we are going to have this bad a time. It has been isolated to the automotive area and energy-related activities, as well as housing.

Senator MONDALE. But in any event, your theory is that what we are dealing with is excess demand and our remedies ought to be aimed

at dealing with that and not at stimulating the economy to assure that people have jobs and so on. Is that correct?

Mr. SIMON. We see no need at this point, Senator Mondale, to stimulate the economy because we believe that the basic demand at this juncture is strong.

Senator MONDALE. All right. Now, you have an inflation rate of what, 14½ percent, annualized for the next year, the highest inflation perhaps since the Korean war. And what are your remedies for dealing with that? I am going to write them down. What would you do? As I understood our discussion earlier, you felt this year's budget had to stay as is; you thought we should terminate any kind of wage-price control power as distinct from extension of Cost of Living Council without any power. What would you do to abate inflation?

Mr. SIMON. There again, going back to the full employment budget concept, we will run a surplus of approximately \$4 billion this year, and in the proposed fiscal 1975 budget, it will be a \$8 billion full employment surplus. I hasten to add what I said before that this full employment budget concept is a sound yardstick, and that is what it is, a yardstick.

Now, we have to avoid both runaway stimulus in the economy and excessive restraint, and we have to walk that fine line.

The deficit this year, we believe, is modest, between \$5 or even \$10 billion, as we have projected for next year. What we have to avoid are the deficits we have seen in the past few years of \$20 billion to \$25 billion, at a time when the economy is moving and was at that time moving toward full employment, however one wishes to define what full employment is. That is the first portion of it, as far as the fiscal side. And monetary policy at that point will be allowed to exercise not too severe a restraint and bear, as I said before, the burden alone. We have to deal, here again, as I said, with the supply and the capacity problems for our industry.

Senator MONDALE. Well, what you have said is that we have to look at fiscal monetary policy and we have to look at supply problems. Now, what would you do in those areas? I did not get your answer. I know the areas, but what is your policy?

Mr. SIMON. The deficit as stated in the \$5 to \$10 billion area for the economy, as we see it for the next 2 years ahead, is modest.

Senator MONDALE. Is that, in your opinion, an inflation restraining policy?

Mr. SIMON. We believe that the full employment surplus that that gives us \$4 billion for this year and upwards of \$8 billion for next year is sufficient restraint, yes, sir.

Senator MONDALE. All right. So, you say one element is a restrictive budget based on a full employment surplus?

Mr. SIMON. Concept, yes, sir.

Senator MONDALE. All right. What is your next strategy for restricting inflation?

Mr. SIMON. Well, as far as the food, I have already commented on that.

Senator MONDALE. That is supply that you want to see, the food supply expanded?

Mr. SIMON. That is correct.

Senator MONDALE. All right. What else would you do?

Mr. SIMON. Well, the manpower programs are something that we have not been completely satisfied with. They ought to be continued and improved so that we have a productive labor force in this country.

Beyond that, I have no specific things to mention at this point.

Senator MONDALE. What about monetary restraints? What is your theory there?

Mr. SIMON. Well, on monetary policy, Chairman Arthur Burns has stated that he is going to tighten, if you will, a little further and bring the growth of the money supply back to a more reasonable level, rather than the over 7 percent that it has been for, I believe, the past few months.

Senator MONDALE. Do you support that?

Mr. SIMON. Yes, sir, I do.

Senator MONDALE. And do you support the maintenance of a prime rate of what is it now, 10 and something?

Mr. SIMON. Senator Mondale, I abhor high interest rates, just as everyone else does, but I do not consider high interest rates a cause of our problems. I consider them a result of the problems.

Senator MONDALE. But, in order to restrain inflation would you want to continue these high interest rates?

Mr. SIMON. There again, this is just about the first time when the inflation rate has finally caught up with the high interest rates. In the past 10 years, they have led well ahead because of the inflationary expectations that we have allowed to become engrained in our economy. That is what has to be runnung out. So, it is not a matter of supporting high interest rates. Nobody supports high interest rates, no. We want moderate interest rates in this country. And how to we do it? We do it by attacking the problem, not the result, and the problem is inflation.

Senator MONDALE. Well, I am asking you what your policy is to restrain inflation, and my question to you is whether you support a continuation of the present high interest rates and restrictive policies? I gather that your answer is yes?

Mr. SIMON. It is not a matter of restrictive policies. We do not consider it unduly restrictive. We think that we are walking that line that avoids runaway stimulus and also avoids excessive restraints. So, we have a difference of opinion, perhaps, on this, Senator.

Senator MONDALE. Well, I just want to know what your policy is. I am not getting into opinions. Do you support Chairman Burns' high interest rate policy that he announced the other day?

Mr. SIMON. Arthur Burns is not supporting high interest rates. He is doing what he believes as the Chairman of the Federal Reserve is a responsible action of a central banker in providing his part of the role. Now, we have to do—

Senator MONDALE. And you support that?

Mr. SIMON. Indeed I do, Senator.

Senator MONDALE. So what are we at, a 10-percent interest rate, tight credit. Are there any other elements in your anti-inflationary program?

Mr. SIMON. At the outset, Senator Mondale, that would have been sufficient. There again, this takes more time than I have had to spend on this, having been otherwise occupied these last few months.

Senator MONDALE. All right, now. With these high interest rates and the tight credit, do you not anticipate a further restriction in the housing market?

Mr. SIMON. High interest rates, obviously, act as an inhibition to people buying homes, although there are Government supports as I said before, including the Ginnie Mae and Fanny Mae, and the home loan advances, as well as the tandem program that should be studied, which we are doing right now, to act as a break and, indeed, as a stimulus for housing.

Senator MONDALE. Well, let me see. What is the current housing construction rate? About 1.46 million, is it not?

Mr. SIMON. That was the last number. That is correct. It averaged out for the quarter I believe at 1,600,000 plus.

Senator MONDALE. Now, interest rates are rising. Do you expect that housing production rate to drop?

Mr. SIMON. I would not expect the housing rate, no, to drop below 1,400,000 level; no, sir.

Senator MONDALE. Well, what would stop it?

Has not the housing market proved to be very sensitive to interest rates and credit restrictions?

Mr. SIMON. It has and it has declined, indicating the sensitivity over the past few months because of the high interest rates that have been with us for awhile. We have seen housing come down in the past year from 2 million starts to 1,400,000 plus right now. So, this reaction has occurred. But, what you also have to look at is housing permits, and they remain at a fairly good level. It was over 1,400,000 last month. So one might say that this reaction has already occurred.

Senator MONDALE. Well, I do not quite understand how you are going to reach your goal of 2,600,000 housing starts when the current rate is 1.4 million and the interest rates are rising. What is your strategy?

Mr. SIMON. Interest rates have risen, Senator Mondale, there is no doubt about that.

Senator MONDALE. Yes, sir.

Mr. SIMON. And if they, indeed, stayed at this level, you are correct, we would not reach the goal of 2,600,000. What we are trying to do is attack the problem, which will bring the interest rates down when people are satisfied that they are not going to have the return on their fixed income investments taken away by inflation.

Senator MONDALE. Do you favor the elimination of all wage and price controls as the Congress currently is prepared to do now?

Mr. SIMON. What we have favored, Senator Mondale, was the continued ability of the Cost-of-Living Council to function as a monitoring agency with the ability to control the health sector, as the President proposed and perhaps even construction.

Senator MONDALE. But no authority beyond that?

Mr. SIMON. No, sir.

Senator MONBALE. You said in your testimony two or three times that we have to return to fundamentals. What do you mean by that?

Mr. SIMON. Basically, the fundamentals that I spoke of were in response to your question of what is economic policy here at the office, to keep away from excessive spending and excessive restraints.

Senator MONDALE. I guess you had said earlier that you oppose the tax cut proposal that some of us made to bring some relief to persons of average income in this country, and, hopefully, stimulate the economy on the theory of these economists that we need to provide more employment.

Mr. SIMON. That is where we have a difference of opinion, Senator, yes.

PLUGGING TAX LOOPHOLES

Senator MONDALE. Now, if we plug some loopholes to make up the difference, so that the budgetary impact overall remains the same, would you support that in order to get some relief to these people who are being tortured by inflation?

Mr. SIMON. I would have to know what plugging of loopholes we are talking about. I think Secretary Shultz in his testimony before this committee some time ago opened his statement by saying that he favored the tax reduction. Everybody favors the tax reduction burden placed on the American people, but only if it is accompanied by a cut, a permanent cut in Federal spending, but that never seems to happen.

Senator MONDALE. Well, would you—if you and I could agree on what loopholes should be closed—would you agree at the same time that the average family is being tortured by inflation?

Mr. SIMON. I think I could agree with that, Senator Mondale.

Senator MONDALE. It seems to me that as I hear your policy, that what we have here is a policy of very high interest rates which have put the clamp on small business, the average consumer, the housing industry, and a restrictive budget coupled with high interest rates, so that we are sure of high unemployment and opposition to any tax relief for the average American who is being tortured by inflation, opposition to any rollback in oil prices which might help abate inflation. And I wonder, I just wondered what we have in mind that might offer some—

Mr. SIMON. To the contrary, Senator.

Senator MONDALE [continuing]. Some hope for the average American that his problems are being thought about.

Mr. SIMON. On the contrary, Senator Mondale. I believe sincerely that I am saying exactly the opposite. The policy, if followed, and the proper discipline, if followed, will result in lower interest rates and a real rate of growth and a reduction in the rate of inflation. That indeed, if you wanted to have a tax cut now, with what we consider excessive stimulus and perhaps even an easy monetary policy to pump the money out temporarily—and we have seen this happen several times in the last few years, temporarily push short rates down—and they would not stay down very long because people would know that that is inflationary and that is where the inflationary expectations become even deeper ingrained. That is what I mean about attacking the fundamentals and the problem, instead of the results of it. I do not like the results of the problem any more than you do, or any other American. No, sir.

Senator MONDALE. Well, I believe that is right. But, when we confront you with the statement of very responsible economists that we are heading into higher unemployment and that the economy can well take

modest tax reductions to stimulate the economy, and to bring some relief to these families that are being tortured, and prevent unemployment, you say, no.

Mr. SIMON. I could give you many other responsible economists who would say exactly the opposite, Senator.

Senator MONDALE. Yes. But you are kind of like the butcher who always comes out on his own side, higher interest rates, depression in the housing market, risking higher unemployment, doing nothing to try to bring some relief to the average family, and it is a typical old-fashioned big banker approach to this Nation's economy. And I think we are going to have some more inflation.

Mr. SIMON. To the contrary.

Senator MONDALE. Please let me finish.

Mr. SIMON. Oh, sure, I am sorry.

ADMINISTRATION'S ECONOMIC RECORD

Senator MONDALE. This administration has been in charge of the economy for some time. They have been feeding us ambrosia for years. We have got the highest inflation we have had in 25 years, unemployment is rising, and the housing market is a disaster: I just saw the other day that home mortgage foreclosures are rising dramatically, and you do not have a single policy at this time to bring some relief to the average American. And I think that they are beginning to say, well, now, who is looking out for us.

Mr. SIMON. That is where I have a fundamental disagreement, Senator, but I believe our policies will bring relief to the American people, because we are not suffering from what you seem to have described as instant inflation. This has come on long before this administration. It has been with us for the last 10 years.

Senator MONDALE. I seem to recall a few years ago we had inflation down to 4½ percent, and employment was rising under phase 2, and all of that was dumped. And now we are up at 14-percent inflation, still rising, the interest rates are a big banker's dream, and our attempts to roll back prices modestly meet with vengeful opposition. Everything we have tried to do to try to lighten this load just a little bit for the average American has met with powerful opposition from this administration, and it looks to me like we are going to have a lot more of it.

Mr. SIMON. I do not believe that. I must admit, Senator, we have a fundamental disagreement.

Senator MONDALE. Well, I would love to be proved to be wrong.

Mr. SIMON. I hope we can, Senator.

Senator MONDALE. Thank you, Mr. Chairman.

The CHAIRMAN. Any further questions, gentlemen?

Senator HANSEN. I would have one, Mr. Chairman.

PRODUCTION INCENTIVES

The distinguished Senator from Minnesota was talking about—I cannot quote him, and you will have to help me, Senator Mondale—these old-fashioned ideas or the old approach that we have been using.

I would ask you, Mr. Simon, if on the basis of the track record of free enterprise of trying to encourage greater production and greater availability of supply on the basis of the incentive that the market-place provides, despite the fact that it is not pretty successful?

Mr. SIMON. It certainly has provided us with the greatest standard of living of any country in this world. There is no doubt about that. We have veered away from these fundamentals, and I am just suggesting that it is a good idea now to come back to them. I recognize that this is not popular in some quarters, nor is it certainly unanimous.

PRICE ROLLBACKS

Senator HANSEN. Well, now, my very good friend from Minnesota, spoke about a modest attempt to roll prices back. We were in London just shortly after the first of the year, and although I had not been there during the war, there were those onboard the plane who likened the situation that night that we landed there to one reminiscent of World War II days saying that the city was pretty well darkened because of an extremely critical coal shortage. They have done these things that are being suggested now. On the basis of the experience other countries around the world have had, vis-a-vis our own track record here, do you have any reason to think that there is a better way of doing it than the way you are trying to do it?

Mr. SIMON. I certainly do not, Senator.

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

The CHAIRMAN. Senator Fannin?

Senator FANNIN. Yes.

INTEREST RATES

Well, Mr. Chairman, I just want to reemphasize and just bring into proper perspective what the distinguished Senator from Wyoming has said. And I certainly agree with him.

But, Mr. Simon, interest rates are a function not only of the Federal Reserve action but the market force; is that not correct?

Mr. SIMON. That is correct, Senator.

Senator FANNIN. And bankers anticipate inflation rate of 10 percent so they charge 12 percent or something like that just to keep the value of their loans, and it is necessary for them to do that; is that not correct?

Mr. SIMON. That is correct, sir.

Senator FANNIN. And if they were to loan money at 6 percent, when inflation is 10 percent, the banks are losing money and naturally they are not in business to lose. If the prime rate or the discount rate dropped below the market rates, the commercial banks will borrow heavily from the Fed, discounting commercial papers and so forth and increase their profits, which is just a normal function; is that not right?

Mr. SIMON. I think one will find that the commercial banking system prospers more with moderate interest rates than they do with high interest rates.

Senator FANNIN. So the Federal Reserve discount rate is a consequence of what the commercial rates of interest are, not vice versa?

Mr. SIMON. That is right, Senator.

Senator FANNIN. Now, the key then is, as Senator Hansen stated, to lower interest rates are a lower actual anticipated rate of inflation?

Mr. SIMON. That is correct, Senator.

Senator FANNIN. And that can be brought about by increased productivity, by doing what you are talking about in the training of employees, the manpower program. I agree that this offers us the same opportunity that we have had over the years to have this Government prosper and the people of this Nation prosper. And I think that is a good goal that you are working toward.

Mr. SIMON. Thank you, Senator.

The CHAIRMAN. Mr. Secretary, I think the record should show that Mrs. Carol Simon is here in the room, and I think that she is your secret weapon, and your best asset, and I congratulate you on your good judgment of bringing Mrs. Simon with you.

Mr. SIMON. Thank you, Mr. Chairman. I agree with you.

Senator MONDALE. On that basis I will vote for you.

The CHAIRMAN. I would like to ask Mr. Macdonald one thing:

Are you aware of any conflict of interest that may be involved with regard to your personal holdings or your financial statement?

Mr. MACDONALD. I am not, Mr. Chairman, and I have committed those assets to a blind trust with the American National Bank in Chicago as the trustee.

The CHAIRMAN. We will insert in the record at this point a memorandum that you have sent to the various officials of the Treasury disqualifying yourself from taking action in any case involving any firm with whom you were formerly associated, as well as letters from both Mr. Macdonald and Mr. Simon stating their willingness to testify before this or other congressional committees if they are confirmed.

[The documents follow:]

OFFICE OF THE SECRETARY OF THE TREASURY,
Washington, D.C., April 19, 1974.

Memorandum for the:

Secretary of the Treasury
Deputy Secretary of the Treasury
Under Secretary for Monetary Affairs
Under Secretary
General Counsel
Deputy Under Secretary
Assistant Secretary for Tax Policy
Assistant Secretary for Administration
Assistant Secretary for International Affairs
Assistant Secretary for Economic Policy
Fiscal Assistant Secretary
Special Assistant to the Secretary (Public Affairs)
Special Assistant to the Secretary (National Security)

Subject: Disqualification from taking actions affecting certain private organizations

Subject to my confirmation as Assistant Secretary of the Treasury (Enforcement, Tariff and Trade Affairs, and Operations), I hereby disqualify myself from any countervailing duty or antidumping matter involving any of the following

private organizations. No such matter should be presented to me for decision, approval or disapproval, recommendation, advice, investigation, or other official action:

- (a) Baker & McKenzie
- (b) Chicago City Bank & Trust Company
- (c) Macdonald Engineering Company
- (d) Scheer Financial Corp. (and affiliates)
- (e) Reed Industries, Inc. (and affiliates)
- (f) Seaboard Life Insurance Company of America

In the event that any matter relating to any of the above listed companies requires attention of the Assistant Secretary of the Treasury (Enforcement, Tariff and Trade Affairs, and Operations), it should be referred to the Secretary, Deputy Secretary or General Counsel of the Treasury Department for action and should not be brought to my attention.

DAVID R. MACDONALD,
*Assistant Secretary-Designate for Enforcement,
Tariff and Trade Affairs, and Operations.*

THE DEPUTY SECRETARY OF THE TREASURY,
Washington, D.C., April 19, 1974.

Hon. RUSSELL B. LONG,
*Chairman, Finance Committee, U.S. Senate,
Washington, D.C.*

DEAR MR. CHAIRMAN: This is to assure you that, in the event the Senate of the United States confirms President Nixon's nomination of me as Secretary of the Treasury, I will be available and agree to testify before any Committee of Congress with respect to any matters under my jurisdiction pertinent to my responsibilities as Secretary of the Treasury.

Sincerely yours,

WILLIAM E. SIMON.

THE DEPARTMENT OF THE TREASURY,
Washington, D.C., March 27, 1974.

Hon. RUSSELL B. LONG,
*Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.*

DEAR MR. CHAIRMAN: This is to confirm that, in the event the Senate of the United States confirms President Nixon's nomination of me as Assistant Secretary for Enforcement, Tariff and Trade Affairs, and Operations of the Department of the Treasury, I agree to testify before any Committee of Congress consistent with my duties as such Assistant Secretary of the Treasury.

Very truly yours,

DAVID R. MACDONALD,
*Assistant Secretary-Designate for Enforcement,
Tariff and Trade Affairs, and Operations.*

The CHAIRMAN. Have you checked with the Treasury's General Counsel's Office to assure that you are in accord with the Conflict of Interest Statutes?

Mr. MACDONALD. Yes, sir, I have an opinion from the General Counsel of the Treasury Department to that effect.

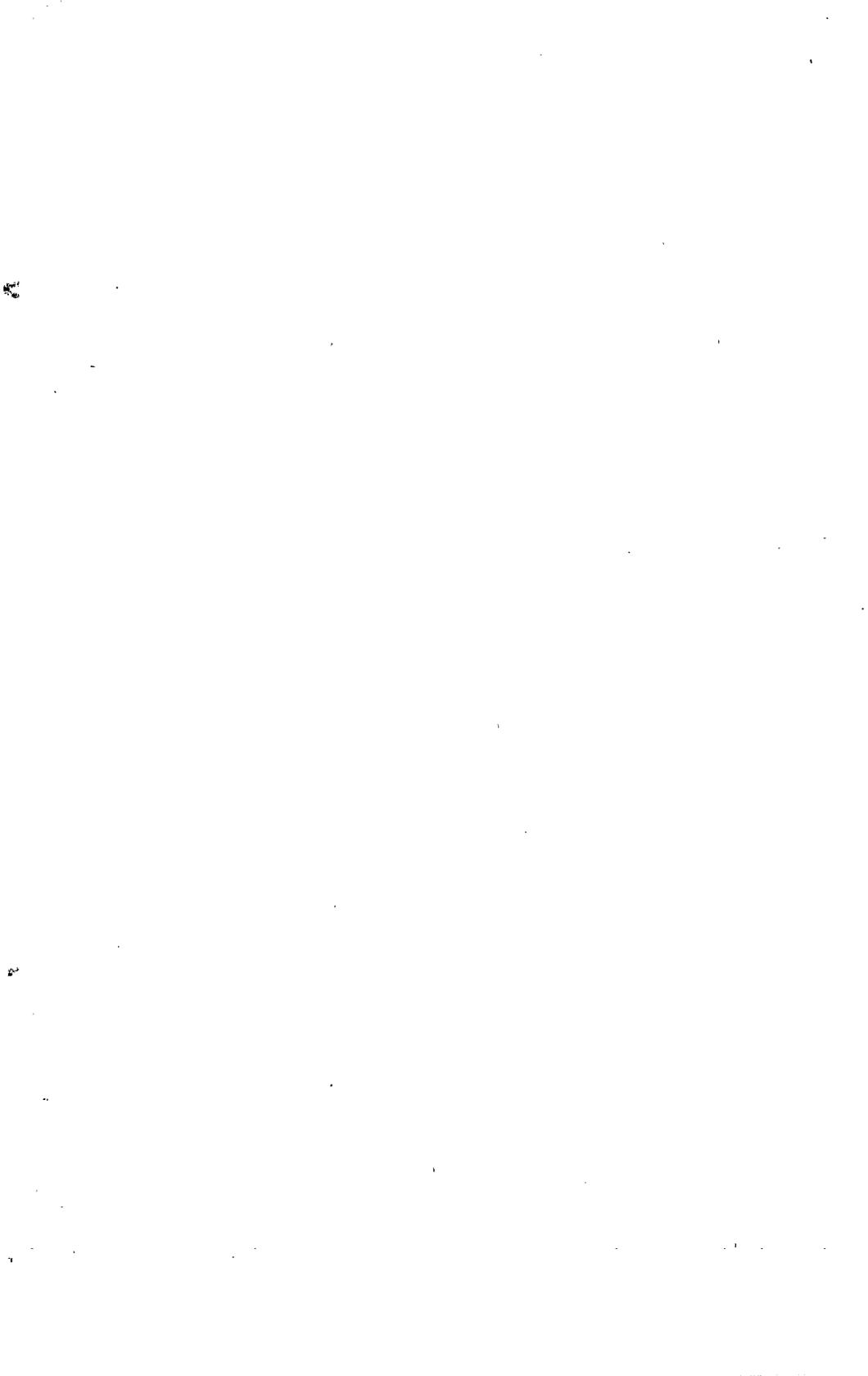
The CHAIRMAN. Thank you very much.

Any further questions, gentlemen?

Well, thank you very much.

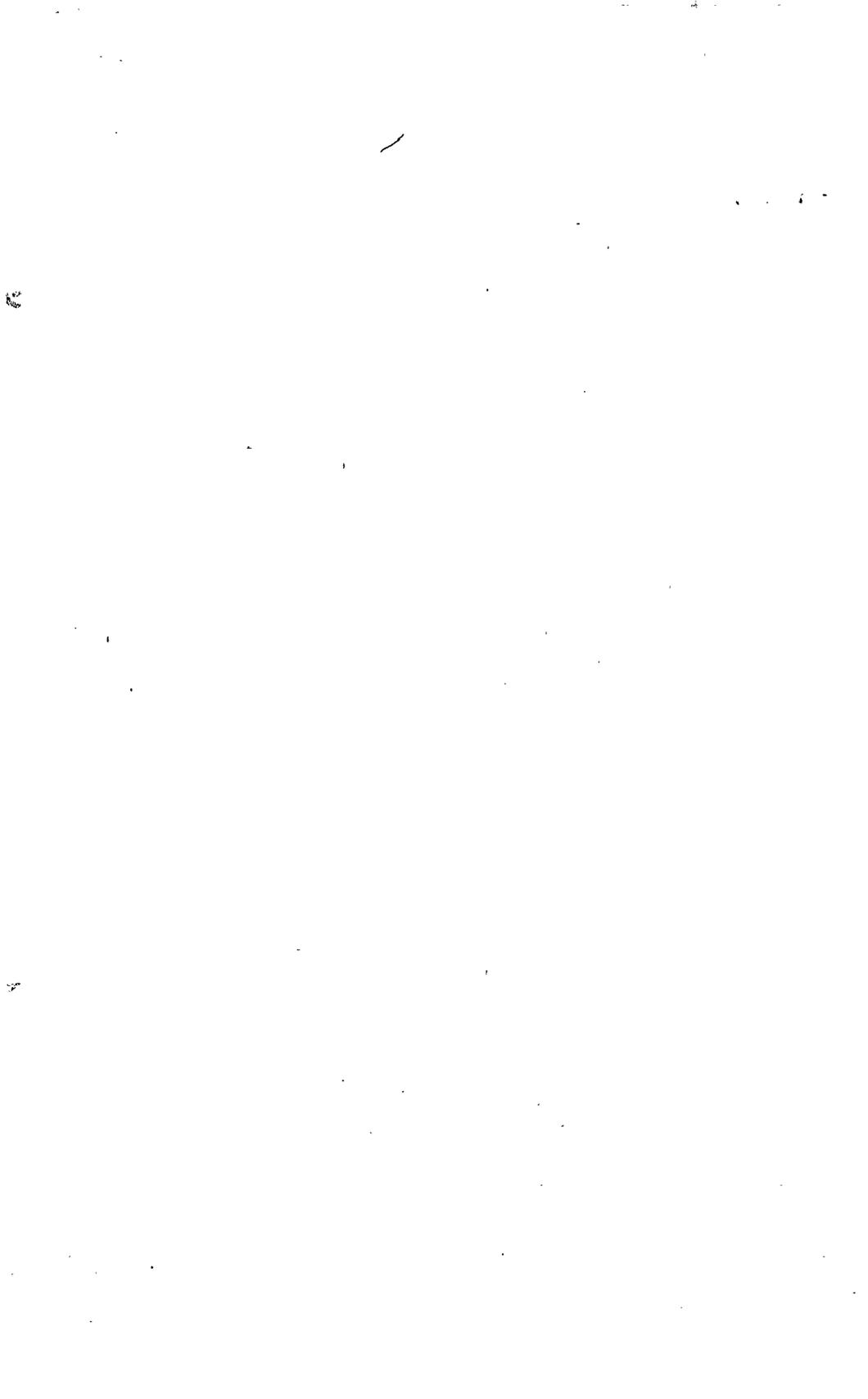
That concludes this hearing.

[Whereupon, at 11:45 a.m., the hearing was concluded.]



APPENDIX

**Correspondence Concerning the Enforcement of the Counter-
vailing Duty Statute Against Dairy Products Imported From
the Common Market**



U.S. SENATE, COMMITTEE ON FINANCE,
Washington, D.C., April 26, 1974.

RUSSELL B. LONG,
*Chairman, Committee on Finance, U.S. Senate,
Dirksen Senate Office Building,*

DEAR MR. CHAIRMAN: I respectfully request that this inquiry and the response to it be made part of the hearing record on the nomination of the Honorable William Simon to be the Secretary of the Treasury of the United States.

Section 303 of the Tariff Act of 1930 as amended provides: "Whenever any country, dependency, colony, province, or other political subdivision of government, person, partnership, association, cartel, or corporation shall pay or bestow, directly or indirectly, any bounty or grant upon the manufacture or production or export of any article or merchandise manufactured or produced in such country, dependency, colony, province, or other political subdivision of government, and such article or merchandise is dutiable under the provisions of this Act, then upon the importation of any such article or merchandise into the United States, whether the same shall be imported directly from the country of production or otherwise, and whether such article or merchandise is imported in the same condition as when exported from the country of production or has been changed in condition by remanufacture or otherwise, there shall be levied and paid, in all such cases, in addition to the duties otherwise imposed by this Act, an additional duty equal to the net amount of such bounty or grant, however the same be paid or bestowed. A Secretary of the Treasury shall from time to time ascertain and determine, or estimate, the net amount of each such bounty or grant, and shall declare the net amount so determined or estimated. The Secretary of the Treasury shall make all regulations he may deem necessary for the identification of such articles and merchandise and for the assessment and collection of such additional duties."

The past four years have been marked by increased importation of dairy products into this country from the European Economic Community which has openly published a schedule of payments it makes to its producers for these exports. In 1972 it is estimated that the European Economic Community paid export subsidies of over \$26 million on dry milk, cheese, butter, and butter oil shipped into the United States.

Despite the clear intention of Section 303 quoted above and despite the repeated representations of interested American citizens, the Treasury Department has continually refused to discharge its duties under the law to thoroughly investigate the matter of these payments and to collect countervailing duties where required.

Therefore, I respectfully request of the nominee for Secretary of the Treasury his response to the following question:

Would Mr. Simon, as Secretary of the Treasury, initiate an investigation into this matter, and if proper, would he oversee the collection of such countervailing duties as are required on dairy imports as described in Section 303?

The simple intent of this provision of the Tariff Act is to protect American industry and businesses from unfair competition with the economic might of foreign governments. I hope that Mr. Simon will agree that this protection legally is the right of the American dairy farmer as well.

Respectfully,

GAYLORD NELSON
WALTER F. MONDALÉ.

EXHIBIT A

E.C.: EXPORT SUBSIDIES FOR DAIRY PRODUCTS, EFFECTIVE FEB. 15, 1974¹

(Cents per pound)

	United States		E.C.	
	New subsidy	Old subsidy	New* subsidy*	Old ² subsidy ¹
Butter with fat content:				
62 percent but less than 78 percent.....	0	(28.95)	41.48	(45.47)
78 percent but less than 80 percent.....	0	(36.44)	53.40	(57.24)
80 percent but less than 82 percent.....	0	(37.37)	53.40	(58.71)
82 percent but less than 99.5 percent.....	0	(38.30)	54.72	(60.19)
Other:				
Not exceeding 99.5 percent (butter oil and ghee).....		38.30	54.72	(60.19)
Exceeding 99.5 percent (anhydrous milkfat).....		46.51	72.23	(77.70)
Cheese, Emmenthal and Gruyere:				
Zone D.....			7.55	(23.31)
Austria.....			16.31	(14.66)
Others.....			33.80	(27.25)
Blue Cheese, except Roquefort.....			27.62	(22.71)
Processed cheese up to 48 percent fat by weight of dry matter, 33 percent fat, but less than 38 percent: Others.....			12.19	(9.63)
Processed cheese:				
Less than 20 percent fat.....			12.19	(9.63)
More than 20 percent fat.....			17.32	(14.23)
40 percent fat or more:				
Zone D.....			28.29	(23.91)
Others.....				
Processed cheese over 48 percent fat with a dry milk content by weight:				
33 percent but less than 38 percent dry matter.....			12.19	(9.63)
38 percent but less than 43 percent dry matter.....			17.32	(14.23)
43 percent but less than 46 percent dry matter.....			28.29	(23.91)
46 percent but less than 55 percent dry matter:				
Zone D.....			17.89	(17.89)
Others.....			28.29	(23.91)
Switzerland.....				
55 percent or more:				
Zone D.....			20.79	(17.89)
Others.....			32.79	(27.91)
Switzerland.....				
Grana, Parmigiano, Reggiano.....			37.17	(28.24)
Flore Sardo, Pecorino.....			45.38	(36.44)
Cheddar, Chester with a fat content by weight of dry matter of 50 percent or more:				
Aged less than 3 mo:				
Zone D.....				
Others.....				
Aged more than 3 mo:				
U.S.S.R. and satellite countries.....			8.20	(31.78)
Others.....			29.32	(31.78)
United States.....			18.06	(31.78)

See footnotes at end of table.

EXHIBIT A—Continued

E.C.: EXPORT SUBSIDIES FOR DAIRY PRODUCTS, EFFECTIVE FEB. 15, 1974¹—Continued

[Cents per pound]

	United States		E.C.	
	New subsidy	Old subsidy	New ² subsidy ³	Old ³ subsidy ³
Tilsit with fat content by weight of dry matter over 39 percent up to 48 percent:				
Zone D:				
Switzerland			6.46	(5.42)
Others			29.93	(23.97)
Asiago, Caciocavallo, Provolone and Ragusano:				
Switzerland			6.46	(5.42)
Others			29.93	(24.30)
Cantal, Edam, Fontina and Gouda:				
Zone D:			21.72	(20.08)
Zone F:			6.46	(5.42)
Switzerland			29.93	(23.97)
Others				
Butter Kasa, Italice, Kerham, Saint Paulin Taleggio, Saint-Nectaire:				
Zone D:			20.63	(18.99)
Zone F:			6.46	(5.42)
Switzerland			27.26	(21.89)
Others				
Others, with fat content 19 percent to 39 percent with a water content up to 62 percent:				
Switzerland			6.46	(5.42)
Others			29.46	(24.30)
Unspecified cheese, grated or powdered, with 85 percent or more dry matter content by weight, over 20-percent fat content by weight, under 5-percent lactose content by weight: Others				
			27.63	(22.16)
Milk and cream, canned in 454 g without sugar:				
Evaporated milk:			4.46	(2.66)
3-percent up to 7-percent fat			7.87	(6.29)
Over 7-percent up to 8.9-percent fat			9.04	(7.20)
Others				
Other canned milk with fat content up to 45 percent in containers up to 2 kg net weight:				
Over 3-percent up to 7-percent fat			4.46	(2.66)
Over 7-percent up to 8.9-percent fat			7.87	(6.29)
Over 8.9-percent up to 11-percent fat			9.04	(6.20)
Over 21-percent up to 39-percent fat			16.21	(15.98)
Over 45-percent fat			33.87	(33.43)
Milk and cream, canned in 454 g with sugar (condensed milk): ⁴				
Up to 6.9-percent fat			3.98	(2.19)
Over 6.9-percent up to 9.5-percent fat			9.76	(7.93)
Nonfat dry milk up to 1.5-percent fat: ⁴				
Without sugar in packages up to 2.5 kg			5.47	(8.76)
Without sugar in bulk			4.37	(0.00)
With sugar added in packages up to 2.5 kg ⁴			5.47	(8.76)
With sugar added in bulk ⁴			4.87	(0.00)
To United States (all NFDM)			0	(4.37)
				or 5.47)
Dried milk without sugar (prepared for retail sales):				
Over 11-percent to 17-percent fat content			19.45	(14.28)
Over 17-percent to 25-percent fat content			22.69	(17.31)
Over 25-percent to 27-percent fat content			26.81	(21.34)
Over 27-percent to 29-percent fat content			27.83	(22.35)
Over 29-percent to 41-percent fat content			27.83	(22.35)
Over 41-percent fat content			34.11	(29.41)
Dried milk with sugar added (prepared for retail sales): ⁴				
Over 11-percent to 17-percent fat content			19.45	(14.28)
Over 17-percent to 25-percent fat content			22.69	(17.31)
Over 25-percent to 27-percent fat content			26.81	(21.34)
Over 27-percent to 41-percent fat content			27.83	(22.35)
Over 41-percent fat content			34.11	(29.41)

¹ Change of value for units of account U.C. = US\$1.2063 plus increases in export subsidies.² As of Jan. 15, 1974.³ Destined for consumption in this zone.⁴ 13.13 ¢/lb on bulk and small package, May 14–July 10, 1973.⁵ Additional subsidy for sugar to be added.⁶ Countries other than United States, Canada, Mexico, and Puerto Rico.

Source of change: E.C., Brussels 1128, Feb. 21, 1974

EC EXPORT SUBSIDY ZONES

Zone A

Burundi
 Cameroon
 Congo (Brazzaville)
 Congo (Kinshasa)
 Ivory Coast
 Dahomey
 Gaboon
 Guines
 Upper Volta

Mali
 Mauretania
 Niger
 Central African Republic
 Madagascar
 Ruanda
 Senegal
 Tchad
 Afara and Issas
 Togo

Zone B

Mexico, States of Central and South America, Islands in the Pacific and Atlantic between 30 and 120 degrees longitude and 30 degrees latitude as well as the Islands Fernando-de-Noronha (Cliffs Sao Paulo and Reas-Atoll), Trinidad, Martin Vaz and the Southern Sandwich Islands.

Zone C

Asian States east of Iran including the Asiatic parts of the USSR and the Islands of the Indian and Pacific Oceans between 60 degrees and 180 degrees latitude except Australia, New Zealand and Japan.

Zone D

Spanish Territory of Iberian Peninsula and Balears.

Zone E

European territory of United Kingdom and Northern Ireland (including the Isle of Man and Channel Islands) except Gibraltar.

Zone F

The territories of the United States situated on the American continent as well as Hawaii.

U.S. SENATE,
 Washington, D.C., April 26, 1974.

Hon. RUSSELL LONG,
 Chairman, Senate Finance Committee,
 Washington, D.C.

DEAR MR. CHAIRMAN: Attached is a letter inquiring about Mr. Simon's policy regarding countervailing duties on dairy imports. It seems most appropriate that the Committee request his appraisal of the situation due to the problems facing the dairy industry in the United States today.

Sincerely yours,

BOB DOLE, *U.S. Senator.*

U.S. SENATE,
 Washington, D.C., April 26, 1974.

Hon. WILLIAM E. SIMON,
 Secretary of the Treasury Designate,
 Washington, D.C.

DEAR MR. SIMON: The law calls for the levying of a duty on imports sold in the United States which have received a bounty or grant from the exporting country.

In the case of dairy products, particularly in the European Community, the facts in this regard not only seem quite clear but are also well publicized. The European Community establishes intervention

prices on manufactured dairy products, such as butter, cheese and nonfat dry milk powder. These intervention prices, analogous to our price supports, are at least a minimum price for these products in the European Community and generally are the actual prices there. At the time they are announced such intervention prices are widely publicized.

Similarly, the European Community announces export subsidies for these dairy products, which are also widely publicized at the time they are announced. The Foreign Agriculture Service of the U.S. Department of Agriculture readily compiles them and makes this list available on request to interested parties. During 1973, for example, the announced export subsidies on nonfat dry milk shipped by the European Community to the United States were established at different levels at different times from zero to 13.13 cents per pound. For butter they were 37.37 cents per pound, for buttermilk 38.3 cents per pound.

Yet in spite of the availability of this evidence and even in spite of the recommendations of Secretary of Agriculture Earl Butz that countervailing duties on these products should be imposed, the Department of the Treasury has taken no action, contending that the needed data are not available to make their findings.

With this brief background we are asking your views as to what your policy will be on enforcing the countervailing duty law on dairy products if you become Secretary of the Treasury.

Sincerely yours,

BOB DOLE, *U.S. Senator.*

THE SECRETARY OF THE TREASURY,
Washington, D.C., April 26, 1974.

HON. RUSSELL B. LONG,
*Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.*

DEAR MR. CHAIRMAN: This letter is written in response to a letter from Senators Nelson and Mondale, dated April 26, 1974, addressed to you, and a letter from Senator Dole, bearing the same date addressed to me with a copy to you. Both letters concern the enforcement of the countervailing duty statute against dairy products imported from the Common Market.

Matthew J. Marks, Acting Assistant Secretary for Enforcement, Tariff and Trade Affairs, and Operations, is currently responsible for this area. David R. Macdonald, Assistant Secretary of the Treasury-Designate for Enforcement, Tariff and Trade Affairs, and Operations, will, provided he is confirmed by the Senate, assume this responsibility. Mr. Marks reports that investigation of the countervailing duty statute as to dairy products is progressing, but has been complicated by the existence of drawbacks of duties and taxes paid on imports to the E.E.C. for cattle feed.

The complicated interplay that existing quotas, additional duties and other trade implements have on our dairy imports, and the possible repercussions which the application of these measures may have on other American agricultural interests, highlight the urgency of

immediate enactment of the 1973 Trade Reform Bill. This bill, with certain revisions which we intend to submit to your Committee, will provide a framework for a multilateral resolution of this problem over the long term, and will permit us the best possible posture to enter negotiations with the Common Market.

Prior to its enactment, however, I am ordering Mr. Marks and, provided he is confirmed, Mr. Macdonald, to intensify the investigation of dairy product exports from the Common Market to the United States and to report back to me concerning this Department's conclusions as to the applicability of the countervailing duty law with respect to these exports. In the event that the Department concludes as a result of their report that the countervailing duty law should be applied, all necessary action will be taken to enforce that law.

Sincerely,

WILLIAM E. SIMON,
Acting Secretary.

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