PUBLIC DEBT AND THE BUDGET

HEARINGS

BEFORE THE

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT GENERALLY

OF THE

COMMITTEE ON FINANCE UNITED STATES SENATE

NINETY-FIFTH CONGRESS

SECOND SESSION

JANUARY 30 AND FEBRUARY 6, 1978

Printed for the use of the Committee on Finance

U.S. GOVERNMENT PRINTING OFFICE
22-544 WASHINGTON : 1978

S361-16

COMMITTEE ON FINANCE

RUSSELL B. LONG, Louisiana, *Chairman*

HERMAN E. TALMADGE, Georgia
ABRAHAM RIBICOFF, Connecticut
HARRY F. BYRD, JR., Virginia
GAYLORD NELSON, Wisconsin
MIKE GRAVEL, Alaska
LLOYD BENTSEN, Texas
WILLIAM D. HATHAWAY, Maine
FLOYD K. HASKELL, Colorado
SPARK M. MATSUNAGA, Hawaii
DANIEL PATRICK MOYNIHAN, New York

CARL T. CURTIS, Nebraska
CLIFFORD P. HANSEN, Wyoming
ROBERT DOLE, Kansas
BOB PACKWOOD, Oregon
WILLIAM V. ROTH, JR., Delaware
PAUL LAXALT, Nevada
JOHN C. DANFORTH, Missouri

MICHAEL STERN, *Staff Director*
GEORGE W. PRITTS, Jr., *Minority Counsel*

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT GENERALLY

HARRY F. BYRD, JR., Virginia, *Chairman*

HERMAN E. TALMADGE, Georgia
MIKE GRAVEL, Alaska
FLOYD K. HASKELL, Colorado

BOB PACKWOOD, Oregon
CLIFFORD P. HANSEN, Wyoming
WILLIAM V. ROTH, JR., Delaware

CONTENTS

ADMINISTRATION WITNESSES

	Page
Altman, Hon. Roger, Assistant Secretary of the Treasury for Domestic Finance	108
Cutter, W. Bowman, Executive Associate Director for Budget, Office of Management and Budget	127
Gardner, Hon. Stephen S., member, Board of Governors, Federal Reserve System	138

PUBLIC WITNESSES

Data Resources Inc., Otto Eckstein, president	2
Eckstein, Otto, president, Data Resources Inc	2
American Enterprise Institute, Rudolph G. Penner, director of tax policy studies	7
Penner, Rudolph G., director of tax policy studies, American Enterprise Institute	7
Meiselman, David I., professor of economics, director, graduate economics program in northern Virginia, Virginia Polytechnic Institute and State university	12
Sindlinger, Albert E., chairman of the board, Sindlinger & Co., Media, Pa	18

COMMUNICATION

Schmidt, Wilson E	147

APPENDIX

Tables on estimated gross and net Government and private debt	149

ADDITIONAL INFORMATION

Committee on Finance press release announcing these hearings	1

PUBLIC DEBT AND THE BUDGET

MONDAY, JANUARY 30, 1978

U.S. SENATE,
SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT
GENERALLY, COMMITTEE ON FINANCE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10 a.m., in room 2221, Dirksen Senate Office Building, Hon. Harry F. Byrd, Jr. [chairman of the subcommittee] presiding.

Present: Senator Byrd.

[The committee press release announcing these hearings follows:]

[Press Release, Jan. 17, 1978]

FINANCE SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT SETS HEARINGS ON PUBLIC DEBT AND BUDGET

Senator Harry F. Byrd, Jr., Chairman of the Subcommittee on Taxation and Debt Management of the Senate Committee on Finance announced today that the Committee will hold hearings on January 30 and February 6, 1978 on the public debt and the implications of President Carter's budget upon the debt.

Hearings on January 30 will begin at 10 a.m., and will consist of a panel of economists including Dr. Otto Eckstein, Dr. Rudolph G. Penner, and Dr. David I. Meiselman. The hearings on February 6 will begin at 10 a.m. and will have as witnesses, W. Bowman Cutter, Executive Associate Director of the Office of Management and Budget, and Roger Altman, Assistant Secretary of the Treasury for Capital Markets and Debt Management.

The hearings will be held in room 2221, Dirksen Senate Office Building.

"President Carter plans to submit the fiscal year 1979 budget to the Congress on January 23. Congress must look closely at the budget and its implications for the national debt and the future performance of our economy."

Senator Byrd noted that the statutory debt ceiling is now $752 billion, and this expires on March 31, 1978.

"Often the Senate is confronted with last-minute legislation to extend the debt ceiling," Senator Byrd said. "These hearings will give the Senate an advance opportunity to explore the public debt and its economic ramifications."

Other witnesses who desire to testify at the hearings should submit a written request to Michael Stern, Staff Director, Committee on Finance, room 2227, Dirksen Senate Office Building, Washington, D.C. 20510 by no later than the close of business on January 25, 1978.

Legislative Reorganization Act.—Senator Byrd stated that the Legislative Reorganization Act of 1946, as amended, requires all witnesses appearing before the Committees of Congress "to file in advance written statements of their proposed testimony, and to limit their oral presentations to brief summaries of their argument."

Witnesses scheduled to testify should comply with the following rules:

1. A copy of the statement must be filed by noon the day before the day the witness is scheduled to testify.
2. All witnesses must include with their written statement a summary of the principal points included in the statement.
3. The written statements must be typed on letter-size paper (not legal size) and at least 75 copies must be submitted by the close of business the day before the witness is scheduled to testify.

4. Witnesses are not to read their written statements to the Committee, but are to confine their fifteen-minute oral presentations to a summary of the points included in the statement.

5. Not more than 15 minutes will be allowed for oral presentation.

Written testimony.—Senator Byrd stated that the subcommittee would be pleased to receive written testimony from those persons or organizations who wish to submit statements for the record. Statements submitted for inclusion in the record should be typewritten, not more than 25 double-spaced pages in length and mailed with five (5) copies by February 15, 1978, to Michael Stern, Staff Director, Committee on Finance, room 2227, Dirksen Senate Office Building, Washington, D.C. 20510.

Senator BYRD. The committee will come to order.

The budget recently submitted to the Congress by the Carter administration estimated that the gross Federal debt at the end of fiscal year 1979 will be $873 billion. This projected increase in the Federal debt is the largest yearly increase in our Nation's history, namely $88.1 billion. The increase in that debt means that the Carter administration is not able yet to bring Federal spending under control.

Many people dismiss Government borrowing with the proposition that the Federal debt is not cause for concern because we owe it to ourselves. I cannot ignore our debt so easily.

Federal spending is really a claim upon the resources of our Nation. In borrowing to finance the Federal deficit and roll over past debts, the Treasury will be competing with the private sector for funds; public debt will be replacing private debt and private equity which could be used to finance the capital investment necessary for the future economic well-being of our Nation.

The statutory debt ceiling is now $752 billion. This ceiling is scheduled to expire on March 31.

Often the Senate is confronted with a last-minute request to continue to increase the debt ceiling. These hearings will provide the Senate with an opportunity prior to the actual debt ceiling hearings to explore in some detail the future course of the Federal debt, the deficit and the implications of Federal spending upon our economy.

We are fortunate today to have a distinguished group of economic analysts to testify before our committee. We have a panel of three economists and, along with them, a noted pollster on economic issues.

The witnesses today will be Dr. Otto Eckstein, president, Data Resources, Inc.; Dr. Rudolph G. Penner, director of tax policy studies, American Enterprise Institute; Dr. David I. Meiselman, professor, graduate economics program in northern Virginia, Virginia Polytechnic Institute; and Albert E. Sindlinger, chairman of the board, Sindlinger & Co., of Media in Pennsylvania.

Next Monday, Government witnesses will present testimony but I think that it is important to get the viewpoint of non-Government experts.

Suppose, Dr. Eckstein, that you lead off, and then we will go to the other witnesses before we go into the question period.

STATEMENT OF OTTO ECKSTEIN, PRESIDENT, DATA RESOURCES INC.

Mr. ECKSTEIN. Thank you very much, Senator Byrd.

According to the Government's estimates, the gross Federal debt will reach $873.7 billion by September 30, 1979. In the ordinary course

of events, the debt will pass the $1 trillion mark in 1981 or, if we are lucky, 1982.

Does it matter? Twenty years ago, most economists would have answered that it matters rather little, because the interest payments are a transfer within the American people. While there was a revival of the classical view that there was an intergenerational burden, the arguments were rather obscure and based on somewhat "iffy" assumptions.

But circumstances have changed in a variety of ways in the last 20 years, and so it is appropriate to use the occasion of the annual ritual of the statutory debt limit extension to reach a new assessment on the importance of the debt burden and of the implications for budget policy.

The debt is growing rapidly because the budget deficits have become so enormous. As chart 1 shows, the net interest burden as a percentage of gross national product, which had changed rather little from the end of World War II until 1967, has risen substantially since then. Short- and long-term interest rates are much higher in response to the last decade of inflation, and the size of the debt has also increased very sharply. The under-financed Vietnam war and the 1967 slowdown produced the first of the recent frightening deficits.

The 1970 recession and the subsequent stimulative fiscal policy added three more large deficits. The great recession of 1974–75 added mightily to the debt, of course. The subsequent recovery, unlike other postwar business cycle recoveries, is not bringing a rapid shrinkage of the deficits. This condition is the first major issue that must be studied.

The President's 1979 budget is a strategy of expansion. The full employment budget, the best available measure of direct budget impact, shows a sizable increase in its deficit both in fiscal 1978 and fiscal 1979. This is somewhat at odds with the media description of the budget as moderate. How did the need for this budget plan develop? What are the actual prospects for the 1979 project after congressional action and administrative implementation? What are the implications for the economy?

According to the Government's estimates, the full employment budget deficit on the unified budget basis increases from $10 billion in fiscal 1977 to $32 billion in 1978 and $37 billion in 1979. DRI has calculated the comparable estimates on the national income accounts basis.

The rise in the deficit is not quite so extreme, reaching a $25 billion deficit for 1979. The difference lies in net lending; the Federal housing agencies are moving back to high lending volumes which are not included in the national income accounts because they are offset by asset acquisitions.

But even at the more moderate NIA estimates, a rising full employment budget deficit in years 4 and 5 of a business cycle expansion deserves close examination. The reasons for this budget strategy are these:

The President has placed employment gains high on his priority scale. The public and the Congress justifiably expect him to show steady declines in the unemployment rate.

It is my own belief that that is the centerpiece of his election platform. Given that goal, you have to look at the economy.

The economy would slow down substantially if the budget did not have an expansionary posture. Consumer spending will rise less than income in 1978 because the debt burden is already excessive.

There is also considerable evidence in automobile and other retail sales that consumers are taking steps to bring their debt burden back in line.

The Government survey of business investment plans leaves little doubt that investment will not be strong enough to carry the economy forward alone. A year ago, the administration adopted a growth strategy based on 10 percent growth in real investment, but that hope must be abandoned in the light of the survey.

Housing starts are very likely to fall before 1978 is over because of high interest rates and recent above-trend activity. Finally, the Federal Reserve, even under the chairmanship of Mr. Miller, is likely to raise interest rates somewhat further as monetary growth is likely to continue to be above the 6.5 percent target ceiling over the next 6 months.

There is really need for action. If you will look at chart 2, you will see that the proposed action is really quite substantial. This shows the history of the full employment budget back in 1956, the first year that you can calculate it reasonably accurately.

You will see in 1956, and through 1965, the full employment budget was in surplus—not the actual budget; these are "iffy" numbers; but the budget would be if there were full employment.

It corrects out the effect of the economy on the budget. We have these very big deficits in the Vietnam war, break-even years in the 1970's, we have a deficit in 1973, a little surplus in 1974, which I believe was a mistake. Then in 1975 the deficits begin once more and can be seen to be growing from 1974 to 1978.

Senator BYRD. If I may, could I interrupt you for a point of clarification?

Are the full employment budget figures that you have submitted here based on zero employment or 4 percent unemployment?

Mr. ECKSTEIN. No. We use the same method now used by the Government, which uses as a baseline a moving, rising, unemployment rate, which at this time takes 4.9 percent as full employment, which is not an unreasonable baseline. It uses 4 percent in the past and then moves it up as the composition of the labor forces distorts young workers and women.

This uses essentially the method used by the Government. The Government has not yet supplied us with full employment estimates for the new budget on this basis.

All right. Will this strategy work?

The Data Resources Forecast, that is how we make a living, is somewhat below the projections in the President's economic report, but the difference between the two projections is moderate, a total of 1.2 percent by 1980. The DRI answers are somewhat lower for three reasons.

First, DRI believes that actual budget outlays will again fall short of the President's proposals. The spending shortfalls of recent years appear to have continued into the current fiscal year.

The President's budget proposals use the second congressional resolution as their baseline, but it is apparent that fiscal year 1978 spend-

ing will be considerably less, about $5 billion less according to the DRI estimates.

While there are some areas in the 1979 budget, particularly the agricultural outlays, which could easily prove to be larger than the President's estimates, more general spending shortfalls are likely to outweigh them.

Second, the DRI forecast is somewhat lower because the large Federal deficit will produce some "crowding out." The DRI model is not monetarist in the sense that every dollar of Federal deficit displaces a dollar of private spending, but the model does reflect the impact of Treasury financing on interest rates.

At current conditions, we estimate the crowding-out coefficient, the loss in private spending for every dollar deficit, at about 30 cents. If money were tight, or the economy were at full employment, it would approach $1 as the monetarist position maintains. If the economy were even more slack, it would even be a lower effect.

At this time, there is no effect.

The Federal Reserve is not likely to permit the rates of increase in the money supply that would be required to fully accommodate unified budget deficits of $61 billion, which convert into financing needs that are substantially greater because of the deficits of off-budget agencies.

In 1979, the Government's estimate of total borrowing from the public is $73 billion, $7 billion more than projected for 1978. While the Government's total financing needs will remain roughly constant in 1979, a large fraction of 1978's deficit will be financed by drawing down unusually large cash holdings.

Finally, DRI projects some final demands to grow a little less than the administration. This is particularly the case in 1979, when DRI sees a lull in the economy due to reduced housing activity.

The main question about this projection, which is a pretty good one, and I think most people would find it quite satisfactory, our own projection—the main question is, will the outside world permit us to follow this strategy? Our own policies are expansionist, but they are not in Japan and West Germany.

This year, the differences in growth rates between ours and the other countries was disequilibriated by the exchange rate, particularly the fall at the end of the year. We did have a large balance of trade deficits.

If the disparity in economic performance continues through all of 1978, the recent policy change to stabilize the dollar will fail, and since the United States is not free to let the dollar sink without limit or to let exchange markets become disorderly, the international constraint would become effective on the U.S. economy. Higher interest rates would be the most direct expression of this influence.

Fortunately, there are scattered signs that the European economies are beginning to gain some momentum. West Germany's real GNP growth rebounded to a 3.4-percent annual rate in the final quarter of 1977, following a 0.4-percent advance in the third quarter. Industrial production and factory orders are also showing good gains in recent months.

In France, industrial production jumped 4.1 percent in November, though it still stood below year-earlier levels and unemployment showed a good improvement in December.

In the United Kingdom, the period of decline and stagnation also seemed to be coming to an end as production rose 0.6 percent in November and retail sales rose a big 3.2 percent in December.

Some of our other principal trading partners are showing less signs of a turnaround. The Canadian economy reached its highest unemployment rate of the postwar period in December, though housing and retail sales showed improvement near yearend. The Japanese economy, the largest industrial economy after our own, did not show much renewal. While production advanced 2.8 percent in November, retail sales remain weak, business fixed investment is flat to declining, and housing starts are not strong despite various Government programs. Public outlays are showing some increases as the more recent stimulus packages are beginning to be felt. The Government has reasserted its 7-percent growth goal for fiscal 1978, though it is too early to assess whether the Government really means to reach it.

In summary the President's short-term fiscal policy proposals are correct, given the actual economic situation. The $25 billion tax reduction and the associated full-employment budget deficits are large and one could argue responsibly for a few billion dollars less. On the other hand, given the size of the full-employment budget deficit planned for years 4 and 5 of the expansion, it would be a serious error to aim at tax reductions beyond $25 billion, or to aim at budget deficits beyond $60 billion.

In the longer term, the presence of a large national debt raises a different set of issues. The burden of the debt is not measured by the interest payments or the absolute size in relation to the GNP, because inflation, including inflation created by the budget, steadily erodes the real burden of the debt. The burden is found elsewhere.

If you want to view it brutally, the 6-percent inflation rate reduces the real burden of a $750 billion debt by $42 billion a year. The real burden is really found somewhere else.

First, an increasing share of the debt is now owed to foreigners. As recently as 1970, the debt held abroad was small. The international monetary crisis that began in 1971 led to the acquisition of $45 billion of our debt by foreigners, principally central banks. The balance of payments deficits created by the oil crisis and the recession led to foreign purchases of another $33 billion in the years 1975–77 and the prospects are that foreign acquisitions will continue near the $20 billion a year mark for some time.

Thus, it is no longer true that we "owe it to ourselves"—some of the debt has become an external burden to the American people and we pay interest like any other debtor.

Besides the interest burden, the new dependence on foreign financing is eroding our freedom of action both in domestic and public policy. While there are some advantages in building economic and political ties to the oil-producing countries who are buying our debt, the United States will pay a price for these relationships. Indeed, the sudden switch in U. S. foreign exchange rate policy this month is generally attributed to this factor.

The Federal debt is offset by very little real Government capital. The big growth in Government spending has been in a variety of income benefit programs, and in grants-in-aid to States which preponderantly also go for current outlays. According to the always interest-

ing special analysis D of the Federal Budget, page 85, of a total 1977 budget outlay of $402 billion, only $24 billion went for civil physical assets, $3 billion for net loans and financial investments, and $11 billion for civil research and development, a total of $38 billion or less than 10 percent.

Another $20 billion went for education and training, which can be considered a form of investment in human resources. On the military side, major equipment and public works represent only $21 billion of $98 billion.

By any reasonable definition, the bulk of the debt is being created for consumption purposes. The continued expansion of the scope of Government, taking an ever larger share of the GNP, gives every sign of curtailing the country's long-term growth.

The growth of the debt reflects a decisionmaking process in which outlays are not validated by a willingness to pay. The weakness of modern fiscal policy has always been that it removes the discipline of the balanced budget. If the political process must levy the taxes to pay for the expenditures, there is likely to be a more careful scrutiny than if the expenditures can be clothed in the virtue of deficit-created stimulus packages.

In a year of recession, the loss of discipline is not important because resource costs really are lower since labor and capital would otherwise be idle. But we are now talking about large deficits in years 4 and 5 of a recovery with no serious prospect of a return to a situation where expenditures again have to be scrutinized in terms of their tax costs.

The dangers posed by this situation to the efficiency of resource use in the public sector should not be ignored.

In dealing with the national debt, one must be realistic. The debt will grow and the Congress will have to raise the debt limit. This committee is wise to focus public attention on the growth of the debt each year. A rapidly expanding debt is a serious sign of weakness in the way we manage our economic affairs. Fiscal policies designed to undo the restraining of monetary policies, ineffectual expenditures with low mutipliers and little long-term value, inflationary public and private policies which limit our prosperity, these and other flaws ultimately become converted into a rising national debt.

Our children and grandchildren will judge us not so much by the size of the debt burden in relation to the GNP, but in terms of our accomplishments in solving our economic problems and thereby gradually slowing the growth rate of a rapidly rising national debt.

Thank you, Senator.

Senator BYRD. Thank you very much, Doctor. That was indeed a very interesting presentation.

The next witness will be Dr. Rudolph G. Penner, director of tax policy studies, American Enterprise Institute.

STATEMENT OF RUDOLPH G. PENNER, DIRECTOR OF TAX POLICY STUDIES, AMERICAN ENTERPRISE INSTITUTE

Mr. PENNER. There seems to be an aura of gloom hanging over American and foreign financial markets. The stock market is valuing the real value of the corporate capital stock very much lower than it

would cost to replace it. The dollar is weak, and generaly there is a feeling that economic policymakers do not know what to do next.

In many ways, I find this pessimism puzzling, because we have done extremely well economically since the horrors of the recession of 1974–75. We have raised employment by 8 million. We have reduced the unemployment rate from a high of 9 percent to 6.4 percent. Even the inflation rate has been, in the last 9 months, about half of what it was during much of 1974.

So the recovery, I think, is proceeding in a satisfactory manner in the sense that real growth is continually lowering the unemployment rate.

The main problem that we face is inflation. While we have made progress in the last 3 years, the consensus forecast is that that rate will remain at about 6 percent over the next 2 years.

Now, I think that it is the worry about inflation that is the single most important element causing uncertainty in domestic and foreign financial markets.

So it is within this context that we begin to debate the President's economic program in 1979 and I would like to concentrate this testimony on first, the appropriateness of the deficit that has been recommended and then on the appropriateness of the income tax propoals.

The same inflation that makes financial markets so uneasy is inexorably pushing taxpayers into higher and higher tax brackets. If a person gets a cost-of-living raise, he finds that that raise is taxed at a higher marginal rate than was a similar raise last year. If he gets a merit increase on top of the cost-of-living raise, it is taxed at even higher marginal tax rates.

The effect of this is well illustrated by a chart that I have attached to my testimony that appeared in the fact sheets that went along with the President's tax message.

The chart uses the ratio of taxes paid to personal income to measure the income tax burden. The chart reveals a sawtooth pattern. Whenever the burden starts to rise, the Congress has typically offset the rise with a legislated tax cut. This occurred throughout the sixties and early seventies and as a result, the tax burden in 1976 was about equal to the burden that was extant in the early 1960's.

There is a slight reduction in the burden in 1977, but despite the President's proposed tax reductions, the tax burden rises in 1978 and 1979. In other words, those proposals do not fully offset the effects of inflation and real growth pushing people into higher tax brackets and, if nothing happens after 1979, the tax burden soars. By 1981, it would reach 12 percent—a level higher than at any time during the period shown in the chart, and a level 20 percent higher than that existing in 1976.

I do not expect that either the administration or the Congress will want to see the burden rise that rapidly and there will be intense pressures to have another tax cut even if the 1979 tax cut advocated by the President is accepted. Those future tax cuts will make it difficult to make progress against lowering the deficit.

The chart, of course, does not even show the social security burden that would cause the total burden to rise even more rapidly.

Despite the fact that the President's tax cut for individuals is not really a tax cut, he is not able to advocate a fall in the deficit of any sig-

nificance. As we look at the appropriateness of this policy, we have to be careful to judge it by the economic conditions that are expected to prevail in 1979 and 1980 when, with some timelags, this deficit will be having its major economic impact. In the absence of bad luck or bad policies, the unemployment rate should be at or under 6 percent for most of those 2 years.

No economist knows for sure when demand pressures will begin again, or, in other words, at what unemployment rate we shall begin to see an acceleration of inflation again. But there are careful students of labor markets who believe that we shall either be at the danger point or perhaps already passed it once the unemployment rate goes below 6 percent.

Therefore, I conclude that, given that inflation is the one macroeconomic problem where we do not seem to be making much progress and given that we shall be reaching fairly low levels of unemployment when this deficit has its major impact, the deficit should be somewhat lower. I would set a target of about $50 billion, recognizing that this does not indicate much progress in lowering the deficit and that it really represents a fairly trivial change in policy in the $2.3 trillion economy expected for fiscal 1979.

However, I advocate that kind of change simply to show that we are worried about the deficit in the long run and I would hope that this would have a salutory psychological impact. I would also hope that it would make Mr. Miller's difficult new job at the Federal Reserve System just slightly easier, and that it would give foreigners slightly more confidence in the ultimate value of the dollar.

How do you get there? My goal is modest, because I recognize the difficulties. The President has suggested that his proposed outlay figure of $500 billion represents a "lean and tight" budget. The next page of my testimony suggests that, while it is certainly lean, it is not Draconian.

I suppose the one point on which I differ from Mr. Eckstein a little bit is this question of the shortfall. I would not swear that we would not have another shortfall in spending in 1979. However, the Office of Management and Budget has gone to extreme lengths to improve their estimates. Some of their assumptions are already out of date. For example, the interest rate on the public debt is higher than what they assume in calculating the interest bill. So I do not think that we should count on a shortfall. Again, I would not swear that one will not occur, but I think that cost overruns are almost equally likely as we look ahead to 1979.

In the prepared testimony, I talk about the difficulties of cutting spending that we all know so well, and conclude that we shall have to show extreme discipline to hold to the level of spending advocated by the President, because there will be enormous pressures to exceed that number.

The question is, then, how do I get to my $50 billion deficit? I get there by having a lesser tax cut. I reduce the President's tax cut in two ways. First of all instead of making the tax cut effective October 1, 1978 as the President suggests, I would delay the implementation until January 1 of 1979. That, alone, would reduce the deficit by about $5 billion, roughly speaking.

I would also lower the amount of the tax cut to about $15 billion with it being shared between individuals and business in about the same way as the President suggests.

How should such an individual tax cut be distributed? I would like to spend a little bit of time on the proposed distribution of the President's tax cut because I do not think that the fact sheets that have been issued by the Treasury are very revealing.

They look at the distribution of those tax cuts at a given level of money income. As I already noted, inflation and real growth is constantly changing that income, so you have to look at comparable people in 1979 and in 1977.

At the very back of the testimony, I have a rather complicated table which adjusts only for inflation, and in the extreme lefthand column of that table, I show dollar levels of income which provide the same purchasing power in 1977 and 1979, given the inflation assumptions in the budget. The budget assumes that the price level in 1979 will be at about 12 percent higher than the price level in 1977. So each of the 1979 income levels in that table are 12 percent higher than the 1977 levels. I then look at the tax burden implied under the 1977 law and under the 1979 law proposed by the President.

The middle three columns show the average tax rates and what happens to them when you combine social security and personal income tax rates. The last column shows what happens to the total tax burden—again in real purchasing power measured in 1977 dollars.

If, for example, you look at the first panel of that table, you see that a person with $8,900 in 1977, gets the same before-tax purchasing power with $10,000 in 1979. A family of four at this income level gets a tax cut of $118 measured in terms of constant purchasing power, so that this particular family would, indeed, be better off as a result of the President's cut.

As we go down the table to higher and higher levels of income, however, we see that the effect of a tax cut is lowered, and the breakeven point is roughly $17,000 in terms of 1977 income. Above that level, the people find that they actually have a tax increase.

If we go all the way up to the $35,600 level in 1977, we find that although the person gets a raise providing the same before-tax purchasing power, or $40,000 in 1979, the family has lost some $557 in purchasing power because the tax burden has risen. In other words, the President is recommending a highly redistributive pattern of cuts when it is considered in conjunction with the social security increases.

This highly redistributive pattern comes on top of other tax changes in the last 3 years that have all favored the lower part of the income distribution. The earned income credit, created in 1975, favored the working poor. The decision to have a $35 per exemption credit instead of raising the basic exemption also favored the lower income groups.

The standard deduction increase in 1977 had its main impact at the lower end of the income scale, while all through this period, inflation and real growth have been pushing the upper half of the income scale into higher and higher marginal brackets. Although the chart that I showed you before indicated that, in the aggregate, the Congress has offset the effects of real growth and inflation, they have not provided a full offset for the top half of the distribution.

The choice of a proper distribution of the tax burden, clearly rests on value judgments. Basically, we must ask how egalitarian should the income distribution be? And, to some degree the decision also rests on economic judgments regarding how much incentive should be given people to work their way up the income ladder. My own judgment is that we have been moving very fast and very far in redistributing income without a very good, explicit debate about what our eventual goals are.

Are we really aiming for an egalitarian society, or do we want to have a society in which the Government plays a lesser role in redistributing income?

When I look at how my small tax cut should be redistributed for 1979, I would like to keep it fairly neutral distributionally, given all of the tax cuts that have favored the lower income groups recently and I would reduce the burden somewhat on the upper half of the distribution.

Roughly speaking, I would try to compensate for inflation. This means designing a tax cut that has the highest proportionate cuts at the bottom of the distribution, but the highest absolute cuts at the top.

In very general terms, it takes that kind of tax cut to correct for inflation because inflation tends to increase the tax burden more rapidly, proportionately, at the bottom of the income distribution. It is those people that experience the most rapid increase in the average tax rate as inflation pushes them further up the income scale.

The sort of tax cut that I would recommend would raise the basic exemptions from $750 to something like $800 and leave some room for cuts in marginal rates, as well.

If one were adjusting for inflation perfectly, you would widen the brackets rather than cut rates, but I think there is some merit in cutting rates on this occasion.

Unfortunately, the size of the tax cut that I am proposing—which would be about 5 percent of tax liabilities or $11 billion—is not sufficient to compensate for inflation and social security tax increases between 1977 and 1979.

Therefore, I am really advocating a tax increase for everybody, and it is unpleasant to do such a horrible thing. But I think that, unless we show more discipline on the spending side, the requirement to bring down the deficit really leaves us no other choice.

I would just like to take 1 minute to talk about two proposals in the budget that might go unnoticed but which I think are very important to this committee.

We have been talking about the role of Government debt in the economy. There is one area of Government activity that never gets much notice. That is the whole area of making direct loans and guaranteeing debt made by private lenders. An immense amount of activity goes on in these areas.

The gross value of Government loans and guarantees are expected to be $99.7 billion in fiscal 1979, and the whole quantity of outstanding loans and guarantees is expected to be $360.8 billion, a value about one-half the value of the national debt.

These activities, while we hardly ever pay any attention to them, have important resource allocation effects. When the Government

guarantees the debt of one person, whether it be a mortgage or a ship loan or whatever, it makes it harder for everybody else who does not have such Government guarantees to borrow money. And, because of the guarantee, a private issue becomes very much like the Govrnment debt, in that it does bear the full faith and credit of the U.S. Government if there is a default. As far as the lender is concerned, such issues compete directly with the national debt and therefore raise the interest bill that has to be paid by the Federal Government.

So guarantees are very important, and yet they have gone virtually uncontrolled and unstudied. The President has proposed that his budget process and the congressional budget process impose an annual limit on guarantees and direct loans, and I would urge you to examine that proposal very carefully, and, I hope, sympathetically,

The other rather unusual proposal which I think merits careful study is the notion of taxing unemployment benefits where adjusted gross income exceeds $25,000 on joint returns or $20,000 on single returns. Where a family like that is receiving unemployment insurance, it is usually because the family contains more than one person in the labor force and in that situation, the tax-free nature of the unemployment benefit means that if someone actually does go out and takes a job, the gain in terms of net income is very, very small.

You can easily create a situation where 80 percent of the salary is essentially lost, and therefore taxing the unemployment benefits would reduce the incentive to stay unemployed longer and I would therefore strongly support this administration initiative.

Thank you.

Senator BYRD. Thank you very much, Dr. Penner.

Dr. David Meiselman, professor, graduate economics program, Virginia Polytechnic Institute. Would you proceed?

STATEMENT OF DAVID I. MEISELMAN, PROFESSOR OF ECONOMICS, DIRECTOR, GRADUATE ECONOMICS PROGRAM IN NORTHERN VIRGINIA, VIRGINIA POLYTECHNIC INSTITUTE AND STATE UNIVERSITY

Mr. MEISELMAN. Thank you, Senator.

As a first approximation, the cost of Government is measured by the resources used in the public sector, not by the taxes we pay. When labor and capital and raw materials are used in the public sector, they are obviously not available for use in the private sector.

Private sector output and employment are thereby lower than they would otherwise be. Doing without the private sector output covering everything from food to houses is the cost of government and public sector output, and the cost associated with the benefits of public sector activities.

This cost exists independently of the means that are used to finance Government expenditures, whether taxes are high enough—or low enough—to balance the budget, or whether there is a budget deficit financed either by selling bonds to the public or by having the bonds purchased by the Federal Reserve with newly created—some would say newly printed—money.

This is why any significant reduction in the costs of Government requires a corresponding reduction of Government expenditures. This is

also why tax reduction without expenditure reduction may give the appearance of a reduction in the costs of Government to some taxpayers, but this is largely an illusion.

The deficit must be financed, and the interest on the public debt must be paid out of future taxes. True, the tax may be deferred to a later date, but the future tax bill will have to be higher because of the interest on the public debt.

I may add that I see no important difference here between future dollars used to pay obligations represented by outstanding Treasury securities, now in the neighborhood of $750 billion and other legal and "moral" unfunded obligations of the Federal Government to pay future dollars for such items as social security, military, and civil service pensions, and the like.

To be sure, these unfunded obligations are subject to modification in the future, just as the real value of Treasury securities are subject to modification by future inflation. In any event, it would appear that current and unfunded obligations are many times greater than the staggering but more precisely measured funded Federal debt.

For the moment, holding aside questions about the relative efficiency of resources used in the private sector versus those used in the public sector and the associated relative returns, each method of financing Government expenditures has a bearing on overall efficiency, both in terms of facilitating a shift of resources from private to public sector use and also in terms of the efficient use of the remaining resources available to the private sector.

Every method of financing Government alters relative prices and changes the context in which private decisions are made. Against the alternative of a hypothetical neutral tax, every tax and every deficit makes the private sector less efficient. Although some kinds of taxes do impose less distortions and inefficiencies than others, in the real world there is no such thing as a completely neutral tax or a neutral deficit. Every tax and every deficit adds its own costs, measured by the loss of the efficiency of the private sector, to the other costs of resources pushed out of the private sector into public sector use.

It is in this sense that no tax is a good tax and no deficit is a good deficit. By the same token, the correct evaluation of the costs of government must also include the loss of output and employment and the inefficiencies resulting from the unavoidable necessity to finance government expenditures.

There is, of course, no precise way to measure whether the benefits of Government expenditures are sufficiently high to justify their costs, especially since the people paying the costs may not be the same as the people receiving the benefits. However, it is widely acknowledged that our present tax and expenditure mechanism is heavily biased toward excessive Government spending, especially since the costs of Government tend to be diffuse whereas the benefits are highly specific.

Indeed, these are compelling reasons for tighter lids on total Government expenditures as well as for the closer links between expenditures and highly visible taxes to pay for those expenditures envisaged by proponents of mandated balanced budgets.

For the present, it would seem that few people feel that they are getting their taxes' worth from the vast array of Government programs. We are paying more and enjoying it less.

23-544—78——2

In light of this, any increase in the Federal budget would appear to be excessive. Indeed, a substantial reduction in Government expenditures and in the scale and scope of Government would seem to be in order.

Taxes generally force or induce us to do things differently and thereby reduce the inherent efficiency of a free market private property system. When a tax increases the cost of labor, fewer workers are employed or they are required to accept a correspondingly lower wage. When a tax reduces the return from a work, we work less, and so forth.

Similarly, deficits also force or induce us to do things differently because limited financial resources otherwise available to finance private sector capital formation are bid away by the financing needs of the U.S. Treasury. These problems are not avoided when the Federal Reserve buys Treasury securities with newly-created Federal Reserve credit; they are compounded by the subsequent inflation.

In any event, in part, taxes and deficits that force or induce us to use less so that the Government can have more also have the unintended results of making the private sector less efficient. As I shall discuss in a few minutes, the problem is especially critical with respect to the impact of public policies on saving and investment because of the differentially heavier burden the tax system now imposes on income devoted to capital formation rather than consumption or Government.

Some Government expenditures are devoted to purchases of goods and services and are thereby resource using in the sense that the Government itself directly acquires the use of labor, capital, or raw materials as would be the case when the Federal Government buys a submarine for national defense or hires more lawyers to promulgate more regulations.

Increasingly, however, a larger and larger fraction of the Federal budget is devoted to transfer payments. In the President's budget document for fiscal 1979, less than 35 percent of total Federal expenditures are for the direct purchase of goods and services by the Federal Government. The remainder of the half-trillion dollar budget is largely devoted to transfer payments to individuals—about 40 percent—grants-in-aid to State and local governments—16 percent—and interest on the national debt—8 percent.

But these expenditures do more than redistribute income by taxing Peter to pay Paul because the taxes and the deficits that pay for the transfer payments and the grants-in-aid make the economy as a whole less efficient.

When transfer payments and the size of the budget are small, this dead-weight loss is correspondingly small. However, the rapid growth in transfer payments and grants-in-aid since the mid-1960's means that financing the massive scale of these programs significantly reduces the size of the pie being sliced up.

Holding aside the difficult ethical and political problems of large-scale income redistribution, I believe that problems of slow growth, inefficiency, impaired employment opportunities and inflation created by the zeal for redistribution are some of the Nation's most vexing and embarrassing problems, problems which cannot be solved without a significant moderation of the Federal Government's redistributionist policies.

I may add that the size distribution of income appears to have been changed little by these policies and in no systematic way. All we can definitively say is that, in aggregate, the Nation is poorer because of the redistributionist policies, in part because of the retarded growth of plant and equipment resulting from the increases in taxes on saving and investment. In turn, less capital means lower labor productivity and thereby both lower wages and impaired employment opportunities.

Moreover, there is now a large and growing number of informed students of the problem who contend that the net effect of recent public policies intended to make income distribution more nearly equal has been to impair opportunities for the poor, weaken the family, and to make income distribution less equal.

It would seem that old ways of thinking about the problems of poverty and unemployment are so deeply ingrained that even when there is acknowledgment that public policies are counterproductive, proposed new solutions repeat many of the same old errors and promise to make a bad situation even worse.

For a current example, consider the welfare system, a disaster area of public policy, and new initiatives to change the system. It is generally recognized that the present welfare system has caused more unemployment and has perpetuated poverty.

The administration's welfare proposal contained in H.R. 9030 attempts to deal with the welfare mess.

At the request of the Law and Economics Center of the University of Miami, I have just completed a detailed analysis of the administration's welfare proposal, including its provisions to create and fully fund the largest public service employment program since the 1930's. With your permission I would like to submit the study for the record.

My analysis concludes that, despite the administration's claims that the program will shift the poor from welfare dependency to productive jobs, especially in the private sector, and at low additional cost to the taxpayers, the results of the new program will be quite the contrary.

Also, my study shows that, if enacted into law, H.R. 9030 would cause a further expansion of the public sector that potentially will attract a large segment of low- and middle-income workers out of the private sector into low productivity, low priority, and largely dead-end public sector employment. Costs will be substantially higher than the administration forecasts. A whole new welfare class is likely to emerge, and family stability will be further impaired.

The ultimate costs will include both lower overall employment and less economic growth. At the same time, the basic causes of the current problems of unemployment and poverty, poor government policies that have increased barriers to employment and to gaining work skills while increasing incentives to unemployment and welfare, all are left intact.

I turn now to several observations about some of the connections between our slow economic growth—since 1960 perhaps the slowest of all the Western industrial countries, and public policy. The major reason for our poor performance is that the American economy has been devoting too many resurces to consumption and to government, and not enough to the capital formation which makes growth possible.

Thus, there has been a slowing of the growth and capital per worker. The sharp rise in the labor force in recent years has not been matched by any corresponding speedup in the rate of capital formation.

To place the recent slowdown in capital formation per worker in perspective, in the 1950–55 period, the growth of capital per worker increased at the rate of 3.6 percent per year, and slowed in the decade thereafter. From 1965 to 1970, capital per worker increased at the rate of 2.6 percent per year.

In the 1970's there has been a sharp decline in the growth of capital per worker. The Congressional Budget Office estimates that it grew at the rate of about 1.6 percent per year between 1970 and 1975 and only 1 percent per year since 1975.

In fact, during the current business cycle expansion since early 1975, real gross nonresidential fixed capital formation has increased only slightly and has actually declined as a fraction of gross national product. This is hardly the basis for the economic growth and the expansion of opportunity which the Nation can and should achieve.

This slowing growth in capital per workers is the result of a number of public policy measures, which, by unduly penalizing saving and investment, have diverted resources that individuals would prefer to devote to capital formation and future consumption toward present consumption by households and by government. And one of the worst sets of policies, resulting in this wasteful distortion, is our Federal tax system.

The fundamental bias against capital formation in our tax system results from the multiple taxation of income which is saved and invested. Individuals must pay taxes on essentially all income they earn, whether they spend it immediately or save it. The same holds true for corporations and their profits.

This means that a dollar of current income is taxed only once when spent on consumer goods.

However, the same dollar of current income devoted to saving is subject to multiple taxation because taxes must also be paid on the interest, dividends, capital gains, and the like that result from saving and investing. The use of income for saving is thereby taxed at substantially higher rates than the use of income for consumption. People naturally respond by saving and investing less.

This distortion by multiple taxation is particularly great in the case of dividends, for the return on equity is also subject to an initial corporate profits tax of 48 percent. To be sure, so-called capital gains are taxed at lower rates than ordinary income, but this only moderates the distortion; it does not eliminate it.

The damage wrought by our Federal tax system has been aggravated by inflation which creates false business profits and false capital gains, and thereby increases the tax bias against saving and investment.

The combination of our present tax system plus inflation itself the result of poor public policy, mainly bad Federal Reserve monetary policy, results in a set of capital levies on both business and individual wealth and also puts individuals into higher income tax brackets when their real pre-tax incomes remain the same. These capital levies and higher tax rates are nowhere to be found in the tax code, and tacitly raising tax rates and imposing capital levies by inflation rather than by

explicit debate and legislation are not among the Congress' more forth right and honorable actions.

For yet another public policy that impairs saving and investment, I would call your attention to a recent study by Prof. Martin Feldstein of Harvard which indicates that the present social security system significantly reduces private saving. Professor Feldstein has reported that social security benefits lead employees to reduce the funds they set aside for their retirement almost dollar for dollar with any increase in social security benefits, thereby reducing the pool of private saving available to finance capital formation.

To sum up, the costs of Government continue to rise. It costs us more; we are enjoying it less. Few of us believe that we are getting our taxes' worth. By trying to level incomes, public policy has reduced the size of the pie without significantly altering its distribution. The tax system, heavily biased against saving and investment when there is no inflation, is made even more biased by inflation, itself the result of poor public policy.

The administration's budget promises more of the same, and the administration's welfare reform, if enacted into law, will result in fewer jobs and still greater welfare dependency.

Central to the solution of these problems is the size of the budget and the deficit. The staggering deficit of the Federal Government must be eliminated, primarily through expenditure control, partly to avoid having the deficit crowd out needed private capital formation.

We must also correct the longstanding bias in the Federal tax system against saving and investment. For full tax equality between the consumption and saving uses of after-tax income, savings should be deductible from the income tax base so that only consumption is taxed. Progressivity can be built into such a tax and I would favor a mild degree of progressivity with appropriate deduction for human capital outlays such as health care and education.

I would also favor an indexing arrangement to keep "real" tax rates intact. With the full deductibility of saving, taxes on corporate income and on capital gains can be eliminated. In addition, taxes such as the estate and gift taxes that yield little revenue and create much mischief can be reduced or eliminated.

A roughly equivalent alternative would be a value added tax with appropriate deductions for capital outlays.

For other desirable tax changes, I would urge the Congress to review the record and follow the examples of the Kennedy administration and of the Congress during the early 1960's, actions which set the stage for a surge of economic growth as well as for the elimination of inflation.

Then, the distortions of the tax system were moderated by effectively reducing the tax biases against saving and investment by means of a combination of policies that included more rapid depreciation and the investment credit as well as the reduction in both corporate and personal tax rates. The Kennedy tax cuts have been more than offset by inflation moving people and businesses into higher tax brackets. We would need tax cuts to get us back to the Kennedy tax rates.

Finally, I would recommend the rejection of the administration's welfare reform package.

Senator BYRD. Thank you very much.

These have been three most interesting presentations from outstanding economists. The committee also has, today, Mr. Albert E. Sindlinger.

You know, we in government frequently tend to be theoretical in our outlook on legislative matters. That may also be the case among economists. I find Mr. Sindlinger's profession a most interesting one because he comes in daily contact, and has been doing it for many years, with several hundred or more consumers each day.

Whatever we may do in government, as I see it, can be easily confounded by how the people themselves react to our actions. It is important that we know, as best we can, something of the thinking of the consumers, especially housewives, who make the bulk of the purchases. What do they think about what is going on in Washington? What do they think about this new tax program of the President? What do they think about the spending policies of the Federal Government?

Mr. Sindlinger, you are in a unique situation to give us information on this. We are delighted to have you, and you may proceed as you wish.

STATEMENT OF ALBERT E. SINDLINGER, CHAIRMAN OF THE BOARD, SINDLINGER & CO., MEDIA, PA.

Mr. SINDLINGER. Thank you for the opportunity of appearing here, Senator.

As you just stated, I am going to talk from the standpoint of my background of having conversations with people, 4½ million households, who have been interviewed over the last 25 years. Anticipating that we may not have a very big audience today, I had some special tabulations made to explain why when you talk budget costs in Washington, you almost have the feeling that you are talking to yourself.

From September 29 through January 25, we made 20,964 interviews, and 189 of these interviews were completed in the suburbs of the six counties of Greater Washington. Whenever my interviewers from Media get their sample selections to call, and when they know that the telefile that they are going to call is the suburbs of Washington, they always crack; now I am going to call in the land of milk, honey, and money.

To illustrate, on page 2 of my testimony, I have a tabulation of 20,964 interviews made in the last 16 weeks. To save time, you can read this and you can see how the consumers related their response to our four key questions on current income, expected household income, expected job security, and expected business conditions.

And then I skip to page 3 where I break that tabulation down into the 189 households interviewed in the six Washington suburbs, and they are listed here as Prince Georges, Montgomery, Arlington, Fairfax Counties, and the places of Alexandria and Falls Church. In those six counties, consumer confidence over the last 16 weeks averaged 78.3 percent. That was because 81 percent of the people had an increase in income, 69 percent expected increased income in the next 6 months, 62 percent expected more jobs, and 71 percent roughly expected better business conditions in the next 6 months.

Now, those six counties that I am referring to represent 0.9 percent of the total households in the United States, which means that there are 99.1 percent of the households not living in the land of milk, honey, and money; and you see over in the righthand column that their confidence is 54.1 percent during the last 16 months.

Twenty-nine percent had an income up, and almost the same number had their income down. Only 30 percent expected gains in income, only 31 percent nationally expect more jobs, and 30 percent expect better business conditions.

So this makes the area in which we are talking—this excludes, by the way, the District of Columbia, because the District of Columbia is like the United States and very much unlike the suburbs.

This table, I think it is important, because everytime I come to Washington, I have been coming here for many, many years, and in recent years I always feel that when I enter the city I need a visa or to show my passport going in and out of this city because it is so unlike the world that I talk to every day.

In order to keep my remarks brief, I have provided some exhibits. Quickly, the first exhibit is to set the mood. The second exhibit, B, is to illustrate the cause of the error of the Federal Reserve Board in making its third annual strikeout in interest rates during 1977; and if we have time, I have exhibit C, to show where our money is and was; and in D, I illustrate the velocity of our money measures and also show the velocity of our money in the last 12 months. And F is a concept of ours where we convert the money that is in the United States to a per household basis.

In G, I point out how ridiculous our labor market figures are. And when we talk about, as was just mentioned a minute ago, that the unemployment rate has been dropped from 9 percent to 6.4 percent, I want to remind the committee that this is a seasonal adjustment decline, and it is very nice to be able to move people around, seasonably adjusted: and when we talk about the 4 million people that the economy has absorbed as new employed people, I would like to remind the committee and Congress that this is not because the economy is so good. This is because people need extra jobs. The second and third member of a household has to go to work to be able to pay all their bills. This is the reason for the increase in the labor market, and it is not because the economy is absorbing more jobs. I would like to get that point cleared up.

If all of the U.S. households—and I think, if we had time, I could document that—if the 70,800,000 U.S. households operated their fiscal and monetary policy the way our Government operates its policy, we would all be broke and bankrupt. And, if all U.S. households and corporations were to keep their books on a seasonably adjusted basis, as the Government operates, and if all income tax returns were to be filed on a seasonably adjusted basis—and why not—like the Federal Government fixes its monetary policy, if we filed seasonably adjusted income taxes, the IRS would have us all in jail. Then who would pay the bills?

In the press release announcing this hearing, Senator Byrd, it is noted that we are talking about a $752 billion national debt ceiling now, and it is going to be more, with over 70 million households. to save time, I would like to remind the committee that this national debt

represents $10,607.54 per household. That is how much the American households owe, and according to a very extensive study that I now have in the field, few people know that they have this national debt on top of the other debts that they do know about, like taking their bank savings and moving it into their checking accounts to pay for oil and the Federal Reserve Board reading this as an explosion in the money supply and raising interest rates because people are raiding their bank savings to pay for oil.

It is even worse for people who live with the credo that you cannot spend more than you make, to have a debt of that magnitude that most people do not even know that exists.

Senator, you have visited my operation and you have heard people talk, and the key thing that comes through in all of our interviewing in recent years is that people say you cannot spend more than you make. So that, without consent and approval, the U.S. households of this country are shouldering an extra $10,000 in debt that most people do not even know they have.

This should not be kept a secret for much longer. It should be ceaselessly publicized and dramatized, to show the people what the Government is really costing them.

We use a great deal of television time to promote the image of the President of the United States. I would think that we ought to use a little television time to promote how much the national debt is and let people realize that they owe—each household over $10,000 at the present time.

Speaking of publicizing, as I was writing this, I observed a television commercial that came to my mind and it was urging people to buy Government savings bonds, as if savings bonds were war bonds, and the commercial suggested that it is a patriotic duty to buy these savings bonds.

A horrible thought ran through my mind yesterday when I saw this, because if some individual company were promoting the sale of savings bonds rather than the Government, would not the FTC come down hard on these commercials as false advertising? Think about it. What will those patriotically bought savings bonds be worth when they mature?

Mr. Chairman, you, better than any other member of this committee know what I am talking about when I refer to people. You and I fully know well that Congress had better not underestimate the ability of the people to handle their own money and, I would like to add, in view of this deficit, to handle their own votes.

Obviously, no one expects these households to come up with this kind of cash to pay this debt, because they do not have it, but once the issue is brought to people's minds, as in a special study that I am now conducting, I can tell you that there will be a new atmosphere and there will be more people attending a hearing like this, if it were not held in Washington.

Once an issue confined to the backburner of public opinion, the Federal deficit, now it has become the hottest topic in the country. We are speaking of the Federal deficit. It has become a hot topic because of what happened not so long ago with the President's recent state of the Union message.

If you are interested, I have some tabulations on how many people watched the program and what their opinions of the state of the Union are. I have made some tabulations here of the question—on page 7, I am referring to now—where we asked, and we have asked this question for the last 22 years—what would you say right now is the No. 1 problem that faces this entire country, that you yourself are most concerned about?

And in reference to this question and the tabulations shown on page 7, I would like to add that when most people are asked this question, they will give multiple responses. They will combine unemployment or inflation or two or three other things, but for this particular question, whenever a respondent gives a multiple disclosure or multiple choice, we ask him, would you please give me your considered No. 1 problem, so that the tabulations come out nearly to 100 percent.

Without taking time here, you can see that suddenly where 3 percent of the Nation last year, when President Ford gave his state of the Union message, only 3 percent of the Nation were concerned about the budget deficit. That figure has now shot up to almost 1 in 5.

During the 1960's until recently, most people cared very little about the deficit because they thought—and, I would add, I think they were educated to think—that somebody else was going to pay the bill and that the deficit is good to make the economy grow. Now, deficit is a dirty word among growing numbers of people from all walks of life and all shades of opinion, all economic strata, who regard the deficit as the primary cause of the Nation's economic dilemma.

In fact, in those tabulations that I showed you, people are now shifting to the deficit in preference to inflation, because they consider the deficit as a major cause of inflation. This was not true 2, 3, and not even thought of 4, 5 or more years ago.

Instead of just expressing concern over the general issue of inflation and unemployment and economic weakness, the people have shifted their focus to hone in on a number of these problems, and until the deficit is reduced or eliminated as people tell us, there can be no lasting cure for inflation or economic stagnation, based upon this special study I am referring to.

Government spending through the deficit is viewed as a keystone of inflation. The need to borrow funds to finance deficit—and people further acknowledge that this keeps interest rates high and a big deficit is regarded as a barrier to the meaningful reduction of burdens from taxes.

Perhaps the biggest monkey conceived by the consumers is the fact that when the Government needs such massive amounts of money to operate, it deprives the economic mainstream of needed funds from the private sector.

I would also like to suggest—I have a booklet here that I have brought along. I was not going to pass it out, but I would like you, Senator, to include this in the record because this is an article written by Dr. Richenbach in West Germany that explains why West Germany is not going to have capital formation and explains why we are not going to have capital formation in this country.

On page 9, I showed some of our confidence parameters. I will save time, because I want some time for some questioning, and you will no-

tice in recent years, as you look at these charts, we have had a very, very fast yo-yoing of confidence in recent years. Up and down, up and down.

Going to page 12, and I want to talk about one of the problems that we have in common, our money supply problem. We are talking about the growth of the money supply. We are talking about how fast the money supply is growing.

If you reduce the money supply to a per-household basis, you will find that most of the money supply growth per household is just about even with the rate of inflation.

The Federal Reserve Board read their figures in error and I would like to refer to exhibit B here, which shows a chart. This chart shows that the Federal Reserve Board, in misreading their seasonally adjusted figures found, in April M-1 was growing at 21.2 percent, then it fell back, then it jumped back again to 19.9 percent and then it fell back and then it jumped up to 12.7 percent in October and fell back, and these were the periods of time when the Federal Reserve Board raised interest rates to cool off what they thought was an explosion in money.

If you look at the chart on the right, which is the Federal Reserve Board's not adjusted figures showing the growth of M-1 month by month, year to year, there was no explosion of money, it was growing under the target rate and here is an example, the seasonal adjustment being misread and having the Federal Reserve Board, for the third straight year, falsely raise interest rates to kill the recovery of 1977 as it was killed in 1976 and as it was killed in 1975, for the same reason.

These false rises in the interest rate over the seasonal adjustment explosion of money, which is only seasonally adjusted, is incompetent. The point is that these improper data and mistakes are leading to implementations of Government policies that hurt people. Before we can make any move toward cleaning up our problems, the Government has got to get its books in order. We have got to stop running our books on a seasonally adjusted basis.

If a business or an individual were to presently seasonally adjust their records to the Internal Revenue Service, and if we all filed seasonally adjusted income taxes we would all be in jail. In fact, I tried a little experiment with my wife, Nellie. I gave her a formula to seasonally adjust our income taxes over the last 5 years, and I am going to try this year to file my taxes in two forms: I am going to file my real taxes and I am going to file a seasonally adjusted tax return and we will see what the IRS does with which return that they want to take, because the Government operates all of its data, all of its books, on a seasonally adjusted basis. Why can I not seasonally adjust my income taxes.

To save time, I came down here, Senator, because I am very worried. I am not as optimistic as the people who live in Washington.

If you recall, Senator, we had a lot of conversations with a lot of people in July of 1974 when we saw this recession coming. When I come to Washington, and when I talk to people in Washington and I talk about the stock market, I am constantly told, as late as yesterday on the telephone, that the stock market is wrong.

On a 4-week moving average, the stock market is the most accurate forecaster of the Nation's economy that exists over the last past two decades. It is an economic barometer that responds to the confidence of people and that is why we have successfully forecast the stock market over the last 20 years.

As I say, I am shocked and dismayed by so many high officials in and out of government who say to me that the stock market is wrong. Given its past record of accuracy, it is, to our way of thinking, incumbent upon them to look at the facts, and particularly, Congress had better start paying some attention to the stock market.

The stock market is saying that the Nation's economy is heading toward a recession and this cannot be arbitrarily dismissed. In a real sense, the low levels and the downward directions of the stock market are involving everything we have touched on today. It is being depressed by the low state of confidence, which, in turn, is resulting from the monetary shortfall bothering the Nation's consumer.

With the limitations on time, to conclude, I place so much emphasis, almost total emphasis, upon the stock market and I would like to discuss this Report No. 29, if we have some time. I use the Standard & Poor 400 Index as a measure of the stock market.

The stock market, as measured by the S. & P. 400 index, is the only accurate figure on the 4-week moving average that exists, that is real. The stock market is not revised over and over, it is not seasonally adjusted and it cannot be fixed up by people, or manipulated, on a 4-week moving average. It can be fixed up, manipulated, for maybe 1 day, 2 days, or maybe a week, but the stock market cannot be manipulated on a 4-week moving average.

Every other Government figure is constantly revised. They are seasonally adjusted, which is a fixup process to cover up the errors in the raw data. That is why these seasonally adjusted figures are so popular, because those who create them can use the seasonally adjusted to revise and cover up their mistakes.

We think, and we make fiscal and monetary policy on the basis, that we have an official inflation rate of 6 to 7 percent. We have discussed this before, Senator. My data for the past 2 years say that the inflation rate for the things that people are buying is now, and has been, over 11 percent for the last 2 years.

The reason that the official inflation rate is 6 to 7 percent is because it is measured on the things that people stopped buying. If I recall, Mr. Chairman, you were able to get a confirmation of this statement of mine that the inflation rate is 11 percent in some testimony that you obtained last year. I think it was from one of the members of the Council of Economic Advisers.

Next month, the BLS is supposed to issue a new CPI, Consumer Price Index, which has already cost $48 million to create and it was due to be released in April 1977 but was postponed because of so-called computer problems. It seems to me in a year they could have solved the computer problem and if NASA can get a man on the Moon, I would think that somebody could come on over and fix up the computer problem the BLS had.

Senator BYRD. If we could, let's get to some questions, because I think you have brought out some most interesting points and I must

say I remember so well in 1974, I guess it was the summer of 1974, when you predicted with such accuracy what was going to happen to the stock market in the next 6 to 8 months, as I recall. It could have been 1973.

Mr. SINDLINGER. We predicated a 20-percent decline. I was wrong; it was 21.

Senator BYRD. I have always thought that Government finance is such a dry subject; there is no political sex appeal to it, and I do not see how it is today, but from what you say in your interviewing, if I understood you correctly, that you find that nearly one person out of five, somewhere between 18 and 20 percent, appear greatly concerned about Government deficits. Is that right?

Mr. SINDLINGER. That is what has all come about since the state of the Union.

Senator BYRD. In other words, your polling shows that, 5 years ago, or 2 or 3 years ago, there was not great concern about deficit financing and the Government's financial position. However, today you have found the people becoming increasingly concerned about this issue.

Mr. SINDLINGER. The President's problem is, in the last state of the Union, he reviewed very clearly and put much emphasis on the deficit. Also, the press, which has become a powerful force in recent years, in the immediate 2 or 3 days after the state of the Union concentrated on the deficit, and concentrated on the fact that the President had promised a reduction in expenses and now was raising the deficit.

This has shocked people and, I guarantee you, Senator, if this hearing were held anyplace other than Washington, this room would be crowded.

Senator BYRD. May I ask other members of the panel what do you see as the current inflation rate and what do envision the inflation will be at the end of this calendar year?

Mr. ECKSTEIN. Senator, since I am a forecaster I will take on that question.

The inflation rate for the year 1978, as measured by the Consumer Price Index, is estimated by us to be 5.6 percent, which is an improvement on the 1977 rate of 6.5 percent. There are some differences in the computation of inflation. New house prices are rising very rapidly, 13 to 14 percent. Food prices have acted with exceptional moderation recently.

At the end of this year, we are looking for an inflation rate of 5.4 percent. That is the rate that will be occurring during the final months of 1978.

The reasons for that forecast are very simple. There is 1 percent from energy inflation, as we move our domestic energy prices to world prices. The unit labor cost factor will be advancing at a 5 to 6 percent rate because wages will be going up 8 percent and only 2 percent of that will be offset by productivity. We do not look for serious demand inflation.

Utilization rates of industry are 83 percent, which are at least 4 to 8 points below the point where demand inflation can be said to exist.

Unemployment is still high and we do feel, as Dr. Penner also emphasized in his statement, that in fact, there has been a rate of improvement on inflation. We got new figures yesterday on the rate

of increase of the highly visible large wage negotiations and they also showed a deceleration of a fraction of a point.

But we recognize that there is a range of error in these kinds of forecasts. The average error, if you look back 8 to 10 years is about 1 percent.

Senator BYRD. The forecast usually has been on the low side, I assume.

Mr. ECKSTEIN. Before 1974, on the low side. Since then, our errors have been, very refreshingly, on the high side.

Mr. SINDLINGER. What do you think the new CPI inflation rate is going to be when it is produced next month?

Mr. ECKSTEIN. I would be astonished, given the importance of the CPI and the wage contracts of some 8 to 10 million Americans, that the rate of inflation of the new index would be very different from the old index. If it would be different, it would not be acceptable.

Mr. SINDLINGER. Is that because they would fix it?

Mr. ECKSTEIN. The Consumer Price Index is a very elaborate undertaking. They price out thousands of items in thousands of stores and the next index will give a little bit different weight to the pieces that they are pricing. Perhaps they will update a little bit what they are pricing.

The inflation rate is really around 6 percent, outside of the housing area where it is higher.

Senator BYRD. One very able American made this comment last week. Inflation is still the biggest problem of the free world.

We have all found how easy it is to step on the accelerator, but we have not learned that we must also apply the brakes. All nations of the Western World have been moving their economies too fast. I know you are very unpopular when you say that, but it is true. Inflation is the enemy of growth, and you cannot have higher levels of employment unless you control inflation. This view is held by William McChesey Martin, former chairman of the Federal Reserve Board.

I am wondering whether the panel generally concurs that inflation is the enemy of growth, and is the biggest problem in the free world?

Mr. PENNER. I would think, sir, I would certainly generally agree with that remark. As I suggested in my testimony, the problem we face, I think, is uncertainty in the future. I think that tends to make businessmen and consumers demand, in the economist's jargon, much more of a risk premium before they decide to invest in something then if they could be confident that inflation would be more stable or declining.

In other words, they demand a much higher rate of return and it is partially responsible for the relatively low levels of investment we have, given the state of our recovery.

Senator BYRD. I am wondering whether the majority of those 70 million households Mr. Sindlinger has been talking about, see the picture a little more clearly than most of us in Washington see this picture, particularly as it regards inflation.

Mr. SINDLINGER. If I may interrupt here, the figure of under 6 percent was just mentioned as an inflation rate. In the President's speech, the state of the Union, he used a 6.9 percent inflation rate and the people I interviewed say, what store does he go to? And the figure was 6.9 percent.

Senator BYRD. Whatever the inflation rate might be, it is very high.

Mr. SINDLINGER. It is perceived to be much higher. Anytime anyone mentions an inflation rate figure of 6 percent, I understand what the figure is, as well as everybody else does, what the public says, what store do they go to?

Senator BYRD. My question is, how can the individual citizen protect himself or herself against inflation?

Mr. MEISELMAN. Unfortunately, there is no way. If we all tried to go into debt, which is the popular way, it means in the process we give up interest rates, and interest rates reflect what people anticipate the future inflation rates are going to be.

There is no way that the people can protect themselves against inflation in any systematic and dependable way, if only because we all have to have a certain amount of money and our money loses value through inflation.

The gains and the losses out of this process are very capricious and haphazard. They do not bear any relationship to what we think of as fair. It has nothing to do with a set of incentives to be efficient or to cooperate, and that is one of the reasons that inflation leads, not only to inefficiency, but also leads to a breakdown of political and social order.

We can chisel our way through for a couple of years, but the cumulative effects are immense and, at the same time, I do not really see that there is enough will to stop it. The basic tool for stopping it is to slow down in the rate of growth in the money supply.

At the present rates of monetary expansion, or even at the rates of the last couple of years, we will have a current rate of inflation. There is no way we can slow down inflation until the money growth is slowed down, and on the basis of recent behavioral norms, it would mean for M-1 that we would have to get the rate of growth for M-1 down to something like 1 percent per year, for M-2 something like 3 or 4 percent per year.

Mr. SINDLINGER. May I ask a question? How is the Federal Reserve Board going to get M-1 down?

Mr. MEISELMAN. They stop the printing press. That is easy.

Mr. SINDLINGER. Fiscal policy dictates that the printing press be run.

Mr. MEISELMAN. The fiscal policy does not dictate that the Federal Reserve—the sense of the law is that monetary policy be divorced from fiscal policy so the Treasury cannot sell obligations to the Federal Reserve.

Mr. SINDLINGER. When Congress spends money it does not have and we have a deficit, somebody has to print the money.

Mr. MEISELMAN. Somebody has to lend the money to the Federal Government.

Senator BYRD. I think Dr. Eckstein got to the heart of the problem—and it was also mentioned by Dr. Penner—when Dr. Eckstein said that the weakness of modern fiscal policy has always been that it removes the discipline of the balanced budget.

This is the great problem that we face today. We, in Congress, have no discipline. There is no means of disciplining the 535 Members of the Congress when it comes to fiscal policy. It is so easy. It is a bonanza the way it is now.

The Congress says, do not worry about the deficit, do not worry about the debt. The way to get along is just to go ahead and spend, add it to the deficit, add it to the debt. There is no disciplinary process asking them for a balanced budget that I can see.

Mr. SINDLINGER. Senator, may I ask that we all look at this forecast in this report No. 29, which shows what Congress, I think, can understand, and that is the stock market, and I just said it is the only accurate figure we have.

The stock market has been declining in 1977, week by week, almost precisely as we have been forecasting it should. Whenever the stock market, the S. & P. 400 index, has been below 100 in the last two decades we have had a recession right behind it.

The stock market for the first 3 weeks of 1978 has averaged, each week, below 100. I am trying to make this forecast wrong. This forecast shows a collapse of the stock market all through 1978 with a crash of 1979 coming early in 1979.

Each week the turnaround for 1979 gets weaker. The reason the stock market is falling is that the stock market fears inflation, and not the rates we are talking about. The stock market sees what is happening to the dollar versus the yen versus the mark, and this all goes back to deficit spending.

The public, I am trying to tell you, is beginning to perceive that our problem is deficit spending. This is our problem.

Senator BYRD. If that is the case—and I hope that that is the case—it is a very healthy development.

Mr. SINDLINGER. I would like to add something that I observed only yesterday. As I said, I am doing a very extensive study, and the greatest error and the reason for the stock market decline and the reason for the confidence decline of 1977 following April 14th is the administration's energy bill, which was immediately perceived when it was announced, as a tax bill. And I think that the record should note that the National Association for the Advancement of Colored People, in a new report just issued, is condemning the energy bill and the arguments are in the study, that the NAACP calls for the deregulation of oil and gas prices with more emphasis on the development of other sources of energy.

I think it is significant that this liberal organization is almost identical to that of the conservative oil industry. If we are going to turn the stock market around, that problem has to be solved.

Senator BYRD. Let me ask the members of the panel at this point as to whether they agree with Mr. Sindlinger's prediction in regard to further substantial declines in the stock market?

Mr. ECKSTEIN. Senator, I do not believe that there is any way on Earth to predict the future path of the stock market so I have studiously avoided forecasting it in my long career as a forecaster.

I do believe, however, that the general tenor of the remarks of this panel are coming out more negative than is justified by the reality.

If you look at other confidence indexes that are released by the University of Michigan Conference Board, they do not show in the collapse of confidence. The Michigan index has retreated from 87 to 83 percent, but in previous periods of a demoralized public, in 1974 and 1975, that index stood at 58 percent.

I think that the actual behavior of the public in the marketplace, or even the behavior of business in the marketplace is far more positive than the behavior of the stock market. Retail sales have been extremely strong until a couple of week ago. I would even take exception that our problem is due to the deficit. The deficit is a part of the problem, but it is a far more complicated process.

The United States did develop some serious economic difficulties out of the Vietnam war, out of the food crisis, and out of OPEC and out of occasionally disastrous monetary policy which did create the great recession of 1974 and 1975. If you look at the actual record of performance of American families in the marketplace and American business, what you see is a remarkable recovery in confidence, in activity and employment, and profits, output—any measure that you wish, a far better recovery than any other advanced country has shown.

The Government deficit should be reduced, and, as I mentioned at length in my testimony, I think to keep the deficit at $60 billion year after year is probably more than is justified and indeed, it is partly caused by a monetary policy that runs in the opposite direction.

Senator BYRD. May I mention at this point, when you mention the $60 billion deficit, and others have mentioned that figure also, that is correct on a unified budget basis, but I have always felt that a more significant figure is not the unified deficit budget figure but the Federal funds deficit, which covers the general operations of Government.

If you take the Government operations, it will be $75 billion. The only reason it gets to $60 billion is that we are running a surplus in the trust funds, in the highway funds and so forth. This is the only way the deficit gets down to $60 billion. For the general operations, it is $74 billion.

Now, it is significant, too, I think, and it ties in with this Federal fund figure, that the administration forecasts on an increase in the national debt for this 1 year, fiscal 1979 compared to fiscal 1978, of $88 billion. An additional $14 billion comes from the off-budget items.

But, if you take, to get back to the national debt itself, in 1972, at the end of that fiscal year, the national debt was $437 billion.

Now, the administration projects that at the end of 1979 it will be $874 billion, precisely double, right down to the dollar, what it was in 1972.

It seems to me that our problem is that the accelerated and accumulated deficits—I admit a great country like this could possibly run deficits for a reasonable length of time and in some reasonable amount—have gotten to a point now, which is totally out of line with what could in any way be considered reasonable. The accumulation of deficit must be what the people to whom Mr. Sindlinger talks—the people in Detroit and Vermont and Florida and Texas and New York—are perceiving as getting worse. It is certainly not getting better.

Mr. SINDLINGER. A comment was made about the University of Michigan and I will send you a report next week to show that the University of Michigan is very accurate in measuring what the stock market does. It has been a ve.y accurate in following the stock market.

If this forecast comes true that I am forecasting—and I have been doing this for many years and I have a lot of clients that pay me much

for this forecast because it has been very accurate—the University of Michigan survey, by the end of 1978, will be at its all-time low.

We cannot continue, based on the things that I am measuring from the people that we are talking to, we cannot continue this economy until we get our house in order.

Senator BYRD. Dr. Meiselman, I believe, mentioned double taxation of dividends.

Mr. MEISELMAN. Not just dividends. A multiple taxation of income devoted to savings in capital formation relative to consumption.

Senator BYRD. Mr. Carter, as a candidate for President, took a very strong position in opposition to the double taxation of dividends, but I note that that, apparently, has been dropped by the wayside. It is not a part of his present tax program.

Does the panel have a particular view, with regard to the double taxation of dividends. Would it be a desirable so-called reform of the tax laws, to eliminate the double taxation of dividends?

Mr. MEISELMAN. I think you have to put it in a larger context, not that one element taken by itself, and I have tried to put it in a larger context, which is in terms of eliminating or moderating the present bias in the tax system against saving and investment, and there are several devices for doing that, and I think that it would be better to talk about the relationship between that one thing and other measures than removing the taxation of dividends by themselves.

I am delighted that the administration dropped an item which seemed to be high on its agenda during the summer which was essentially to remove the differential rate for the taxation of capital gains. My idea of the tax system, capital gains would not be subject to any tax at all.

Senator BYRD. My guess is the reason that the administration changed on that issue is because it found very little support in the Congress for taxing capital gains as ordinary income. I was surprised myself at the lack of support in the Congress for the elimination of that special treatment on capital gains.

I had assumed that is the administration had recommended it, and certainly it indicated it was going to recommend it, that it would pass. But I have found that my Democratic colleagues who I thought would have supported such a proposal were very much opposed to it because they have been hearing from the public back home. The public sees the difference that many around Washington do not seem to see, that there is a difference between taxing income and taxing the sale of a capital asset.

I personally think that the Congress was mistaken in increasing the capital gains tax in 1969.

Mr. MEISELMAN. I would hope that the Congress would be able to move toward indexing the tax code; as I mentioned in my testimony, and as Dr. Penner mentioned, the effect of the inflation has been to increase our tax rates substantially and that is one of the most serious side effects of inflation.

Mr. ECKSTEIN. Senator, I thought we missed the opportunity of a generation when we let the President's tax proposal of last September disappear without a trace. The income from capital would have been reduced very substantially by those proposals. The tax system would

23-544 O—78——3

have been a much better one thereafter, because we would rely on the open capital market and rely less on the retention of earnings of large corporations.

My own amateur political analysis of what happened is that the financial community was so frightened of the one major element of tax increase, which was the increase in capital gains taxation, that they preferred what they have, which they understand, to a very dramatic improvement in the tax system which they would have been the major beneficiaries of.

Whether it is possible to go back to this matter at this time, I do not know.

Senator BYRD. You are talking now of a tradeoff?

Mr. ECKSTEIN. There was a tradeoff. There was a tightening of capital gains, a loosening of taxation of dividends and also a 50 percent ceiling on all income, including income from dividends and interest.

We analyzed that with our models in some detail and did some studies on the impact on different groups and so on and it would indeed—the President's proposal would have been a substantial improvement of the taxation of income from property.

Senator BYRD. Would you advocate changing the capital gains tax without having some other corresponding reduction in the tax on capital?

Mr. ECKSTEIN. The President's new proposals do tighten up on capital gains once more, and my own belief is that one reason the stock market has acted so badly over 15 years is that we have steadily deteriorated the taxation of income through the market, from capital obtained in the marketplace, and steadily reduced the burden of taxation on income from capital that stays within the corporation.

We have bet on retained earnings and penalized more and more the taxation of earnings of the private family that it can get from property it holds through the marketplace.

The new proposals do it once more through the provisions of the minimum income tax and the application of the 25-percent ceiling on capital gains, which to me is just back to the post-war tax policy that began with President Eisenhower in 1954.

Senator BYRD. Let me see if I understand it. You think that it would be unwise to eliminate the 25-percent ceiling on capital gains?

Mr. ECKSTEIN. Yes; I believe it is going the wrong direction. We should be more generous with capital that is allocated through the marketplace and less generous with capital that just stays within the business.

Mr. PENNER. I would like to make a narrow comment on the problem of the double taxation of dividends. I think that economists generally would agree that the corporate tax is a very bad tax and various commissions and committees have made proposals for fully integrating it with the personal income tax.

I think, however, that the lawyers generally oppose economists on that because they feel that complete integration would be very hard to administer. As a concession to the lawyers, the kind of proposals that the administration was talking about were very, very partial eliminations of the double taxation of dividends. Such approaches would affect different firms very differently and, I think, would also generate a lot of uncertainty in capital markets.

So I would conclude that instead of adopting the particular proposals that were in the September package, we should try to solve the administrative problems related to a complete integration of the two taxes. Then you could eliminate the double taxation of dividends and the double taxation of reinvested profits as well.

Senator BYRD. Personally, I would like to see the elimination of double taxation of dividends. I think it would be a good thing for the country.

I have found, in holding hearings on it some months ago, that the business community itself cannot agree on just how that should be done. Until the business community can reach some sort of agreement or consensus it would be rather difficult, I suppose, to get it accomplished. However, I would like to see it tried.

In regard to the President's tax reduction, which I think all of you have mentioned, the median income in my own State of Virginia is about $14,500. As I understand the President's tax proposal, when you get much above that median figure—I am speaking now of a family of four—those who are above it do not receive any significant tax reduction, and as I understand the figures, and many get an increase.

Mr. PENNER. Senator, I do not know the Virginia data, but for the country as a whole, it has to be remembered that the median income for a family of four is considerably above the median for all families, because by the time a family has two children they have worked their way up the income scale.

Mr. SINDLINGER. And the wife is working.

Mr. PENNER. I think nationwide the median income for a family of four will be close to the $20,000.

Mr. SINDLINGER. It is about $19,000.

Mr. PENNER. Over $20,000 by 1979. That kind of a family would certainly have a tax increase.

Senator BYRD. Let me see if I interpret the figures right. That would mean that 50 percent or more of the families would have a tax increase?

Mr. PENNER. I certainly think so, looking at levels of income with the same purchasing power in 1977 and 1979.

Mr. SINDLINGER. I think you will find, because the upper incomes have fewer exemptions than the lower incomes, I think you will find the way I have calculated it, that about 92 percent of the people above the median would have a tax increase or 62 percent of all taxpayers.

Senator BYRD. I am not sure that that is generally realized by the taxpayers. The impression coming from television and political speeches is that almost everyone, except a very small group at the top, will have a tax reduction. I do not read the figures that way.

Mr. SINDLINGER. What I am trying to say, my interviewing since the State of the Union shows that almost everybody above $18,000 has already figured out that they will pay more taxes rather than less.

Mr. PENNER. Even my numbers do not tell the whole story. As I said in the text—but did not mention in my summary—to the extent that the people are in the higher income category or above $22,900 because they have more than one worker in the family, the situation is even worse because the social security tax base increases will hit them more heavily, than in my example where I assumed one worker per family. My conclusion is that far more than half of the population will end up paying more taxes. Of course, it has to be pointed

out that, at most income levels, they would be even worse off were it not for the President's income tax cut proposal.

Senator BYRD. Dr. Meiselman?

Mr. MEISELMAN. My hunch is that there are large numbers of people in the upper half of the income distribution who are very disturbed about the huge increases in social security taxes, especially even though it is very difficult and sometimes impossible to find out the relationship between the social security taxes you pay and the so-called benefits you get down the road, it is becoming much clearer to people, especially in the upper income groups or the upper half that for every dollar they put in, they get a few pennies back.

That is being viewed—my hunch would be, I have not spoken to very many people about this—that massive increases in social security taxes is disturbing a large number of people. I know that it disturbs me.

Senator BYRD. I assume that most of you would agree with the general figure given by Mr. Sindlinger. He said 62 percent of the taxpayers will have an actual increase under this proposal.

Mr. ECKSTEIN. The meaning of that phrase, if you include the social security tax increases. The tax bill itself is a reduction for most people, even in the upper income brackets. It is a decrease even for those who do not avail themselves of tax shelter.

We all know social security had to be put on a foundation of an $8 to $12 billion tax increase. It was absolutely necessary to assure the American people that their pensions were secure.

The actual social security bill that was passed by this Congress, wisely, last fall is one in which the benefits do improve very substantially in the upper-middle income brackets. The Congress rejected the proposal of the President to split the employee-employer tax and did raise both symmetrically, and that again, increases the entitlement to the benefit.

The social security system, except for the double escalation which had to be removed, will do a better job for the American people because of these tax increases. The question is, if you take the composite tax package, the social security increases, some include the energy increases and these cuts, what happens to the tax burden of the ordinary people?

I think the fact is that the bill that this administration presented is one where the largest part of the benefit goes to the bottom half of the American people.

In the context of the coming welfare reform and other things, I am not sure to let the poor people of this country out of the tax system is not such a bad idea.

We used to believe that we wanted, for the sake of tax consciousness, for everybody to pay income taxes. This really does represent a change that was begun under President Nixon that we want to let the poor out of the personal income tax.

That is really what this bill does. It gets another several million out of the tax system altogether.

Mr. PENNER. If I could comment on social security, I guess I am not as optimistic about that as Dr. Eckstein. The actual rate of return that people will earn because they pay the tax on an increased base is very, very small. It is much smaller, given the indexing system

adopted by the Congress, than they could earn in a private pension fund in the future.

I personally think that we missed a great opportunity to slow down the rate of the growth of the burden of social security when the Congress chose to index future social security benefits to wage levels in the economy rather than to follow the prescription of a panel of experts that was appointed by the Congress, and which recommended price indexing. Under this proposal, benefits grow more slowly than wages, but only to the extent that the economy becomes richer in real terms. With that kind of proposal in effect, we could have avoided a very large part of the tax increase that the Congress felt it necessary to adopt.

Senator BYRD. The social security program is so important to so many people that Congress had to take a positive step toward insuring its continuing solvency.

Mr. Sindlinger?

Mr. SINDLINGER. I would like to add that one of the major reasons that this new idea from the public about the deficit came up between the first and the end of January, was that most people got their first 1978 check in the middle of January and saw what happened to their check in social security taxes. This is what drove it home to them.

Senator BYRD. When you mentioned your 62-percent figure awhile ago——

Mr. SINDLINGER. Sixty-two percent of those who pay taxes would be paying more taxes.

Mr. PENNER. I assume that does not take into account the effects of inflation?

Senator BYRD. That does not take the effects of inflation?

Mr. SINDLINGER. The effects of inflation, no.

Senator BYRD. Does it take into consideration the social security?

Mr. SINDLINGER. Yes; combined. This is what I am measuring, this is what people are sensing.

Senator BYRD. I think that this has been a very interesting and stimulating discussion today and I want to, on behalf of the committee, thank each one of you for taking the time and making the effort to join us, and I think it has been tremendously helpful and I am grateful for each of you being here.

[The prepared statements and attachments of the preceding panel follow:]

HEARINGS ON PUBLIC DEBT AND BUDGET—STATEMENT TO SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT, COMMITTEE ON FINANCE, U.S. SENATE, JANUARY 30, 1978

My name is David Meiselman. I am a Professor of Economics at Virginia Polytechnic Institute and State University where I am also Director of its Northern Virginia Graduate Program in Economics.

A week ago the President sent his half-trillion dollar budget for Fiscal Year 1979 to the Congress, and it is most appropriate that the Subcommittee on Taxation and Debt Management of the Senate Finance Committee is holding hearings on Public Debt and the Budget at this time. I am honored and pleased to participate in these hearings, and I wish to think the Subcommittee for this opportunity to present my views.

Three Presidential documents, The State of the Union Message, The Budget and The Economic Report of the President, addressed to the Congress and to the nation in the last ten days of January, set the stage for public discussion and Congressional action in some of the main areas of economic policy. Perhaps

at no time of the year is more attention paid to the broad problems and potentials of fiscal policy and the public debt. Accordingly, I shall attempt to present several considerations which may help the Subcommittee evaluate the effects of some of the main tools and aggregates of fiscal policy.

As a first approximation, the cost of government is measured by the resources used in the public sector, not by the taxes we pay. When labor and capital and raw materials are used in the public sector, they are obviously not available for use in the private sector. Private sector output and employment are thereby lower than they would otherwise be. Doing without the private sector output covering everything from food to houses is the cost of government and public sector output, and the cost associated with the benefits of public sector activities. This cost exists independently of the means that are used to finance government expenditures, whether taxes are high enough—or low enough, to balance the budget, or whether there is a budget deficit financed either by selling bonds to the public or by having the bonds purchased by the Federal Reserve with newly created—some would say, newly printed, money.

This is why any significant reduction in the costs of government requires a corresponding reduction of government expenditures. This is also why tax reduction without without expenditure reduction may give the appearance of a reduction in the costs of government to some taxpayers, but this is largely an illusion. The deficit must be financed, and the interest on the public debt must be paid out of future taxes. True, the tax may be deferred to a later date, but the future tax bill will have to be higher because of the interest on the public debt.

I may add that I see no important difference here between future dollars used to pay obligations represented by outstanding Treasury securities, now in the neighborhood of 750 billion dollars, and other legal and "moral" unfunded obligations of the Federal Government to pay future dollars for such items as social security, military and civil service pensions, and the like. To be sure, these unfunded obligations are subject to modification in the future, just as the real value of Treasury securities are subject to modification by future inflation. In any event, it would appear that current and unfunded obligations are many times greater than the staggering but more precisely measured funded federal debt.

For the moment, holding aside questions about the relative efficiency of resources used in the private sector versus those used in the public sector and the associated relative returns, each method of financing government expenditures has a bearing on overall efficiency, both in terms of facilitating a shift of resources from private to public sector use and also in terms of the efficient use of the remaining resources available to the private sector.

Every method of financing government alters relative prices and changes the context in which private decisions are made. Against the alternative of a hypothetical neutral tax, every tax and every deficit makes the private sector less efficient. Although some kinds of taxes do impose less distortions and inefficiencies than others, in the real world there is no such thing as a completely neutral tax or a neutral deficit. Every tax and every deficit adds its own costs, measured by the loss of the efficiency of the private sector, to the other costs of resources pushed out of the private sector into public sector use. It is in this sense that no tax is a good tax and no deficit is a good deficit. By the same token, the correct evaluation of the costs of government must also include the loss of output and employment and the inefficiencies resulting from the unavoidable necessity to finance government expenditures.

There is, of course, no precise way to measure whether the benefits of government expenditures are sufficiently high to justify their costs, especially since the people paying the costs may not be the same as the people receiving the benefits. However, it is widely acknowledged that our present tax and expenditure mechanism is heavily biased towards excessive government spending, especially since the costs of government tend to be diffuse whereas the benefits are highly specific. Indeed, these are compelling reasons for tighter lids on total government expenditures as well as for the closer links between expenditures and highly visible taxes to pay for those expenditures envisaged by proponents of mandated balanced budgets. For the present, it would seem that few people feel that they are getting their taxes' worth from the vast array of government programs. We are paying more and enjoying it less. In light of this, *any* increase in the federal budget would appear to be excessive. Indeed, a substantial reduction in government expenditures and in the scale and scope of government would seem to be in order.

Taxes generally force or induce us to do things differently and thereby reduce the inherent efficiency of a free market private property system. When a tax increases the cost of labor, fewer workers are employed or they are required to accept a correspondingly lower wage. When a tax reduces the return from work, we work less, and so forth. Similarly, deficits also force or induce us to do things differently because limited financial resources otherwise available to finance private sector capital formation are bid away by the financing needs of the U.S. Treasury. These problems are not avoided when the Federal Reserve buys Treasury securities with newly-created Federal Reserve credit; they are compounded by the subsequent inflation.

In any event, in part, taxes and deficits that force or induce us to use less so that the government can have more also have the unintended results of making the private sector less efficient. As I shall discuss in a few minutes, the problem is especially critical with respect to the impact of public policies on saving and investment because of the differentially heavier burden the tax system now imposes on income devoted to capital formation rather than consumption or government.

Some Government expenditures are devoted to purchases of goods and services and are thereby resource using in the sense that the government itself directly acquires the use of labor, capital or raw materials as would be the case when the Federal Government buys a submarine for national defense or hires more lawyers to promulgate more regulations. Increasingly, however, a larger and larger fraction of the federal budget is devoted to transfer payments. In the President's Budget document for fiscal 1979, less than 35 percent of total federal expenditures are for the direct purchase of goods and services by the Federal Government. The remainder of the half-trillion dollar budget is largely devoted to transfer payments to individuals (about 40 percent), grants-in-aide to state and local governments (16 percent) and interest on the national debt (8 percent).

But these expenditures do more than redistribute income by taxing Peter to pay Paul because the taxes and the deficits that pay for the transfer payments and the grants-in-aide make the economy as a whole less efficient. When transfer payments and the size of the budget are small, this dead-weight loss is correspondingly small. However, the rapid growth in transfer payments and grants-in-aide since the mid-1960's means that financing the massive scale of these programs significantly reduces the size of the pie being sliced up. Holding aside the difficult ethical and political problems of large-scale income redistribution, I believe that problems of slow growth, inefficiency, impaired employment opportunities and inflation created by the zeal for redistribution are some of the nation's most vexing and embarrassing problems, problems which cannot be solved without a significant moderation of the Federal Government's redistributionist policies. I may add that the size distribution of income appears to have been changed little by these policies and in no systematic way. All we can definitively say is that, in the aggregate, the nation is poorer because of the redistributionist policies, in part because of the retarded growth of plant and equipment resulting from the increases in taxes on saving and investment. In turn, less capital mean lower labor productivity and thereby both lower wage and impaired employment opportunities.

Moreover, there is now a large and growing number of informed students of the problem who contend that the net effect of recent public policies intended to make income distribution more nearly equal has been to impair opportunities for the poor, weaken the family and to make income distribution less equal.

It would seem that old ways of thinking about the problems of poverty and unemployment are so deeply ingrained that even when there is acknowledgment that public policies are counter-productive, proposed new solutions repeat many of the same old errors and promise to make a bad situation even worse.

For a current example, consider the welfare system, a disaster area of public policy, and new initiatives to change the system. It is generally recognized that the present welfare system has caused more unemployment and has perpetuated poverty.

The Administration's welfare proposal contained in H.R. 9030 attempts to deal with the welfare mess.

At the request of the Law and Economics Center of the University of Miami, I have just completed a detailed analysis of the Administration's welfare proposal, including its provisions to create and fully fund the largest public service em-

ployment program since the 1930's.[1] With your permission I would like to submit the study for the record. My analysis concludes that, despite the Administration's claims that the program will shift the poor from welfare dependency to productive jobs, especially in the private sector, and at low additional cost to the taxpayers, the results of the new program will be quite the contrary.

Also, my study shows that, if enacted into law, H.R. 9030 would cause a further expansion of the public sector that potentially will attract a large segment of low- and middle-income workers out of the private sector into low productivity, low priority, and largely dead-end public sector employment. Costs will be substantially higher than the Administration forecasts. A whole new welfare class is likely to emerge, and family stability will be further impaired. The ultimate costs will include both lower overall employment and less economic growth. At the same time, the basic causes of the current problems of unemployment and poverty, poor government policies that have increased barriers to employment and to gaining work skills while increasing incentives to unemployment and welfare, all are left intact.

I turn now to several observations about some of the connections between our slow economic growth—since 1960 perhaps the slowest of all the Western industrial countries, and public policy. The major reason for our poor performance is that the American economy has been devoting too many resources to consumption and to government, and not enough to the capital formation which makes growth possible. Thus, there has been a slowing of the growth of capital per worker. The sharp rise in the labor force in recent years has not been matched by any corresponding speedup in the rate of capital formation.

To place the recent slowdown in capital formation per worker in perspective, in the 1950–55 period the growth of capital per worker increased at the rate of 3.6 percent per year, and slowed in the decade thereafter. From 1965 to 1970, capital per worker increased at the rate of 2.6 percent per year. In the 1970's there has been a sharp decline in the growth of capital per worker. The Congressional Budget Office estimates that it grew at the rate of about 1.6 percent per year between 1970 and 1975 and only 1 percent per year since 1975. In fact, during the current business cycle expansion since early 1975, real gross non-residential fixed capital formation has increased only slightly and has actually declined as a fraction of Gross National Product. This is hardly the basis for the economic growth and the expansion of opportunity which the nation can and should achieve.

This slowing growth in capital per worker is the result of a number of public policy measures, which, by unduly penalizing saving and investment, have diverted resources that individuals would prefer to devote to capital formation and future consumption towards present consumption by households and by Government. And one of the worst sets of policies, resulting in this wasteful distortion, is our Federal tax system.

The fundamental bias against capital formation in our tax system results from the multpile taxation of income which is saved and invested. Individuals must pay taxes on essentially all income they earn, whether they spend it immediately or save it. The same holds true for corporations and their profits. This means that a dollar of current income is taxed only once when spent for consumer goods. However, the same dollar of current income devoted to saving is subject to multiple taxation because taxes must also be paid on the interest, dividends, capital gains and the like that result from saving and investing. The use of income for saving is thereby taxed at substantially higher rates than the use of income for consumption. People naturally respond by saving and investing less. This distortion by multiple taxation is particularly great in the case of dividends, for the return on equity is also subect to an initial corporate profits tax of 48 percent. To be sure, so-called capital gains are taxed at lower rates than ordinary income, but this only moderates the distortion; it does not eliminate it.

The damage wrought by our Federal tax system has been aggravated by inflation which creates false business profits and false capital gains, and thereby increases the tax bias against saving and investment. The combination of our present tax system plus inflation, itself the result of poor public policy, mainly bad Federal Reserve monetary policy, results in a set of capital levies on both business and individual wealth and also puts individuals into higher income tax brackets when their real pre-tax incomes remain the same. These capital levies and higher tax rates are nowhere to be found in the tax code, and tacitly raising tax rates and imposing capital levies by inflation rather than by explicit debate

---

[1] David I. Meiselman, "Welfare Reform and the Carter Public Service Employment Program: A Critique," a Law and Economics Center Occasional Paper, University of Miami School of Law, 1978.

and legislation are not among the Congress more forthright and honorable actions.

For yet another public policy that impairs saving and investment, I would call your attention to a recent study by Prof. Martin Feldstein of Harvard which indicates that the present social security system significantly reduces private saving. Professor Feldstein has reported that social security benefits lead employees to reduce the funds they set aside for their retirement almost dollar for dollar with any increase in social security benefits, thereby reducing the pool of private saving available to finance capital formation.

To sum up, the costs of Government continue to rise. It costs us more; we are enjoying it less. Few of us believe that we are getting our taxes' worth. By trying to level incomes, public policy has reduced the size of the pie without significantly altering its distribution. The tax system, heavily biased against saving and investment when there is no inflation, is made even more biased by inflation, itself the result of poor public policy. The administration's budget promises more of the same, and the administration's welfare reform, if enacted into law, will result in fewer jobs and still greater welfare dependency.

Central to the solution of these problems is the size of the budget and the deficit. The staggering deficit of the Federal Government must be eliminated, primarily through expenditure control, partly to avoid having the deficit crowd out needed private capital formation.

We must also correct the long-standing bias in the Federal tax system against saving and investment. For full tax equality between the consumption and saving uses of after-tax income, savings should be deductible from the income tax base so that only consumption is taxed. Progressivity can be built into such a tax and I would favor a mild degree of progressivity with appropriate deduction for human capital outlays such as health care and education. I would also favor an indexing arrangement to keep "real" tax rates intact. With the full deductibility of saving, taxes on corporate income and on capital gains can be eliminated. In addition, taxes such as the estate and gift taxes that yield little revenue and create much mischief can be reduced or eliminated.

A roughly equivalent alternative would be a value added tax with appropriate deductions for capital outlays.

For other desirable tax changes I would urge the Congress to review the record and follow the examples of the Kennedy Administration and of the Congress during the early 1960's, actions which set the stage for a surge of economic growth as well as for the elimination of inflation. Then, the distortions of the tax system were moderated by effectively reducing the tax biases against saving and investment by means of a combination of policies that included more rapid depreciation and the investment credit as well as the reduction in both corporate and personal tax rates. The Kennedy tax cuts have been more than offset by inflation moving people and businesses into higher tax brackets. We would need tax cuts to get us back to the Kennedy tax rates.

Finally, I would recommend the rejection of the administration's welfare reform package.

23-544 O - 78 - 4

L&EC

Welfare Reform

And the Carter Public Service Employment Program:

A Critique

David I. Meiselman
Professor of Economics
Virginia Polytechnic Institute & State University

An LEC Occasional Paper

THE LAW AND ECONOMICS CENTER of the University of Miami School of Law was established in August, 1974 to further the development of law and economics as intellectually integrated disciplines. Its purpose is to bring market economics principles into public policy decisionmaking and in that regard to strengthen scholarship in economics by relating economics meaningfully to the substance and procedures of law. Its efforts are consciously focused on issues bearing on the maintenance of a free society. Although part of the School of Law, contributing both to the School and to the University, the Center is directed as a discrete entity and is independently responsible for raising almost all of the funds required for its activities.

LEC's activities include:

Teaching institutes in market economics for law professors, Federal judges, and government officials.

Teaching institutes in law for economics scholars.

The John M. Olin Fellowship Program, a three-year course of legal studies for trained economists leading to the Juris Doctor degree.

Interdisciplinary seminars in law and economics, centered around public policy issues.

A continuing program of directed research on pivotal public policy questions.

FACULTY

Henry G. Manne, Director and Distinguished Professor of Law

John H. Moore, Associate Director and Research Professor of Economics

Peter H. Aranson, Special Research Administrator and Research Professor

Kenneth W. Clarkson, Professor of Economics

Louis De Alessi, Professor of Economics

Donald L. Martin, Professor of Economics

Roger LeRoy Miller, Professor of Economics

James S. Mofsky, Professor of Law

Copyright ©1978 Law and Economics Center
University of Miami School of Law
Coral Gables, FL 33124

Library of Congress Catalog Card Number 77-95219
ISBN 0-916770-05-2

Permission to quote from or to reproduce liberal portions of this publication is granted when due acknowledgement is made.

Printed in the United States of America.

PREFACE

On August 6, 1977, in the sixth month of his Administration, President Jimmy Carter announced his welfare reform proposal, the Program for Better Jobs and Income. About five weeks later, the Carter plan was introduced in the Congress (HR 9030). Welfare reform had been a major issue in the Carter campaign, and the plan, as expected, was comprehensive, calling for public service jobs, income support, tax reduction, and the elimination of many present programs.

In response to the Carter welfare reform plan, Dr. David I. Meiselman has authored a comprehensive and scholarly study; as readers must become aware, this study is one that we shall ignore at our peril. Applying a careful analysis of labor markets, unemployment, and public service employment to the Carter program, Dr. Meiselman finds that the Administration's proposal would provide little or no incentive to work for those now on welfare or unemployed. Indeed, the destabilizing influence of present welfare programs on work incentives, good working habits, and family stability are transferred unabated to—and are even aggravated by—the Carter proposal.

Dr. Meiselman argues, furthermore, that the assumptions about labor markets that are used to justify the Carter proposal simply do not hold water. Unemployment statistics themselves are inflated by the government's own policies. And, real unemployment is largely a product of present government welfare programs and government intervention in the labor market.

Nor does our knowledge of past and present public service employment programs offer hope for the Carter plan. These programs generate demands for workers and resources now in the private sector. State and local governments substitute public service employment funds for budgeted expenditures, thus producing no new jobs, especially for the unemployed. Worse yet, the private sector must bear the cost of public service employment either in higher taxes or in greater rates of inflation. This added burden impairs the ability of the private sector to create jobs, and more unemployment and other economic distress results. The public sector, in effect, "crowds out" the private sector.

While welfare recipients will refrain from working under the Carter plan, many workers now employed in the private sector will take public service employment jobs. Dr. Meiselman predicts that "a new welfare class" will emerge among middle class America. Disregarding the indirect costs of the Administration's proposal, it is argued that the immediate direct costs are three to four times the Administration's estimates.

Americans are fast becoming inured to waking up each day to discover that some well-intentioned and established government program has become a monster out of control. The Social Security System is one example of these new and unpleasant discoveries. Medicare is another. And, the Penn Central-Amtrak-Conrail route of progressive governmental intervention in, and degradation of, rail service is a third.

In the instance of the Carter Program for Better Jobs and Income we are

adequately forewarned by Dr. Meiselman's craftsmanlike analysis that we are courting yet another disaster. Were we so forewarned in earlier times, and had those warnings been heeded, our leaders might have acted more wisely.

Peter H. Aranson
Research Professor and
Special Research Administrator

Coral Gables, Florida
January, 1978

CONTENTS

I. INTRODUCTION 1

II. WILL PSE INCREASE *TOTAL* EMPLOYMENT? 4

Segmented Labor Market Models
Problems in Measuring Unemployment
Unemployment: Causes and Incentives
    Unemployment Insurance and Welfare Benefits
    Government Intervention in the Labor Market
Problems with Public Service Employment
    Targeting, Government Employment Skill Levels, and Resource Requirements
    Fiscal Substitution
    Competing with the Private Sector
    The Potential Direct Cost
Crowding Out

III. THE PROGRAM FOR BETTER JOBS AND INCOME 16

The Specifics of the PBJI
    Job Training and Employment
    Income Support Program
    Tax Reduction Provisions
    Fiscal Relief for State and Local Government
Evaluating the PBJI as Welfare Policy
    Work Incentives and the Potential Supply of Targeted PSE Workers
    A New Welfare Class
    Costs of the PBJI

BIBLIOGRAPHY 27

ABOUT THE AUTHOR

David I. Meiselman is Professor of Economics and Director of the Graduate Economics Program in Northern Virginia, Virginia Polytechnic Institute and State University. He is chairman of the editorial board of *Policy Review* and a member of the advisory board of the *Journal of Money, Credit, and Banking*. Dr. Meiselman is an Adjunct Scholar of the American Enterprise Institute for Public Policy Research and a Research Associate of the Center for the Study of Public Choice. Dr. Meiselman has been chairman of a presidential task force on inflation and an advisor and consultant to business and government. Dr. Meiselman's books include *Varieties of Monetary Experience* and *The Term Structure of Interest Rates*. The author of several articles, Dr. Meiselman served from 1966 to 1971 as Frederick R. Bigelow Professor of Economics and Director of the Bureau of Economic Studies, Macalester College.

Welfare Reform

And the Carter Public Service Employment Program: A Critique

David I. Meiselman*

I. INTRODUCTION

The growing importance of public service employment and training programs as a public policy issue parallels the secular rise in the nation's average unemployment rate over the past two decades. High unemployment levels have become a persistent economic problem. Even during periods of economic expansion, particular demographic groups such as teen-age blacks continue to experience high unemployment rates. Reported unemployment rates for minority and low-skilled workers, moreover, may fail to account for many persons who have voluntarily withdrawn or refrained from entering the labor market.

Fiscal policies have aimed at reducing aggregate unemployment and increasing aggregate output. The tools of fiscal policy have been increases in aggregate government expenditures and various tax reductions and incentives. These policies have been highly expansionary according to measures used by the proponents of fiscal policy, such as the size of the government deficit. Yet such expansionary fiscal policies seem not to have made much of a dent in the overall unemployment rate. Nor have public service employment programs seemed to have made much of a dent in the unemployment rate. There is some argument that public service employment may actually have resulted in more total unemployment rather than less.

Statistics on increases in unemployment compensation, in Federal expenditures for income-tested programs (that is, Aid to Families with Dependent Children (AFDC), food stamps, and Supplemental Security Income), in the number of welfare recipients, and in the annual average unemployment rate provide a perspective on the magnitude of the current dilemma. Between 1960 and 1977, annual unemployment insurance payments increased from $3 billion to $16 billion. Federal transfers alone through income-tested welfare programs and as grants-in-aid to the states to support these programs at the local level in 1976 totaled almost $47 billion. Welfare expenditures as a percentage of gross national product have more than doubled over the past sixteen years, while the number of persons enrolled in these programs

*I wish to acknowledge the collaboration and assistance of Barbara Fields. Her rigorous and probing research and analysis is evident in every section of the paper.

climbed to over 30 million.[1] Total enrollments today represent almost 15 percent of the nation's population. The 1960-76 period saw the average unemployment rate rise from 5.5 percent to 7.6 percent, peaking at 8.5 percent in 1975.

Congress has responded to these trends by passing ever more comprehensive and costly manpower programs. The Area Redevelopment Act, passed in 1961, sought to relieve the structural unemployment of the 1950s through training programs designed to augment skill levels of particular groups of displaced workers. The scale and goals of this first postwar Federally funded manpower program seem quite modest today. Congressional funding in 1962 of the state-sponsored Community Work and Training program was the first Federal attempt since the depression to extend "relief" beyond training opportunities in the form of public service employment to able-bodied male welfare recipients. This program was expanded (financially and to include females) by the Economic Opportunity Act of 1964.

During the early part of the 1970s, the congressional intent of manpower policy shifted from providing training and rehabilitation services to direct job creation, or public service employment (PSE). (Exceptions include the Job Corps, the Neighborhood Youth Corps, and the Youth Conservation Corps, all of which addressed youth unemployment and crime rather than unemployment generally.) The Work Incentive Program (WIN), enacted in 1971, focused on inducing welfare recipients to seek gainful employment in the private and public sectors.

While those states with disproportionately high welfare costs, such as California, have continued to focus on requiring welfare recipients to work off their grants, Federal policy has vacillated between using PSE as a countercyclical policy for those temporarily unemployed during cyclical recessions and as a welfare policy for those more or less permanently unemployed or poor. Both the earlier Public Employment Program (PEP) and the current public employment program, the Community Employment and Training Act (CETA), were intended to operate as countercyclical measures. Approximately 300,000 PSE slots were funded under CETA in 1976. Of the participants in these slots, however, only 25 percent were receiving public assistance or unemployment compensation before public employment.

The Carter Administration's recently unveiled welfare reform proposal, the Program for Better Jobs and Income (PBJI), incorporates as one of its three major elements an ambitious manpower policy. Like much earlier legislation, the PBJI is directed at the long-term unemployed and minority groups. It proposes to create and fully fund the largest public service employment program since the 1930s. The program would replace CETA but use its extensive system of local governmental prime contractors to implement its job creation objectives. Nearly $9 billion would be allocated to creating up to 1.4 million special public service jobs and training positions in 1980, the initial year, if enacted, of the PBJI's life. Nearly all of these jobs would be reserved for adults caring for dependent children and receiving public welfare.

The second major element of the Carter proposal is an income support program to

[1] This total includes all persons receiving AFDC, Supplemental Security Income, and Food Stamps. There is an indeterminate amount of double counting of AFDC enrollees and those purchasing food stamps.

replace the current welfare system. It is claimed that the PBJI's benefit structure would induce welfare recipients to seek gainful employment by providing supplementary income guarantees to low income persons in either special public service jobs or regular employment. Those families in which no one would be "expected" to work will receive basic income support payments (welfare).

The third and final element of the reform package is tax reduction through an expansion of the earned income tax credit and an increase in the minimum taxable income (from the current $7,200 of adjusted gross income to $9,080). The existing earned income tax credit for income levels below $8,000 would be increased, and tax benefits of the credit would be extended to families with incomes up to $15,620 from regular employment. If enacted, *this provision would lower the tax liability of more than 50 percent of all families*.

The Administration proposal is envisioned as a long-term anti-poverty program to accomplish three goals. First, the program is expected to increase the productivity of the structurally unemployed, particularly those persons now receiving public assistance, by improving their skill level and work habits through experience and training. Second, proponents believe the program will replace welfare dependency with gainful employment through the revised benefit structure. Third, the Carter Administration expects the program to provide fiscal relief to state and local governments while simultaneously reducing welfare costs and fulfilling "unmet social needs."

This study analyzes the efficacy and efficiency of using such direct government job creation programs as welfare or anti-poverty measures. It focuses on the Administration's proposal because the immediacy, complexity, and permanence of that proposal threaten to impose enormous financial and economic burdens on American workers and taxpayers. (The PBJI is not the only legislation that imposes such a threat. The Humphrey-Hawkins bill now pending before Congress is based on the same anti-poverty objectives and to a large degree has the same potential consequences.)

At issue here is whether, as its proponents contend, the PBJI or any other long-term public employment program to reduce unemployment among the disadvantaged can mitigate the inflation-unemployment tradeoff associated with more traditional fiscal policies. This issue is especially acute because of other government programs, such as high and rising minimum wages, which reduce private job opportunities and increase unemployment. The argument of the PBJI's proponents depends critically on several unrealistic assumptions about how these programs function and how labor markets, in particular, function.

Proponents of PSE as welfare policy ignore the unpleasant reality that these programs must be financed either by higher taxes or by more government borrowing, both of which reduce private sector output and employment. The myopic neglect of the necessity to finance additional government expenditures and of the effects of the financing itself, explain the inadequate public awareness of the aggregate impact of these programs. This lack of awareness is worse yet because people fail to comprehend how public sector expenditures and employment crowd out private output and employment.

II. WILL PSE INCREASE *TOTAL* EMPLOYMENT?

The objectives of Federally funded PSE programs have shifted from the short-term countercyclical stabilization of state and local employment during recessionary periods to the long-term improvement of the relative income and employment position of lower income persons.

Proponents of PSE as a welfare or anti-poverty measure argue that, if it is properly "targeted" at the current poor, direct governmental job creation is a policy instrument uniquely capable of increasing total employment and real output without triggering inflationary pressures. In other words, they claim that PSE can lower the economy's long-run "non-accelerating inflation rate of unemployment." A further argument is that once those in the program have acquired skills and better work habits they can move into private employment.

Segmented Labor Market Models

These arguments rest on the notion that the labor market in the United States is essentially segmented into two (or more) separate and distinct markets: primary and secondary labor markets. Workers in one market are believed not to be in competition with workers in the other market because differences in the skill level of each group supposedly preclude their substitution in the production process. Overall wage trends are assumed to be dominated by the tightness of the primary market. Advocates of this view of the labor market contend that the secondary market has a chronic "excess" supply of labor. So, an increase in demand in the secondary market increases employment without raising wage or labor costs. (Those who adopt the segmented labor market notion never satisfactorily pose or answer the question of why there is a persistent excess supply—why this market never clears.)

Labor market models based on the idea of segmentation and its related consequences explain the presumed "excess" supply of labor in the secondary market as resulting either from worker characteristics or from the size and capital intensity of industry.[2] The former models, based on worker characteristics, explain differential rates of unemployment between primary and secondary market workers as resulting from the skill and educational level, reliability, commitment, and motivation for learning of each group. The latter models, based on industry characteristics, argue that primary market workers obtain the degree of security they enjoy because their employers, *assumed to be large organizations*, require the continuity of employment and skill level those workers offer. Secondary workers, in contrast, are assumed to be employed by *smaller firms*. Such firms are believed to be more exposed to fluctuations in aggregate demand or to be offering services on a seasonal basis. No rigorous attempt has been made to identify which segments of the labor force are in which

[2]There are several variants of these models, including the dual, queue, and segmented market models. For a more thorough exposition of the characteristics of each of these models see Martin N. Bailey and James Tobin, "Direct Job Creation, Inflation, and Unemployment," prepared for the Brookings Institution Conference on Direct Job Creation (April 1977), 21-23.

idealized market setting, or to reconcile differences in the empirical presumptions of the secondary market hypothesis advocates, such as whether small firms or large firms specialize in employing secondary market workers.

Regardless of how each model postulates the market's segmentation, the models differ only insignificantly in their policy implications. Segmented market models hypothesize that, since the source of "wage inflation" is the primary rather than secondary labor market and since the measured "excess" supply of secondary labor is presumed to be chronic, direct government employment of the hard-core unemployed can increase total employment and output with only minimal pressure on overall wages or the inflation rate. And, it is asserted, these benefits, with little associated inflation, would accrue not only over the short run but in the long run as well.

The general proposition that there are several distinct labor markets, or labor market segments, may appear realistic to some laymen. Widely publicized employment statistics have shown an increasing disparity in the unemployment rates among various demographic groups generally believed to have different skill levels. Youths and non-whites often register unemployment rates double and sometimes several times as high as the rate for mature male workers. The visibility of these statistics lends credibility to the policy recommendations of segmented market theorists. Whatever the source of the disparity in unemployment rates, however, the segmented market approach cannot explain why the disparity has been widening, or why 30 years ago essentially no disparity existed. Indeed, unemployment among black teen-agers was lower than among white teen-agers years ago.[3]

One problem with segmented labor market models is that they are deeply rooted in Keynesian economic theory, which is simply inappropriate, especially given current economic conditions. Proponents of the use of fiscal policy for short-term stabilization purposes appear to be retreating from the belief that today's unemployment can be "cured" by stimulating aggregate nominal demand. Instead, they are proposing *selective* fiscal strategies conditioned by the same theoretical framework but selectively pinpointed at the ailing sectors of the economy rather than at the economy as a whole. In effect, instead of throwing money unselectively at the problem of aggregate unemployment, they propose throwing money at particular pockets of unemployment but with little concern for where the money is raised.

Public service employment is a prime example of trying to place the effect of government expenditures (the fiscal stimulus) directly on the perceived problem, in this case the hard-core unemployed. Those who believe in this approach appear to argue that by increasing the demand for specific, underutilized labor inputs, rather than for labor in general, aggregate output can be augmented at no additional resource or inflation costs.[4] Consistent with the Keynesian approach, this view of unemployment is demand determined, even in secondary markets. There is no proper acknowledg-

[3]Walter E. Williams, "Government Sanctioned Restraints That Reduce Economic Opportunities for Minorities," *Policy Review* 2 (Fall 1977), 6-7.

[4]Bailey and Tobin, "Direct Job Creation, Inflation, and Unemployment."

ment of supply factors, and there is a corresponding failure to appreciate fundamental changes in the structure of unemployment. Those who hold this view, therefore, fail to explain *why* unemployment is so high either overall or among particular groups in the labor force. Instead, in the face of high unemployment statistics, there is almost a conditioned reflex to call for more and more government spending.

Problems in Measuring Unemployment

Any public policy toward unemployment, despite its benign intentions, must have a realistic view of how unemployment is measured and how a change in policy can affect the accuracy of that measurement. The overall unemployment rate is supposed to measure the percentage of the civilian labor force that is seeking employment. The Bureau of Labor Statistics also categorizes this total rate according to certain demographic characteristics, such as race, sex, and age. The overall unemployment rate and the subcategories of the unemployment rate are supposed to indicate first, the extent of underutilization of available resources (that is, the number of those offering labor services but unable to find work at the current wage level) and second, the severity of unemployment.

Analysts have become increasingly aware that "measured" unemployment is an imperfect, sometimes poor, indicator of labor market conditions. Part of the problem with the measured unemployment rate is that it does not reflect changes in the labor force participation rate—the proportion of the noninstitutional population 16 years of age and over who are working or looking for a job. Increases in the number of persons seeking work for the first time or reentering the labor market add to the measured unemployment rate even if there has been no change in total employment.

Labor force participation varies in the short run with the level of business activity, increasing during periods of expansion and rising wages and contracting during recessions. Over the long run, basic demographic, economic, and cultural changes influence the age and sex composition of the labor force, as well as its size. The rising female participation rate over the past decade or so is a good example of how economic and cultural changes can affect both the composition and size of the labor force. Current high unemployment rates among youths, of course, reflect the baby boom decade. Therefore, there are relatively more first time entrants in the labor market, as well as relatively more people who plan to enter and leave the labor market more often. These phenomena alone would cause the measured unemployment rate to rise.

Unemployment rates also do not reflect the duration of unemployment and the degree of turnover in workers from one reporting period to the next. Geoffrey Moore suggests constructing an index to measure both dimensions: duration of unemployment, which indicates the seriousness of the problem from the unemployed worker's standpoint, and the average level of unemployment.[5] Moore's "index of unemploy-

[5] Geoffrey H. Moore, *How Full is Full Employment? and Other Essays on Interpreting the Unemployment Statistics*. (Washington, D.C.: American Enterprise Institute, 1973).

23-544 O - 78 - 5

ment severity" demonstrates that recent unemployment experience has not been as severe as is generally believed. While the 1971 unemployment rate of 5.9 percent was equalled or exceeded only three times since 1948, the average duration of unemployment was exceeded in eleven years between 1948 and 1970.

These and other deficiencies inherent in the measured unemployment rate make it a poor index of labor market activity. A superior, albeit somewhat rough, indicator is the employment ratio, defined as the proportion of the noninstitutional population over 16 years of age that is currently *employed*. The employment ratio is now near its historical high, while measured unemployment remains about 7 percent. For public purposes, the employment ratio presents a far more accurate picture of labor market conditions.

Beyond these statistical and definitional problems, institutional changes affect the unemployment rate. Among the most recent of these changes is the 1971 addition of a work registration requirement for welfare eligibility. Clarkson and Meiners estimate that the current overall unemployment rate has been inflated by as much as 2.1 percentage points because people must register for work, and thus be declared "unemployed," to be eligible for certain welfare benefits.[6]

Unemployment: Causes and Incentives

Unemployment Insurance and Welfare Benefits. The unemployment rate also fails to differentiate between voluntary and involuntary unemployment. Hence, the rate is not, as it is intended to be, a precise indicator of "hardship" or of market failure. Significant disincentives to work, including both unemployment insurance and several welfare benefits, have been built into government tax and transfer programs. Following the old and enduring law of economics, as the cost of being unemployed has fallen, there has been more unemployment. In a not so subtle way, these programs also subsidize erratic work habits and planned seasonal unemployment.[7] They also impair the orderly acquisition of job skills *on* the job, where most skills are obtained.

The "replacement rate" (non-taxable transfers of welfare benefits and unemployment compensation to the unemployed compared with after-tax income to those gainfully employed) is now very high, especially for low income persons and families. The level of the replacement rate influences the incentive to work. Men whose earnings approximate the current minimum wage, for example, receive unemployment compensation equal to over 80 percent of after-tax net income. Married women, because of the progressivity of the income tax, experience even higher replacement rates and, depending on the number of children in the household, may even add more

[6]Kenneth W. Clarkson and Roger E. Meiners, "Government Statistics as a Guide to Economic Policy: Food Stamps and the Spurious Increase in the Unemployment Rates," *Policy Review*, 1 (Summer 1977), 27-51.

[7]Martin S. Feldstein, "The Economics of the New Unemployment," *The Public Interest*, 33 (Fall 1973), 3-42.

to the family's *net* income by remaining unemployed than by working. For millions of Americans, working is simply less remunerative than being unemployed. In addition, being unemployed means that one has time to do other things like taking care of children, fishing, fixing up the house, working for unreported wages, and the like.

Unemployment insurance also reduces the cost of job search for those genuinely looking for a job. But, this was an original intention of unemployment insurance and is socially efficient up to some point. Some researchers believe that today the job search has become excessively prolonged beyond what is justified by the potential increase in lifetime earnings.

Government Intervention in the Labor Market. Direct government intervention in the labor market—in the form of minimum wage legislation and sanction of union power—is a very significant cause of unemployment.[8] For many of the unskilled and the young whose productivity is low because of limited experience and education, the legal minimum wage is a major deterrent to employment because it causes the cost of hiring them to exceed their productivity.[9] Lack of employment opportunities is serious enough. The problem of limited job training is compounded by the minimum wage because nonemployment impairs the acquisition of job skills or systematic on-the-job training. In most respects, the traditional apprenticeship system, which trained the workers of the Western World for centuries, has been destroyed.

Feldstein and others suggest that the minimum wage actually has the ironic effect of lowering the lifetime income potential of the disadvantaged by substantial amounts.[10] Recent extensions of occupational coverage for Federal legal wage minima eliminate still more private opportunities for training and increase more than proportionately the adverse effect of these minima. Any attempt to index the wage minima, as has been suggested, will maintain the real differential between the productivity of low-skill workers and the nominal wage required under law. If these wage minima were left permanently at their existing level, then inflation would tend to ameliorate the minimum wage effects. The recently legislated increase in minimum wages, however, will thus make the unemployment situation even worse.

Union practices have much the same effects on employment, on-the-job training, and lifetime earnings except that these effects are concentrated in certain industries. Unions have the power to set apprenticeship qualifications, often to the exclusion of certain minority groups, and to establish minimum apprenticeship wages. It is always to the advantage of journeymen members to have applicable minimum wages in their own industry as high as possible. High minimum wages insure that hiring those qualified for journeymen's wages will always be more cost effective than hiring less skilled workers.[11] It is not surprising that union leaders are usually the most vociferous proponents of legislation to increase legal wage minima.

[8]United States Congress, Congressional Budget Office, "Public Employment and Training Assistance: Alternative Federal Approaches," Budget Issue Paper (Washington, D.C.: United States Government Printing Office, 1977).

[9]Feldstein, "The Economics of the New Unemployment."

[10]Feldstein, "The Economics of the New Unemployment."

Legal and government sanctioned minimum wages are probably the single most important barrier to the employment of teen-agers and other low-skill workers. Feldstein's recent study of unemployment among demographic groups tends to substantiate the importance of minimum wage effects on teen-age unemployment.[12] Feldstein estimated the responsiveness of the unemployment rate among different age and sex demographic groups to changes in the rate for mature males (all those over 24 years old). The rate for mature males is indicative of the general tightness of the labor markets. Feldstein found that teen-age unemployment for all groups (males, females, whites, and non-whites) would still exceed 10 percent even *if* the rate for mature males fell to 1.5 percent. The rate for non-white teen-agers would remain about 24 percent under these conditions. It should be noted that teen-age unemployment accounts for a significant portion (possibly as much as 30 percent) of the overall unemployment rate, which suggests that unemployment would remain high even during economic prosperity. Among those over 20, only the rate for non-white females would exceed 6 percent when that for the control group approximated 1.5 percent.

Certain cultural forces undoubtedly do contribute to current high levels of unemployment among teen-agers and others. These forces include motivation, educational opportunity, the general level of family wealth, and the replacement rate implicit in income transfer programs. The minimum wage, nevertheless, must be responsible to a large degree, for much of contemporary unemployment.

Persons with low skill levels may be expected to have low incomes. But low skill alone does not explain unemployment as the segmented market models postulate. Those models of the labor market use unemployment statistics to demonstrate that the market is not working efficiently. This assertion of an inefficient labor market, in turn, is the principal justification for government intervention through direct employment policies. Public service employment, in essence, would add yet another layer of government simply to offset the adverse effects of existing Federal policies.

To summarize, the market is working, but it labors under the artificial constraints imposed by government regulations and policies. That the minimum wage exceeds the market clearing wage for many low-skilled persons alone explains a significant amount of "measured" unemployment. Government tax and transfer programs effectively lower the cost of prolonged job search and subsidize unstable employment and periodic voluntary withdrawal from the labor market. Such voluntary unemployment accounts for an increasing fraction of overall unemployment, but it is hardly indicative of market failure. Long-term trends in the age and sex composition of the labor force and the responsiveness of the supply of labor to economic and other influences also tend to be camouflaged by reported unemployment statistics.

Today's unemployment situation is characterized by temporary and voluntary withdrawal from employment, except for those persons denied employment opportunities

[11] Williams, "Government Sanctioned Restraints That Reduce Economic Opportunities for Minorities," 14-15.

[12] Feldstein, "The Economics of the New Unemployment," 7-8.

because of legal wage minima and other government policies. Less than 50 percent of all unemployment arises from persons *losing* their jobs. *In this labor market context, proposals for public service employment programs, especially massive and permanent ones, are misguided and potentially serious threats to the economy.*

Problems with Public Service Employment

Proponents of public service employment programs claim that they are virtually a "free lunch." They contend that the cost of "creating" public jobs will be offset partially by savings in government transfer payments and partially by the "social value" of the public services provided.[13] Wage pressures will not surface, they argue, because of the chronic "excess" supply of labor in the secondary labor market. Indeed, some researchers go so far as to contend that public service employment might actually contribute to a reduction in the rate of inflation. Nostalgia for the 1930s, however, will not change the reality that unemployment today is not the same phenomenon as unemployment in the 1930s. The view of a labor market with workers standing in line for jobs unavailable because the pace of economic activity is too slow to absorb them is quite inappropriate with employment ratios at historically high levels.

Direct government job creation intended to redistribute income to those currently poor by the government's definition will be very costly in terms of a lower level of total output and a higher rate of inflation in the long run. Costs will be even higher the more expansive and permanent the program.

Targeting, Government Employment Skill Levels, and Resource Requirements. PSE jobs, in the first place, cannot be "targeted" with any degree of certainty at the hard-core unemployed, especially through local government initiative. Local governments simply have too great an incentive and opportunity to transform Federal grant programs into general revenue sharing and to use the funds to hire an entirely different group of workers who meet the relatively high skill requirements for state and municipal employment. The nature of unemployment, moreover, suggests that "targeting" jobs will be easier said than done even if the Federal Government implements the jobs program directly. Proponents of PSE either are ignorant of or choose to ignore the realities of the current labor market situation. If targeting is less than perfect, PSE workers will be drawn from private employment, resulting in a reduced supply of labor in the private sector. This reduced supply of labor will lead to higher labor costs and increased product prices. Evidence and analysis do indicate that targeting is far from perfect.

Second, even if one could identify an easily segregated group of unemployed persons whose skills were strictly noncompetitive with the needs of private employers, nevertheless creating public sector jobs of any kind requires the use of other resources. Supervisory personnel are not likely to be found among the unskilled "target" group.

[13] Bailey and Tobin, "Direct Job Creation, Inflation, and Unemployment;" United States Department of Health, Education, and Welfare, "Welfare Reform," *H.E.W. News* (August 1977).

Material or capital inputs, whether they are brooms, typewriters, uniforms, hospital equipment, or building materials, will be required to complement PSE workers. These materials, of course, are in addition to the resources required to administer the PSE program at the state and Federal level. Theorists supporting PSE wrongly assume the existence of an infinitely elastic supply of unskilled labor and capital inputs, and they wrongly assume that unskilled labor as well as capital are free goods that would otherwise go unused. Government bidding for these resources, contrary to these incorrect assumptions, will indeed divert capital, materials, and skilled and at least some unskilled labor from other uses.

Fiscal Substitution. Experience with past and present public employment programs leaves little room for doubt that fiscal substitution, or "displacement" at the local level will continue substantially to neutralize Federal policy objectives. "Displacement" occurs when state and local governments spend Federal grant money earmarked for a particular purpose such as PSE on expenditures for goods and services they had already budgeted. In other words, Federal funds are substituted for local tax effort. The Congressional Budget Office has acknowledged that fiscal substitution may run as high as 100 percent within two years of a program's implementation.[14]

In a recent study, Johnson and Tomola used time series data to estimate the impact of the PEP and PSE-CETA on total employment.[15] They found that these programs have a substantial effect on state and local employment for the first two quarters but are subject to a high degree of fiscal substitution in subsequent quarters. Specifically, they found that 100 PSE jobs resulted in 104, 91, 69, 42, 18, and finally only 3 incremental state and local government employment slots in the first through sixth quarters respectively. The high standard errors of the estimates indicate one difficulty with PSE, to wit, how to differentiate these employees from those holding regular public jobs. Wiseman, in a study of the PEP, found nearly identical results by the third quarter, but his study showed no initial increment in regular public jobs beyond the funded 100 PSE slots.[16] The PEP, therefore, failed to induce any net increment in local government spending.

More important than the amount of net employment are the characteristics of the program participants. Evidence from diverse sources implies that CETA participants are best classified as being from the middle of the skill range, not as unskilled. Fewer than 46 percent of the persons hired under CETA were "economically disadvantaged" according to the government's definition (one who lives in a family receiving cash welfare payments or earning income less than the poverty threshold). Only 15 percent of all CETA participants in PSE or training programs had been

[14]United States Congress, Congressional Budget Office, "Public Employment and Training Assistance: Alternative Federal Approaches," 27.

[15]George E. Johnson and James D. Tomola, "The Fiscal Substitution Effect of Alternative Approaches to Public Service Employment Policy," *The Journal of Human Resources*, 12 (Winter 1977), 14.

[16]Michael Wiseman, "Public Employment as Fiscal Policy," *Brookings Papers on Economic Activity*, 1 (1976), 67-104.

receiving welfare before entering the program. And findings of a national survey show that a substantial fraction, over 20 percent of PSE workers, are actually employed on the day before getting the subsidized job.[17]

Competing with the Private Sector. The problem with using state and local government as the vehicle for direct job creation is that this sector of the economy is relatively skill intensive compared to the experienced civilian labor force. Hence, the kinds of employees local government officials can *use* are simply *not* the targeted unskilled, although they may be unemployed. Eli Ginzberg estimates that two-thirds of the 9 million net new government jobs provided in the United States between 1950 and 1976 can be characterized as "good" jobs in terms of total compensation, job security, and opportunity for advancement. All but 700,000 of these jobs were added to state and local payrolls.[18] The majority of these workers has skill levels higher than the average level of the experienced civilian labor force. The stability and security afforded by state and local employment has probably also drawn more unskilled workers with a greater degree of job commitment than have been available to many private employers.

The available evidence thus suggests that PSE programs compete directly for workers with the private sector. This competition has two direct and perverse effects on the economy. First, by subsidizing state and local government employees, Federal employment programs effectively reduce the relative price of state and local services to the taxpayers of the respective jurisdictions. Increased demand at the artificially low price of labor has led to a more rapid increase in the amount and kinds of services provided by these governmental units. Expansion under these conditions, however, is extremely inefficient since it has not been market determined.

Second, with the Federal subsidy, state and local governments can compete more successfully with the private sector for labor and capital inputs. Even at competitive wage rates, state and local governments are advantaged in bidding for labor services because they tend to offer greater security and stability of employment to workers with any given level of skill than does the private sector. As we shall see, more unemployment results as workers wait longer and search longer for these preferred public sector jobs rather than take private sector jobs.

Proponents of PSE as a welfare measure view fiscal subsitution as a major obstacle. They blame the failure of past programs even nominally to affect the rates of unemployment on the amount of displacement that has occurred at the local level. If this potential for abuse were removed, they argue, PSE would realize gains in total employment. Beyond tightening maintenance of effort requirements and rigidly enforcing regulations, proponents of PSE anticipate that a more expansive Federal program—and each year's legislation emphasizes more costly initiatives—would greatly reduce the degree of substitution and increase the effectiveness of Federal policy.

[17]Wiseman, "Public Employment as Fiscal Policy," 101.

[18]Eli Ginzberg, "The Job Problem," *Scientific American*, 237 (November 1977), 43-51.

The Potential Direct Cost. Evidence from European countries, particularly the Netherlands, which greatly extended its public employment programs over the past few years, suggests that massive programs are subject to most of the problems associated with American programs to date. What proponents of PSE fail to appreciate is that the potential demand for these jobs far exceeds the number of people currently reported on welfare or as unemployed. For reasons I suggest earlier, public sector employment is more attractive at any given wage rate than private sector employment. This enhanced attractiveness holds especially during periods of economic instability. Potential applicants include many people currently employed in private sector jobs, the involuntarily unemployed, some of the voluntarily unemployed (depending on the rate of replacement of income offered by transfer programs), many of those receiving welfare, and an *unknown* number of persons who are not currently members of the labor force. It is ironic that the United States is contemplating massive public employment at a time when most European countries are questioning the efficiency of their public employment.

A massive public employment program presumably would create jobs for all who "need" and apply for them. Assume for the moment that proponents of PSE could actually prevent fiscal substitution as they contend. What would be required of such a program?

Lowering the current unemployment rate 3 percent would require funding and creating about 3 million PSE slots. The state and local government sector now employs approximately 12.5 million persons. The Bureau of Labor Statistics projects this number to grow by approximately 3 percent per year or by just under 400,000 new employees annually through 1985. To provide an increase in employment sufficient to realize a 4 percent unemployment rate between *now* and 1985 would require a doubling of that projected growth rate. But, these calculations assume no increase in the labor force. If all of the "potential" labor force participants who indicated in a recent Department of Labor survey that they "want a job now" were to surface and be guaranteed a job, at least 8 million, not 3 million, PSE jobs would be required.[19] At $10,000 per year per job slot, the estimated cost per PSE-CETA job in 1976, this effort could potentially add about $80 billion per year to Federal expenditures for this part of the program alone. To be sure, there may be some reduction in other Federal expenditures, but at most these are likely to be only a small fraction of the staggering $80 billion.

Faced with such huge expenditures it is likely that the Federal response will be further to limit access to the PSE program, so that the ambitious aims of the program will have to be compromised. *Indeed, the typical mistake in all Federal programs is to underestimate the responsiveness of the public to important changes in costs, benefits, and incentives.* In our efforts to arrive at new solutions, the examples of Medicare, Unemployment Compensation, and the existing welfare system should help us to avoid a repetition and magnification of old mistakes.

[19]Ginzberg, "The Job Problem."

Crowding Out

Whether the final increase in Federal expenditures for this program will be $80 billion a year or a smaller amount, the problem of how to finance the additional expenditures remains. Any complete analysis of the PSE program must include both a recognition of the financing problems and an analysis of the impacts of financing the additional required expenditures. The omission of these considerations has been, and continues to be, one of the most fundamental and serious shortcomings in nearly all analyses that underpin this and similar proposals. As we shall see, this omission helps to explain why so many large and complex programs designed to solve a host of problems have made little or no aggregate impact.

The evidence is clear that the aggregate expenditure level, nominal Gross National Product, is linked to and determined by the quantity of money.[20] The quantity of money, in turn, is determined by the monetary policies of the Federal Reserve. For a given money supply, which fixes the total of private and public expenditures, an increase in any category of expenditures must be associated with a decrease in other expenditures to keep the total of private and public expenditures the same. Thus, for a given quantity of money, an increase in government expenditures is at the expense of a decrease in private expenditures. The public sector, in other words, "crowds out" the private sector.[21]

For a given stock of money, it follows that any increase in government spending must be financed either by higher taxes or by borrowing. Higher taxes will depress expenditures for private sector goods and services, thereby shrinking private sector output and employment. Thus, an increase in the number of public sector jobs will accompany a decrease in the number of private sector jobs. Labor is more efficient in the private sector, and lost private sector output generally would have been more useful and valuable than the additional public sector services. Most public sector services are likely to be in activities that people would not voluntarily purchase at current market prices, which more accurately reflect costs. Hence, an increase in public sector employment will diminish private sector employment, and the efficiency of the economy as a whole will suffer. The real value of output will fall, causing an increase in inflation. Average real wages and total employment, in turn, also must fall.

[20]David I. Meiselman, "Statement to the Subcommittee on Domestic Monetary Policy of the Committee on Banking, Currency, and Housing, United States House of Representatives, *Hearings on the Impact of the Federal Reserve's Money Policies on the Economy*, 94th Congress, 2d Session, June 9, 1976; David I. Meiselman, "The Impact of Countercyclical Monetary and Fiscal Policies on Housing," in Department of Housing and Urban Development, *Housing in the Seventies: Volume II* (Washington, D.C.: Government Printing Office, 1976); David I. Meiselman, "World-wide Inflation: A Monetarist View," in David I. Meiselman and Arthur Laffer, eds., *The Phenomenon of Worldwide Inflation* (Washington, D.C.: American Enterprise Institute, 1975).

[21]For a comprehensive summary of the analysis of and evidence about crowding out, see Keith M. Carlson and Roger W. Spencer, "Crowding Out and Its Critics," in *Federal Reserve Bank of St. Louis Review* (December 1975). For a despairing view, see Bailey and Tobin, "Direct Job Creation, Inflation, and Unemployment," 7.

Borrowing to finance the increase in Federal expenditures has the same general effect as taxing. When the Federal Government borrows more, the increased demand for funds drives up interest rates as part of the process in which the Federal Government bids financial resources away from the private sector. Higher interest rates are part of the mechanism for shifting financial resources to the Federal Government and away from the private sector. Higher interest rates depress private spending, especially for capital goods such as housing. Debt-financed government spending crowds out housing and business expenditures for plant and equipment.

Impairing capital formation also has serious consequences for labor productivity because that productivity depends on the amount of capital; more specifically, labor productivity depends upon the ratio of capital to labor. With less capital, labor productivity is lower. Real wages, in turn, are also lower, and employment opportunities are curtailed. Thus, by this mechanism alone, creating some PSE jobs in the short run will be at the expense of lower wages and fewer jobs in the long run. Of course, other mechanisms indicate no increase in *total* employment, even in the short run.

Besides taxing and borrowing there is only one other way to finance more government expenditures. The Federal Government can effectively get the funds to pay its bills by having the Federal Reserve increase the money supply. The direct result will be still more inflation. The indirect result of more inflation will be an increase, rather than a decrease, in unemployment.[22]

Demand stimulus alone will not solve a supply problem. Specific pockets of unemployment remain largely because of poor public policies. The government's printing press cannot paper over the causes or consequences of those policies. The ensuing inflation solves no problems; it adds more.

The problem of fiscal substitution by state and local governments, which I discuss earlier, provides evidence about, and is linked to, the lower value people place on public sector activities compared with those in the private sector. To the extent that fiscal substitution takes place, such substitution reflects the perception of local taxpayers that the services and activities the Federal Government is trying to force them to consume are of little or no value at all! Federal dollars are effectively used to reduce local taxes or to finance increases in other local services, but not the services the Federal Government "prefers." If it is worthwhile having Federal contributions to local citizens in general, it would seem that a general tax cut at the Federal level would be a more efficient and direct way to allocate such contributions. A Federal tax cut also would save on the present substantial amount of administrative expense and bureaucratic meddling. In addition, because PSE programs effectively subsidize local government expenditures, these programs thereby induce a higher level of such expenditures than local citizens would prefer if they paid for them out of their own

[22]For analysis of and evidence about the proposition that more inflation leads to more unemployment, see Milton Friedman, "Nobel Lecture: Inflation and Unemployment," *Journal of Political Economy* 85 (June 1977), 451-472; David I. Meiselman, "More Inflation: More Unemployment," *Tax Review* (January 1976); and David I. Meiselman, "Unemployment and the Variability of Inflation: A Feasibility Study," unpublished manuscript prepared for the United States Department of Labor (September 1977).

revenue resources. A Federal tax cut instead of PSE programs, therefore, would correspondingly help to avoid still more local government activities of low productivity and low value. Given the slowdown in recent years of our economic growth, shifting resources to create more make-work and busy-work projects hardly would seem to be called for today.

III. THE PROGRAM FOR BETTER JOBS AND INCOME[23]

The Carter Administration's "Program for Better Jobs and Income" is composed of three major elements: a job training and employment program; a revised welfare and supplementary income program with work incentives; and a revision of the earned income tax credit and minimum taxable income components of the Federal income tax provisions. The bill also provides for state and local fiscal relief. These elements are interrelated because the financial incentives of each part depend on those of the others. Here, I sketch briefly the intent and specification of each of these components. Then, the entire program is evaluated in the context of the analysis presented in Section II.

Specifics of The PBJI

Job Training and Employment. The stated goal of the job training and employment component of the PBJI is to provide opportunities for work or training for principal wage earners in families with children. State and local governments would be responsible for job search, training, and placement, and for creating subsidized jobs within the existing CETA network of prime sponsors.

The PBJI would be funded by $8.8 billion in 1980 to create 1.4 million public service jobs and job-training slots to provide employment for up to 2.5 million persons who cannot find private sector employment or regular public employment. Approximately 85 percent of these jobs would pay the minimum wage of $3.30 per hour when initiated in 1981. Wages up to 25 percent more, or $4.15 per hour, would be permitted for the remaining jobs to allow flexibility for rewarding work leaders and good performance.

Those states currently paying welfare benefits greater than the Federal minimum would be required to augment the minimum wage by an amount sufficient to maintain the Federal incentive structure between work and welfare compensation. Since supplemental wages could not exceed 10 percent of the current minimum wage, this provision will not adequately protect the work incentive benefit structure.

The job training and employment program would require no *income or asset tests for determining eligibility*; however, applicants must be unemployed and show "evidence" of a five-week job search. Each subsidized job is intended to serve as

[23]This discussion and analysis is based on the Carter Administration's proposal as specified in United States Department of Health, Education, and Welfare, "Welfare Reform." The final form of the bill associated with the proposal may differ from this HEW release.

transitional employment, and participants would be obliged to conduct an annual job search and to accept private employment whenever it is offered. The proposal never specifies just how the job search would be verified.

Two-parent families, single persons, childless couples, and single parents whose children are fourteen or over, would be required to accept work if offered. Heads of single-parent families with children between seven and fourteen would be expected to work part time when available work does not interfere with child-care, and full time if appropriate day care facilities are made available. Presumably, those exempted from work—the aged, blind or disabled, and single parents whose children are under seven—would not be excluded from consideration if there are sufficient PSE slots. Under no condition would more than one PSE job be awarded per family "unit," although other family members would remain eligible to participate in other Federal or state training or youth programs.

Since all low-income families with children would be eligible for PSE, participants would be drawn from a much larger pool than current welfare recipients. The Department of Health, Education, and Welfare estimated that over 44 percent of this pool would be persons not currently receiving AFDC, food stamps, or other relief. If approximately 44 percent of PSE slots were indeed filled with people now on welfare, AFDC caseloads would drop by only 28 percent.[24]

Federal guidelines are supposed to assure the appropriateness of job opportunities relative to skill levels of the "target" groups and to provide for training as part of job activities. Provisions of the PBJI generously encourage flexible hours and provision of part-time employment to accommodate participants.

The jobs program anticipates stimulating local projects not currently feasible on a large scale in most communities. HEW identifies thirteen major categories of such jobs and estimates the number of participants likely to hold each job.[25]

200,000—aiding the elderly and infirmed;
200,000—constructing and maintaining local recreational facilities;
150,000—improving public safety;
150,000—paraprofessionals in local schools;
150,000—providing child care;
125,000—supervising recreation programs;
100,000—cleaning neighborhoods and controlling insects and rodents;
100,000—refurbishing school facilities;
75,000—supporting cultural activities;
50,000—monitoring environmental quality;
50,000—weatherizing homes;
25,000—providing facilities for the handicapped;
25,000—aiding in waste treatment and recycling.

Many of these jobs duplicate services performed by private sector small businesses and in some instances require labor skills competing directly with union

[24]United States Department of Health, Education, and Welfare, "Welfare Reform."
[25]United States Department of Health, Education, and Welfare, "Welfare Reform."

members. Most of these jobs also appear to require skills beyond those normally attributed to the "targeted" poor, and one wonders whether some of the job categories are fancy names for leaf-rakers and baby-sitters.

The legislation includes a "fail-safe" provision authorizing the Secretary of Labor to arrange employment opportunities directly with public and private nonprofit agencies if the state and local governments do not provide the required number of jobs.

Income Support Program. The cash assistance component of the PBJI consolidates three of the largest income-tested transfer programs: Aid to Families with Dependent Children, Supplemental Security Income, and Food Stamps. The principal objective of this restructuring of the nation's welfare system is to discourage welfare dependency and to convert hundreds of state and county welfare programs having vastly different eligibility rules, benefits, and regulations into a single, Federally funded welfare system. The PBJI also anticipates applying computer technology to monthly benefit calculations to reduce administrative costs and overpayments arising from unreported income and to eliminate fraud.

The new system would be partially supplemented and administered by state and local governments. The system provides a basic two-tier benefit structure, which bases payments on family size and willingness to work. The upper tier provides benefits equal to approximately 65 percent of the poverty threshold. The second, and much lower, tier of benefits is intended to create work incentives by providing only subsistence income. Virtually no one in the noninstitutionalized civilian population would be categorically excluded from receiving some level of income assistance as long as the living unit meets income and asset requirements. Married couples without children, single persons, those living in "group quarters," students, aliens and other residents here and in the territories of the United States would all be eligible for some, albeit differential, welfare benefits.

This cash support system would afford benefits to existing welfare recipients who are expected to work, to those persons currently working at a low income, and to those persons exempted from employment for reasons of blindness, disability, age of children, and the like. Cash benefit determination would involve extremely complex calculations, considering the large number of parameters influencing the total value of such awards. These parameters cannot be summarized briefly. Enumeration would be complicated and not especially systematic. Benefit penalties against earned income differ, moreover, depending on whether or not a member of the family unit is expected to work. Matching provisions would encourage states to augment Federal benefit levels up to 100 percent of the poverty level. Future benefit levels in any one state may or may not equal the national benefit or existing welfare payments.

Some examples may serve to illustrate the general emphasis and complexity of the differential cash assistance provisions. Consider a single-parent family of four. (Income is based on a 2000 hour work year.) If the head of the household is exempted from work, the family would receive a Federal guarantee of $4,200, unless the state chose to supplement the Federal payment.

If the youngest child is between seven and fourteen years of age and the parent is required to work part time, earnings from PSE plus the supplementary income bonus would total $5,370. However, should the parent refuse to work, annual benefits would fall to $2,300. Total earnings from a half-time private sector job at the minimum wage would be slightly higher, $5,635, because of the earned income tax credit.

If the youngest child is over fourteen years, full-time employment would be required. In this case, earnings from a special public service job would amount to $6,540 and those from private employment would total $7,005. (Cash benefits for a family of four do not phase out completely until income reaches $8,400.) The differential, in this and other cases, between non-work public service employment, and private work does not appear adequate to produce the intended effects.

Single persons, currently entitled only to $600 worth of food stamp benefits, would receive an income guarantee of $1,100 under the proposal. They would be expected to work, although they would not be eligible for special public jobs. Benefits decrease 50¢ for each additional dollar earned. Note that this is a much higher tax rate than these persons now face. Single persons do not qualify for the earned income tax credit. When FICA is subtracted from wages, a far greater disincentive to work is built into the proposal than exists under current law.

The PBJI encourages states and districts now having higher welfare benefits, such as California, New York, and the District of Columbia, to maintain their differential cash assistance up to the calculated poverty level by agreeing to offset a substantial fraction of these costs in addition to the $4,200 Federal share. Apparently the Administration believes that the national benefits floor would not represent an adequate income in certain parts of the country. Differences in the cost of living, however, do not parallel welfare differentials. These indices, moreover, do not reflect the intrinsic values, such as climate, associated with particular geographic locations, and, of course, cannot reflect individual preferences. When states supplement welfare payments up to the poverty threshold, as the bill encourages them to do, they must also increase the minimum wage payable to PSE employees. This is true regardless of the condition of local labor markets.

Tax Reduction Provisions. Liability under the Federal income tax in 1977 begins with adjusted gross incomes above $7,200. The Administration's proposal apparently intends to recommend an increase in the minimum taxable income to $9,080, although the precise method of establishing this threshold was not delineated.[26]

The PBJI would also modify and expand the earned income tax credit. This 1975 tax law provision currently provides $400 in benefits (in cash or reduced taxes) to families with $4,000 of earnings, $200 for those earning $2,000 or $6,000, and no benefits if earnings exceed $8,000. Since work disincentives would thus be created for families earning between $4,000 and $8,000, many of whom would also be eligible for cash assistance, the PBJI proposes to extend the credit to income levels

[26]Sheldon Danziger, Robert Haveman, and Eugene Smolensky, "The Program for Better Jobs and Income: A Guide and a Critique," prepared for the Joint Economic Committee of the United States Congress (October 1977), 7.

up to $15,620! The tax credit would be calculated monthly and would be reflected in the withholding process. Nearly 50 percent of all families would benefit by this expansion of the earned income tax credit. As an incentive for job holders to leave subsidized employment, earnings from such employment would not be eligible for the earned income tax credit.

Fiscal Relief for State and Local Governments. Fiscal relief is a major stated objective of the reform proposal. States, on the average, will realize savings in their welfare expenditures of 18.1 percent, which must be distributed to localities in proportion to their total burden of state welfare costs. Those states and cities that have traditionally paid the highest benefits will realize the largest savings. California, New York State, and the District of Columbia, for example, will receive relief (as a percent of their current level of effort) of approximately 31, 36, and 56 percent, respectively. No state would save less than 10 percent. The bill therefore rewards communities that have previously been most guilty of encouraging (or underwriting) welfare dependency.

Evaluating the PBJI as Welfare Policy

To assess the PBJI, as well as similar programs containing target unemployment goals, against its stated objective (reducing the level of unemployment, particularly among the hard-core unemployed, at minimal acceptable rates of inflation) one must answer several critical questions. Will the work incentives provided current welfare recipients induce a substantial portion of them to seek PSE? Beyond the "target" unemployed, what is the potential total supply of applicants for PSE? How rapidly will state and local governments respond to changes in "measured" unemployment, and what kinds of jobs are they likely to "create" to meet the demand for PSE? What will be the resource and inflation costs of the outcome or, more specifically, what is the probable impact of the program on total employment, the distribution of income, and total output?

Work Incentives and the Potential Supply of Targeted PSE Workers. Our evaluation begins with the question of work incentives. The benefit structures of the income maintenance program and the revised earned income tax credit were designed with the intention of providing work incentives to welfare recipients without changing the relative position of those low income persons currently employed. Those benefit structures also were intended to encourage family stability.

There are an overwhelming number of alternative benefit schedules depending on marital status and the ages and number of dependent children in each household. To simplify the task of examining the incentive structure, a welfare family of four with a female head of household will be singled out for reference. Households with female heads represent a substantial fraction of total AFDC caseloads and expenditures. These households also tend to be the most welfare dependent and resistant to public policy attempts to induce gainful employment. The accompanying table

shows the components of income for an eligible four member household with a female head.

COMPONENTS OF TOTAL INCOME: FEMALE-HEADED FAMILY OF FOUR, ELIGIBLE FOR AFDC AND NOT EMPLOYED[27]

	Case I: Not Expected to Work		Case II: Expected to Work Part-Time		Case III: Expected to Work Full Time	
	Present System	Proposed System	Present System	Proposed System	Present System	Proposed System
Regular earned income	0	0	0	0	0	0
Special public job earnings	0	0	0	$2,650	0	$5,300
Supplementary income bonus[1]	0	$4,200	0	2,875	0	1,550
Earned income tax credit[2]	0	0	0	0	0	0
Payroll tax[3]	0	0	0	−155	0	−310
Federal income tax	0	0	0	0	0	0
AFDC[4]	$720-$5,712	0	$720-5,712	0	$720-5,712	0
Food stamps[5]	$1,992-696	0	1,992-696	0	1,992-696	0
Total income	$2,712-6,408	4,200	2,712-6,408	5,370	2,712-6,408	6,540

[1]The amount by which States might supplement the work bonus would be added to this total. If States choose to supplement, they must also supplement the wage of the special public job. The guarantee of $4,200 is reduced by 50 cents for each $1 of earnings of those expected to work less than full time. For those expected to work full time, the guarantee is only $2,300, but the first $3,800 of earnings are not taxed.
[2]The earned income tax credit is available to families with children, but not for special public jobs.
[3]Employee's share of the payroll tax—5.85 percent.
[4]The minimum benefit shown is for Mississippi; the maximum, for New York.
[5]The bonus value of food stamps is computed by assuming a standard deduction of $50 per month for a couple and $100 per month for a family of 4.

The most obvious problem with the proposed benefit schedule is the implicit wage per hour of PSE work. The PSE wage for mothers expected to work in full- or part-time jobs amounts to only $1.17, which hardly appears to be a sufficiently attractive wage to induce actual employment. Studies of WIN found that work related expenses, such as child care and travel, were significant determinants of welfare mothers' work effort.[28] The differential wage provided by PSE is simply not adequate to cover these costs, even taking into account child care deduction. And, the wage differential is certainly insufficient to reward work effort outside the home. These persons will be best off under this system by *registering* for work but failing to get or to keep a job, since the penalty for refusal is a 50 percent reduction in family benefits. Studies show that work requirements carrying penalties this severe will induce welfare mothers to work.[29] The Administration's proposal, however, essentially negates any positive

[27]This table is based on Tables 1 and 2 in Danziger, Haveman, and Smolensky, "The Program for Better Jobs and Income: A Guide and a Critique," 15-16.

[28]Sar A. Levitan and David Marwick, "Work and Training for Relief Recipients," *The Journal of Human Resources*, 8 (Supplement 1973), 5-18.

[29]See, for example, Irwin Garfinkel and Larry T. Orr, "Welfare Policy and the Employment Rate of AFDC Mothers," *National Tax Journal*, 27 (June 1974), 275-284.

effect from this inducement because of the proposal's relatively small incremental income provided for PSE employment.

The accompanying table also illustrates the substantial geographical differences in the impact of the Administration's program. Welfare recipients in Mississippi will automatically receive nearly 50 percent more income. The PBJI essentially imposes on state and local governments a required conformity with national standards, which will impact on the number and location of welfare recipients. Substantial increases in the income provided welfare families in certain parts of the country are likely to affect adversely the attitudes and motivation of a substantial number of low income, private sector workers, to the detriment of private employment, output, and costs.

The benefit structure contains several other adverse incentive effects. First, it does not, as intended, encourage family stability. Fathers not living with the family are guaranteed the $1100 income provided for singles, but those fathers would add only $600 if they remained with their families. Second, the program continues to encourage welfare mothers to bear children, only with a somewhat different time pattern. The program provides an incentive for mothers to space their children's births so that they have a child under seven as long as possible. Moreover, benefits increase beyond the $4,200 payment (for a family of four) with each child up to a total of six children. Maximum national benefits peak at $6,000 for a mother with six children; total family income with a father living separately would be $7,000, with no taxes or work expenses deducted so long as employment is avoided.

The $4200 national benefit for a family of four, at the state's option, may be augmented with Federal matching grants up to the $6440 poverty threshold. This provision of the PBJI not only perpetuates existing geographical differentials in welfare expenditures, but also rewards those states that have been most guilty of encouraging welfare dependency. Since the minimum wage supplements are limited to increases of 10 percent beyond the national level, there will be geographic differences in the work incentives that the bill provides. Assuming that the highest paying states will elect to supplement as provided, welfare recipients effectively will be rewarded more handsomely for avoiding employment in the most heavily populated welfare states.

A recent study by Garfinkel and Orr of the effects of work incentives on the employment rate of welfare mothers showed how limited these effects, as well as others, might be on the employment rate. Garfinkel and Orr report, "Even if one were to simultaneously decrease the guarantee by 40%, the tax rate by 35 percentage points, and aggregate unemployment by 1.5 percentage points; increase the levels of the set-aside and deductions by $50, and the percentage of the caseload receiving rehabilitation services by 10%; and impose a work test in all states, our estimates imply that 50 percent of the AFDC mothers in a typical state would still not work."[30]

These findings suggest that even though the PBJI imposes a strict work test as a condition of receipt of benefits, a significant increase in employment rates among welfare mothers is unlikely. However, the PBJI may create an artificially high measured

[30] Garfinkel and Orr, "Welfare Policy and the Employment Rate of AFDC Mothers," 283.

23-544 O - 78 - 6

labor supply, or number of registrants for work programs. One problem with PSE as a welfare policy is that there is no way to make people actually work, unless one is satisfied with herding the "target" group into a room to keep them away from home for X hours per day. Since one cannot *fire* anyone from PSE, and since one cannot make anyone *do* anything either, the most probable outcome is a large pool of welfare recipients registered to work and held indefinitely in the category "awaiting assignment." Those so categorized receive the maximum net spendable income for a minimum expenditure of time and effort.

For those who do respond positively to the rather small income differentials, and who willingly participate in PSE and job training, the outlook is bleak for long-term employment in either the public or private sector. Given the low skill level of the average welfare recipient relative to the needs of state and local governments, and given the true overall costs of creating public jobs (that is, additional costs of labor and capital resources and administration), neither a state nor a local government has an incentive to provide an adequate number of these jobs. The program's ultimate goal of moving PSE employees into private sector employment after training and "rehabilitation," moreover, must be seen as "pie-in-the-sky" in view of past experience with Federally funded training programs, especially since little training is envisaged in the program. Indeed, it would seem that the likely poor work context would corrupt rather than upgrade skills.

"Graduates" from WIN registered gains in hourly wages that were either modest or nonexistent. Thirty percent of all males and three out of every five women enrollees were still making only $2.00 per hour after leaving the training program. Attrition rates were high from the outset because child-care allowances were inadequate and training bonuses above welfare amounted in some cases to as little as $1.50 per day. The attrition rates increased steadily as participants became disillusioned by feedback on graduates.[31] The Department of Labor claims only a 20 percent success rate in moving participants permanently off welfare.

The Congressional Budget Office reports that even intensive training programs fail to raise participants' lifetime income potential. The average manpower training enrollee (either a youth or a minority group member) achieved a yearly post-training income differential of only $400. Most of this differential, however, stemmed from an increase in hours worked per week or in weeks worked per year, rather than from higher hourly earnings.[32]

Most programs aimed at welfare recipients rather than at the poor in general, such as WIN and the $50 million welfare demonstration under the Emergency Employment Act of 1971, have been implemented only with long lead times and an underutilization of appropriated funds. California, to take but one example, did not even bother to submit an application for funds under the Emergency Employment Act. Except for PSE-CETA, in which participation is not restricted to current welfare

[31]Levitan and Marwick, "Work and Training for Relief Recipients.

[32]United States Congress, Congressional Budget Office, "Public Employment and Training Assistance: Alternative Federal Approaches," 28-29.

recipients, appropriations were very rapidly absorbed by most eligible localities.[33]

State and local governments may react in ways destructive of the PBJI goals because welfare recipients cannot easily be assimilated into their work forces; or, because these governmental units are unwilling to participate unless they can effectively substitute Federal money for local taxes; or, because administration costs are differentially higher for programs like WIN, with no net reduction in total welfare costs. Whatever the reason, state and local governments are not likely to follow the intent of the PBJI.

A New Welfare Class. While the PBJI does not appear to be designed effectively to put welfare recipients into PSE, it shows great promise for inducing a substantial fraction of working class and lower middle class Americans out of private sector employment and into public sector jobs. At best, the PBJI will have the regrettable effect of transferring to the middle class the incentives to disrupt family status so lamented in the current welfare system. This disruption arises from the earned-income-tax credit and minimum tax provisions of the PBJI.

A substantial fraction (approximately 42 percent in 1974) of all individual tax returns report adjusted gross income below $15,000. The expanded earned income tax credit would provide tax relief to all of these household units with children. In today's economy many families have two wage earners and, in these circumstances, probably have total incomes exceeding $15,000 by large amounts. (In 1974, fully 73 percent of all returns showed adjusted gross incomes under $30,000.) The progressivity of the income tax tends to discourage marriage for many couples pursuing joint careers, and this disincentive will be greatly reinforced by the proposed expansion of the earned income tax credit and increase in the minimum taxable income. Many families with double incomes up to $30,000 will find that separate mailing addresses, if not living quarters, could pay off handsomely. Alternatively there would be cash and income incentives to outright divorce.

Suppose that a husband and wife each earns $12,000, and their adjusted gross income is $20,000. Their 1976 tax liability would have ranged between $2400 and $2800, assuming three to four dependents and deductions equal to 10 percent of income. Under the Administration's program, this family could reduce its income tax liability to $1430 and gain an approximate offset of $650 against the wife's FICA tax by separating. The total tax reduction is about 73 percent! In some cases it may be advantageous for each parent to claim some of the children as dependents, so that each secures the benefits of the earned income tax credit, further reducing their joint tax liability. It is possible in this income range to reduce Federal income tax liability to zero *and* gain an earned income tax credit refund substantially offsetting social security taxes. No one should be so naive as to believe that some middle class Americans will fail to take advantage of a new tax avoidance scheme if one is presented to them.

Beyond the disincentives to family stability, it is not difficult to conceive of situa-

[33]Levitan and Marwick, "Work Training For Relief Recipients."

tions in which the household could not possibly help but be better off if one or both wage earners withdrew from private employment in favor of PSE. Public employment offers far more security than is enjoyed by many low income workers. People awaiting PSE jobs are guaranteed welfare benefits frequently higher than unemployment insurance provides.

The PBJI, moreover, explicitly states that welfare and supplemental income benefits are to increase automatically to keep pace with inflation and that the Administration intends periodically to raise benefits in *real* terms.[34] Presumably, minimum wages, already scheduled to rise to $3.30 per hour in 1981, will be similarly pegged so that the so-called work incentives of the benefit structure will be maintained. Minimum wages that rise faster than productivity will create more unemployment and increase further the number of potential PSE workers. Studies have shown that so great is the attraction of stable. secure public employment, many people prolong their job search just to await these jobs, especially during periods of economic contraction. A recent study has demonstrated how an increase in the public sector itself tends to increase measured unemployment by this mechanism alone.[35] If the PBJI guarantees employment to all takers, then the potential labor supply to the government under this program is likely to be of nightmarish proportions.

It should be noted that the tax provisions of the PBJI are critical to the proposal's financial structure. If the earned income tax credit remained at current levels, then all heads-of-households employed at wages approximating the 1981 minimum wage would be far better off on welfare.

Those low and middle income and skilled workers who would intentionally drop out of the private sector under the PBJI are just the kind of workers state and local governments can use at least up to some saturation level. In creating PSE slots to absorb them, the government competes directly with the private sector and pushes up the relative wage of public and private workers. There is a definite limit to the creation of local jobs in the short run unless local taxpayers radically change their attitudes. The public sector, however, will grow, if slowly, while the private sector labors to support the public sector and the overwhelming welfare burden. Total employment probably will fall even in the short run, and the rate of growth in real output will decline over time.

One of the potentially most adverse implications of the scenario is that the *production potential* of the economy declines over time. This decline can be expected not only because of the effects of an increasingly large public sector, but also because of the redistribution of income that results from rising relative wages of low- and moderate-skilled groups. As the relative wage of unskilled or semi-skilled workers rises, future labor market participants alter their plans to attain higher, more specialized academic and vocational educations. These education decisions are extremely responsive to changes in lifetime income prospects. Thus, the more successfully the PBJI

[34]United States Department of Health, Education, and Welfare, "Welfare Reform," 15.

[35]David A. Coulter, "A Two Sector Model of the Labor Market," unpublished paper prepared for the Carnegie-Rochester Conference on Public Policy (November 18-19, 1977).

artificially redistributes income and opportunity to its target group or to other low skill workers, the more deleterious will be the PBJI's long-run consequences.

Costs of PBJI. With typical myopia, the PBJI's authors have neglected completely to account for the potential long-run resource and inflation costs its implementation would impose on the economy. The same faulty and biased foresight results in initial cost projections that not only are much too low, but also are extremely inaccurate and misleading.

The Carter Administration estimates that the total Federal cost of funding the PBJI's major provisions will be $30.7 billion for the first year the program is in full operation. Included is $19.2 billion for public cash assistance payments, $8.8 billion for PSE and training, $1.5 billion to cover the earned income tax credit for those receiving income supplements, and $1.2 billion to cover the emergency block grants to the states and child-care deductions. This total neglects the rather substantial earned income tax credit benefits, expected to exceed $3.4 billion, for persons in the middle-income range. The Administration argues that, although the earned income tax credit is a critical part of its work incentive measures, these expenditures or tax forgivenesses do not represent welfare expenditures.

Offset against these projected costs are $27.9 billion in current Federal expenditures that would be cancelled. A major offset is the $23.0 billion in current outlays for AFDC, SSI, food stamps, and the stimulus portion of CETA and WIN. Several other current expenditure categories, extended unemployment insurance compensation, housing subsidies and projected reductions in HEW's budget (from reduced fraud and abuse) are used to offset $1.5 billion of estimated costs.

Including as offsets prospective reductions in housing subsidies and wellhead tax revenue refunds, supposed to be made directly to individuals and included in an energy bill as yet unpassed, represents what is sometimes euphemistically termed "creative account!" More puzzling is the inclusion of lost tax revenues from the existing earned income tax credit, since such future costs are excluded from the other side of the accounts.

It is indefensible to include anticipated contributions to the social security and unemployment compensation trust funds from PSE workers. Social security contributions result in a Federal *liability* in future years of an as yet unknown amount. This account is a separate trust fund, and revenues are not available for general government expenditures. Unemployment compensation is also an insurance scheme, funded by a tax on labor income. If unemployment goes down, the tax rate on the currently employed should go down and allow workers to enjoy a higher nominal after-tax income. They and their employers will need that higher income to pay the taxes necessary to support the PBJI.

The Carter Administration estimates a $2.8 billion first year *net* cost for the PBJI. The true net cost should now realistically be considered to be three to four times that high, even disregarding the likely private sector costs that have been neglected in the Administration's analysis. Unfortunately, it is on the basis of this $2.8 billion net cost estimate that the PBJI will be "sold" to the American people.

BIBLIOGRAPHY

Bailey, Martin N., and Tobin, James. "Direct Job Creation, Inflation, and Unemployment." Paper prepared for the Brookings Conference on Direct Job Creation, April 1977.

Carlson, Keith M., and Spencer, Roger W. "Crowding Out and Its Critics." *Federal Reserve Bank of St. Louis Review* (December 1975).

Chiswick, Barry R., and O'Neill, June A., eds. *Human Resources and Income Distribution*. New York: Norton, 1977.

Clarkson, Kenneth W., and Meiners, Roger E. "Government Statistics as a Guide to Economic Policy: Food Stamps and the Spurious Increase in the Unemployment Rates." *Policy Review* 1 (Summer 1977): 27-51.

———, *Inflated Unemployment Statistics: The Effects of Welfare Work Registration Requirements*. Coral Gables, Fla.: Law and Economics Center, University of Miami, 1977.

Coulter, David A. "A Two Sector Model of the Labor Market." Paper presented at the Carnegie-Rochester Conference on Public Policy, 18 November 1977.

Danziger, Sheldon; Haveman, Robert; and Smolensky, Eugene. "The Program for Better Jobs and Income: A Guide and Critique." Study prepared for the joint Economic Committee, U.S. Congress, October 1977.

Fechter, Alan. "Job-Creation Through Public Service Employment Programs." Unpublished paper. Prepared for the Joint Conference of the National Council on Employment Policy and the School of Labor and Industrial Relations, Michigan State University, East Lansing, Michigan, May 19-20, 1977. Revised June 8, 1977.

———, *Public Employment Programs*. Washington, D.C.: American Enterprise Institute, 1975.

Feldstein, Martin S. "The Economics of the New Unemployment." *The Public Interest* 33 (Fall 1973): 3-42.

Friedman, Barry L., and Hausman, Leonard J. "Work, Welfare, and the Program for Better Jobs and Income." Study prepared for the Joint Economic Committee, U.S. Congress, October 1977.

Friedman, Milton. "Nobel Lecture: Inflation and Unemployment." *Journal of Political Economy* 85 (June 1977): 451-472.

Garfinkel, Irwin, and Orr, Larry L. "Welfare Policy and the Employment Rate of AFDC Mothers." *National Tax Journal* 27 (June 1974): 275-284.

Ginzberg, Eli. "The Job Problem." *Scientific American* 237 (November 1977): 43-51.

Gramlich, Edward M., and Galper, Harvey. "State and Local Fiscal Behavior and Federal Grant Policy." *Brookings Papers on Economic Activity* 1 (1973): 15-58.

Hall, Robert E. "The Rigidity of Wages and the Persistence of Unemployment." *Brookings Papers on Economic Activity* 2 (1975): 301-349.

Johnson, George E. "The Public Finance of Public Service Employment." Paper presented at the Brookings Conference on Direct Job Creation, April 1977.

———, and Tomola, James D. "The Fiscal Substitution Effect of Alternative Approaches to Public Service Employment Policy." *The Journal of Human Resources* 12 (Winter 1977): 3-26.

Kemper, Peter, and Moss, Philip. "The Efficiency of Targeted Job Creation: Conjectures Based on Early Supported Work Experience." Paper presented at the Brookings Conference for Research on Poverty, March 1977.

Levitan, Sar A., and Marwick, David. "Work and Training for Relief Recipients." *The Journal of Human Resources* 8 (Supplement 1973): 5-18.

———, and Taggert, Robert. *Emergency Employment Act: The PEP Generation.* Salt Lake City: Olympus, 1974.

Meiselman, David I. "The Impact of Countercyclical Monetary and Fiscal Policies on Housing." *Housing in the Seventies: Volume II,* Department of Housing and Urban Development, 1976.

———. "More Inflation: More Unemployment," *Tax Review* (January 1976).

———. Testimony before U.S. House of Representatives, Subcommittee on Domestic Monetary Policy. *Hearings on the Impact of the Federal Reserve's Money Policies on the Economy,* 94th Cong., 2d sess., 9 June 1976.

———. "Unemployment and the Variability of Inflation: A Feasibility Study." Unpublished. Paper prepared for United States Department of Labor, September 1977.

———. "Worldwide Inflation: A Monetarist View." In *The Phenomenon of Worldwide Inflation,* edited by David Meiselman and Arthur Laffer. Washington, D.C.: American Enterprise Institute, 1975.

Moore, Geoffrey H. *How Full Is Full Employment? and Other Essays on Interpreting the Unemployment Statistics.* Washington, D.C.: American Enterprise Institute, 1973.

O'Neill, Dave M. *The Federal Government and Manpower.* Washington, D.C.: American Enterprise Institute, 1973.

Rees, Albert. "An Overview of the Labor-Supply Results." *The Journal of Human Resources* 9 (Spring 1974): 158-180.

Smith, Sharon P. "An Examination of Employment and Unemployment Rates." *Federal Reserve Bank of New York Quarterly Review* (Autumn 1977): 14-18.

Tax Foundation, Inc. "The President's Welfare Reform Proposals: 1977—A Summary with Initial Reactions and Comments." New York: Tax Foundation, Inc., 1977.

United States Congress, Congressional Budget Office, "Public Employment and Training Assistance: Alternative Federal Approaches." Budget Issue Paper (Washington, D.C.: United States Government Printing Office, 1977).

United States Department of Health, Education, and Welfare, "Better Jobs and Income Act: H.R. 9030—A Summary and Sectional Explanation." 13 September 1977.

United States Department of Health, Education, and Welfare, "Welfare Reform." *H.E.W. News* (August 1977).

Weicher, John. "Aid, Expenditures, and Local Government Structure." *National Tax Journal* 25 (December 1972): 573-583.

Williams, Walter E. "Government Sanctioned Restraints that Reduce Economic Opportunities for Minorities." *Policy Review* 2 (Fall 1977): 7-30.

Wiseman, Michael. "Public Employment as Fiscal Policy." *Brookings Papers on Economic Activity* 1 (1976): 67-104.

L&EC *Occasional Paper* **LEC 4-4/178**

Welfare Reform and the Carter Public Service Employment Program: A Critique by Professor David I. Meiselman acknowledges that there is a real unemployment problem in the United States. Many Americans are poor. It is generally recognized that the present welfare system has caused more unemployment and has perpetuated poverty.

This essay examines closely the Carter Administration's welfare proposal, H.R. 9030, and especially its provisions for public service employment. Despite the Administration's claims that the program will shift the poor from welfare dependency to productive jobs, especially in the private sector, and at low additional costs to the taxpayers, this study finds quite the contrary.

If enacted into law, H.R. 9030 would cause a further expansion of the public sector that potentially will attract a large segment of low- and middle-income workers out of the private sector into low productivity, low priority, and largely dead-end public sector employment. Costs will be substantially higher than the Administration forecasts. A whole new welfare class is likely to emerge, and family stability will be further impaired. The ultimate costs will include both lower overall employment and less economic growth. At the same time, the basic causes of the current problems of unemployment and poverty, poor government policies that have increased barriers to employment and to gaining work skills while increasing incentives to unemployment and welfare, all are left intact. The egalitarian zeal for equalizing distress, which is inherent in the Carter proposal, is not an acceptable solution.

$2.50

ISBN 0-916770-05-2

LAW AND ECONOMICS CENTER
UNIVERSITY OF MIAMI SCHOOL OF LAW
Post Office Box 248000
Coral Gables, FL 33124 (305) 284-6174

STATEMENT OF OTTO ECKSTEIN, PRESIDENT, DATA RESOURCES, INC., AND PAUL M. WARBURG, PROFESSOR OF ECONOMICS, HARVARD UNIVERSITY

According to the government's estimates, the gross federal debt will reach $873.7 billion by September 30, 1979. In the ordinary course of events, the debt will pass the $1 trillion mark in 1981.

Does it matter? Twenty years ago, most economists would have answered that it matter rather little, because the interest payments are a transfer within the American people. While there was a revival of the classical view that there was an intergenerational burden, the arguments were rather obscure and based on somewhat "iffy" assumptions.

But circumstances have changed in a variety of ways in the last 20 years, and so it is appropriate to use the occasion of the annual ritual of the statutory debt limit extension to reach a new assessment on the importance of the debt burden and of the implications for budget policy.

THE SHORT-TERM ISSUES

The debt is growing rapidly because the budget deficits have become so enormous. As Chart 1 shows, the net interest burden as a percentage of gross national product, which had changed rather little from the end of World War II until 1967, has risen substantially since then. Short and long-term interest rates are much higher in response to the last decade of inflation, and the size of the debt has also increased very sharply. The underfinanced Vietnam War and the 1967 slowdown produced the first of the recent frightening deficits. The 1970 recession and the subsequent stimulative fiscal policy, added three more large deficits. The great recession of 1974–75 added mightily to the debt, of course. The subsequent recovery, unlike other postwar business cycle recoveries, is not bringing a rapid shrinkage of the deficits. This condition is the first major issue that must be studied.

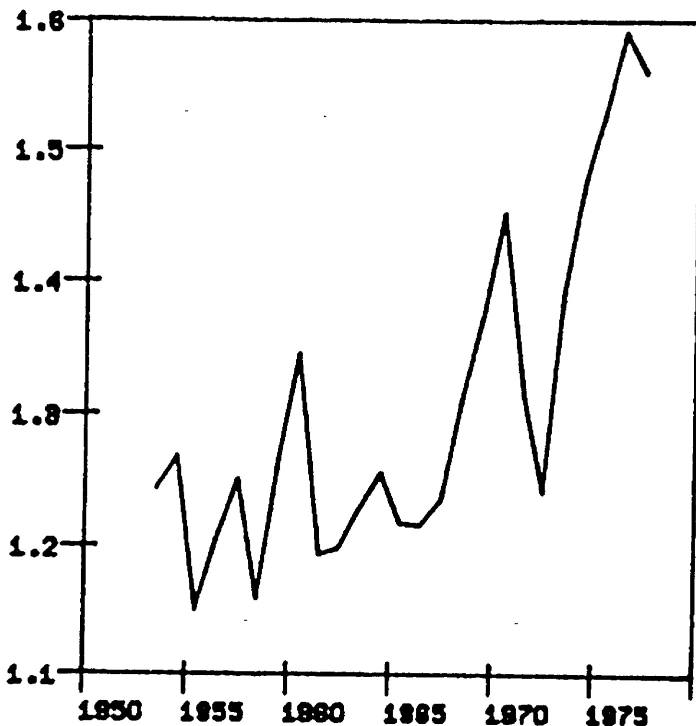


CHART 1.—Net interest as a percent of GNP.

THE 1979 BUDGET IN PERSPECTIVE

The President's 1979 budget is a strategy of expansion. The full employment budget, the best available measure of direct budget impact, shows a sizeable increase in its deficit both in fiscal 1978 and fiscal 1979. This is somewhat at odds with the media description of the budget as moderate. How did the need for this budget plan develop? What are the actual prospects for the 1979 project after Congressional action and Administrative implementation? What are the implications for the economy?

According to the government's estimates, the full employment budget deficit on the unified budget basis increases from $10 billion in fiscal 1977 to $32 billion in 1978 and $37 billion in 1979. DRI has calculated the comparable estimates on the national income accounts basis. The rise in the deficit is not quite so extreme (Table 1), reaching a $25 billion deficit for 1979. The difference lies in net lending: the Federal housing agencies are moving back to high lending volumes which are not included in the national income accounts because they are offset by asset acquisitions.

TABLE 1.—*Full employment budget surplus or deficit (—) billions of dollars—fiscal years*

Unified budget basis:[1]	
1977	—10
1978	—32
1979	—37
National income accounts basis:[2]	
1977	—8
1978	—19
1979	—25

[1] Source: Office of Management and Budget.
[2] Source: DRI estimate, based on President's budget.

But even at the more moderate NIA estimates, a rising full employment budget deficit in years four and five of a business cycle expansion deserves close examination (chart 2). The reasons for this budget strategy are these:

1. The President has placed employment gains high on his priority scale. The public and the Congress justifiably expect him to show steady declines in the unemployment rate.

2. The economy probably would slow down substantially if the budget did not have an expansionary posture. Consumer spending will rise less than income in 1978 because the debt burden is already excessive. There is also considerable evidence in automobile and other retail sales that consumers are taking steps to bring their debt burden back in line. The government survey of business investment plans leaves little doubt that investment will not be strong enough to carry the economy forward alone. A year ago, the Administration adopted a growth strategy based on 10% growth in real investment, but that hope must be abandoned in the light of the survey. Housing starts are very likely to fall before 1978 is over because of high interest rates and recent above-trend activity. Finally, the Federal Reserve, even under the chairmanship of Mr. Miller, is likely to raise interest rates somewhat further as monetary growth is likely to continue to be above the 6½% target ceiling over the next 6 months.

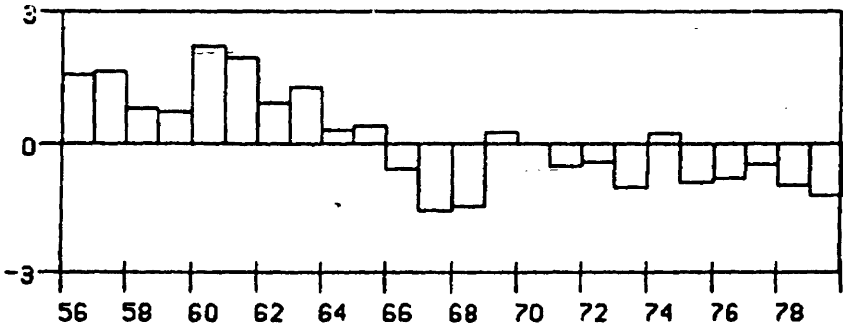


CHART 2.—Full employment budget surplus or deficit as a percent of GNP (fiscal years, NIA basis)

Source: DRI estimates; fiscal years 1978 and 1979 based on President Carter's 1979 budget.

WILL THE BUDGET STRATEGY WORK?

The DRI forecast is somewhat below the projections in the President's economic report, but the difference between the two projections is moderate, a total of 1.2 percent by 1980 (table 2). The DRI answers are somewhat lower for three reasons. First, DRI believes that actual budget outlays will again fall short of the President's proposals. The spending shortfalls of recent years appear to have continued into the current fiscal year. The President's budget proposals use the Second Congressional Resolution as their baseline, but it is apparent that fiscal 1978 spending will be considerably less, about $5 billion less according to the DRI estimates. While there are some areas in the 1979 budget, particularly the agricultural outlays, which could easily prove to be larger than the President's estimates, more general spending shortfalls are likely to outweight them.

TABLE 2.—*Real GNP growth (percent)*

President's projections:	
1978	4.7
1979	4.8
1980	4.8
DRI forecast:	
1978	4.5
1979	3.9
1980	4.7

Second, the DRI forecast is somewhat lower because the large Federal deficit will produce some "crowding out." The DRI model is not monetarist in the sense that every dollar of Federal deficit displaces a dollar of private spending, but the model does reflect the impact of Treasury financing on interest rates. The Federal Reserve is not likely to permit the rates of increase in the money supply that would be required to fully accommodate unified budget deficits of $61 billion, which convert into financing needs that are substantially greater because of the deficits of off-budget agencies. In 1979 the government's estimate of total borrowing from the public is $73 billion, $7 billion more than projected for 1978. While the government's total financing needs will remain roughly constant in 1979, a large fraction of 1978's deficit will be financed by drawing down unusually large cash holdings. Finally, DRI projects some final demands to grow a little less than the Administration. This is particularly the case in 1979, when DRI sees a lull in the economy due to reduced housing activity.

WILL THE OUTSIDE WORLD PERMIT US TO FOLLOW THIS STRATEGY?

The President's expansionist fiscal policy is a very different approach from that followed by Japan and West Germany. During 1977, the differences in growth rates produced a large disequilibrium in international trade, and at year-end a sharp decline of the dollar. If the disparity in economic performance continues through all of 1978, the recent policy change to stabilize the dollar will fail, and since the United States is not free to let the dollar sink without limit or to let exchange markets become disorderly, the international constraint would become effective on the U.S. economy. Higher interest rates would be the most direct expression of this influence.

Fortunately, there are scattered signs that the European economies are beginning to gain some momentum. West Germany's real GNP growth rebounded to a 3.4 percent annual rate in the final quarter of 1977, following a 0.4 percent advance in the third quarter. Industrial production and factory orders are also showing good gains in recent months. In France, industrial production jumped 4.1 percent in November, though it still stood below, year-earlier levels, and unemployment showed a good improvement in December. In the United Kingdom, the period of decline and stagnation also seemed to be coming to an end as production rose 0.6 percent in November and retail sales rose a big 3.2 percent in December.

Some of our other principal trading partners are showing less signs of a turnaround. The Canadian economy reached its highest unemployment rate of the postwar period in December, though housing and retail sales showed improvement near year-end. The Japanese economy, the largest industrial economy after our own, did not show much renewal. While production advanced 2.8 percent in November, retail sales remain weak, business fixed investment is flat to declining, and housing starts are not strong despite various government programs. Public outlays are showing some increases as the more recent stimulus packages are beginning to be felt. The government has reasserted its 7 percent goal for fiscal 1978, though it is too early to assess whether the government really means to reach it.

In summary, the Preseident's short-term fiscal policy proposals are correct, given the actual economic situation. The $25 billion tax reduction and the associated full-employment budget deficits are large and one could argue responsibly for a few billion dollars less. On the other hand, given the size of the full-employment budget deficit planed for years four and five of the expansion, it would be a serious error to aim at tax reductions beyond $25 billion, or to aim at budget deficits beyond $60 billion.

THE LONGER-TERM CHANGES

In the longer term, the presence of a large national debt raises a different set of issues. The burden of the debt is not measured by the interest payments or the absolute size in relation to the GNP, because inflation, including inflation created by the budget, steadily erodes the real burden of the debt. The burden is found elsewhere.

1. An increasing share of the debt is now owed to foreigners. As recently as 1970, the debts held abroad was small. The international monetary crisis that began in 1971 led to the acquisition of $45 billion of our debt by foreigners, principally central banks. The balance of payments deficits created by the oil crisis and the recession led to foreign purchases of another $33 billion in the years 1975–77, and the prospects are that foreign acquisition will continue near the $20 billion a year mark for some time. Thus, it is no longer true that we "owe it to ourselves"—some of the debt has become an external burden to the American people and we pay interest like any other debtor.

Besides the interest burden, the new dependence on foreign financing is eroding our freedom of action both in domestic and foreign policy. While there are some advantages in building economic and political ties to the oil producing countries who are buying our debt, the United States will pay a price for these relationships. Indeed, the sudden switch in U.S. foreign exchange rate policy this month is generally attribute to this factor.

2. The Federal debt is offset by very little real government capital. The big growth in government spending has been in a variety of income benefit programs, and in grants-in-aid to states which preponderantly also go for current outlays. According to the always interesting Special Analysis D of the Federal Budget (page 85), of a total 1977 budget outlay of $402 billion, only $24 billion went for

civil physical assets, $3 billion for net loans and financial investments, and $11 billion for civil research and development, a total of $38 billion, or less than 10%. Another $20 billion went for education and training, which can be considered a form of investment in human resources. On the military side, major equipment and public works represent only $21 of $98 billion. By any reasonable definition, the bulk of the debt is being created for consumption purposes. The continued expansion of the scope of government, taking an ever larger share of the GNP, gives every sign of curtailing the country's long-term growth.

3. The growth of the debt reflects a decision-making process in which outlays are not validated by a willingness to pay. The weakness of modern fiscal policy has always been that it removes the discipline of the balanced budget. If the political process must levy the taxes to pay for the expenditures, there is likely to be a more careful scrutiny than if the expenditures can be clothed in the virtue of deficit-creating stimulus packages. In a year of recession, the loss of discipline is not important because resource costs really are lower since labor and capital would otherwise be idle. But we are now talking about large deficits in years four and five of a recovery, with no serious prospect of a return to a situation where expenditures again have to be scrutinized in terms of their tax costs. The dangers posed by this situation to the efficiency of resource use in the public sector should not be ignored.

CONCLUDING COMMENTS

In dealing with the national debt, one must be realistic. The debt will grow and the Congress will have to raise the debt limit. This committee is wise to focus public attention on the growth of the debt each year. A rapidly expanding debt is a serious sign of weakness in the way we manage our economic affairs. Fiscal policies designed to undo the restraint of monetary policies, ineffectual expenditures with low multipliers and little long-term value, inflationary public and private policies which limit our prosperty, these and other flaws ultimately become converted into a rising national debt. Our children and grandchildren will judge us not so much by the size of the debt burden in relation to the GNP, but in terms of our accomplishments in solving our economic problems and thereby gradually slowing the growth rate of a rapidly rising national debt.

STATEMENT OF R. G. PENNER, AMERICAN ENTERPRISE INSTITUTE[1]

TAX CUTS, DEFICITS AND THE ECONOMY

There is an aura of gloom hanging over the U.S. economy. The stock market values the real capital stock of the average corporation far below what it would cost to replace it. Foreigners have little confidence in the dollar, and there is a general feeling that economic policymakers don't know what to do next.

Given our recent economic record the extreme pessimism is puzzling. Only three years ago we were plunging into the worst recession since the 1930's, and the unemployment rate was soaring. But since its peak of 9.0 percent in 1975, it has fallen to 6.4 percent, while employment has gone up by 8 million workers. Prices which rose over 12 percent from December 1973 to December 1974 have been rising at about one-half that rate over the last 9 months. If we could halve the rate again over the next 3 years, I am sure that everyone would be overjoyed.

But though the recovery is proceeding in a satisfactory manner—in the sense that real growth is continuing to lower the unemployment rate—there is a strong consensus that we have stopped making progress against inflation. It is said that the rate is "stuck" at 6 percent or that we have entered the great stagnation swamp. This is peculiar terminology in that the inflation rate has been far from "stock" and has been fluctuating quite a bit with food price changes and the severe winter of last year. When people say that the rate is "stuck," they are really referring to the forecasts for the next 2 years and not to the recent past. I cannot quarrel with their forecasts except to say that any price forecast is extremely uncertain. Nevertheless, it remains that the inflation rate is the one macro economic problem where few expect much progress over the next two years and this is the single, most important variable responsible for the malaise in the foreign exchange and stock markets.

It is within this context that we begin to debate the President's economic program for 1979. Time does not allow a thorough analysis of the entire budget

[1] Views expressed in this testimony are those of the author and do not necessarily reflect views of the staff, advisory panels, officers or trustees of AEI.

in all of its detail; so I would like to concentrate this testimony on the appropriateness of the recommended deficit and on some of the major individual income tax proposals.

The same inflation that makes financial markets so uneasy is inexorably pushing taxpayers into higher and higher tax brackets. A person receiving a cost-of-living raise typically finds that a higher marginal tax rate is applied to that raise than was applied to earlier wage increases and as a result, the taxpayer finds that although the employer seemed to compensate for inflation, there has actually been a loss in after-tax purchasing power. Any merit raise is also taxed at higher marginal rates and as a result, the total tax burden, as measured by the average tax rate, rises without Congress changing any tax laws.

The phenomenon is well illustrated by the attached chart which accompanied the President's tax message. In 1976, the individual tax burden as measured by the ratio of taxes to personal income was about the same level that had prevailed in the early sixties. In other words, legislated reductions in rates have, in the aggregate, offset the effects of inflation and real growth that I described above. The 1977 tax changes lowered the ratio slightly, but despite the so-called tax cuts advocated by the President, the ratio rises in 1978 and 1979. In other words, the President's proposals do not involve cuts in the aggregate individual tax burden. They only prevent it from rising as fast as it would under constant tax laws. If nothing further is done after 1979, the burden soars over the next two years to a level almost 20 percent higher than that prevailing in 1976.

This chart does not include the scheduled increases in social security taxes which will cause the total burden to rise even more steeply after 1977. Consequently, with regard to these two most important taxes paid by individuals and families we are really debating how much taxes should rise—not how much they should fall.

Despite the rise in the individual tax burden, the rise in recommended spending levels and business and other miscellaneous tax cuts lead to a recommended 1979 deficit level that is little changed from 1978's. I find that disturbing given that we are in a reasonable recovery.

In examining this situation, it is important to judge it by the economic conditions that are expected to prevail in calendar 1979 and 1980 when—with time lags—this budget will be having its main economic impact. In the absence of bad luck or bad policies, the unemployment rate will be at or below 6 percent for almost all of those two years. No one knows for sure when demand inflation will become a problem again, but there are careful students of labor markets who think that we shall be near to or perhaps already passed the danger point once unemployment goes below 6 percent.

I, therefore, conclude that caution is required and this budget should show more progress in reducing the deficit. I would set a target of about $50 billion, recognizing both that this does not indicate much progress and that it represents a trivial change in policy in the $2.3 trillion economy expected for fiscal 1979. However, it would at least be a move in the right direction and it would have a salutory psychological impact. It would make Mr. Miller's difficult new job at the Fed just a little easier, and it should give foreigners a little more confidence in the ultimate value of the dollar.

How do you get there? My goal is modest because I recognize the difficulties. The President has suggested that his proposed outlay figure of $500.2 billion represents a "lean and tight" budget. Much is made of the reduction in spending from 22.6 to 22.0 percent of GNP. Yet outlays are to exceed current service levels by almost $8 billion.

The share of the Federal Government in GNP falls in part because outlays on certain income maintenance programs rise less rapidly than GNP given the projected fall in unemployment. For example, the GNP share of unemployment compensation, AFDC, and food stamps falls 0.14 percentage points. There is a 0.2 percentage point fall in agriculture's share because of an assumption of fewer disasters and good market conditions—due in part to acreage set asides. (These are tenuous and highly uncertain assumptions to say the least.) In addition, defense continues to fall relative to GNP—by 0.09 percentage points. There are other declines and offsetting increases, some of which are quite large, but while this may be a lean budget it certainly is not stingy and there is an array of small new programs.

In addition, OMB has undertaken intense efforts to eliminate the shortfall problem and while some spending overestimates may still remain, I think that overruns are now equally likely in 1979. For example, interest rates on the debt are already above those assumed in the budget.

As usual, the pressure groups are lining up and asking for more and there are cuts proposed by the President that are unlikely to be sustained. Like every President since World War II, he cuts impact aid for education and like every President before him, he is very likely to be rebuffed. Though relatively minor, this program provides my favorite illustration of the difficulty of controlling government spending.

Everyone has his or her own list of programs that should be cut, but those programs exist because their proponents have more political clout than the budget cutters. I reluctantly conclude that it will take extreme discipline to hold to the $500 billion level. Yet, if we are to show any responsibility at all with regard to the deficit, higher spending means a higher tax burden on the American people. Hopefully, that unpleasant fact will provide economizers with more incentive as we confront the budget proposals.

If the President's spending target is accepted, my deficit goal requires a lesser tax cut for fiscal 1979. One could move part way to the goal by delaying the President's proposed cuts from October 1, 1978 to January 1, 1979. This has the disadvantage that many believe that the tax system will be imposing a serious drag by the last calendar quarter of 1978, but on the other hand I think that there may be some technical problems in adopting only one-quarter of the tax cut for calendar 1978. Treasury has probably worked out a plan for this transition, but it is not revealed in the budget or fact sheets accompanying the Tax Message. Whatever the plan, I suspect it is hard to avoid either a complex tax form in 1978, or some inequities as small groups of taxpayerrs find their taxes increased inadvertently. My own conclusion is that the tax cut should be postponed one quarter.

It is, however, important to make any changes in the investment tax credit retroactive to January 1, 1978. Otherwise investment decisions will be badly distorted as investors postpone their plans to take advantage of any future moves to greater generosity. Significant instability could result.

The size of the tax cut from current law that can be afforded for 1979, given a deficit goal of $50 billion, depends on one's view of the so-called feedback effect, or in other words, the increases in Treasury revenues inspired by the greater economic prosperity engendered by the cut. There are many different theories regarding this feedback mechanism. As a result, there are many different estimates of its importance and the speed with which it reveals itself. My own view is that the feedback is fairly modest in the short run.

I do not have the statistical facilities available to make very precise estimates, but I believe that a tax cut of about $15 billion effective January 1, 1979 would be roughly consistent with my deficit target of $50 billion for fiscal 1979. The cut could be spread between business and individuals in roughly the same proportion as advocated by President Carter.

Before discussing the appropriate distribution of individual cuts, it is useful to examine the distribution proposed by President Carter. Although it is said that he reduced his earlier emphasis on tax reform, I would say that the reform which remains is itself highly radical. The substitution of a tax credit for the basic exemption by itself greatly strengthens the degree to which the tax system redistributes income from the upper half to the lower half of the income distribution. President Carter's proposed rate reductions offset part of this impact, but the offset is far from complete.

When one looks at the distributional impact of his program, I do not believe that the Treasury fact sheets are very revealing, because they look at the distributional impacts at a given level of money income. But money income is constantly changing because of inflation and real growth. In Table 1, I have adjusted only for inflation. The table compares adjusted gross income with the same purchasing power in 1977 and 1979 given the inflation assumptions made in the budget. It then calculates the burden imposed by the individual income tax and the employee's share of the social security tax under current law in 1977 and the President's proposals in 1979. The burden is measured both by the average combined tax rate and by the change in the tax liability—also measured in terms of 1977 purchasing power.

The table shows net tax reductions for families of four below about $17,000 in 1977 dollars. Tax increases occur above that level. If these families got merit increases on top of cost of living increases, the break-even point would occur lower in the distribution. In addition, if families above the social security wage base of $22,900 in 1979 contain two earners with total wage income above the base, the tax increase would be greater than shown. In short, the proposed income tax changes combined with the legislated social security tax increases have a significant redistributive impact.

This would come on top of other tax changes in the last three years that all favored the lower part of the income distribution. The earned income credit, created in 1975, provided significant benefits to the working poor; the decision to adopt a $35 per exemption credit in lieu of an increase in the $750 exemption favored lower income groups; and 1977's increase in the standard deduction tended to favor the lower half of the income distribution. All of this time, inflation and real growth has been pushing the upper half of the distribution into higher and higher marginal tax brackets.

The choice of a proper distribution of the tax burden rests on value judgments regarding the proper income distribution in society and on economic judgments regarding the importance of providing incentives to people to work their way up the income ladder. My own judgment on both grounds is that we have recently been moving too far and too fast in redistributing income without a good explicit debate regarding our ultimate goals.

My own recommended individual income tax cut for 1979 amounts to slightly more than 5 percent of tax liabilities. I would spread the cut throughout the income distribution. If no other tax reforms were enacted, we could afford something like a $50 increase in the basic exemption (from $750 to $800) and some minor cuts in some marginal tax rates. Any revenue raising reforms could facilitate further exemption increases and rate reductions.

At constant money incomes, such cuts should try to provide the greatest proportional tax reductions at the bottom of the income scale, but the highest absolute cuts at the top. In very general terms, this is the pattern of cuts necessary to correct for inflation, although a perfect correction would widen tax brackets rather than cutting rates and would increase all credits, standard deductions, etc.

Unfortunately, the cuts that I am proposing are not sufficient to compensate for inflation and social security tax increases between 1977 and 1979, and except for a few cases, everyone whose money income kept pace with inflation would see their effective tax rate rise. It is unpleasant to advocate such a tax increase, but I see no responsible alternative unless we show more disciplin on the spending side.

MISCELLANEOUS PROPOSALS

There are two budget proposals which have great merit and one of particular interest to this Subcommittee. The first, which is of direct interest, is the proposal to control credit guarantees, described in detail on page 27 of the main Budget document. Gross loans and guarantees are expected to be $99.7 billion in 1979 and outstanding loans and guarantees are estimated to be $360.8 billion at the end of 1979. These activities have important resource allocation effects in the economy. The guarantees make it harder for those who do not receive them to obtain credit and because guaranteed loans compete so directly with issues of Federal debt, they directly raise the interest bill that must be paid by the Federal Government. Despite their importance, they have gone virtually uncontrolled and unstudied. I, therefore, urge you to examine the President's proposal carefully and I hope sympathetically.

Another proposal would tax a portion of unemployment benefits where adjusted gross income exceeds $25,000 on joint returns and $20,000 on single returns. In such situations, which usually occur because of two or more workers in a family, the tax free nature of unemployment benefits often almost eliminates the whole net gain from taking a job which provides taxable net income. This encourages long searches for just the right job and therefore, imposes upward pressure on the unemployment rate. I would, therefore, strongly support this Administration initiative.

Individual Income Taxes as a Percent of Personal Income, 1960-1982

(Arrows Identify Years of Major Effect of Significant Tax Legislation)

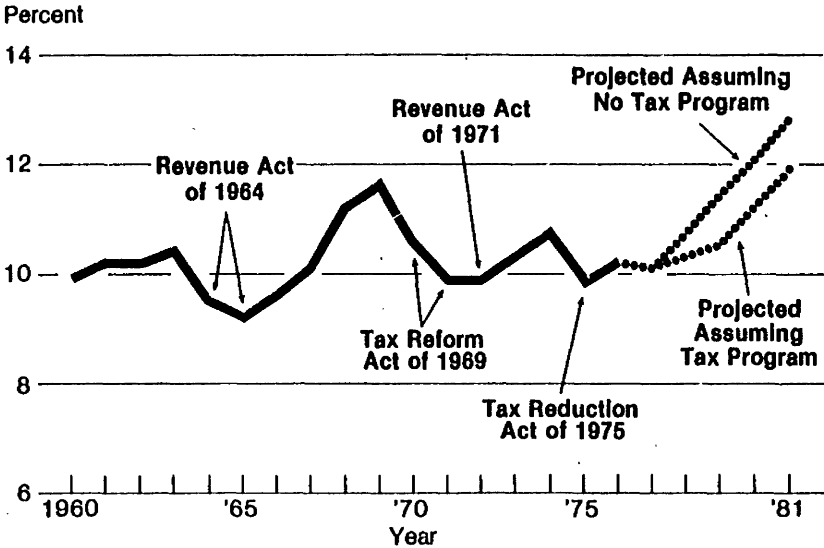


TABLE 1.—INDIVIDUAL INCOME AND SOCIAL SECURITY TAX BURDENS ON FAMILIES OF 4 WITH THE SAME REAL ADJUSTED GROSS INCOME 1977 AND 1979

AGI	Average including tax rate	Average social security tax rate	Combined average tax rate	Combined burden in 1977 dollars
1977—$8,900	2.94	5.85	8.79	783
1979—$10,000	1.34	6.13	7.47	665
Change in tax burden	−1.60	+.28	−1.32	−118
1977—$13,350	8.06	5.85	13.91	1,857
1979—$15,000	7.15	6.13	13.28	1,773
Change in tax burden	−.91	+.28	−.63	−84
1977—$16,910	9.73	5.71	15.43	2,610
1979—$19,000	9.21	6.13	15.34	2,594
Change in tax burden	−.52	+.42	−.09	−16
1977—$17,800	10.08	5.42	15.50	2,760
1979—$20,000	9.55	6.13	15.68	2,791
Change in tax burden	−.53	+.71	+.18	+31
1977—$26,700	13.17	3.62	16.78	4,482
1979—$30,000	13.03	4.68	17.71	4,729
Change in tax burden	−.14	+1.06	+.93	+247
1977—$35,600	15.81	2.71	18.52	6,593
1979—$40,000	16.58	3.51	20.09	7,150
Change in tax burden	+.77	+.80	+1.57	+557

Note: The calculations assume that the entire AGI consists of wages or that at least the wage base is earned where AGI exceeds that base. It is further assumed that there is only 1 earner per family and that the taxpayer takes either the standard deduction or itemized deductions equal to 23 percent of AGI in 1977 and 20 percent in 1979.

23-544 O - 78 - 7

STATEMENT OF ALBERT E. SINDLINGER, CHAIRMAN OF THE BOARD, SINDLINGER & CO. OF MEDIA IN PENNSYLVANIA

Thank you for the opportunity to appear before you once again and to comment on a pressing national issue from the perspective of the American people.

My research background is based upon having interviewed 4,622,478 different U.S. households over the last thirty years since 1948.

From September 29, 1977 through last Wednesday, January 25th, my company has interviewed 20,964 different households at random by long distance telephoning within our 487 sample counties or places throughout the 48 contiguous states from our central office enabling us to monitor and police each interview as it is being conducted.

Six of these places grouped together, make up the suburbs of Washington, excluding the District of Columbia, where 189 interviews were completed.

As our interviewers who make these long distance calls each day obtaining their random assignment county telephone cards telling them which households to interview that make up the national sample—

When they pick up a selected sample number to call to complete within the suburbs of Washington—not the District, except for Georgetown—they crack—*I'm going to call in the land of milk, honey, and money.*

To illustrate what they mean, I instructed our computer to run nationwide tabulations on our four key confidence questions for the past 16 weeks of nationwide interviewing—the center column here is the male responses—females on the right—with the total on the left—projected to all U.S. households.

CONFIDENCE COMPONENTS—16 WEEKS FROM SEPT. 29, 1977, THROUGH JAN. 25, 1978

	Total			Male			Female		
	Sample	Percent	Projected (thousands)	Sample	Percent	Projected (thousands)	Sample	Percent	Projected (thousands)
Universe of total sample projected to all household	20,964	100.0	70,893	10,346	100.0	34,987	10,618	100.0	35,906
With household money supply	11,377	54.3	38,473	5,572	53.9	18,843	5,805	54.7	19,630
A. Current income status:									
1. Income is up	6,278	29.9	21,230	3,131	30.3	10,588	3,147	29.6	10,642
2. Income is down	5,893	28.1	19,928	3,056	29.5	10,334	2,837	26.7	9,594
3. Income is same	8,756	41.8	29,610	4,145	40.1	14,017	4,611	43.4	15,593
4. Don't know/refused	37	.2	125	14	.1	47	23	.2	78
Up/down balance	385	1.8	1,302	75	.7	254	310	2.9	1,048
B. Household income forecast:									
1. Expect up	6,803	32.5	23,005	3,404	32.9	11,511	3,399	32.0	11,494
2. Expect down	4,308	20.5	14,568	1,973	19.1	6,672	2,335	22.0	7,896
3. Expect same	9,179	43.8	31,040	4,666	45.1	15,779	4,513	42.5	15,261
4. Don't know/refused	674	3.2	2,280	303	2.9	1,025	371	3.5	1,255
Up/down balance	2,495	11.9	8,437	1,431	13.8	4,839	1,064	10.0	3,598
C. Employment forecast:									
1. Will be more jobs	6,657	31.8	22,511	3,352	32.4	11,335	3,305	31.1	11,176
2. Will be fewer jobs	5,268	25.1	17,815	2,572	24.9	8,698	2,696	25.4	9,117
3. Same jobs as now	8,416	40.1	28,460	4,158	40.2	14,061	4,258	40.1	14,399
4. No opinion	623	3.0	2,107	264	2.6	893	359	3.4	1,214
More/fewer balance	1,389	6.6	4,697	780	7.5	2,638	609	5.7	2,059
D. Business forecast:									
1. Will be better	6,453	30.8	21,822	3,322	32.1	11,234	3,131	29.5	10,588
2. Will be worse	4,311	20.6	14,579	2,014	19.5	6,811	2,297	21.6	7,768
3. Same as now	9,560	45.6	32,329	4,726	45.7	15,982	4,834	45.5	16,347
4. No opinion	640	3.1	2,164	284	2.7	960	356	3.4	1,204
Better/worse balance	2,142	10.2	7,243	1,308	12.6	4,423	834	7.9	2,820

	Percent
A. Current income index	114.6
B. Expected income index	88.5
C. Expected jobs index	107.7
D. Expected business index	133.3
E. Forecast confidence index	109.9

As the above illustrates, during the past four months only 54.3 percent of all U.S. households reported a positive Household Money Supply—HM$ as we identify it.

This is the second computer run ordered for today.

To illustrate what they mean, I instructed our computer to run this tabulation on our four key confidence questions.

The left column below represents all of the nationwide interviews completed during the past sixteen weeks, with the response projected to all U.S. households—sampled during that period, which averaged 70,893,000.

The center column represents only those interviews completed within the six places—which represents 0.9 percent of all nationwide interviewing.

The right column represents the rest of the nation—the other 99.1 percent of all U.S. households who do not live in *the land of milk, honey, and money.*

CONFIDENCE COMPONENTS—16 WEEKS FROM SEPT. 29, 1977, THROUGH JAN. 25, 1978

	Total			The 6 Washington suburbs [1]			The rest of the 99.1 percent of United States		
	Sample	Percent	Projected (thousands)	Sample	Percent	Projected (thousands)	Sample	Percent	Projected (thousands)
Universe of total sample projected to all household	20,964	100.0	70,893	189	100.0	639	20,775	100.0	70,254
With household money supply	11,377	54.3	38,473	148	78.3	500	11,229	54.1	37,973
A. Current income status:									
1. Income is up	6,278	29.9	21,230	153	81.0	517	6,125	29.5	20,713
2. Income is down	5,893	28.1	19,928	10	5.3	34	5,883	28.3	19,894
3. Income is same	8,756	41.8	29,610	25	13.2	85	8,731	42.0	29,525
4. Don't know/refused	37	.2	125	1	.5	3	36	.2	122
Up/down balance	385	1.8	1,301	143	75.7	483	242	1.2	818
B. Household income forecast:									
1. Expect up	6,803	32.5	23,005	131	69.3	443	6,672	32.1	22,562
2. Expect down	4,308	20.5	14,568	18	9.5	61	4,290	20.6	14,507
3. Expect same	9,179	43.8	31,040	35	18.5	118	9,144	44.0	30,922
4. Don't know/refused	674	3.2	2,279	5	2.6	17	669	3.2	2,262
Up/down balance	2,495	11.9	8,437	113	59.8	382	2,382	11.5	8,055
C. Employment forecast:									
1. Will be more jobs	6,657	31.8	22,512	118	62.4	399	6,539	31.5	22,113
2. Will be fewer jobs	5,268	25.1	17,814	19	10.1	64	5,249	25.3	17,750
3. Same jobs as now	8,416	40.1	28,460	47	24.9	159	8,369	40.3	28,301
4. No opinion	623	3.0	2,107	5	2.6	17	618	3.0	2,090
More/fewer balance	1,389	6.6	4,697	99	52.4	335	1,290	6.2	4,362
D. Business forecast:									
1. Will be better	6,453	30.8	21,822	134	70.9	453	6,319	30.4	21,869
2. Will be worse	4,311	20.6	14,579	28	14.8	95	4,283	20.6	14,484
3. Same as now	9,560	45.6	32,329	23	12.2	78	9,637	45.9	32,251
4. No opinion	640	3.1	2,165	4	2.1	14	636	3.1	2,151
Better/worse balance	2,142	10.2	7,243	106	56.1	358	2,036	9.8	6,885

[1] Includes the counties of Prince Georges, Montgomery, Arlington, Fairfax, and the places Alexandria and Falls Church.

How the response within the 639,000 households with the Washington suburbs differ from the other 70,254,000 U.S. households (including the District of Columbia) can be clearly viewed.

Why I present this table is to illustrate the difficulties I have encountered in explaining to people in government—the plight of the 99.1 percent which is the real United States—those American people who pay to support the 0.9 percent with job security.

In order to keep my remarks brief—to provide background for further discussion—I have prepared these exhibits.

A . . . is to set the current mood as reported by the press.

B . . . is to illustrate the cause of the error the Federal Reserve Board made in falsely making interest rates rise for a third annual strike out during 1977.

C . . . is to show where our money is and was—in billions of dollars.

D . . . is to illustrate the velocity of our money measures—how many times money turns over per annum.

E . . . is money velocity over the past twelve months.

F . . . is a Sindlinger concept of converting all money to a per-household basis—i.e., to people.

G . . . is to raise the point of how ridiculous—our labor market figures have become.

H . . . is the weekly Sindlinger Report #29 to illustrate what the stock market is trying to tell Congress and the Administration.

If we have time, I think I can document and demonstrate how—IF our 70,893,000 U.S. households operated their fiscal and monetary policy the way our government does—they would all be broke and in bankruptcy.

And if all U.S. households and if all corporations were to keep their books on a seasonally adjusted basis—as the government operates—and, that if all income tax returns were filed on a seasonally adjusted basis—like the Fed fixes monetary policy—IRS would have everybody in jail—and then who would finance our government?

In the press release announcing this hearing, Senator Bryd noted how this committee will consider the possible extension of the $752 billion national debt ceiling and explore the "public debt and its economic ramifications". The aim is laudable. The national debt is staggering and any attempt to raise the ceiling deserves the most careful attention. But even more mind boggling than the sheer size of the debt is the very large stake that each American household has in this accumulation of long-running budget deficits.

During January, my organization, Sindlinger & Company of Media, in Pennsylvania, sampled 70,893,000 households across the United States during continuous and daily telephone surveys on the economic conditions and political opinions of American consumers. For this year, through January 28th, we have sampled 5,006 different households.

It has been my three-decade belief that the only way to look at every measure of money is through people because it is people who use money. Therefore, I prefer to present measures of money stock that are broken down on a per-U.S. household basis. (See Exhibit F).

Only in this way can we determine if there is truly enough money to serve the people's needs.

In a reverse of this approach, we should also be expressing the debt and the deficit on a per-household basis, for this will demonstrate the real burden of the total bill on the American people.

If the $752 billion debt is divided by the 70,893,000 households, it becomes clear to people that the national debt is roughly $10,607.54 per household. In other words, each American household, above and beyond its own visible debt, owes another $10,607.54—which according to an extensive study now in the field—very few people know they have this national debt—on top of their other debts which they know about—like paying for oil.

For American households, an unknown debt of over $10.000 would be alarming.

But, it's even worse for people who live by the credo of "You can't spend more than you make" to have a debt of that magnitude that most don't even know exists.

Without its consent or approval, each U.S. household in the country must shoulder an additional $10,000 in debt amassed by the very people the household members voted into office to protect their money.

This should not be kept a secret for much longer. It should be ceaselessly publicized and dramatized to show the people what the government is really costing them.

Speaking of publicizing—as I write this, I have just observed a television commercial urging people to buy government savings bonds—as if savings bonds were war bonds—and it is suggested that it is a patriotic duty to buy these bonds.

A horrible thought runs through my mind.

If some individual company were promoting the sale of savings bonds—rather than the government—would not the FTC come down hard on these commercials as false advertising? Think about it—what will those "patriotically bought" savings bonds be worth when they mature?

Mr. Chairman, you, better than any member of this committee, know what I am talking about when referring to people. We have conversed frequently, and you have paid a personal call on me to witness Sindlinger & Company's survey operations first hand.

You and I know fully well that Congress had better not underestimate the ability of the people to handle their own money.

Obviously, no one expects each households to come up with that kind of cash to liquidate the national debt, for the money is not there. But at $10,000 per household, the debt is a definite financial monkey on the back of each one and an increasing number of Americans are coming to this realization even without knowing the exact figures.

Once an issue confined to the back burner of public opinion—the federal budget deficit has become the hottest topic in the country that we're measuring.

In the week following President Carter's State of the Union message, one of five persons we interviewed listed the deficit and government spending as the number one problem in the country. As late as last year, only about 3 percent, mostly intensive fiscal conservatives, gave it priority status.

Here we insert a table for two comparative periods in time, based upon this question:

What would you say—right now—is the number one problem that faces this entire country—that you, yourself—are most concerned about?

For this question, where a respondent gave multiple problems—as most people do—our interviewers probed for the number one problem to eliminate the multiple responses.

COMPARISON TABLE FOR NO. 1 PROBLEM FACING THIS NATION

	March 1975	Week ending Jan. 25, 1978
1. Crime/unsafe streets/gangs/robberies/violence	2.1	2.2
2. Drugs	.5	2.4
3. Inflation/high prices	25.4	13.2
4. Unemployment	22.6	1.1
5. High taxes	1.5	4.3
6. High interest rates	.3	.9
7. Housing	.6	.3
8. Schools/education	.2	.2
9. Quality of city services	0	0
10. Corruption in government/dishonesty in government	3.3	3.8
11. Pollution/ecology	.8	.2
12. Energy crisis/fuel	2.6	5.7
13. Shortages of foods	.6	0
14. The courts	0	0
15. International problems	.2	1.3
16. Immorality/not practicing the golden rule/lack of religious training	1.2	1.0
17. Aged/health care	.1	.4
18. Deteriorating neighborhoods/vacant homes	0	.1
19. National defense	.4	.2
20. Population explosion	.7	0
21. Traffic	.4	0
22. Racial discrimination/racial imbalance	.4	.2
23. Land/air/sea/tragedies/death	0	0
24. General low caliber people/lack of morality	1.3	1.0
25. President and top officials unresponsive to citizens/government officials overspending	4.0	4.8
26. Too much foreign aid/trade	.1	4.7
27. Stock market lows	.1	4.7
28. Greed/selfishness among people/industry and labor	.7	1.0
29. Power of labor unions/demand for high wages/strikes	.9	1.5
30. Big business/high profits	.8	.3
31. Welfare rolls	.5	.5
32. Farm problems/low income for farmers	.6	1.7
33. Recession/depression/bad economy	14.1	1.3
34. Do-nothing Congress	.9	.6
35. President's lack of action	1.1	9.1
36. Mideast war	1.5	5.8
37. Corporate profits down/closing of businesses	.5	1.3
38. Play areas and facilities for children	0	0
39. Communism	.4	.2
40. Allowing one minority to rule	.6	.2
41. Transportation poor	.1	.5
42. Heavy traffic	.1	.1
43. More optimism/media's power	.4	0
44. Parking	0	0
45. Waste/nonproductivity	.3	.6
46. Don't know	.3	.3
47. Nothing	.6	.5
48. Decrease government spending/less government deficit	1.8	18.1
49. Republican Party	.5	0
50. Wage and price controls needed	.2	0
51. Wages not compatible with prices	.7	.4
52. Big business controlling legislation	.3	0
53. Devaluation of dollar	.8	1.9
54. Fixed income of elderly	.5	.3
55. President Carter	0	1.5

During the 1960s and until recently, most people cared little about the deficit because they thought it kept the economy going.

Now deficit is a dirty word among growing numbers of people from all walks of life, all shades of opinion, all economic strata who regard the deficit as the primary cause of the nation's economic dilemma.

Instead of just expressing concern over the general issues of inflation, unemployment and economic weakness, the people have shifted their focus to hone in on the nub of these problems.

Until the deficit is reduced or eliminated, people tell us, there can be no lasting cure for inflation or economic stagnation—based upon a special study now being conducted.

Government spending through the deficit is viewed as a key exacerbant to inflation. The need to borrow funds to finance the deficit, the people further

acknowledge, keeps interest rates high. Similarly, the big deficit is regarded as a barrier to a meaningful reduction in burdensome taxes.

And the public today rightfully links inflation with unemployment and recession.

They know that when inflation runs high, consumers must curtail spending and when consumer spending droops, jobs are threatened.

But perhaps the biggest monkey perceived by the consumer is the fact that when the government needs such massive amounts of money to operate, it deprives the economic mainstream of needed funds to expand the private sector and make jobs. Money spent by the government frequently disappears into some non-productive never, never land. Big government literally shortchanges the economy. It is now taking money away from people at the rate of over $10,000 per household. As inflation increases, so does this amount.

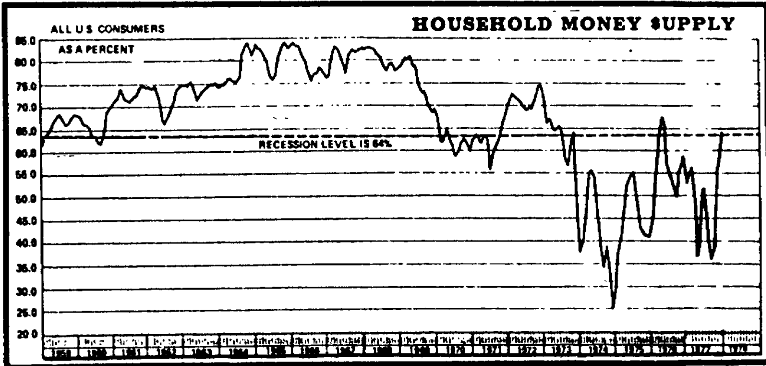
Mr. Chairman, you should hear people respond to the question on this $10,000 debt in a special study we are conducting, and how people have never considered the fact that they owe this huge amount.

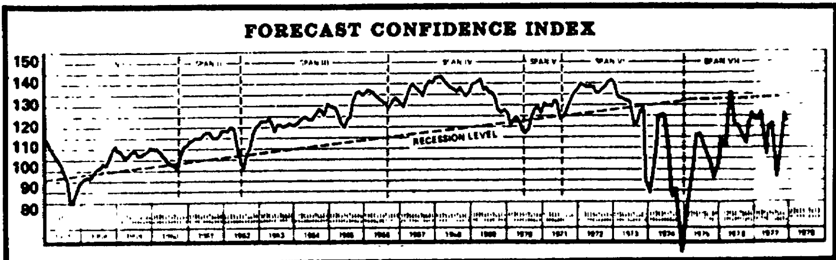
This monetary shortfall is not something imaginary. It plagues people all the time in a very real way and is manifested by a continual "yo-yoing" of Consumer Confidence.

If you recall, the most important information resulting from Sindlinger's daily surveys concerns the levels and directions of Consumer Confidence across the nation. As Sindlinger defines it, confidence is not an unmeasurable psychological consideration, but a quantitative measurement based on people, jobs and money.

And, we know that before any sustained economic recovery can begin, it must be preceded by a brisk, sustained rise in consumer confidence. Over the last few years, confidence often has been anything but sustained. It has zigged up and zagged down without a stop, a condition that we term "yo-yoing".

Most recently, we logged a rather healthy rise in confidence over the final quarter of 1977 to nearly the 70 percent level. By the first of the year, confidence peaked and again is now headed downward at a fast rate.





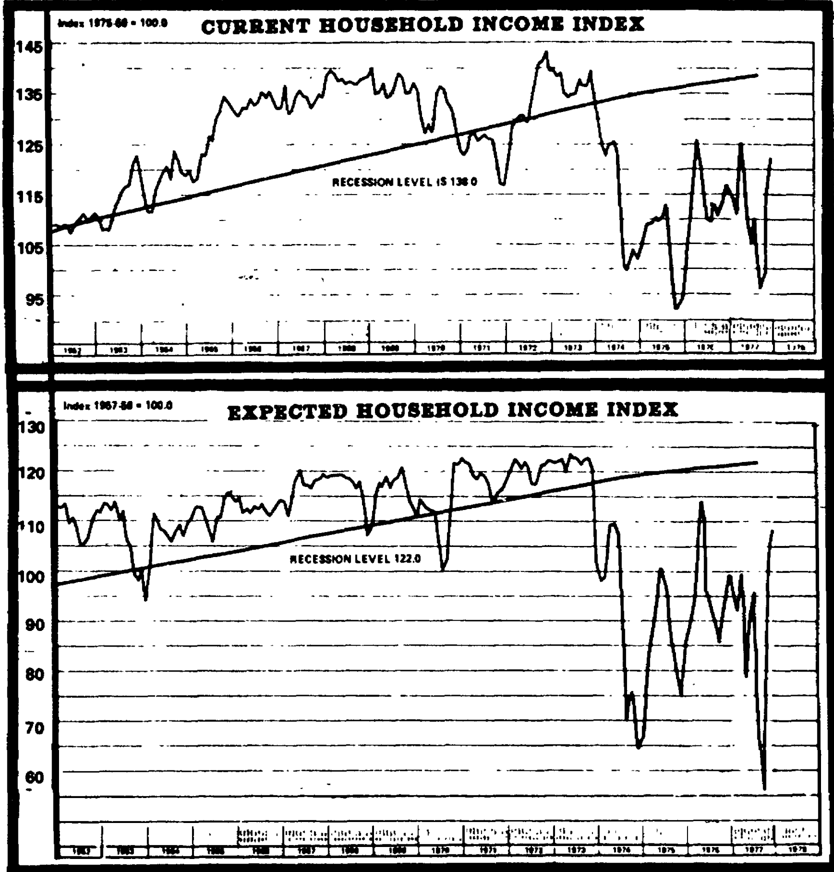
Sindlinger 9

It has become increasingly clear that each of these turns responds to a monetary situation.

The late 1977 consumer confidence rise started when it looked like President Carter would reappoint Arthur Burns as Federal Reserve chairman. Most people regarded Burns as *the protector of their money.* The decline came after Burns was sidetracked.

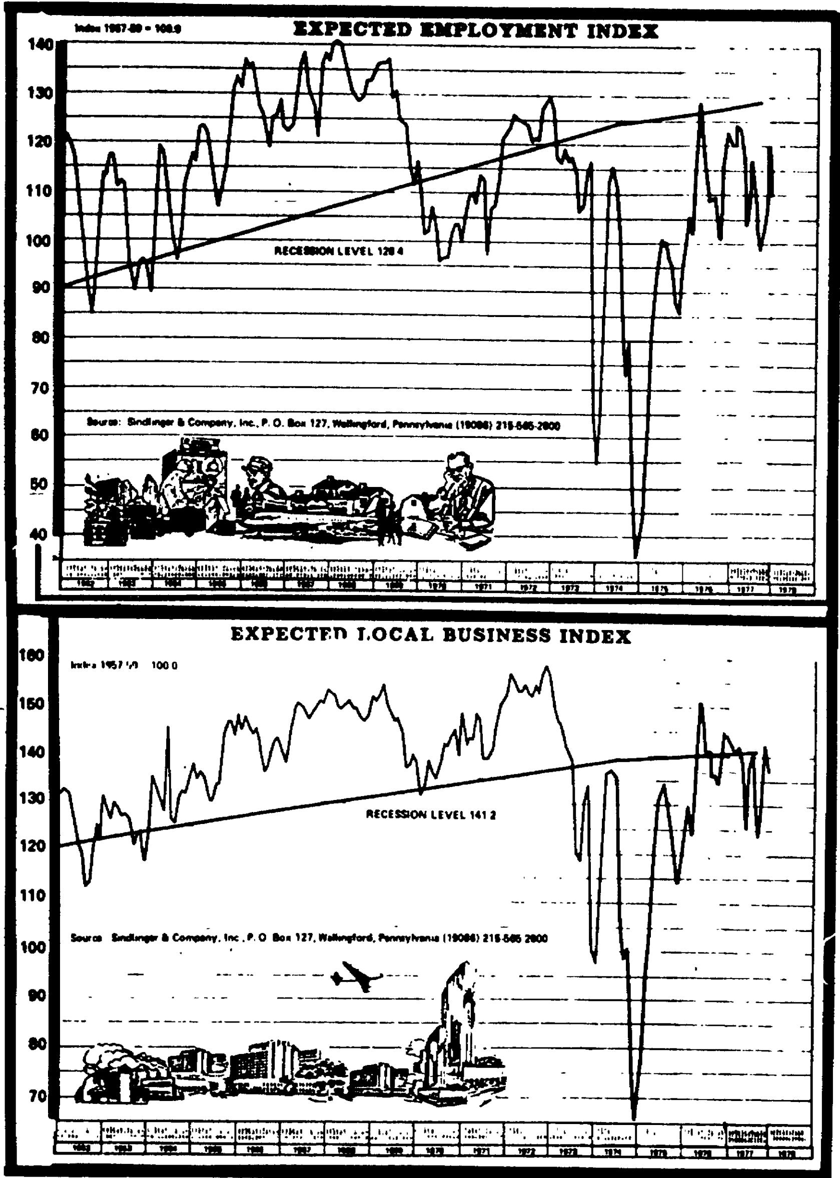
Anything that will depress the value or the amount of people's money—i.e. high interest rates, an increased deficit—inflation—similarly depresses confidence.

Anything that increases the value of people's money—builds strong confidence.



Sindlinger 10

11



Moreover, the Federal Reserve Board's own money supply figures, if read properly, shed additional light on the people's monetary shortfall and show the reasons for the public's intensified concern over money. For this purpose, we must use the Fed's non-adjusted money stock measures, prior to their seasonal adjustment and we must break them down on a per-household basis. The figures we will employ are for the month of December. (See exhibits C and F.)

A key factor to bear in mind in this respect is inflation.

If we factor inflation into the data, we find that in many cases, on a per-household basis, there has actually been negative "real growth" in some measures.

Most notably, there is the checking account component of M1 which is the key vehicle for consumer spending. On an aggregate basis, this component posted a year-to-year growth rate of 6.5 percent, or barely above the "official" 1977 inflation rate of 6 percent. (See Exhibit C.)

But when spread among the 70.8 million households, the growth rate, because households have grown at a faster rate than checking account balances, plunges to 3.8 percent. This is well below the "official" inflation rate and signals negative growth. (See Exhibit F.)

Bank savings are another example of how the facts do not support the figures.

On an aggregate basis, bank savings grew in December at a still high 10.1 percent, but the rate is down to 7.3 percent on a per-household basis.

After inflation is subtracted, the growth rate per household is minuscule.

The figures show nothing like a monetary explosion nor even anything resembling an adequacy of money at the level where it's most needed—among the people.

Unfortunately, our government policy makers fail to see the true plight of the people because they ignore the figures we have presented. They are hung up on the seasonally adjusted or so-called "official" figures.

Seasonally adjusted figures are dead wrong.

They are distorted by the five past years of economic aberrations and consistently flash false signals to policy makers which lead to improper decisions. And because they are at their worst in producing data on jobs and money—the two primary ingredients of confidence as we measure it—they literally blind government officials to the plight of the people—especially when those who reside in *the land of milk, honey, and money*—have it so good.

The Fed's false rise in interest rates last May was purely based on seasonally adjusted figures which purported to show a monetary explosion. The Fed's own non-adjusted data not only showed that the explosion never took place, but that the growth rate didn't even approach the Fed's target of 8.5 percent.

The temporary growth in the money supply during April resulted from just one thing: PEOPLE moved money into their checking accounts out of savings to pay their taxes, and the seasonal adjustment did not cope with this move.

But the Fed interpreted this entirely natural step as an explosive phenomenon, and in applying the monetary brakes aborted a promising economic recovery for the third straight year.

We have, as Senator Byrd knows, written extensively about the errors in the seasonal adjustment of the unemployment figures—how the adjustment tends to artificially depress unemployment in the first half of a year and then artificially inflate it in the second half. The errors reached a peak with the December report showing a decline in seasonally adjusted unemployment to 6.4 percent.

By this time, we're not alone in questioning the data. It has been met with skepticism from many observers, one of whom is also appearing before this committee today.

The point is that these improper data and mistakes are leading to implementation of government policies which hurt people.

Before we can make any move toward cleaning up our problems, the government must get its books in order.

If a business or an individual were to present seasonally adjusted records to the Internal Revenue Service, they would wind up in jail.

In fact, I tried a little experiment with my wife, Nellie, who handles all our financial matters. We worked out a formula, involving our finances of the last five years, that provided for paying taxes on a seasonally adjusted basis. We actually found our taxes were reduced.

If everyone tried this approach, they probably also could save a lot of money, although the Treasury would be the poorer.

It may seem ironic, but the American people may be getting a better break from the stock market in describing their problems. We hope we have some time to discuss this.

The stock market is trying to tell Congress and the Administration something—and, it's not good.

The stock market cannot be ignored.

On a four-week moving average basis, it's the most accurate forecaster of the nation's economy. And it is an economic barometer that responds to the confidence of the people, which is why we have been able to successfully forecast it over the last twenty years.

We are shocked and dismayed by so many high officials in and out of government and experts who say the market is wrong.

Given its past record of accuracy, it is, to our way of thinking, incumbent upon them to at least look at the facts.

The stock market is saying we are headed toward a recession and this cannot be arbitrarily dismissed.

In a real sense, the low levels and downward directions of the market are embodying everything we've touched upon today. It is being depressed by the low state of confidence which in turn is resulting from the monetary shortfall bothering the nation's consumers.

With the limitation on time, to conclude—I place so much emphasis—almost total emphasis—upon the stock market—and use the Standard & Poor's 400 Industrial Stock Index as the measure (see Exhibit H) because——

This is the only accurate figure—on a four-week moving average that is in existence—which is real.

The stock market is not revised and is not seasonally adjusted and it cannot be fixed up by people, or manipulated, on a four-week moving average.

Every other government figure is constantly revised. They are seasonally adjusted, which is a *fix up* process to cover up errors in the raw data. That is why these seasonally adjusted figures are so popular with those who create them. They revise the seasonally adjusted figures to cover up mistakes.

We think and we make fiscal and monetary policy on the basis that we have an "official" inflation rate of 6 to 7 percent. My data for the past two years say the inflation rate for the things people buy has been over 11 percent.

If I recall, Mr. Chairman—you were able to get a confirmation on this at hearings we attended together.

In February, BLS is supposed to issue the new CPI—which cost $50 million to create, which was due in April 1977, but postponed because of so-called *computer problems*.

What kind of a new seasonally adjusted CPI the BLS will produce next month will make fascinating reading—after their latest seasonal adjustment revision that showed the creation of 1,359,000 new jobs from October to December 1977—more than three times the number they supposedly counted. (See Exhibit G.)

To conclude, here are some points, incidents, events and ideas—which if we had time, need discussing:

How the error of the seasonal adjustment of M1 in Jannuary 1973 started the snowball rolling downhill.

Our *Paul Revere Ride* to Washington, D.C. in —uly 1974—warning of the recession and what could have been done to stop it.

Our Thanksgiving 1976 warning to President Ford that he better get that seasonal adjustment junked—or, he would be the first president to be seasonally adjusted out of a job.

Over the decades, whenever the S & P 400 Index was under 100 for four weeks, we had a recession. For the last three weeks of January 1978 it has been under 100—and the recession I see—may not be held to a recession.

While Congress and the Administration did nothing to stop the last recession—we don't have much time to stop the one we are about in now.

That stock market has got to be reversed and it still can be turned up.

Most economists and most politicians—consider that when an economy gets into trouble—*you buy your way out* with a tax cut, add to deficit spending—let inflation pay for it.

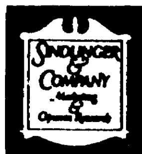
But in 1978—there is only one way we can restore and strengthen Consumer Confidence to hold: to restore the value of the dollar; curb the growth of inflation; turn the stock market around; and avoid the coming recession—
and that is—to start to reduce the Federal deficit and debt—not to continue adding to it—as now planned.

Simply, we have to put the money back in the hands of the people, and out of government.

A tax cut, let me add, is not the way this year. It would only enlarge the deficit and scare people even more. And, at present levels of falling confidence, there is no guarantee that any of the money going to the people through tax cuts—which incidentally would be less than bountiful on a per-household basis—would be spent to stimulate the economy.

Any business or individual that's up to its neck in debt like the government, facing bankruptcy, would try to cure its problem by cutting spending. We think it's about time that the government stopped trying to use the budget deficit to stimulate the economy and let the private sector try its hand for a change.

We have never tried that yet—and on this I have some ideas, based upon my daily conversations with *the American people* throughout the nation.



S M T W T F S

Issued January 1978

The Sindlinger Report

A Condensed Weekly Digest On Consumer Econom'cs Reporting On People, Jobs, And, Money

For Your Information --- FYI

Outlook uncertain for autos in '78 as economists grope

By Edward Lapham
Financial Editor

The bulls and the bears are at it again, and it is a struggle of immense interest to the entire auto industry.

Even as the bulls, led by Detroit and a handful of economists, were predicting good things for 1978, the ranks of the bears began swelling as key indicators and five consecutive dismal 10-day sales reports seemed to suggest a pattern. Some of the indicators:

• Automobile credit extended in October was off slightly after seasonal adjustment, with liquidations rising, although non-auto category credit extensions remained strong, according to Federal Reserve data.

• The Dow-Jones Industrial Average dropped more than 13 points in the opening round of 1978 trading.

• The flow of money into federally insured savings and loan associations in November slowed to its smallest growth in nearly a year and a half, down 32 percent from October's net inflow, said the Federal Home Loan Bank Board.

• The dollar continued to weaken against Swiss, German, Japanese and even British currencies.

There are few economists who believe the economy is headed into a recession in 1978 or that auto sales will plummet to the bottom of the cycle, as they did in 1974-75, but there is little doubt that the current trendline is not aimed at Detroit's loftier forecasts.

• As of late last week, GM had not budged from its 11 75 million car forecast. Said one official, "We're staying with the forecast, we'll just have to do a better job selling cars."

Richard A Stuckey, assistant chief economist at E I Du Pont de Nemours & Co., said he believes that GM will be forced to "take pause and reevaluate" its forecast.

Stuckey said he believes that new-car sales for calendar 1978 will be about 10 8 million, a figure used by many others as well last week.

One indicator Stuckey watches is credit extensions.

"Credit extensions as a percent of disposable income will probably reach its historical peak sometime in late spring," he said. "When that has happened in the past, auto sales have started to decline in the cycle."

Although the auto industry is an important segment of the economy, Stuckey believes that a recession in 1978 is "most unlikely." "There still is strength in other segments," he said. "Housing starts are not going

Continued on Page 46 Col 1

Continued from Page 1

to decline so rapidly, the government is still spending and autos probably will decline slowly to about 10 0 million in 1979."

• Why, then, is there a growing wave of pessimism?

The reason is uncertainty. An old Wall Street adage says, "We can deal with good news or bad news, but we can't deal with uncertainty." And the stock markets, which many people believe reflect the real health of the economy, have been doing poorly lately because of uncertainty . . Which only compounds the uncertainty.

Analysts aren't even sure whether the market will go up or down; published reports in respected business journals last week offered all manner of opinions, including extreme opposites.

Albert Sindlinger, market researcher and publisher of the Sindlinger Report, believes that the stock market "will drag the U. S into a recession" in 1978. And because he believes the stock market is the best measure of consumer attitudes about car purchases, he sees massive layoffs hitting the industry in February.

"People aren't buying cars because they don't like what's offered," he said. "They don't like the smaller cars and they don't believe there's an energy crisis."

Sindlinger also said that the people lack confidence in the Carter Administration and his energy and tax policies and that the President is suffering from overexposure.

Early this year, Mr. Ed Lapham of *Automotive News* telephoned your Editor, as he did others.

Since Mr. Lapham did a very good job of reporting our remarks, we pass this FYI along to all clients who may have missed this reading.

We have underlined in color those points we made in our telephone conversation which Mr. Lapham reported herewith.

(continued OVER)

46 / Automotive News, January 9, 1978

What will '78 really be like for autos?

Economic crystal ball is clouded

Other consumer sentiment surveys have not found the same lack of confidence, but some economists do agree with at least parts of Sindlinger's analysis.

NOTE:

In reference to the above, the Michigan SRC reported confidence down on the date of this article.

One of those areas of agreement is market saturation. Stuckey cited low scrappage rates and household formations as having pumped up sales. Sindlinger referred to "hedge buyers" who've "been out of the market for three, four or five years."

• Frank Popovich, automotive services manager of Data Resources, Inc., said there is definitely market saturation.

"There is market saturation in the minis, subcompacts and compacts, where the Japanese have got a hold on the market," he said. "There is also market saturation in the 'personal' trucks which take 85 percent of all truck sales."

Popovich, like Sindlinger, blamed the selection of cars for contributing to market apathy. And while his estimate of 1978 sales was very close to Stuckey's 10.8 million, he said there was increased danger for domestics because the Japanese have the ability to "move right on up from two-door to four-door and then lengthen the wheelbase to larger sizes" because they have "mastered" the fuel economy and emissions problems.

While car dealers across the U. S. have seen their floor traffic slow to a crawl, topics like money supply, inflation, Social Security tax increases, tight credit and housing starts are being discussed by economists and decision makers whose differing opinions seemingly cannot determine the "right" economic route.

Chrysler Corp entered 1978 having already announced "inventory adjustment" shutdowns. American Motors has pinned its survival hopes on a slim share of a growing market. Both will face real trouble if the market doesn't grow.

Sluggish sales also mean a model mix dilemma; auto makers must meet Corporate Average Fuel Economy requirements and if the "right" cars aren't selling that means a whole new set of scheduling problems.

One market analyst suggested that GM could do much to improve the "looks" of the market by "arm twisting" lease buyers into taking 300,000 deliveries in a given 10-day period "say in February" by offering "$50 or $100" discount per car.

Such an action would of course have antitrust implications and would do little to solve the problem of empty showrooms.

Just as the auto makers have been accused of making things "look" better, they have also been accused of using "bandwagon forecasts" and GM Chairman Thomas A. Murphy admitted in December that he believes too much negative talk can hinder economic growth.

George W. Cloos, vice-president of the Chicago Federal Reserve Bank and Fed auto analyst, does not consider them bandwagon forecasts, he calls them "sales goals."

He does not make predictions, but rather monitors the predictions of others. Cloos did say, "I'd be very surprised if sales in 1978 are as high as 1977."

But he was not as pessimistic about the economy or autos as some.

"I think there'll be more of the rolling adjustments in production and if a strike or the weather closes a plant they won't try very hard to make up output unless it's a hot model," he said.

Hot models just might be the key. Sindlinger has long said that "people buy cars. Detroit doesn't sell them," maintaining that the auto makers must supply what is demanded, not what government regulates.

What is significant about Mr. Lapham's well-written and fully researched article on new car sales is his lead and importance placed upon credit extended and the direction of the stock market being related to new automobile sales.

This was the point your Editor had made in our conversation with Mr. Lapham — and a point we have been making for the past two decades.

Observe left, how sluggish sales also mean a model mix dilemma.

And observe, the last paragraph,

Our reference to how government bureaucrats are now designing Detroit's new cars has an ironic twist.

Recent new car buying plans show the market is strong and good among government employes, especially in the suburbs of Washington.

For government employes who plan to buy a small car — most plans are for imports. For plans for domestic cars — most plans are for the larger new cars.

1978 new model car sales are following Sindlinger's buying plans projection.

And as Ed Lapham so well reported herewith — the stock market direction in forecasting new car sales — applies to the total economy — for the stock market is the only accurate figure — on a four-week moving average — that exists, to forecast the economy.

S | M | T | W | T | F | S

Date of Release

January 30, 1978

NEWS RELEASE

Sindlinger & Company, Inc., 600 N. Jackson St., Media, Pa. (19063)
215-565-2800

The $752 billion national debt is a "financial monkey on the back" of every American, leading consumer researcher Albert E. Sindlinger today told a congressional committee.

The massive debt and the continuing budget deficits which feed it, Mr. Sindlinger said, are regarded by a growing number of people as the root cause of all of the nation's economic ills, including inflation, stagnation and stubbornly high unemployment.

"Once an issue confined to the back burner of public opinion, the federal budget deficit has become the hottest topic in the country that we're measuring," Mr. Sindlinger told the Senate Finance Subcommittee on Taxation and Debt Management headed by Senator Harry F. Byrd, Jr. of Virginia.

Mr. Sindlinger is Chairman of Sindlinger & Company, an economic/political opinion research firm based in Media, Pa., which gathers data on the economic conditions and political opinions of the American consumer through continuous daily telephone interviews of consumers in all parts of the 48 contiguous states.

Mr. Sindlinger told the senators that in the seven days following President Carter's January 19th State of the Union message, the federal deficit and government spending became the nation's number one issue. Nearly one of every five persons interviewed by his organization cited the deficit as the country's number one problem.

In order to put the deficit into better perspective, Mr. Sindlinger said, the $752 billion debt, when divided into the nation's 70,893,000 households equals $10,607.53 per household. In other words, each American household, above and beyond its visible debt, owes another $10,000 which most people don't even know about.

"But, at $10,000 per household," Mr. Sindlinger added, "the debt is a definite financial monkey on the back of each one and an increasing number of Americans are coming to this realization without even knowing the exact figures I have given you this morning."

According to his findings, Mr. Sindlinger said, people view the deficit as inflationary, as a prop for high taxes, and as a cause of high interest rates.

"But perhaps the biggest monkey perceived by the consumer is the fact that when the government needs such massive amounts of money to operate, it deprives the economic mainstream of needed funds to expand the private sector and make jobs," he said. "Money spent by the government frequently disappears into some non-productive never, never land. Big government literally short-changes the economy. It has taken money away from people and added to their debt at the rate of $10,000 per household."

Mr. Sindlinger said the big deficits have impaired the liquidity of American consumers and depressed the confidence that is needed to bull the economy. "Until the deficit is reduced or eliminated, they tell us there can be no lasting cure for inflation or economic stagnation," he said.

- more -

Mr. Sindlinger noted that the situation is best illustrated by the declining stock market which is being depressed by this low confidence and, according to his projections, is headed lower throughout 1978.

Describing himself as "shocked and dismayed" by the tendency of high officials to say the stock market is wrong despite its outstanding record of accurate economic forecasting, Mr. Sindlinger said: "The market is saying we're headed toward a recession and this cannot be arbitrarily dismissed."

Mr. Sindlinger warned Congress and the Administration that they better soon hear what the stock market is telling them.

He added that a tax cut will not help the situation, because it will "enlarge the deficit and scare people even more."

"Any business or individual that's up to its neck in debt like the government would try to cure its problem by cutting spending," he said. "We think it's time the government stopped trying to use the budget deficit to stimulate the economy and let the private sector try its hand." To do this, Mr. Sindlinger offered a few suggestions to the committee.

Mailed from Media in Pennsylvania on January 25, 1978

Vol 3 — No. 29

S	M	T	W	T	F	S

Based Upon
January 18, 1978
Confidence Parameters

The Sindlinger Report

A Condensed Weekly Digest On Consumer Economics
Reporting On People, Jobs, And, Money

SCP STOCK MARKET FORECAST EDITION FOR NEXT 88 WEEKS OUT

How Far Away Are We From Recession? Maybe We Are There Now !

Over the past 1,181 weeks (22.7 years) whenever the S & P 400 Stock Index has been under 100.0 for four consecutive weeks, this has been the signal for a recession.

As of January 18th -- the 400 Index on a four-week moving average was 101.4 — only 1.4 points above 100.0.

As of January 24th — at press time, the 400 Index on a four week average is down to the 99.9 level.

For the past three weeks the 400 Index has been 98.8 for January 11th, 99.7 for January 18th and is now at 98.2 — for a three-week average below the 100.0 recession level by 1.1 points at a 98.9 level.

One more week (i.e., by February 1st) for the 400 Index to be below 100.0 is a new early warning signal to Congress, the White House, and the Federal Reserve Board.

PRIOR WARNING SIGNALS

It was April 1973 that Sindlinger's Confidence Parameters (SCP) were forecasting our last coming recession.

It was on August 25, 1973 when the 400 Index was at 115.4 when Sindlinger warned its clients how . . . *A good time to sell (stock) may be coming up* SCP was then forecasting an October '73 rally and then the 400 Index should slide to about the 100 recession level by July 4th, 1974.

It happened, as the 400 Index rallied to 124.1 on October 24, '73 to then turn down to 99.3 by June 26th '74 and then down to 94.5 by July 5th '74, below the SCP forecast decline.

It was over the July 4th 1974 weekend when most economists were still saying NO RECESSION, that the stock market was due for a rally among the professional opinions However, by July 4, 1974 — Sindlinger was reporting

- a collapse in new car sales for year-end.
- people withdrawing money from local banks to put under their mattresses.
- all confidence parameters were falling down sharply.
- Forecast Confidence Index (FCI) was on on a slide, even greater than the November '73 oil embargo month, as the impact of rising prices for oil was just beginning to impact the economy.

and
- SCP was then forecasting the 400 Index to fall over 20 percent to below 75.0 by December 1974. And this happened.

It was on July 12, 1974 that Sindlinger made his *Paul Revere Ride* to Washington spending a week in allerting Congress, The White House, the Cabinet, the Treasurey, and the Fed — to do something (which could have been done) to avert the then coming recession. The only suggestion we made upon which action was taken was to raise the FDIC to $40,000 because members of Congress have bank accounts.

HERE WE ARE AGAIN

As we write, we just had a telephone call from Senator Harry F. Byrd, Jr. (I.Va.) who has been reading our recent client reports — and he recalls our Washington trip in July '74 and subsequent conversations. Senator Byrd knows what the stock market is now telling Congress.

The First Six Key Confidence Parameters	LATEST	JANUARY		DECEMBER				NOVEMBER				
	18	11	4	28	21	14	7	30	23	16	9	2
I. Current Income Index	119.8	121.4	125.2	128.7	127.3	125.2	125.4	123.9	120.8	118.4	106.3	102.8
II. Expected Income Index	79.9	83.7	88.8	102.4	108.5	109.9	113.2	113.1	109.3	108.8	81.4	76.7
III. " Job "	94.6	96.5	101.9	106.2	109.4	111.2	113.3	117.0	120.8	126.8	116.4	111.2
IV. " Business "	124.1	126.7	129.1	135.5	138.7	137.7	137.6	139.8	143.1	149.7	139.2	135.3
V. Household Money Supply (HMS) As A Percent	58.9%	60.7%	64.6%	68.7%	67.9%	61.3%	61.4%	60.6%	59.9%	57.2%	45.3%	43.6%
VI Forecast Confidence Index	99.6	102.4	106.6	114.7	118.3	119.7	121.4	123.4	124.4	12[illegible].5	112.4	107.8

November 10th, 1977 was the date the Carter/Burns feud was cooled off with all confidence parameters up sharply by November 16th and continued to increase through December 28th when Burns was fired and all parameters are now declining

◀ Indicates recent high levels

ABOUT THE WEEKLY SCP STOCK FORECAST CHART & TABLE

Each Sindlinger's nationwide interviewing week starts on Thursday, ending Wednesday to coincide with the Fed banking week.

Each Friday morning, Sindlinger's *First Six* of its 32 different confidence parameters for each Wednesday week ending are available (see first page) along with the stock market close and the Fed's 7 weekly money measures for the prior updates — with other key data.

Each Monday, Sindlinger's Computer Program (SCP) adds the latest week's forecasts to the table below and plots the chart right to illustrate the trends created by the latest SCP stock market forecast (black thin line) in comparison to the prior seven weekly SCP forecasts, as numbered in color.

SCP does not forecast what the stock market will do — for nobody can do that. What SCP forecasts is what the stock market SHOULD DO — and the market on a four-week moving average — does what it should do — 90% of the time.

Forecast Weeks Ahead Based Upon Past 8 Weeks Forecasts		Actual	Forecast (illegible heading) 1	Forecast (illegible heading) 2	Forecast (illegible heading) 3	Forecast (illegible heading) 4	Forecast (illegible heading) 5	Forecast (illegible heading) 6	Forecast (illegible heading) 7	Forecast (illegible heading) 8
1173	16.	105.8	.0	.0	.0	.0	.0	.0	.0	.0
1174	23.	106.1	.0	.0	.0	.0	.0	.0	.0	.0
1175	30.	106.2	107.3	.0	.0	.0	.0	.0	.0	.0
1176 Dec.	7.	[illegible]	[illegible]	101.6	.0	.0	.0	.0	.0	.0
1177	14.	[illegible]	[illegible]	[illegible]	101.1	.0	.0	.0	.0	.0
1178	21.	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	.0	.0	.0	.0
1179	28.	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	.0	.0	.0
1180 Jan	4.	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	.0	.0
1181	11.	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	.0
1182	18.	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1183	25.	.0	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1184 Feb	1.	.0	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1185	8.	.0	97.1	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1186	15.	.0	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1187	22.	.0	[illegible]	[illegible]	103.4	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1188 Mar	1.	.0	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1189	8.	.0	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1190	15.	.0	97.2	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1191	22.	.0	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1192	29.	.0	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1193 Apr	5.	.0	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1194	12.	.0	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1195	19.	.0	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1196	26.	.0	[illegible]	[illegible]	[illegible]	[illegible]	93.0	[illegible]	[illegible]	[illegible]
1197 May	3.	.0	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1198	10.	.0	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1199	17.	.0	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1200	24.	.0	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1201	31.	.0	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1202 Jun	7.	.0	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1203	14.	.0	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1204	21.	.0	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1205	28.	.0	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1206 Jul.	5.	.0	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1207	12.	.0	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1208	19.	.0	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1209	26.	.0	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1210 Aug.	2.	.0	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1211	9.	.0	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1212	16.	.0	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1213	23.	.0	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1214	30.	.0	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1215 Sep.	6.	.0	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1216	13.	.0	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1217	20.	.0	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1218	27.	.0	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1219 Oct	4.	.0	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1220	11.	.0	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1221	18.	.0	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	90.0	[illegible]	[illegible]
1222	25.	.0	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1223 Nov	1.	.0	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1224	8.	.0	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1225	15.	.0	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1226	22.	.0	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1227	29.	.0	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1228 Dec	6.	.0	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1229	13.	.0	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1230	20.	.0	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1231	27.	.0	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

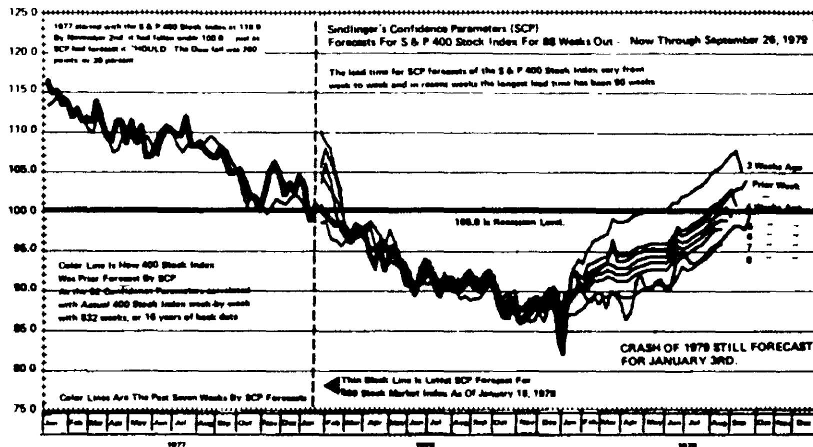
January 18, 1978 is the date for the latest SCP forecasts for the S & P 400 Stock Index — with a forecast lead time of 88 weeks out.

Observe, above the color line left, how the actual 400 Stock Index for the first three weeks of 1978 came in below the SCP rally forecasts. We could still get one last rally, however.

For the year 1978, prior SCP forecasts had the below 100 level to start in mid February — but the actual is declining several weeks ahead of the SCP forecasts.

SCP has many rallies forecast for the 400 index for 1978 — but with each rally the 400 Stock Index SHOULD lose ground.

HOW SINDLINGER'S (32) CONFIDENCE PARAMETERS (SCP) ARE FORECASTING WHAT MARKET SHOULD DO INTO 1979



Observe How 1979 Rebound Is Loosing Strength

(continued from first page)

Senator Byrd knows that the stock market is trying to tell something to Congress — and has invited us to explain what it is — at hearings scheduled for 10 a.m. Monday, January 30th.

Also on this same day, Henry Ford II is the lead-off speaker at a four-day session scheduled at the White House, and he has some knowledgeable things to say — which will collaborate what we have to tell Congress.

On Wednesday, February 1st, Eliot Janeway's Seminar in Washington will wrap it all up — in our efforts to avert what the stock market is saying — i.e., our next recession is coming fast.

Thus, the week of January 30th is another Sindlinger *Paul Revere Ride* to the land of milk, honey, and money.

As subsequent *Sindlinger Reports* will document, President Carter's State of the Union message to Congress solidified the SCP accuracy of the 400 Stock Index being forecast here.

WHERE WE ARE NOW

For weeks, as advised, SCP has been forecasting a rally that won't take place, with the actual 400 Stock Index coming in below the SCP market decline.

Latest SCP forecasts as of January 18th still has (thin black line) the crash of '79 to come the first week of 1979 with the 400 Stock Index falling to 83.3 low and then turning up.

But observe, how for the past three forecast weeks the 88th week out is loosing the rebound levels.

As of January 4, 1978 — SCP had the 400 Stock Index to rebound from the 83.2 low to 105.4 by September 12, '79

As of January 11, 1978 — SCP had the rebound from the 82.7 low to 104.0 by September 19, '79

Now, as of January 18th, 1978 — SCP has the low still at 82.3 for January 3rd, '79 — but the rebound by September 26, '79 (88 weeks out) is now down to 98.7

SCP FORECASTS FOR 1979

Following are the SCP forecasts for the S & P 400 Stock Index for those lead time weeks into 1979 i.e., 88 weeks out from the dates of the last five weekly SCP forecasts as shown

		Dec '77		January '78		
		21	28	4	11	19
1232	Jan 3, '79	88.8	[illegible]	[illegible] ◁	[illegible] ◁	[illegible] ◁
1233	" 10, "	89.3	[illegible]	[illegible]	[illegible]	[illegible]
1234	" 17, "	90.2	92.9	93.1	[illegible]	[illegible]
1235	" 24, "	91.4	92.3	94.2	[illegible]	[illegible]
1236	" 31, "	90.9	91.8	91.7	[illegible]	[illegible]
1237	Feb. 7, "	91.5	93.6	95.4	92.4	99.1
1238	" 14, "	92.7	93.8	96.5	92.9	88.8
1239	" 21, "	93.0	94.2	96.9	93.2	90.1
1240	" 28, "	93.4	94.5	97.2	93.6	89.9
1241	Mar. 7, "	93.8	94.6	97.5	93.9	89.0
1242	" 14, "	93.5	96.7	99.3	95.8	90.2
1243	" 21, "	93.1	94.6	98.9	93.9	89.6
1244	" 28, "	93.1	94.6	98.9	93.9	88.6
1245	Apr 4, "	93.2	94.8	99.1	94.1	86.5
1246	" 11, "	93.7	95.3	99.6	94.6	87.5
1247	" 18, "	94.1	95.7	99.9	94.9	91.3
1248	" 25, "	94.3	95.8	100.1	95.1	92.4
1249	May 2, "	94.5	96.0	100.3	95.3	90.3
1250	" 9, "	94.6	96.2	100.5	95.5	90.2
1251	" 16, "	94.5	96.1	100.3	95.4	91.3
1252	" 23, "	94.5	96.1	100.3	95.4	91.7
1253	" 30, "	94.6	96.2	100.5	95.5	90.1
1254	Jun 6, "	95.5	97.0	101.3	96.3	90.5
1255	" 13, "	96.7	98.3	101.3	97.6	93.7
1256	" 20, "	96.3	97.8	102.1	97.3	94.4
1257	" 27, "	96.5	98.1	102.3	97.4	94.7
1258	Jul. 4, "	97.0	98.6	102.8	97.9	93.7
1259	" 11, "	97.4	98.9	103.2	98.2	93.6
1260	" 18, "	97.7	99.3	103.5	98.6	94.0
1261	" 25, "	98.3	99.9	104.1	99.2	94.6
1262	Aug. 1, "	99.2	100.8	105.0	100.1	95.5
1263	" 8, "	99.7	101.2	105.5	100.5	95.9
1264	" 15, "	100.1	101.7	105.9	101.0	96.4
1265	" 22, "	100.8	102.4	106.7	101.8	97.2
1266	" 29, "	99.5	103.0	107.4	102.5	97.9
1267	Sep. 5, "	.0	100.9	107.9 ◀	103.0	98.5
1268	" 12, "	.0	.0	105.4	103.1	98.4
1269	" 19, "	.0	.0	.0	104.0 ◀	97.9
1270	" 26, "	.0	.0	.0	.0	99.7

As of January 1978, each of the last three weekly SCP forecasts has the low point for the 400 Stock Index for January 3, 1979 --- a year away - - at the 82 2 to 83 2 level ◀

But observe how on January 4th, 1978 SCP had a rebound for the 400 Stock Index at 107 9 September 5, '79 ◀

January 11, '78 had a lower rebound at 104 0 for September 19th, 1979, but the latest SCP forecast has no rebound above 100, the recession level.

WHY IS THIS?

As prior stated --- what controls the level of the SCP forecasts for the 400 Stock Index are our confidence parameters - which have fallen each week since December 28, '77

What controls the direction of the stock market is the imbalance in the Fed s money measure parameters

What controls turning points are the interest rate parameters

Rising interest rates within SCP are inflationary which depresses our confidence parameters, and thus the stock market

SINDLINGER & COMPANY, INC.
600 N. Jackson Street, Media, Pennsylvania (19063)
215 565-2800

For the past three SCP forecasts, the break in rising interest rates is scheduled for the first week of 1979 ◁

How deep the recession goes at this point depends upon how high interest rates actually go, and how low confidence actually falls

If by any chance, the Treasury has to pay 8% to finance the current growing government deficit then SCP would have the January 1979 crash of the stock market not to turn up, but to go down further. If this should happen, to hold the 1979 recession to only a recession -- would be a difficult task.

For how this moving picture develops, follow our center page chart each week, and clients should make their investment plans accordingly.

If there is another thing sure in life -- (other than death and taxes) -- we have come to the conclusion that the stock market on a four week moving average is the most accurate forecaster of the economy that exists - - and SCP can forecast what the stock market SHOULD do - they way we do it

ABOUT PSYCHOLOGICAL FACTORS

To forecast what the stock market SHOULD DO - the way we do it - SCP utilizes 32 confidence parameters - see front page of last issue #28 for the list

Each of these 32 different confidence parameters are definitive measurements which interlock with their push/pull to create the final correlation projection which now has a lead time for the 400 Stock Index of 88 weeks out (See left).

There is no psychological factor within SCP other than that measured within our expected components of confidence While psychological factors have no numbers --- they do have influence on the confidence numbers For example

A SWITCH OF PRIORITY ON ISSUES

One of our key open end questions asked daily is to determine what people perceive as the number one problem that concerns them the most

- Prior to 1971, the list was long with crime at the top
- Since 1971 the list is shorter with inflation way at the top Up to 76% during 1977.
- The governments s deficit as the number one problem was only 1 8% in 1975 and was only 3 6% for the two weeks following President Ford s State of the Union Address on January 19, 1977

As we go to press within one week after Carter s 1978 State of the Union Address - the deficit has shot up to over 25% as the number one problem The implications of this are horrendous, to be discussed in future Sindlinger Reports

EXHIBIT A To Accompany Testimony Of Albert E. Sindlinger For January 30, 1978 Hearings By The Sub-Committee On Taxation And Debt Management Of The Senate Committee On Finance.

Supplement For *The Sindlinger Report* Vol. 3 No. 30 — Part II

In the *New York Times* of Sunday, January 22nd, Thomas E. Mullaney does a first rate job of weaving President Carter's State of the Union message into the general economic tenor of the nation.

His object is to offer his readers some idea as to how the policies enunciated in the address are impacting the economy and the people

Mullaney admittedly finds this hard to do because the atmosphere is uncertain, the facts often contradictory and difficult to assess

This is to his credit and the credit of numerous other columnists who in similar exercises found the situation confusing and made no bones about saying it

As an example of the confusion, Mullaney cites the seemingly divergent findings on Consumer Confidence by three separate and respected research units.

Not surprisingly, Sindlinger is not included because we, unlike the others, do not send out press releases to make our information available to the media for free. Free information is always as good as what one pays for it

But because our job is the day in, day out measurement of Consumer Confidence across the land, we know some things about those surveys that are not in Mullaney's or anyone else's published writings

We happen to know that all three surveys are right

And we happen to know why they are in such apparent conflict and confusing to everyone

To clear up the confusion for our clients, we have prepared a complete explanation in our upcoming *The Sindlinger Report #30*

This weekly report of course will customarily include the latest data on the real levels of genuine Consumer Confidence in the nation as of the latest Wednesday

ABOUT SURVEYS

Whether we like it or not public opinion polls or surveys have become important and significant in the nation's economic and political life

Like people some public opinion polls are good and some are bad and some get by

The criteria of any public opinion survey is its accuracy record of what the survey forecasts

Sindlinger surveys are primarily geared to forecasting what the stock market SHOULD DO for the stock market is the only accurate figure on a four week moving average of the U S economy

And over the two decades on a four week moving average the stock market DOES WHAT IT SHOULD DO as can be forecast by consumer confidence parameters 99% of the time

For ease of reading, we have underlined in color Mr Mullaney's references to surveys

Latest Sindlinger data are included in subsequent exhibits

THE ECONOMIC SCENE

The State of the Union

By THOMAS E. MULLANEY

WASHINGTON—The mood here last week was upbeat, both in the latest economic data and in the series of annual messages from the White House to the American people—quite in contrast to recent sentiments in the stock market, the foreign exchange markets and the public opinion polls.

President Carter's State of the Union, economic and tax messages were all tinged with an overtone of conservatism and conciliation, and they were devoid of any major surprises or initiatives. The motivation was obviously both political and psychological. The Administration, suffering from waning support in the public surveys and needing so much backing for its programs in Congress, could hardly be negative on the objectives or the results it foresees for its energy, tax and other legislative proposals.

Before the President went to Congress to present his goals for the coming year, the latest poll by The New York Times and CBS News showed that public confidence in his ability to handle the nation's huge unemployment, inflation and budget problems had dropped [illegible]

"Militarily, politically, economically and in spirit," the President said, the state of the union is sound. "We are a great country, a strong country and a dynamic country and so we will remain."

With that, the business and economic world would heartily agree. They would also applaud the President's pledge to hold down Government spending, his statements about the damage of continuing inflation, his renewed disavowal of mandatory wage and price controls and his recognition of the need to limit the role of the Government in economic affairs.

"The Government," the President declared in his Thursday night address to Congress, "can't be the manager of everything and everybody."

Then on Friday the President unveiled the details of his economic program along the lines previously indicated—a $25 billion tax reduction package, an enlargement of the Administration's jobs program for youth and the disadvantaged and an anti-inflation program relying on voluntary cooperation by business and labor to hold their increases below the average of the last two years.

While most aspects of the tax program are widely endorsed in business and economic circles, there are elements in them that are controversial and unwelcome in both business and political quarters, and the package may therefore encounter difficulty before it is adopted by Congress.

Since those were well known beforehand as were his views on the need for his energy program, there were questions whether the financial markets would perceive the President's messages as evidence of a well coordinated economic game plan that would remove the uncertainties that have diminished confidence in the Administration's policies.

Several recent surveys of consumer and business confidence, buying intentions for new cars, homes and appliances or the operations plans of various industries showed a decidedly mixed trend. The varying character of the survey results was one major reason why there has been so much confusion and uncertainty about this year's general business prospects.

The most gloomy of the soundings from the public came two weeks ago when the highly respected Survey of Consumer Attitudes by the University of Michigan detected a sharp drop in the public's confidence and purchase plans last month.

More recently, however, two other samplings of the public's economic sentiments were issued for virtually the same period, and they were considerably more positive. Especially so was the Conference Board's Consumer Confidence Index and its Buying Plans Index, both of which registered strong gains of about 10 percent last month. The first was at its highest point in five years.

Another favorable reading on the mood of the public came a few days ago from New York's Citibank, which said its poll of adults across the country (a total of 1,000, against the 5,000 households in the Conference Board sample) showed consumer confidence definitely on the rise in December.

Among businessmen, the sentiments in the polls were not very upbeat at all. In its quarterly survey of more than 1,000 chief executive officers of companies of various sizes, the Conference Board found its measure of business confidence in the general economic outlook falling sharply in the final quarter of last year. The index dropped to 52 from 58 in the third quarter and from 71 in the second quarter of last year. With respect to their own industries, however, the executives exhibited a much smaller decline in confidence.

The latest survey of businessmen's expectations, conducted among more than 1,400 leaders in manufacturing, wholesaling and retailing by Dun & Bradstreet Inc., was rather neutral. It showed them looking for little change in the first quarter of 1978 from the preceding quarter with respect to sales, inventories and employment, while their profit predictions took a decidedly gloomier turn.

Despite the mixed character of the consumer and business surveys and the continued depressed state of the stock market, the latest news from the real world of business and the economy was quite good overall. It showed that the old year ended on a strong note, in contrast to the weakness that was evident 12 months earlier.

In real terms (subtracting the influence of inflation) the gross national product of the United States advanced at a fairly healthy rate of 4.2 percent in the final three months of last year, in contrast to the small gain at an annual rate of 1.2 percent in the closing quarter of 1976. When the actual December figures are available for inventories and the nation's foreign trade, there will be revisions in the fourth-quarter G.N.P. statistics for last year—and they might well push the gain upward.

What was most encouraging about the economic performance in the final quarter of last year—and indeed throughout 1977—was the strength of real final sales. That indicated a strong underlying demand for the goods of the nation's industries, and should aid further production growth in the first half of this new year.

There were other areas of the American economy that ended 1977 on a high plane. The most significant were December's 8 percent surge in new housing activity to an annual rate of 2,286,000 units, which was the highest in nearly five years, and the strong 1.3 percent gain in personal income, which provides a solid base for further consumer spending in support of the total economy.

Even though there is some skepticism over the seasonal adjustment formula in the latest employment and unemployment statistics, it is clear that the nation made notable progress on that front also during 1977. As the President noted, some four million new jobs were added to the economy last year and one million persons left the unemployment rolls.

To those who have asked why there was such a surge in employment and a sharp drop in unemployment last year when real growth of the economy was lower than in the earlier quarters of 1977, Courtney Slater, chief economist of the Commerce Department, said there was a decline in average hours worked last month. That suggested, she said, that much hiring probably occurred in retailing and in other industries that did not increase total output significantly and also that many employers were probably taking on workers rather than increasing overtime.

Mrs. Slater also said there were several factors that should be helpful for extending economic growth in the first half of this year. She cited the extra tax refunds that will be coming to many Americans because of payroll over-withholding in the first half of last year, the fact that some state and local taxes are being reduced and the further fact that job-creation programs are still building toward peak levels by mid-year.

Like other Government officials, Mrs. Slater said she believed the economy would be reaching a slowing state in the second half of this year that will require the $25 billion tax reduction that President Carter has suggested.

"If we pursue appropriate policies and especially those that support an expansion of real income," she said, "our economy should continue to grow throughout 1978."

Although there is opposition in various quarters to certain parts of the President's new program of economic stimulus, most private economists and businessmen also agree that further stimulus late this year will be needed. They maintain that the new stimulus, however, will have to be constructed in a way that does not significantly intensify inflationary pressures.

EXHIBIT B

To Accompany Testimony Of Albert E Sindlinger For January 30, 1978 Hearings By The Subcommittee On Taxation And Debt Management Of The Senate Committee On Finance

Below is how *The Wall Street Journal* on January 23, 1978 reported FOMC's December '78 monthly meeting and note the target shifts

Observe this ◀ paragraph and how interest rates were raised further on January 6th

Fed Panel Voted Rise In Growth Goals of M1, M2 at Latest Meeting

By a WALL STREET JOURNAL Staff Reporter

WASHINGTON — The Federal Reserve System's money supply panel voted at its Dec. 19-20 meeting for a slight increase in money supply growth targets.

The 12-member Open Market Committee, while choosing to leave the federal funds interest rate unchanged, raised the two-month target growth ranges for the two key measures of the money supply.

The growth target for M1, cash in circulation plus checking accounts, was raised to 2½% to 8½% from the 1% to 7% approved at the previous meeting Nov. 15. The target for M2, which also includes most consumer-type savings accounts at commercial banks, was raised to 6% to 10% from 5% to 9%.

The panel voted to keep the interest rate on federal funds at the level prevailing on Dec. 19-20 and within the same 6½% to 6¾% range approved in October. Federal funds are the overnight reserves that banks lend one another, and the interest rate on them responds directly to the purchases and sales of government securities that the Fed uses to make the money supply expand or contract.

▶ The records of the December meeting were made public, as is customary, about a month after the session. They indicate that the panel members took note of the slowdown in the growth of the monetary aggregates in recent weeks.

On Jan. 6, according to the minutes, the committee authorized an increase to $1.5 billion from $1 billion in the open account maintained by the system open market account in view of continuing unsettled conditions of the foreign exchange markets. On that day the Fed also raised its discount rate on loans to member banks to 6½% from 6%, in another move to aid the dollar.

U.S. FINANCIAL DATA

Week ending, January 18, 1978

[illegible]

Changes in the Money Stock in Selected Periods
(Seasonally Adjusted)

Period	Change in Money Stock (billions of dollars)	Period	Change in Money Stock (billions of dollars)
1977		1977	
3/30 - 4/6	$ 5.5*	7/20 - 9/28	$0.6
4/6 - 6/29	1.0	9/28 - 10/5	4.6*
6/29 - 7/6	1.9*	10/5 - 12/28	1.5
7/6 - 7/13	-1.6*	12/28 - 1/4/78	4.7*
7/13 - 7/20	4.7*	1/4/78 - 1/11/78	-3.6*

[illegible]

Annual Rates of Change in the Money Stock
(Seasonally Adjusted)

March 1977	April 1977	May 1977	June 1977	July 1977	August 1977	Sept. 1977	Oct. 1977	Nov. 1977	Dec. 1977
5.5%	21.2%	0.8%	4.6%	19.9%	6.0%	7.6%	12.7%	-1.8%	8.2%

* Indicates periods of one week

* Prepared by Federal Reserve Bank of St. Louis
Released January 20, 1978

Above is the most read *Fed Watchers* report watched by the Fed Watchers — the January 20 1978 communication by the St. Louis Fed Bank

Here is where the Fed, in only reading their seasonal adjustment of M1, got the idea that M1 had exploded in April, July and October last year

And observe left how the astute FOMC in December — *took note of the slowdown in the growth of the monetary aggregates in recent weeks.*

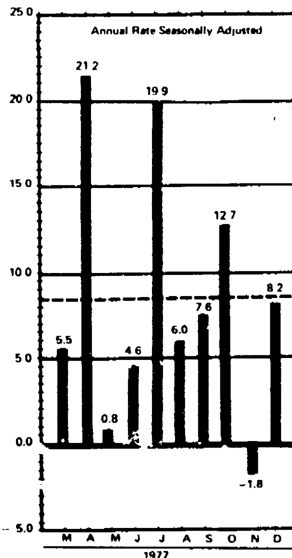
LEFT OUT — By The FOMC!

FOMC is the arm of the Federal Reserve Board that is responsible for setting monetary policy. It is, of course, guided by recent trends in money supply growth and contraction

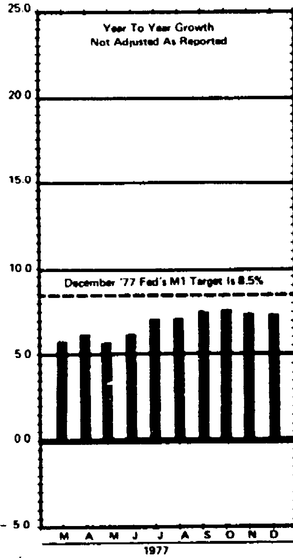
As FOMC read the trends last April they called for putting on the brakes and raising interest rates in May 1977 for the third straight annual strike out — i.e., the third time in succession the committee falsely raised interest rates and aborted a promising economic recovery

What the *Journal* reader did not read in this story was the rationale for FOMC's action. The supposed monetary explosion of last April that prompted the interest rate force-up was purely a figment of the seasonal adjustments. The documentation of the money explosion is shown in the St. Louis Fed's communication (above) and the left chart above. Both are demonstrating the growth rate of seasonally adjusted monetary figures

HOW FED READS M1'S GROWTH SEASONALLY ADJUSTED TO CREATE ERROR IN INTEREST RATE RISE



THE ACTUAL M1 GROWTH BEFORE QUIRKED UP WITH PHONEY SEASONAL ADJUSTMENT



As we now testify, the previously reported seasonally adjusted figures are being revised to conform with new seasonal factors for 1978. By 1982, the 1977 figures will have been revised five times and the nation then will learn there really was no explosion in the Spring of 1977

But we don't have to wait that long. What's more, the facts were available to FOMC at the very time it made the wrong move.

The right hand chart shows the year to year growth rate of Fed's own M1 figures before they were seasonally adjusted — virtually the same way in which they were reported by member banks

Had FOMC looked at that chart, it would have known there was no explosion. In fact, the growth rate was well shy of the Fed's own target. And the growth rate hasn't even reached the target for the rest of 1977 either

EXHIBIT C

To Accompany Testimony Of Albert E. Sindlinger For January 30, 1978 Hearings By The Sub Committee On Taxation And Debt Management Of The Senate Committee On Finance

Actual Fed & GNP Reported Money .. A-R

NOT SEASONALLY ADJUSTED

Prior Year Dec. ● Old Money 1959 Actual	December 1960	FRB & Actual For Month of Dec. 1960 — 1 Money Weight	2 Money Share	3 % Growth	Year-to-Year Change ■ New Money — Money Weight	$ Share of Growth
$ 29.5	A - Currency In Circulation	$ 29.6	$ 5.86	.3	$ .1	1.33
117.6	B - Checking Accounts	118.4	23.43	.7	.8	10.67
147.1	C - M1	148.0	29.28	.6	.9	12.00
66.6	D - Bank Savings	72.0	14.25	8.1	5.4	72.00
213.7	E - M2	220.0	43.53	2.9	6.3	84.00
.0	F - Bank CD's	.0	.00	.0	.0	.00
213.7	G - M4-Commercial Banking	220.0	43.53	2.9	6.3	84.00
213.7	H - M2	220.0	43.53	2.9	6.3	84.00
93.2	I - Non-Bank Savings	102.3	20.24	10.0	9.1	124.00
306.7	J - M3	322.3	63.77	5.1	15.6	208.00
.0	K - Bank CD's	.0	.00	.0	0	.00
306.7	L - M5-Money Work Force	322.3	63.77	5.1	15.6	208.00
54.2	M - Government Securities	52.5	10.38	-3.1	-1.7	-22.67
360.9	N - Total Liquid Assets	374.8	74.16	3.9	13.9	185.33
3.2	O - Commercial Paper	4.5	.89	40.6	1.3	17.33
364.1	P - Total Accounted For Money	379.3	75.05	4.2	15.2	202.67
159.6	D + I Protection Money	174.3	34.49	9.2	14.7	196.00
204.5	All Other Job Producing Money	205.0	40.56	.2	.5	6.67
133.8	Q - Other Uncounted Money	126.1	24.95	-5.8	-7.7	-102.67
497.9	R - Current Dollar GNP	505.4	100.00	1.5	7.5	100.00

● Old Money Is The Dollar Amount For Each Measure For Same Month Last Year — **In Billions Of Dollars** — ■ New Money Is The Change From This Year Versus Last Year

Actual Fed & GNP Reported Money .. A-R

NOT SEASONALLY ADJUSTED

Prior Year Dec. ● Old Money 1975 Actual	December 1976	FRB & Actual For Month of Dec. 1976 — 1 Money Weight	2 Money Share	3 % Growth	Year-to-Year Change ■ New Money — Money Weight	$ Share of Growth
$ 75.1	A - Currency In Circulation	$ 82.0	$ 4.67	9.2	$ 6.9	4.4
228.1	B - Checking Accounts	239.3	13.49	4.9	11.2	7.16
303.2	C - M1	321.3	18.11	6.0	18.1	11.57
366.1	D - Bank Savings	424.0	23.90	15.8	57.9	37.02
669.3	E - M2	745.3	42.01	11.4	76.0	48.59
83.4	F - Bank CD's	64.2	3.62	-23.0	-19.2	-12.28
752.7	G - M4-Commercial Banking	809.5	45.63	7.5	56.8	36.32
669.3	H - M2	745.3	42.01	11.4	76.0	48.59
425.0	I - Non-Bank Savings	492.6	27.77	15.9	67.6	43.22
1094.3	J - M3	1237.9	69.78	13.1	143.6	91.82
83.4	K - Bank CD's	64.2	3.62	-23.0	-19.2	-12.28
1177.7	L - M5-Money Work Force	1302.1	73.40	10.6	124.4	79.54
121.9	M - Government Securities	136.5	7.69	12.0	14.6	9.34
1299.6	N - Total Liquid Assets	1438.6	81.10	10.7	139.0	88.87
47.7	O - Commercial Paper	53.0	2.95	11.1	5.3	3.39
1347.3	P - Total Accounted For Money	1491.6	84.09	10.7	144.3	92.26
791.1	D + I Protection Money	916.6	51.67	15.9	125.5	80.24
556.2	All Other Job Producing Money	575.0	32.41	3.4	18.8	12.02
270.2	Q - Other Uncounted Money	282.3	15.91	4.5	12.1	7.74
1617.5	R - Current Dollar GNP	1773.9	100.00	9.7	156.4	100.00

● Old Money Is The Dollar Amount For Each Measure For Same Month Last Year — **In Billions Of Dollars** — ■ New Money Is The Change From This Year Versus Last Year

Actual Fed & GNP Reported Money .. A-R

NOT SEASONALLY ADJUSTED

Prior Year Dec. ● Old Money 1976 Actual	December 1977	FRB & Actual For Month of Dec. 1977 — 1 Money Weight	2 Money Share	3 % Growth	Year-to-Year Change ■ New Money — Money Weight	$ Share of Growth
$ 82.0	A - Currency In Circulation	$ 90.0	$ 4.54	9.8	$ 8.0	3.86
239.3	B - Checking Accounts	254.9	12.86	6.5	15.6	7.51
321.3	C - M1	344.9	17.41	7.3	23.6	11.37
424.0	D - Bank Savings	466.8	23.56	10.1	42.8	20.62
745.3	E - M2	811.7	40.96	8.9	66.4	31.98
64.2	F - Bank CD's	75.9	3.83	18.2	11.7	5.64
809.5	G - M4-Commercial Banking	887.6	44.79	9.6	78.1	37.62
745.3	H - M2	811.7	40.96	8.9	66.4	31.98
492.6	I - Non-Bank Savings	562.4	28.38	14.2	69.8	33.62
1237.9	J - M3	1374.1	69.35	11.0	136.2	65.61
64.2	K - Bank CD's	75.9	3.83	18.2	11.7	5.64
1302.1	L - M5-Money Work Force	1450.0	73.18	11.4	147.9	71.24
136.5	M - Government Securities	146.1	7.37	7.0	9.6	4.62
1438.6	N - Total Liquid Assets	1596.1	80.55	10.9	157.5	75.87
53.0	O - Commercial Paper	63.9	3.22	20.6	10.9	5.25
1491.6	P - Total Accounted For Money	1660.0	83.77	11.3	168.4	81.12
916.6	D + I Protection Money	1029.2	51.94	12.3	112.6	54.24
575.0	All Other Job Producing Money	630.8	31.83	9.7	55.8	26.88
282.3	Q - Other Uncounted Money	321.5	16.23	13.9	39.2	18.88
1773.9	R - Current Dollar GNP	1981.5	100.00	11.7	207.6	100.00

● Old Money Is The Dollar Amount For Each Measure For Same Month Last Year — **In Billions Of Dollars** — ■ New Money Is The Change From This Year Versus Last Year

HOW TO READ SINDLINGER'S A THROUGH R MONEY TABLES

The A through P lines list Federal Reserve Board (Fed) monthly money aggregates as identified

A + B = C Money or M1 — The so-called narrow money supply used for the purchase of goods and services

C + D = E Money or M2 — As broader money, where bank savings are added to M1

E + F = G Money or M4 — Which is all the money the Fed measures within the commercial banking system ... also, A through G are measured and reported weekly. M4 is large bank CD's added to M2

H Money is a repeat of M2, where

H + I = J Money or M3 — Adding all non bank savings to all commercial bank money

J + K (a repeat of F) = L Money — As the Fed's M5 ... which Sindlinger defines as the Money Work Force, i.e. the money that directly makes or does not make jobs, including savings and loan money for housing

L + M = N Money — Which Sindlinger defines as total liquid assets of the government within Fed measured money

N + O = P Money — As total accounted for money (within GNP) as measured monthly by the Fed

When (D) ... bank savings ... are added to (I) as non bank savings ... Sindlinger defines this as *Protection Money*

All other job producing money is D + I subtracted from P

R — The bottom line is GNP (Gross National Product) in current dollars extrapolated monthly from the quarterly figure

Q Money, therefore, is the difference between P money as counted by the Fed and GNP's money not counted by the Fed, i.e. R – P = Q. Balance of payments are included in Q money

WHAT THE VERTICAL COLUMNS MEAN

Column 1 — is defined as current money weight, i.e. the amount of money for each month as reported by the Fed for each measure as identified

The far left column ... is defined as ● old money ... what was reported for the same month the prior year

■ New money weight ... second from right column is the year to year add, i.e. the amount of annual growth or contraction in dollars

Column 3 — is the percent year to year growth of ■ new money

Column 2 — represents the money share of each measure ... where (R) or GNP is equal to 100% or $100.00 for total money

The far right column is the money share of new money growth, i.e. where the ... new money added each year is going

EXHIBIT D

To Accompany Testimony Of Albert E Sindlinger For January 30, 1978 Hearings By The Subcommittee On Taxation And Debt Management Of The Senate Committee On Finance

THE VELOCITY OF TOTAL MONEY BY MEASURES

For December For Select Years

Money Is In Billions Of Dollars	1959		1960		1976		1976		1977	
	$	Velocity	$	Velocity	$	Velocity	$	Velocity	$	Velocity
A - Currency In Circulation ●	29.5	16,878	29.6	17,076	75.1	21,538	82.0	21,633	90.0	22,017
B - Checking Accounts ●	117.6	4,230	118.4	4,269	220.1	7,091	239.3	7,413	254.9	7,776
C - M1 ●	147.1	3,385	148.0	3,415	303.2	5,335	321.3	5,521	344.9	5,745
D - Bank Savings ●	66.6	7,476	72.0	7,019	366.1	4,418	424.0	4,184	466.8	4,245
E - M2	213.7	2,330	220.0	2,297	669.3	2,417	745.3	2,380	811.7	2,441
F - Bank CD's ●	.0		.0		83.4	19,394	64.2	27,631	75.9	26,107
G - M4-Commercial Banking	213.7	2,330	220.0	2,297	752.7	2,149	809.5	2,191	887.6	2,232
H - M2	213.7	2,330	220.0	2,297	669.3	2,417	745.3	2,380	811.7	2,441
I - Non-Bank Savings ●	93.0	5,354	102.3	4,940	425.0	3,806	492.6	3,601	562.4	3,523
J - M3	306.7	1,623	322.3	1,568	1094.3	1,478	1237.9	1,433	1374.1	1,442
K - Bank CD's	.0		0		83.4	19,394	64.2	27,631	75.9	26,107
L - M5-Money Work Force	306.7	1,623	322.3	1,568	1177.7	1,373	1302.1	1,362	1450.0	1,367
M - Government Securities ●	54.2	9,186	52.5	9,627	121.9	13,269	136.5	12,996	146.1	13,563
N - Total Liquid Assets	360.9	1,380	374.8	1,348	1299.6	1,245	1438.6	1,233	1596.1	1,241
O - Commercial Paper ●	3.2	155,594	4.5	112,311	47.7	33,910	53.0	33,470	63.9	31,009
P - Total Accounted For Money ●	364.1	1,367	379.3	1,332	1347.3	1,201	1491.6	1,189	1660.0	1,194
D + I Protection Money ●	159.6	3,12?	174.3	2,900	791.1	2,045	916.6	1,935	1029.2	1,925
All Other U S Producing Money	204.5	2,435	205.0	2,465	556.2	2,908	575.0	3,085	630.8	3,141
Q - Other Uncounted Money ●	133.8	3,721	126.1	4,008	270.2	5,986	282.3	6,284	321.5	6,163
R - Current Dollar GNP	497.9	1,000	505.4	1,000	1617.5	1,000	1773.9	1,000	1981.5	1,000

THE VELOCITY OF MONEY

The relationship between Gross National Product or GNP as the bottom line (defined as R money, see Exhibit C) over time with the change in the money supply (via specific money measures) that brought GNP about, is called *The Velocity Of Money*

To compute Velocity of Money the GNP figure is divided by the selected money measure or aggregate

$$\frac{\text{GNP}}{\text{Money Aggregate}} = \text{Velocity}$$

For example , to calculate M1 for December 1977

$$\frac{\$1\ 981\ 5\ \text{billion}}{\$\ 344\ 9\ \text{billion}} = 5\ 745\ \text{per annum}$$

Thus on the average, as of December 1977 each dollar of M1 money was being spent a little over 5 7 times in purchasing goods and services per annum

The Federal Reserve Board has the responsibility of the supply of money i e to regulate the flow of spending is the textbook explanation

The flow of consumer spending, however depends NOT only on the supply of money but also on that supply's rate of turnover its velocity as illustrated here by select periods

VELOCITY OF MONEY

To illustrate velocity of money change, the table left selects our 1959-60 recession period to compare with the last three years, where *velocity* is calculated for each December, the last month of each year

Left table illustrates velocity for each money measure, based on the total money reported for each December

The right table is a Sindlinger creation to observe the velocity of new money ONLY, i e , the new money added to each money measure during the year - from December to December, as indicated

Key measures to watch are starred

Where the economy is going from the consumer's point of view is seen by the right new money velocity table and observe A B C D F and I money.

Where the Fed is involved, observe M money

Where business is involved, observe money

New Money Is In Billions Of Dollars	New Money Dec 1960		New Money Dec. 1976		New Money Dec., 1977	
	$	Velocity	$	Velocity	$	Velocity
A - Currency In Circulation ●	.1	75,000	6.9	22,667	8.0	25,950
B - Checking Accounts ●	.8	9,375	11.2	13,964	15.6	13,308
C - M1 ●	.9	8,333	18.1	8,641	23.6	8,797
D - Bank Savings ●	5.6	1,339	▷57.9	2,701	▷42.8	4,850
E - M2	6.3	1,190	76.0	2,058	66.4	3,127
F - Bank CD's ●	0	75,000	-19.2	-8,146	11.7	17,744
G - M4-Commercial Banking	6.3	1,190	56.8	2,754	70.1	2,650
H - M2	6.3	1,190	76.0	2,058	66.4	3,127
I - Non-Bank Savings ●	9.3	.806	67.6	2,314	69.8	2,970
J - M3	15.6	.481	143.6	1,089	136.2	1,520
K - Bank CD's	.0	75,000	-19.2	-8,146	11.7	17,744
L - M5-Money Work Force	15.6	.481	124.6	1,257	147.9	1,404
M - Government Securities ●	1.7	-4,412	14.6	10,712	9.6	21,625
N - Total Liquid Assets	13.9	.540	138.8	1,125	157.5	1,318
O - Commercial Paper ●	1.3	5,769	5.3	29,509	10.9	19,046
P - Total Accounted For Money ●	7.2	.493	144.3	1,084	168.4	1,233
D + I Protection Money ●	14.7	.510	125.5	1,246	112.6	1,844
All Other Job Producing Money	.5	15,000	18.8	8,319	55.8	3,720
Q - Other Uncounted Money ●	-7.7	-.974	12.1	12,926	39.2	5,296
R - Current Dollar GNP	7.5	1,000	156.4	1,000	207.6	1,000

The Fed has NO CONTROL over money velocity - the consumer controls this by his/her level of Consumer Confidence and where and when consumers use their money

In Sindlinger's concept of consumer economics, the consumer confidence parameters being measured daily tell us how consumers are using their current money and how they plan to use their expected money

Knowing this, Sindlinger's Confidence Parameters (SCP) can forecast in advance each of the above money measures and can also calculate and forecast velocity changes

WE ARE PAYING FOR OIL OUT OF BANK SAVINGS

As Exhibit C shows, D money or bank savings, in December 1976 were growing at 15 8% and

$57 9 billion of new money was added over 1975 with the new money velocity (top right) at 2 701

For December 1977 the growth rate of D money or bank savings had declined to 10 1% As an add, bank savings as of January 18th are down to 9 7% and SCP is forecasting a further decline into 1978

For December 1977 the new money add to bank savings was $42 8 billion down by $15 1 billion from 1976's new money add But observe how the velocity of 1977 bank savings is up to 4 850

Sindlinger interviewing reveals that this $15 1 billion decline in bank savings during 1977 was transferred to checking accounts by consumers to pay for oil

EXHIBIT E — Velocity of Money by Aggregates By Months for 1977

	Jan. $	Jan. Velocity	Feb. $	Feb. Velocity	Mar. $	Mar. Velocity
A - Currency in Circulation	80.5	22.265	[illegible]	[illegible]	[illegible]	22.4[illegible]
B - Checking Accounts	239.2	7.493	229.1	[illegible]	230.8	[illegible]
C - M1	319.7	5.606	320.9	[illegible]	312.[illegible]	[illegible]
D - Bank Savings	431.5	4.154	437.1	[illegible]	443.8	4.125
E - M2	751.2	2.386	747.2	2.4[illegible]	756.7	2.4[illegible]
F - Bank CD's	63.1	28.404	61.3	29.540	60.9	30.057
G - M3-Commercial Banking	[illegible]	2.201	808.5	2.240	[illegible]	2.240
H - M2	751.2	2.386	747.2	2.423	[illegible]	2.421
I - Non-Bank Savings	500.2	3.583	505.9	3.579	513.6	3.564
J - M3	1251.4	1.432	1253.1	1.445	1269.8	1.442
K - Bank CD's	63.1	28.404	61.3	29.540	60.9	30.057
L - M5-Money Work Force	1314.5	1.363	1314.4	1.378	1330.7	1.376
M - Government Securities	133.8	13.395	134.2	13.493	133.2	13.742
N - Total Liquid Assets	1448.3	1.238	1448.6	1.250	1463.9	1.250
O - Commercial Paper	53.9	33.257	54.4	33.287	56.7	33.464
P - Total Accounted For Money	1502.2	1.193	1503.0	1.205	1518.6	1.205
D + I Protection Money	931.7	1.924	943.2	1.920	957.4	1.912
All Other Job Producing Money	570.5	3.142	559.8	3.236	561.2	3.262
Q - Other Uncounted Money	290.1	6.178	307.8	5.883	311.9	5.869
R - Current Dollar GNP	1792.3	1.000	1810.8	1.000	1830.5	1.000

	Apr. $	Apr. Velocity	May. $	May. Velocity	Jun. $	Jun. Velocity
A - Currency in Circulation	82.8	[illegible]	83.4	[illegible]	84	[illegible]
B - Checking Accounts	[illegible]	[illegible]	232.[illegible]	[illegible]	237.2	7.968
C - M1	322.3	5.761	315.5	[illegible]	321.4	5.866
D - Bank Savings	447.[illegible]	4.133	450.7	4.149	453.1	4.161
E - M2	770.0	2.403	766.2	2.440	774.5	2.434
F - Bank CD's	60.1	30.785	61.1	30.634	63.0	29.924
G - M3-Commercial Banking	830.1	2.229	827.3	2.262	837.5	2.251
H - M2	770.0	2.403	766.2	2.440	774.5	2.434
I - Non-Bank Savings	520.2	3.557	514.1	3.568	531.2	3.549
J - M3	1290.2	1.434	1280.3	1.449	1305.7	1.444
K - Bank CD's	60.1	30.786	61.1	30.608	63.0	29.924
L - M5-Money Work Force	1350.3	1.370	1351.4	1.384	1368.7	1.377
M - Government Securities	135.1	13.695	133.1	14.049	141.2	13.351
N - Total Liquid Assets	1485.4	1.246	1484.5	1.260	1509.9	1.249
O - Commercial Paper	56.3	32.863	57.6	32.464	59.4	31.737
P - Total Accounted For Money	1541.7	1.200	1542.1	1.213	1569.3	1.201
D + I Protection Money	967.9	1.912	974.8	1.918	984.3	1.915
All Other Job Producing Money	573.8	3.224	567.3	3.296	585.0	3.223
Q - Other Uncounted Money	308.5	5.997	327.8	5.704	315.9	5.968
R - Current Dollar GNP	1850.2	1.000	1869.9	1.000	1885.2	1.000

	Jul. $	Jul. Velocity	Aug. $	Aug. Velocity	Sep. $	Sep. Velocity
A - Currency in Circulation	85.7	[illegible]	[illegible]	[illegible]	86	[illegible]
B - Checking Accounts	241.5	7.870	239.4	[illegible]	242.[illegible]	[illegible]
C - M1	327.2	[illegible]	325.2	[illegible]	326.[illegible]	5.888
D - Bank Savings	456.8	4.161	459.2	4.172	460.7	4.194
E - M2	784.0	2.424	784.4	2.443	788.8	2.449
F - Bank CD's	62.8	30.264	64.5	29.704	65.5	29.501
G - M3-Commercial Banking	846.8	2.244	848.9	[illegible]	854.4	2.262
H - M2	784.0	2.424	784.4	2.443	788.9	2.449
I - Non-Bank Savings	538.1	3.532	542.2	3.536	548.2	3.525
J - M3	1322.1	1.438	1326.6	1.444	1337.1	1.445
K - Bank CD's	62.8	30.264	64.5	29.704	65.5	29.501
L - M5-Money Work Force	1384.9	1.372	1391.1	1.377	1402.6	1.378
M - Government Securities	138.0	13.772	134.8	14.213	141.1	13.695
N - Total Liquid Assets	1522.9	1.248	1525.9	1.256	1543.7	1.252
O - Commercial Paper	58.8	32.323	59.4	32.254	60.0	32.205
P - Total Accounted For Money	1581.7	1.202	1585.3	1.229	1603.7	1.205
D + I Protection Money	994.9	1.910	1001.4	1.913	1008.9	1.915
All Other Job Producing Money	586.8	3.238	583.9	3.281	594.8	3.249
Q - Other Uncounted Money	318.9	5.960	330.6	5.795	328.6	5.880
R - Current Dollar GNP	1900.6	1.000	1915.9	1.000	1932.3	1.200

	Oct. $	Oct. Velocity	Nov. $	Nov. Velocity	Dec. $	Dec. Velocity
A - Currency in Circulation	86.9	[illegible]	88.4	22.230	90.3	22.017
B - Checking Accounts	245.6	[illegible]	246.9	[illegible]	254.9	7.774
C - M1	332.5	5.861	335.3	5.861	344.9	5.745
D - Bank Savings	461.9	[illegible]	464.[illegible]	4.230	466.8	4.245
E - M2	794.4	2.447	799.9	[illegible]	811.7	2.441
F - Bank CD's	68.4	28.490	71.6	27.446	75.9	26.107
G - M3-Commercial Banking	864.8	2.253	871.5	2.255	887.6	2.232
H - M2	794.4	2.447	799.3	2.457	811.7	2.441
I - Non-Bank Savings	554.7	3.516	557.5	3.525	582.4	3.523
J - M3	1349.1	1.443	1357.4	1.446	1376.1	1.442
K - Bank CD's	68.4	28.490	71.4	27.446	75.9	26.107
L - M5-Money Work Force	1419.0	1.373	1429.0	1.375	1450.0	1.367
M - Government Securities	137.1	14.216	135.6	14.492	146.1	13.563
N - Total Liquid Assets	1556.1	1.252	1564.6	1.256	1596.1	1.241
O - Commercial Paper	63.9	30.496	63.9	30.753	63.9	31.008
P - Total Accounted For Money	1620.0	1.203	1628.5	1.207	1660.0	1.194
D + I Protection Money	1016.1	1.914	1022.1	1.923	1029.2	1.925
All Other Job Producing Money	601.9	3.236	606.4	3.241	630.8	3.141
Q - Other Uncounted Money	328.7	5.979	336.6	5.838	321.5	6.163
R - Current Dollar GNP	1948.7	1.000	1965.1	1.000	1981.5	1.000

VELOCITY OF MONEY ILLUSTRATED HERE IS NOT SEASONALLY ADJUSTED

The table above tracks the velocity of each key money measure, A R, for each month of 1977. Under each month are two columns of figures. The left one is the monthly count of the money measure in billions of dollars. The right one is the velocity for that measure in each month expressed at an annual rate.

Velocity offers important information about the way people are using their money.

For A money, currency in circulation, the velocity is rather constant throughout the year with a turnover of 22 times at an annual rate in each month. This is not unusual. Currency is the petty cash of the economy and is used by people in meeting minor commitments which are by and large inelastic.

Checking accounts, or B money, present a rather different picture that provides important clues about consumer spending.

In May, the velocity rose to more than eight after being well below that level for the prior four months. Similarly, the velocity reached past 8 in August.

Both of the accelerations stemmed from tax considerations. In May, consumers were replenishing their checking accounts after paying out federal income taxes the prior month. In August, they were replacing funds that were being paid out in July and August to meet local taxes.

The changes in velocity on checking accounts also impacted the M1 aggregate or C money.

In May, M1 velocity moved past 5.9 — the highest rate of turnover for 1977. In August, the velocity was close to 5.9 and this was the second highest rate of the year.

The heavier than average turnover in May and August played a factor in Federal Reserve Board decisions to tighten money and raise interest rates in both those months. The Fed interpreted the increased activity in M1 as a monetary explosion that required action. In fact, the aggregate in both months merely responded to consumer shifts of money to pay taxes and out of savings.

Another view of the consumer's situation comes from D money or bank savings. The velocity held in the 4.1 range for the first eight months of the year, then moved close to 4.2 in September, and exceeded 4.2 for the final three months of 1977.

This resulted from rising oil bills. Consumers were tapping their savings accounts to get money to pay oil. A slowdown in the growth of savings was another manifestation of this trend.

M money, or government securities, show a responsiveness to Fed policy. The velocity rises above 14 in May — the month of the false force up in interest rates, and again in August when the policy was tightened a bit more. The generally restrictive stance also was underscored by the velocity of over 14 in October and November.

Commercial paper has shown a declining velocity as the year proceeded. However, the slowdown did not become significant until the last three months of 1977 when velocity was well below that of January 1977.

EXHIBIT F

To Accompany Testimony Of Albert E. Sindlinger For January 30, 1978 Hearings By The Subcommittee On Taxation And Debt Management Of The Senate Committee On Finance

Actual Fed & GNP Reported Money ... A-R

NOT SEASONALLY ADJUSTED

AS OF DECEMBER 1980

Prior Year Dec. Old Money 1980 Actual	Money Weight In Billions Of Dollars	FRB & Actual For Month of Dec 1980: 1 Money Weight	2 Money Share	3 % Growth	Year-to-Year Change, New Money: Money Weight	$ Share of Growth
$ 566.02	A - Currency In Circulation	$ 560.25	$ 5.[illegible]	-1.0	$ -5.77	-46.20
2256.42	B - Checking Accounts ..	2240.90	23.43	-.7	-15.44	-123.67
2022.44	C - M1	2001.23	20.78	-.8	-21.21	-169.87
1277.87	D - Bank Savings	1362.76	14.25	6.6	84.89	679.66
4100.31	E - M2	4163.99	43.53	1.6	63.68	509.85
.00	F - Bank CD's	.00	.00	0	.00	.00
4100.31	G - M4-Commercial Banking	4163.99	43.53	1.6	63.68	509.85
4100.31	H - M7	4163.99	43.53	1.6	63.68	509.85
1784.61	I - Non-Bank Savings	1936.25	20.24	8.5	151.64	1215.89
5884.72	J - M3	6100.24	63.77	3.7	215.52	1725.94
.00	K - Bank CD's	.00	.00	.0	.00	.00
5884.72	L - M5-Money Work Force	6100.24	63.77	3.7	215.52	1725.94
1039.96	M - Government Securities	993.68	10.39	-4.4	-46.27	-370.46
6924.67	N - Total Liquid Assets	7093.92	74.16	2.4	169.25	1355.08
61.40	O - Commercial Paper	85.17	.89	38.7	23.77	190.31
6986.07	P - Total Accounted For Money	7179.09	75.05	2.8	193.02	1545.40
3062.28	D + I Production Money	3299.01	34.49	7.7	236.73	1895.36
3923.79	All Other Job Producing Money	3880.08	40.56	-1.1	-43.71	-349.96
2567.25	Q - Other Uncounted Money	2386.72	24.95	-7.0	-180.53	-1445.40
9553.32	R - Current Dollar GNP	9565.81	100.00	1	12.49	100.00

Old Money Is The Dollar Amount For Each Measure For Same Month Last Year — **As Per Household** — New Money Is The Change From This Year Versus Last Year

Actual Fed & GNP Reported Money ... A-R

NOT SEASONALLY ADJUSTED

AS OF DECEMBER 1976

Prior Year Dec. Old Money 1975 Actual	Money Weight In Billions Of Dollars	FRB & Actual For Month of Dec 1976: 1 Money Weight	2 Money Share	3 % Growth	Year-to-Year Change, New Money: Money Weight	$ Share of Growth
$ 1136.66	A - Currency In Circulation	$ 1149.77	$ 4.62	6.4	$ 71.1[illegible]	4.32
3397.08	B - Checking Accounts	3472.09	13.49	2.2	75.01	4.55
4515.53	C - M1	4661.86	18.11	3.2	146.33	8.87
5452.30	D - Bank Savings	6151.97	23.90	12.8	699.67	42.43
9967.83	E - M2	10813.83	42.01	8.5	846.00	51.31
1242.07	F - Bank CD's	931.50	3.62	-25.0	-310.57	-18.84
11209.90	G - M4-Commercial Banking	11745.33	45.63	4.8	535.43	32.47
9967.83	H - M2	10813.83	42.01	8.5	846.00	51.31
6329.49	I - Non-Bank Savings	7147.31	27.77	12.9	817.82	49.60
16297.32	J - M3	17961.14	69.78	10.2	1663.82	100.91
1242.07	K - Bank CD's	931.50	3.62	-25.0	-310.57	-18.84
17539.39	L - M5 Money Work Force	18892.65	73.40	7.7	1353.26	82.07
1815.45	M - Government Securities	1980.53	7.69	9.1	165.08	10.01
19354.84	N - Total Liquid Assets	20873.17	81.10	7.8	1518.33	92.08
710.39	O - Commercial Paper	769.00	2.99	8.3	58.61	3.55
20065.23	P - Total Accounted For Money	21642.17	84.08	7.9	1576.94	95.64
11781.79	D + I Production Money	13299.28	51.67	12.9	1517.49	92.03
8283.44	All Other Job Producing Money	8342.89	32.41	.7	59.45	3.61
4024.07	Q - Other Uncounted Money	4095.99	15.91	1.8	71.92	4.36
24089.30	R - Current Dollar GNP	25738.16	100.00	6.8	1648.86	100.00

Old Money Is The Dollar Amount For Each Measure For Same Month Last Year — **As Per Household** — New Money Is The Change From This Year Versus Last Year

Actual Fed & GNP Reported Money ... A-R

NOT SEASONALLY ADJUSTED

AS OF DECEMBER 1977

Prior Year Dec. Old Money 1976 Actual	Money Weight In Billions Of Dollars	FRB & Actual For Month of Dec 1977: 1 Money Weight	2 Money Share	3 % Growth	Year-to-Year Change, New Money: Money Weight	$ Share of Growth
$ 1149.77	A - Currency In Circulation	$ 1272.70	$ 4.54	7.0	$ 82.93	3.63
3472.09	B - Checking Accounts	3604.56	12.86	3.8	132.47	5.80
4661.86	C - M1	4877.26	17.41	4.6	215.40	9.44
6151.97	D - Bank Savings	6601.05	23.56	7.3	449.08	19.66
10813.83	E - M2	11478.31	40.96	6.1	664.48	29.11
931.50	F - Bank CD's	1073.31	3.83	15.2	141.81	6.21
11745.33	G - M4-Commercial Banking	12551.61	44.79	6.9	806.28	35.33
10813.83	H - M2	11478.31	40.96	6.1	664.48	29.11
7147.31	I - Non-Bank Savings	7952.94	28.38	11.3	805.63	35.30
17961.14	J - M3	19431.25	69.35	8.2	1470.11	64.41
931.50	K - Bank CD's	1073.31	3.83	15.2	141.81	6.21
18892.65	L - M5-Money Work Force	20504.55	73.18	8.5	1611.90	70.62
1980.53	M - Government Securities	2066.01	7.37	4.3	85.48	3.75
20873.17	N - Total Liquid Assets	22570.56	80.55	8.1	1697.39	74.37
769.00	O - Commercial Paper	903.61	3.22	17.5	134.61	5.90
21642.17	P - Total Accounted For Money	23474.18	83.77	8.5	1832.01	80.27
13299.28	D + I Production Money	14553.99	51.94	9.4	1254.71	54.97
8342.89	All Other Job Producing Money	8920.19	31.83	6.9	577.30	25.29
4095.99	Q - Other Uncounted Money	4546.35	16.23	11.0	450.36	19.73
25738.16	R - Current Dollar GNP	28020.53	100.00	8.9	2282.37	100.00

Old Money Is The Dollar Amount For Each Measure For Same Month Last Year — **As Per Household** — New Money Is The Change From This Year Versus Last Year

The proper way to view money is on a per household basis. This is because the nation's 70 million households are its basic mini economic units and the people living in them are the primary users of money. Thus, breaking the money aggregates down on a per household basis shows how much money is actually available to people and whether money is growing adequately enough to accommodate people.

In general, money on a per household basis has been growing at a slower rate than the monetary aggregates. This is because households are growing at a faster rate than total money.

But in a very real sense, money on a per household basis has actually shown negative growth ... when inflation is factored in. Examples are in Column 3 of the December 1977 table which shows year to year growth rates for each aggregate on a per household basis.

The "official" inflation rate for 1977 was pegged at 6 percent.

B money, or checking accounts, the primary repository of the consumer's spendable funds, grew only 3.8 percent ... or far below the inflation rate. Growth for this key consumer aggregate in "real" terms was therefore negative.

D money, or bank savings, showed a fairly healthy growth rate even on a per household basis. But when inflation is subtracted, the "real" growth rate is minuscule.

In fact, the only aggregate that permitted total commercial bank funds ... M4 or G money ... to slightly exceed the rate of inflation in growth was F money or bank CD's, which a year earlier had been growing negatively. The switch came about because *big money* investors sought a method for cashing in on high interest rates.

CD's are not the province of the consumer but business and large investors. The same is true of commercial paper which showed a 17.5 percent growth rate principally because of moves by corporations to take advantage of high interest rates. Commercial paper also had the highest velocity of any of the money measures.

Outside the commercial bank area, there was an apparently strong growth in non-bank savings, another key measure dominated by consumers. But inflation chopped that rate about in half and left this measure with a modest gain.

When viewed on a per household basis, and when inflation is factored in, the money that is needed and used by consumers is growing very slightly, or not at all.

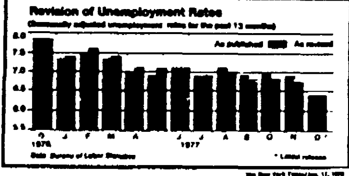
Erratic Swings in Employment and Labor Force

Employment (Full and part time employees)	*Not Seasonally Adjusted	*Seasonally Adjusted
October 1977	92 730 000	91 230 00
November, 1977	92 473 000	92 180 000
Increase, Oct.-Nov.	+[illegible]	+[illegible]
December 1977	92 623 000	92 530 00
Increase, Nov.-Dec.	+[illegible]	+[illegible]
Total Increase in employment, Oct.-Dec., 1977	+[illegible]	+1,[illegible]

Total Civilian Labor Force (Job seekers plus employed)	*Not Seasonally Adjusted	*Seasonally Adjusted
October 1977	98 450 000	98 071 000
November 1977	98 818 000	98 877 000
Increase Oct.-Nov.	+368 000	+806,000
December, 1977	98 502 000	98 919 000
Decrease Nov.-Dec.	-316,000	+42 000

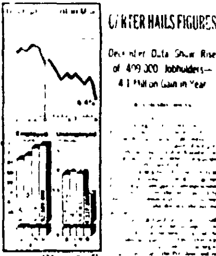
* Seasonally Adjusted means [illegible]

Source: Bureau of Labor Statistics



The New York Times/Jan. 11, 1978

SURGE IN WORK TRIMS JOBLESS RATE TO 6.4%, THE LOWEST SINCE '74



We present this series of articles on the December unemployment report for purposes of discussion.

As the Chairman knows, Sindlinger has been commenting for four years on the errors of the seasonal adjustment in calculating job and jobless figures, errors which we believe were intensified with the December data that showed such a large decline.

We have proven our case time, and time again.

Apparently, the December report was too much for some other observers and we are no longer alone (See Leonard Silk's column). Note the comments of fellow witness Otto Eckstein on the December report.

Leonard Silk

Reactions to Jobless Rate: 'Implausible' and 'Incredible'

The Economic Scene

The unexpected announcement by the Bureau of Labor Statistics that "unemployment dropped sharply" last month to 6.4 percent of the civilian labor force is being challenged as "implausible" by some of the country's leading economists and manpower experts. The reliability of the new employment and unemployment figures has an important bearing on whether and how much economic stimulus, including President Carter's proposed tax cut, will be needed to keep the economy moving toward full employment.

Those who believe the economy is already expanding fast enough—or some think, too fast, given their fears of inflation—put their emphasis on the employment rather than unemployment numbers.

The bureau has reported that total employment, seasonally adjusted, increased by 800,000 in November and by 468,000 more in December, for a two-month gain of 1,258,000.

Many economists find this number "incredible." One such is Otto Eckstein, president of Data Resources Inc., the large economic research firm, who says that the November-December employment increase is the biggest two-month gain in the last three decades, with the exception of April to May 1960, when employment bounced back from a 947,000 decline. But the jump in November-December of 1977 followed a long string of monthly advances, which brought the year's total rise in employment to a reported 4.1 million in December.

* * *

It is difficult to find anything in the performance of the United States economy during the last month of 1977 that would account for so rapid a spurt in jobs as the Bureau of Labor Statistics is reporting, according to Mr. Eckstein. Industrial production rose only 0.5 percent in November and was up in the fourth quarter at an estimated annual rate of only 3.7 percent, well below the average of 6 percent during the first three quarters of the year.

Gross national product, corrected for inflation, rose at an estimated annual rate of only 4 percent in the fourth quarter, which was also well below the average rate of gain of 6.3 percent during 1977's first three quarters.

There are seeming inconsistencies in the bureau's data on employment. The so-called household employment data,

Continued on Page 51, Column 3

WHAT'S IN A NUMBER?

There are lies, damned lies and statistics. Or so humorist Mark Twain was fond of saying, and so a good many Americans suspected recently when newly revised figures showed a sharp, unexpected improvement in the nation's unemployment rate. Was the Carter Administration trying to make the picture look [illegible]? Almost surely not. Sar A. Levitan, who is a George Washington University economist and head of a new National Commission on Employment and Unemployment Statistics appointed by President Carter to review statistical procedures, argues bluntly that the numbers are "very good as far as what they purport to measure." The question, he says, is whether these statistics measure the proper things.

That question is more than academic. Unemployment figures, for example, were used last year to allocate $16 billion in annual aid to local communities. Escalator clauses triggered by changes in the consumer price index are written into many major labor contracts and government benefit programs. "When you start putting dollars on the numbers," says one government official, "everyone gets interested."

STRAINED CREDIBILITY

The revised unemployment rate was a glaring case in point. After a change in the seasonal adjustment, said Commissioner Julius Shiskin of the Bureau of Labor Statistics, a jobless index that had been pictured as hanging stubbornly around 7 per cent since April turned out to have been in a fairly steady decline to 6.4 per cent in December (chart). Liberal economists immediately scoffed, but even such conservatives as Alan Greenspan declared that the revised [illegible] only [illegible] credibility.

The jobless figures are compiled monthly by 1,000 Census Bureau workers who call on a national sampling of 56,000 households, asking which family members 16 years old and up are employed, looking for work, or not working and not looking. Some critics say these samplings underestimate actual unemployment; others say they overstate it. Both may be right. On the one hand, nearly 1 million "discouraged workers" who have given up hope of finding a job aren't reported as unemployed, and part-time workers are considered employed even though they may want a full-time job and can't get one. At the same time, it's arguable whether high-school girls looking for part-time baby-sitting chores should be considered officially unemployed—as they are.

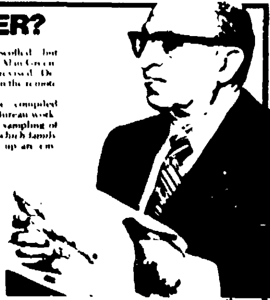
Once collected, the raw job numbers are put through a sophisticated "seasonal adjustment," designed to prevent normal fluctuations in employment from causing erratic movements on the jobless charts. The number of unemployed people jumps substantially every January, for instance, when workers hired for the Christmas selling season are laid off. Using a formula based on the previous four years, the Bureau of Labor Statistics determines this normal change in employment and adjusts its reported jobless figure to discount it. Thus, thousands can lose their jobs in January without changing the reported unemployment rate. But the adjustment formula changes slightly each year, as a fresh year's data enter the four-year cycle. This year, the revision dropped 1973—which was distorted by the economic shocks of the OPEC nations' oil-price hike—and included the smoother history of 1977. The result was the new curve.

The government also switched gears recently in the reporting of another key indicator: wholesale prices. The BLS sidetracked the old wholesale-price index, which counted price changes at every level of the production cycle, in favor of a "finished-goods index," which records prices of products just before they pour into the retail markets. The old WPI reflected volatile swings in raw materials and food prices—changes that often are ironed out by the time the affected goods reach consumers.

THE CHANGING CONSUMER

Next month the consumer price index will also be revised to reflect changing spending habits. The unusually complex revision has taken eight years and cost $50 million. But the new index is already under fire—among other critics, the AFL-CIO [illegible]

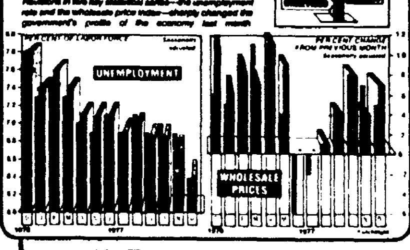
DAVID POLLAK with WILLIAM J. COOK in Washington [illegible]



Chief statistician Shiskin: New variables

CHANGING THE CHARTS

Revisions in two key statistical series—the unemployment rate and the wholesale price index—sharply changed the government's profile of the economy last month



Senator BYRD. The committee will stand in recess.

[Thereupon, at 12 noon the subcommittee recessed to reconvene at the call of the Chair.]

PUBLIC DEBT AND THE BUDGET

MONDAY, FEBRUARY 6, 1978

U.S. SENATE,
SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT
GENERALLY OF THE COMMITTEE ON FINANCE,
Washington, D.C.

The subcommittee met, pursuant to recess, at 10 a.m. in room 2221, Dirksen Senate Office Building, Hon. Harry F. Byrd, Jr., presiding.

Present: Senator Byrd.

Senator BYRD. The hour of 10 having arrived, the committee will come to order.

Today begins the second day of hearings on the budget, the deficit, and the debt. The Federal debt will increase from fiscal year 1978 to fiscal year 1979 by $88.1 billion. This is the largest yearly increase in the Federal debt in our Nation's history.

The increase in our Federal debt and the deficit for fiscal year 1979 of $60 billion for the unified budget indicates that our Government still does not have Federal spending under control. Indeed, it seems to be going in the opposite direction.

President Carter's budget for fiscal year 1979 takes us further away from the goal of achieving a balanced budget.

I do commend those who have the responsibility for submitting financial documents to the Congress from this present administration for being frank and forthright and, for the most part, clearly stating the assumptions which were made concerning the future costs of our economy and the implications of this data upon the budget projections.

We have, today, witnesses from the Treasury, the Office of Management and Budget, and also from the Federal Reserve Board. Now, I will change the order slightly for presentation of witnesses. I understand that Hon. Roger Altman, Assistant Secretary of the Treasury for Domestic Finance has a commitment to be out of the city later this morning, so at this point, the committee will call on Roger Altman, Assistant Secretary of the Treasury for Domestic Finance. Mr. Altman, welcome. May I say that you may handle your presentation in any way that you wish. Your entire testimony will be put in the record. If you wish to, you could summarize it, but, in any case, the text will be put in the record.

I will state for the record also, which I assume that all of you are aware, that this hearing today does not take the place of the formal hearing which will be held later, in early March, I assume, on the formal proposal by the administration to increase the statutory debt limit.

Mr. Altman, you may proceed as you wish.

Mr. ALTMAN. Thank you, Mr. Chairman and, with your permission, I will summarize my testimony, with the full text being inserted into the record.

I would like to begin by thanking you for permitting me to go first. It is really on account of the snowstorm that Secretary Blumental and I have to take the train to New York rather than to fly, as we had planned and therefore have to leave earlier, so you are kind to permit me to start.

STATEMENT OF HON. ROGER ALTMAN, ASSISTANT SECRETARY OF THE TREASURY FOR DOMESTIC FINANCE

Mr. ALTMAN. Let me say that I am pleased to be here today to discuss with you the public debt limit. The present temporary limit of $752 billion will expire on March 31, and then, of course, the debt limit would revert to the permanent ceiling of $400 billion. And so, legislative action by March 31 will be necessary to permit the Treasury to continue to borrow in order to refund securities maturing after that date and to raise the necessary new cash.

In addition, Mr. Chairman, to permit the Treasury to continue borrowing on a long-term basis, it also will be necessary to increase the $27 billion limit on the amount of bonds which we may issue without regard to the 4¼ percent interest rate ceiling on Treasury long bonds.

Finally, we are repeating our earlier request for authority to permit the Secretary of the Treasury, with the approval of the President, to change the interest rate on U.S. savings bonds, if that should become advisable.

Beginning with the debt limit, our estimates of the amounts of debt subject to limit at the end of each month through 1979 are attached to my testimony. Those attachments indicate that the debt will increase to $778 billion at the end of this fiscal year and to approximately $868 billion at the end of fiscal 1979.

Senator BYRD. Let me interrupt you there. Is that not the largest increase in the gross public debt which our Nation has had in any year during its entire history?

Mr. ALTMAN. No; I do not believe so, Mr. Chairman. I believe that fiscal 1976, the increase then was larger.

Senator BYRD. Well, what was the increase in fiscal 1976?

Mr. ALTMAN. Well, the increase in our public borrowing alone—public borrowing—was $83 billion and adding to that the trust fund surpluses, which are additive to the public debt limit, and off-budget financing, indicates that that figure in 1976, I believe, was larger than the 1979 figure.

Certainly, I know that our borrowing from the public, the effect of our borrowings on the market, will be notably smaller in 1979 than it was——

Senator BYRD. Well, let me give you, if I may, the exact figures, then, since you do not seem to have them at your fingertips. At the end of the fiscal year 1975, the national debt was $544 billion. At the end of the fiscal year 1976, it was $632 billion. That is an increase of $88 billion.

Your figures show that you project an increase of $88.1

Mr. ALTMAN. Mr. Chairman, my understanding is different, but I would be happy to review it, and——

Senator BYRD. Well, state what your understanding is. I got these figures from the Treasury.

Mr. ALTMAN. If you look at borrowing from the public——

Senator BYRD. I am speaking now of the national debt. What do you consider to have been the national debt at the end of fiscal 1975?

Mr. ALTMAN. Well, let me answer you this way, sir. The way that I look at it is the following: In fiscal 1976, our public borrowing was $83 billion; in fiscal 1979, our public borrowing will be $73 billion.

Now, there are differences, yes, between the total increase in the debt, subject to limit, and the——

Senator BYRD. That is what we are speaking of.

Mr. ALTMAN. Yes, but I am saying, Mr. Chairman, that I think it is more relevant——

Senator BYRD. Well, you may think it is more relevant, but I would like to get the facts. If my facts are wrong, I got them from the Treasury, and I would be glad if you would correct them. But my facts show that the public debt including off-budget borrowing, if your recommendation is approved, will increase from a projected $787 billion for fiscal 1978, to $874 billion?

Mr. ALTMAN. Up to $868 by the end of fiscal 1979. An increase to $868 is what we project, sir.

Senator BYRD. You project $868 billion?

Show me the budget document to which you refer? I want to get these facts clear.

Mr. ALTMAN. Mr. Chairman, I believe that I am correct. The increase in fiscal 1979 will be smaller—only slightly, to be sure—than that in fiscal 1976, and I am looking at the——

Senator BYRD. It will be greater than fiscal 1977?

Mr. ALTMAN. Yes; it will be greater than fiscal 1977.

Senator BYRD. It will be greater than fiscal 1978?

Mr. ALTMAN. Yes, sir.

Senator BYRD. Now, the Budget in Brief, on page 73, shows at the end of the year, the outstanding gross Federal debt will be $874—$873.7. I rounded it off to $874 billion.

That is the Budget in Brief, part 5, budget tables, page 73.

Mr. ALTMAN. Well, the difference between my figure and your figure is that your figure includes the debt of Federal agencies in addition to the direct debt, or guaranteed debt, and it is just a different way of looking at it. It is another measure of total Federal debt.

But still, using your basis, using your basis, the increase in fiscal 1979 will be somewhat smaller—nothing to be proud of, but somewhat smaller—than the increase in fiscal 1976.

Senator BYRD. Thank you. Please proceed.

Mr. ALTMAN. The $90 billion increase in the debt subject to limit in fiscal 1979 reflects, as you know, the administration's current budget estimates of the 1979 unified budget deficit of $60.6 billion, a trust fund surplus of $13.9 billion, and a net financing requirement for off-budget entities of $12.5 billion.

Let me turn now, Mr. Chairman, to our fiscal 1979 need for an increase.

Senator BYRD. Just a moment, sir. I am still a little unclear on this.

On page 2 of your statement, you say the $90 billion increase in the debt in fiscal year 1979 and so forth. So it is a $90 billion increase, is that correct?

Mr. ALTMAN. Yes, but, Mr. Chairman, as you know, among other things, the trust fund surpluses are added to the debt subject to limit, even though they are not directly reflective of budget deficits.

Senator BYRD. Well, the point I am trying to establish is that you are asking, I take it, from page 2 of your statement for an increase of $90 billion in the statutory debt limit. Is that correct?

Mr. ALTMAN. That is correct.

Senator BYRD. Now, at any other time, has as much as $90 billion been added to the statutory debt limit in the space of 1 year?

Mr. ALTMAN. My understanding, Mr. Chairman, is yes, the amount of total increase in the total debt, subject to limit in fiscal 1976 was slightly larger than that, and I would be happy to provide a detailed answer on that for the record.

But my understanding is that the 1976 increase was slightly larger than that, yes.

Senator BYRD. Well, I would like for you to establish whether the figure that my office got from the Treasury is incorrect. The figure is $632 billion at the end of fiscal 1976.

Mr. ALTMAN. I believe that what your office has done, Mr. Chairman, is to add, in the 1976 computation, the just under $11 billion of agency borrowings, Federal agency borrowings, to the public debt amounts. Those are not amounts which add to the debt subject to limit. I think what your office has simply done—I cannot be sure—is to—it appears to me—is to add roughly $11 billion in 1976 agency debt to the public debt securities of that year, then compared that to the public debt figure of 1979. I think it is a bit of apples and oranges, but again, I would be happy to get together with your staff and straighten it out.

[The following was subsequently supplied for the record:]

FEDERAL FINANCES AND DEBT OUTSTANDING, FISCAL YEARS 1970-79

[In billions of dollars]

	1970	1971	1972	1973	1974	1975	1976	TQ	1977	1978[1]	1979[1]
Federal funds deficit	13.1	29.9	29.3	25.6	18.7	52.5	68.9	11.0	54.5	72.1	74.5
Less: Trust fund surplus (−) or deficit	−10.3	−6.8	−5.9	−10.7	−14.0	−7.4	−2.4	2.0	−9.5	−10.3	−13.9
Equals: Total unified budget deficit	2.8	23.0	23.4	14.8	4.7	45.1	66.4	13.0	45.0	61.8	60.6
Plus: Deficit of off-budget Federal entities[2]				.1	1.4	8.1	7.2	1.8	8.7	11.5	12.5
Equals: Total deficit	2.8	23.0	23.4	14.9	6.1	53.1	73.7	14.7	53.7	73.4	73.1
Less: Nonborrowing means of financing[3]	2.6	−3.6	−3.9	4.4	−3.1	−2.3	9.3	3.3	−.2	−7.4	−.1
Equals: Total borrowing from the public	5.4	19.4	19.4	19.3	3.0	50.9	82.9	18.0	53.5	66.0	73.0
Plus: Change in debt held by Government agencies[4]	10.1	7.4	8.4	11.8	14.8	7.0	4.3	−3.5	9.2	10.4	15.1
Equals: Change in gross Federal debt	15.5	26.9	27.9	31.1	17.8	57.9	87.3	14.5	62.8	76.4	88.1
Less: Change in Federal agency debt	1.7	.3	1.3	−.2	−.9	1.1		−.2	1.4	1.5	1.5

FEDERAL FINANCES AND DEBT OUTSTANDING, FISCAL YEARS 1970-79—Continued

[In billions of dollars]

	1970	1971	1972	1973	1974	1975	1976	TQ	1977	1978[1]	1979[1]
Equals: Change in gross public debt	17.2	27.2	29.1	30.9	16.9	59.0	87.2	14.3	64.1	78.0	89.6
Plus: Change in other debt subject to limit[5]	-.7	-1.2		-.4		.1	.1				
Equals: Change in debt subject to limit	16.5	26.0	29.1	30.5	16.9	59.0	87.3	14.3	64.1	78.0	89.6
Debt outstanding (end of fiscal years):											
Gross Federal debt[6]	382.6	409.5	437.3	468.4	486.2	544.1	631.9	646.4	709.1	785.6	873.7
Less: Federal agency debt[6]	12.5	12.2	10.9	11.1	12.0	10.9	11.4	11.7	10.3	8.8	7.3
Equals: Gross public debt	370.1	397.3	426.4	457.3	474.2	533.2	620.4	634.7	698.8	776.8	866.4
Plus: Other debt subject to limit[5]	2.5	1.3	1.3	.9	.9	1.0	1.1	1.1	1.1	1.1	1.1
Equals: Debt subject to limit	372.6	398.6	427.8	458.3	475.2	534.2	621.6	635.8	700.0	777.9	867.5

[1] Estimate.
[2] Consists largely of Federal Financing Bank borrowings to finance off-budget programs.
[3] Consists largely of changes in Treasury cash balances.
[4] Consists largely of trust fund surplus or deficit.
[5] Net of certain public debt not subject to limit.
[6] Fiscal year 1976 figure includes reclassification of $471,000,000 of Export-Import Bank certificates of beneficial interest from asset sales of debt.

Source: Special Analysis E of the Fiscal Year 1979 Budget, January 1978.

Senator BYRD. The fact is, you are asking for an increase of $90 billion for the upcoming fiscal year, is that correct?

Mr. ALTMAN. That is correct.

Senator BYRD. Now, has any Secretary of the Treasury, or his representative, come before this committee any time in the last 10 years and asked for a $90 billion increase in the national debt subject to limit?

Mr. ALTMAN. I do not believe that a request, Mr. Chairman, was actually made at any one moment for a single increase in that amount. But I believe that——

Senator BYRD. It would have to be increased by the Congress. The facts are all there.

Mr. ALTMAN. That is true but, of course, as you know, the public debt has not always been increased for full years. For example, this past September we came and asked for an increase from September to September—September 1977 to September 1978. Congress decided to increase us only for 6 months.

Senator BYRD. It happened to be my amendment that did that, so I am well familiar with it.

Mr. ALTMAN. That is right.

So, in the past—I would have to look back over the historical record——

Senator BYRD. Well, I would like to get a categorical answer from the Treasury Department on whether any Secretary of the Treasury has ever come before this committee in recent history, within the past 10 years?

Mr. ALTMAN. I believe the answer is no.

Senator BYRD. All right. That satisfies me.

Mr. ALTMAN. I was discussing the question of our long bond authority, simply pointing out that to meet our 1979 requirements, our current $27 billion authority to issue bonds on a long-term basis, without regard to the 4¼ ceiling would need to be increased by $10 billion—that is, to $37 billion.

We have, to date, used almost $20 billion of the $27 billion authority, including the $1.25 billion which we auctioned last week, and so we have about $7 billion remaining. A $10 billion increase, therefore, would permit the Treasury to continue our recent pattern of bond issues throughout fiscal 1979.

The reason we have been using the long-term market, Mr. Chairman, is to enable us to make further progress toward achieving a better balance in the maturity structure of the debt and toward reestablishing the overall market for Treasury long term securities.

I think both of those are vital to efficient management of the public debt.

Let me briefly turn to the savings bonds question, if I may. In recent years, we frequently recommended that Congress repeal the 6-percent ceiling on the rate of interest which Treasury may pay on U.S. savings bonds. Before 1970, that ceiling had been increased many times, but the current 6 percent statutory ceiling was enacted in 1970. Yet, as market rates of interest rose, it became clear that an increase in the savings bond interest rate was necessary to provide investors in savings bonds with a fair rate of return.

It is not our view, Mr. Chairman, that an increase in the interest rates paid on savings bonds is necessary today. But we are concerned that the present approach, whereby each increase must be legislated, does not provide sufficient flexibility to adjust that rate in response to changing market conditions.

The delays encountered in the legislative process simply may result in inequities to savings bonds purchasers and holders as market rates fluctuate.

Mr. Chairman, let me close by suggesting that your committee consider a more effective procedure for controlling the size of the public debt. We do not think that the present statutory debt limit is an effective way for Congress to control the debt.

In fact, the debt limit may actually divert public attention from the real issue, which is control over the Federal budget. The increase in the debt each year, as you know, is simply a result of earlier decisions by the Congress on the amounts of Federal spending and taxation.

Accordingly, the only way to control the debt is through firm control over the Federal budget.

Now, to be sure, the Congressional Budget Act of 1974 has greatly improved congressional budget procedures and provided a more effective means of controlling the debt. And that new budget process assures that Congress faces up each year to the public debt consequences of its decisions on taxes and spending.

Beyond that, the statutory limitation on the public debt occasionally has interfered with the efficient financing of the Government and actually resulted in increased costs to the taxpayer.

For example, as you remember, when the temporary debt limit expired on September 30 last year, new legislation was not enacted until

October 4, and the Treasury was required, in the interim, to suspend the sale of savings bonds and other public debt securities, which resulted in a good deal of public confusion, as well as additional costs to the Government.

And so, Mr. Chairman, we think that the public debt would be more effectively controlled and better managed by tying the debt limit to the new congressional budget process. We are simply putting this proposal on the table for you and the other members of the subcommittee to consider, in the hope that we can work together to devise a more acceptable way of controlling the debt.

Thank you, and I will try to answer any of the questions that you may have.

Senator BYRD. Thank you, Mr. Secretary.

Now, as you point out in your testimony, the debt, subject to the debt limitation, will need to be increased for not only the current fiscal year, I take it, but also, of course, for the upcoming fiscal year.

Mr. ALTMAN. Yes, sir.

Senator BYRD. Now, I do not find—I have gone over it hurriedly, I must say—the precise figure to which you would recommend the limit be increased if the Congress saw fit to increase it next month to fiscal year 1979. What figure would that be?

Mr. ALTMAN. Well, it would be an increase to $871 billion, Mr. Chairman, reflecting an $868 billion forecast of the total debt subject to limit in September 30, 1979, and the usual $3 billion margin for contingencies. That, of course, compares to the $752 billion limit which is the current one, extending through March 31.

So $752 to $871 billion.

Senator BYRD. Yes. Now, the $752 billion, if I read your statement accurately, would need to be increased, you feel—or Treasury feels—by $29 billion to take care of the needs through fiscal year 1978.

Mr. ALTMAN. I believe that figure is right; yes.

Senator BYRD. And then the $90 billion that you are speaking of would be for the fiscal year ending 1979?

Mr. ALTMAN. That is correct.

Let me emphasize, as you know, that these increases in the public debt are simply the result of the fiscal decisions which the Congress in effect makes during the budget process. They are nothing more than arithmetic derivation of the congressional budget——

Senator BYRD. I was going to point out that the Treasury, as such, has no direct responsibility in causing the debt increase. I think the responsibility lies jointly with the Congress and the administration and, in this case, the Office of Management and Budget and the President. We will get to this later.

But I recognize, and I want the record to show, that the Treasury is presenting what it estimates will be the needs of the executive branch if the President's budget is enacted into law as is. Is that not correct?

Mr. ALTMAN. That is correct, although I must say that we are all part of the same team.

Senator BYRD. You are part of the same team, and if you want to assume part of the responsibility, that is all right with me, but I did not realize that Treasury had the responsibility of making up the budget.

23-544—78——9

Mr. ALTMAN. Well, we consider ourselves important partners in the formulation of overall fiscal policy, a major element being budgetmaking, so yes, I think we share all of that responsibility.

Senator BYRD. All right. That is all right with me. I was just trying to point out that I did not feel that you had that responsibility; that it was elsewhere. But, we will let the record stand as you said it.

So your figures are based on what the President submitted to the Congress.

Mr. ALTMAN. That is correct, sir.

Senator BYRD. Now, whatever the final debit figure will be at the end of this fiscal year, or at the end of the upcoming fiscal year based on the new budget, it is a very, very high figure, and I calculate roughly that the total debt at the end of fiscal year 1979 will be almost exactly double the total debt at the end of fiscal 1972, which is not very long ago.

My question is this. Often the national debt is dismissed on the basis that it is not important since we owe it to ourselves. Do you agree with that viewpoint?

Mr. ALTMAN. No; I must say, Mr. Chairman, that I do not fully agree with that. We have been asked that question many times in testimony before the Congress; and while it is true that certain debt held either by the trust funds or by the Federal Reserve is debt owed to other Government entities, I take the view that a debt obligation is a debt obligation, regardless of to whom it is owed; and in effect, the Federal Government owes a total of almost $720 billion today, of debt subject to limit.

Senator BYRD. Now, of the debt, roughly $100 billion, as I understand it, is owed to non-U.S. citizens or foreign governments. Is this correct?

Mr. ALTMAN. That is right. About $109 billion is owed to foreigners.

Senator BYRD. So if the rationale were carried to its conclusion that the national debt is not important because we owe it to ourselves, in the first place, that $100 billion owed to foreign governments or foreign individuals would have to be repudiated, if you were going to repudiate the debt?

Mr. ALTMAN. That is true, but I do not think that any of us were in favor of repudiating our debt.

Senator BYRD. I would not think so either. That is why it seems to me that the statement made by many from time to time that the debt is not important because we owe it to ourselves is not a valid assertion.

Let me ask you this. What would happen to the banks and insurance companies in this country if that view were taken and we decided to just wipe out the debt because we owed it to ourselves.

Mr. ALTMAN. Well, I think the effects would be severe because, among many other things, banks and insurance companies and other major financial institutions hold very large amounts of our debt, which, of course, they count as assets, and, in effect, a great portion of their asset base would be eliminated and their financial solidity severely affected as a result.

Senator BYRD. It would play havoc with the banks, I would think, and with the insurance companies too. It would play havoc, would

it not, with the social security trust funds and other trust funds. Are many of those funds not in Government bonds?

Mr. ALTMAN. Yes.

Senator BYRD. So it would play havoc with the 33 million social security recipients. It would just be totally unthinkable to say that the obligations of the U.S. Government will be repudiated.

Mr. ALTMAN. I agree.

Senator BYRD. What will be the peak borrowing periods for the Treasury during fiscal year 1978 and fiscal year 1979?

Mr. ALTMAN. Well, each year our peak borrowing quarters are the first and the second and the fourth—fiscal quarters. This year, fiscal 1978, our largest quarter is the current one—second fiscal quarter. And while we have not projected specific quarter-by-quarter borrowing amounts for fiscal 1979, the trend should not be particularly different.

Senator BYRD. Henry Kaufman, an economist for Soloman Bros. and Albert Cox, from Merrill Lynch, have indicated that financing of the large Federal deficit will have an adverse effect on private borrowing, especially housing and business.

What is your view on that?

Mr. ALTMAN. Well, that gets to the oft-asked question of crowding out.

Senator BYRD. Of what?

Mr. ALTMAN. Of crowding out, as it is so often called. Will the financing of the Federal Government crowd out private borrowers?

Our view, Mr. Chairman, is that it will not. Let me make two or three points quickly on that.

Senator BYRD. What percentage of the lendable funds will the Government be in the money market for during the remainder of this fiscal year, and for the next fiscal year, since you are talking about the next fiscal year as well as this one?

Mr. ALTMAN. Well, I do not have a specific percentage because, among other things, there are very different estimates as to the total amount of credit in our economy, which is the percentage that you are really asking for.

But I would say this. Our demands on the financial markets will be smaller in fiscal 1978 and in fiscal 1979 than they were in 1975 and 1976.

Senator BYRD. Well, we have long since left 1975 and 1976. We are in 1978, now.

Mr. ALTMAN. I understand but, for a couple of reasons, I do not think we are going to have a major negative effect on the financing of our private sector, particularly housing or business. And the reason I do not think so is that we do not expect the type of convergence of market, financial market forces and basic economic forces which occurred in 1974 and 1975 and gave rise, then, to all of the fears and discussions about crowding out.

We have a lot of slack today, at least a fair amount, in both our markets, ample credit supplies, and in our economy. We are only operating at roughly 83 percent of our industrial capacity.

For those reasons——

Senator BYRD. Suppose we did not have that slack?

Mr. ALTMAN. If we did not have as much slack in both our financial markets and in our economy, sure.

Senator BYRD. Well, as I understand it, the objective of your administration and the objective of the Congress is to have less slack.

Mr. ALTMAN. That is correct.

Senator BYRD. That is my understanding of the objectives of current economic policy.

Mr. ALTMAN. That is right.

But you are asking me whether or not I think that in 1978 and in 1979 the amount of Government financing and borrowing will have a major, negative impact on the financing of our private sector. I am saying no, I do not think so, because the amounts that we will raise in proportion to the availability of credit will not be such that we will be taking away a great deal.

Senator BYRD. What do you think Government borrowing will be in relation to overall borrowing—70 percent, 60 percent?

Mr. ALTMAN. Our borrowing as a percentage of total credit?

Senator BYRD. Yes.

Mr. ALTMAN. Far smaller than that. Far smaller than that. I believe—well, a recent estimate that I looked at over the last week in terms of total credit supplied to the economy in 1978, was $430 billion and our borrowing from the public in 1978, actually our market borrowing—market borrowing now—would be less than $50 billion, or around $50 billion.

So we are borrowing around $50 billion from the market, the total of which is $430 billion.

Senator BYRD. What will be the impact of Government borrowing upon interest rates?

Mr. ALTMAN. Well, as you know, Mr. Chairman, we do not forecast interest rates. Our budget for fiscal 1979 assumes the level of interest rates which were prevailing at the time that the budget was forecast.

Senator BYRD. And what is that? What did you assume?

Mr. ALTMAN. I believe that the assumption in the short-term area, which is where most of our borrowing occurs, simply because most of our borrowing is for the purpose of rolling over existing debt, is 6.1 percent.

Senator BYRD. Well, now you are paying 8 percent, are you not?

Mr. ALTMAN. The average interest rate on the public debt is 6.6 percent, in terms of the entire debt. We are paying—we auctioned 7-year securities last week which resulted in an interest cost to us of almost 8 percent.

Senator BYRD. 8.23 percent, was it not?

Mr. ALTMAN. No; that was the long-term security, Mr. Chairman, not the intermediate. We sold a package of 3-year and 3-month, 7-year, and then 27-year and 3-month securities.

Senator BYRD. But the Government is now paying roughly 8 percent for money?

Mr. ALTMAN. No, sir, we are paying less than that. Most of our borrowing occurs in the short-term area, and we are paying a good deal less than 8 percent today. In fact, 3-month Treasury bills are currently in the neighborhood, on a coupon-equivalent basis, of 6.8 percent and while our interest costs on longer term borrowing are higher

than that, the overall cost to us at the moment is substantially less than 8 percent.

Senator BYRD. Well, your budget has a figure of $55 billion for interest for fiscal year 1979.

Mr. ALTMAN. That is right.

Senator BYRD. Now, you had to have some assumptions in order to get that figure.

Mr. ALTMAN. Yes.

Senator BYRD. Now, what did you assume?

Mr. ALTMAN. We assumed the interest rates prevailing.

Senator BYRD. What figure did you assume?

Mr. ALTMAN. Well, the one I have in front of me is 6.1 percent on our short-term borrowing, which in turn represents most of our borrowing. The blended rate, or the effective rate, is probably somewhat higher than that, because we do not do all of our borrowing on a short-term basis, so it is probably in the area of 6.5 percent, Mr. Chairman. I will supply that specifically for the record.

[The following was subsequently supplied for the record:]

Budget estimates for interest on the public debt are made by the Office of Management and Budget. The interest which must be paid during the budget year on public debt securities which are outstanding at the time the estimate is made is calculated by multiplying the effective interest rate on each security by the amount of that security outstanding. For outstanding securities that will mature in the budget year, the OMB methodology assumes that these will be refunded by the issuance of like securities, e.g., bills, notes, bonds, with like maturities. Similarly, for borrowing to raise new cash, the methodology assumes that the maturity of new issues will be comparable to the maturity distribution of the outstanding debt. OMB does not predict changes in interest rates. Therefore, estimated interest rates, based on market yields on outstanding securities of comparable maturities prevailing at the time the estimates are made, are applied to the estimated amounts of refunding and new cash borrowings.

The interest rates used in the January 1978 Budget presentation are as follows:

Interest Rates Used to Estimate Interest on the Public Debt in the January 1978 Budget

Maturity:	Interest rate[1] (Percent)
13 weeks	6.1
26 weeks	6.4
52 weeks	6.75
1 to 3 years	7.0
3 to 6 years	7.25
Over 6 years	7.5

[1] Rates based on market yields prevailing in December 1977.

Senator BYRD. The point I am making is $55 billion for interest payments is going to be a low figure. In other words, interest is going to be higher than $55 billion.

Mr. ALTMAN. Well, yes.

Senator BYRD. Would you not think so?

Mr. ALTMAN. If interest rates are higher throughout 1979 than they were at the time that the budget was assembled, yes the actual interest on the public debt will be higher. But we are not even into 1979 yet, in fact we have several months to go, and it is not at all clear that that will be the case.

Senator BYRD. Now, you projected last year that the debt cost would be $46.6 billion for fiscal 1978. What is your more recent figure in that regard?

Mr. ALTMAN. $48.6 billion.

Senator BYRD. So it is up $2 billion, or roughly 5 percent?

Do you see inflation remaining at 6 percent?

Mr. ALTMAN. Essentially yes, Mr. Chairman. The official administration forecast is for an inflation rate in 1978 of approximately 6 percent, yes.

Senator BYRD. Do you feel that the large projected deficits for the remainder of fiscal 1978 and for fiscal 1979, as set forth in the budget, as leading to greater inflation?

Mr. ALTMAN. No; I do not, sir. I do not. We have, after all, as I said earlier, a relatively high degree of slack in our economy. That is one of the reasons why we have a budget deficit, we are not operating at full capacity or full employment, and we do not see ourselves bumping up against types of bottlenecks, either in terms of industrial use or the financial markets or otherwise, which would begin to feed inflationary pressures. No.

Senator BYRD. I understand that the administration is proposing to establish controls over Federal loan guarantee programs. In what programs do loan guarantees appear, and how do you propose to develop a system of control over those guarantees?

I am not sure whether that should be directed to you or to Mr. Cutter.

Mr. ALTMAN. Well, Mr. Cutter can probably answer it better than I can. We have both worked on it, but——

Senator BYRD. Well, if you have worked on it, go ahead.

Mr. ALTMAN. Well, I would like to turn it to him. I think he is the best person to answer it.

Mr. CUTTER. Sir, there are loan guarantee programs throughout the Federal Government. Our concern with loan guarantee programs is that typically they are perceived by advocates outside the Government, within the Government—the executive branch and the Congress—as free goods. Since they are not quite the same as direct loans and we do not count them as outlays—that is, since we do not count them the same as direct loans—they are often seen as a form of backdoor budgeting, as a way of getting around the discipline of the budget.

Senator BYRD. If I understand it correctly, I think you have developed a good approach.

Mr. CUTTER. Well, that is our concern, and the direction we would like to go in is to have the President establish, on the executive branch, a ceiling on guarantees and then to ask that a similar ceiling be imposed, both in the congressional budgeting process and in the appropriation process.

Senator BYRD. Well, now would you submit for the record the programs in which the loan guarantees appear? In other words, enumerate the programs, and then how do you propose to develop a system of control over these guarantees.

Mr. CUTTER. I would be happy to submit the first part for the record, and as for the second, I have outlined to you the general form that our control over such guarantees would take, and we will be developing that this year for implementation in the 1980 budget. I am

not sure I completely understood your question. If you would like an amplification of that for the record, I would be happy to submit it.

Senator BYRD. Thank you.

[The material referred to was subsequently supplied for the record:]

A list of Federal loan guarantee programs is contained in the following document: House Committee on Banking, Finance, and Urban Affairs, Subcommittee on Economic Stabilization, Catalog of Federal Loan Guarantee Programs (September 1977), 329 pps.

We are aware of the following omissions from this catalog:

Department of Housing and Urban Development: Public housing; urban renewal; college housing; and Government National Mortgage Association mortgage-backed securities.

Department of Health, Education, and Welfare: College facilities.

Department of the Treasury: New York City seasonal financing.

National Aeronautics and Space Administration: Lease guarantees.

Funds appropriated to the President: International Financial Institutions capital contributions.

Small Business Administration: Agriculture business loans; and agriculture disaster loans.

Federal Deposit Insurance Corporation: Franklin Bank loan.

National Credit Union Administration: Loan guarantees.

D.C. Stadium loan guarantee.

Postal Service: Lease guarantees.

Senator BYRD. Mr. Secretary, the money supply is a key factor, of course, in making economic projections for the budgetary purposes. What are the administration's assumptions about the growth of the money supply?

Mr. ALTMAN. Mr. Chairman, I do not know precisely what our assumptions are. I think, to a large extent, they are one element in our forecasts on inflation, but I will be happy to check and supply you with an answer for the record as to what assumptions on that overall front we are using.

[The following was subsequently supplied for the record:]

The money supply has behaved in a volatile manner in recent years, making it difficult to predict its future course with precision. In formulating the projections underlying the Budget, it was assumed that financial market conditions would be such as to accommodate the 4½ to 5 percent growth rate projected with no exceptional pressures on interests rates. The money supply growth associated with such market conditions will depend on the rate of money turnover, i.e., velocity. Since velocity changes have been erratic recently, it would be foolhardy to try to predict its future course.

Senator BYRD. I understand that you and Secretary Blumenthal—as you mentioned earlier—plan to go to New York City.

Mr. ALTMAN. Yes, sir.

Senator BYRD. The New York City situation is of considerable concern to many Members of the Congress. Could you give us a brief outline of the situation as you see it today?

Mr. ALTMAN. I would be happy to.

Esentially, Mr. Chairman, as I am sure you know, the President is committed to preserving New York City's solvency. His position is that if an extension of Federal lending to New York is necessary to preserve that solvency, then he will propose it.

Secretary Blumenthal will be testifying before the House Banking Committee, Subcommittee on Economic Stabilization on February 23 for purposes of presenting the administration's recommendations, specific recommendations to the Congress, on New York City.

But it is fair to say that we intend to propose some form of extended Federal lending. Yet, any such proposal will be explicitly conditioned on a series of commitments from the relevant city and State parties, both public and private, commitments which will assure the New York City's budget moves into true balance over the period of any extension Federal lending.

Senator BYRD. Well, what will the private sector have to do with the New York City budget?

Mr. ALTMAN. Well, the private sector has less to do with the budget than they have with the financing of the budget, but another set of commitments that we must have, and we will not proceed relative to Congres unles we do have, is a set of lending commitments from the financial community as well as certain others, such as the pension fund, so that the Congress can be sure, and the administration can be sure, that any Federal lending after June 1978 is secure because the other needs of New York City, which will not be accommodated by the Federal Government, will be financed and not, in effect, left hanging.

What I am trying to say is that the Federal Government today does not finance all of New York City's borrowing needs, and in the post-June period, whatever the Congress might approve will not be financing at all—in fact, will not finance as much as half. So that, for New York City's sake and for the sake of the Federal Government in protecting our loans, we must be sure that the amounts which we do not finance are financed, because if they were not to be, then the city would not be solvent and our loans would be in jeopardy.

So we need commitments from the city in terms of its budget and a series of public and private entities in terms of the financing of the city's needs over the next 4 years, and that is what we are in the process of seeking, and the reason that Secretary Blumenthal and I are going to New York—if we ever get there, on the noon Metroliner.

But our positions will be outlined to the Congress later this month.

Senator BYRD. You have studied this matter carefully. Did New York City have a balanced budget in fiscal 1976?

Mr. ALTMAN. Not on any conventional basis, absolutely not.

Senator BYRD. Did New York City have a balanced budget in fiscal 1977?

Mr. ALTMAN. In addition to a $357 million operating deficit the budget was balanced under a State law which counted as a revenue $572 million in bond proceeds. Thus, the budget was not balanced in a generally accepted accounting sense.

Senator BYRD. Does that same assertion hold true for the current fiscal year?

Mr. ALTMAN. Yes, but I should say, only in fairness, that there has been a great reduction in the budget deficit there. In fiscal 1975, the budget deficit on a conventional basis including capitalized expenses, a generally accepted accounting principles basis, was $2 billion.

Senator BYRD. What was it in 1976?

Mr. ALTMAN. In 1976 it was approximately $1.3 billion.

Senator BYRD. $2 billion and $1.3 billion.

What was it in 1977?

Mr. ALTMAN. Well, I think I probably gave you the wrong figure. I think it was 900 million including capitalized expenses in 1977 and perhaps $1.6 billion in 1976.

And this year, it is in the area of $1 billion including the capitalized expenses. They have reduced it, in other words, by 50 percent. Now a $1 billion budget deficit is still a very large one for a municipality, even though New York City's budget is the largest of any by a municipality by far.

Senator BYRD. Does not the New York State law require the municipalities to operate on a balanced budget?

Mr. ALTMAN. Well, it does, Mr. Chairman, but a special State law was passed in 1975 to give New York 10 years over which to phase out a habit of using some of the city's capital budget for purposes of financing its operating expenses. And they had approximately $800 million of operating expenses which were being financed from, essentially, the capital budget in fiscal 1975.

So the city got 10 years, by State law, to phase that out.

Now, when I say they have a $1 billion deficit, under State law, they can exclude the capitalized expenses from that figure, thus they have a much smaller deficit than that. They have just announced a potential fiscal 1979 deficit of $457 million. So it is much smaller than $1 billion.

But on any conventionally accepted accounting basis, you know, your operating budget is your operating budget and all of your operating expenses are in it, and so adding those operating expenses in the capital budget to the normal budget means that, despite State law, they nevertheless have a deficit of approximately $1 billion according to generally accepted accounting principals.

But the deficit has been cut in half since 1975, and it is our view that, over the next 4 years, with appropriate local effort, which we must be sure takes place, the budget can be brought finally into true balance. And once it is—and I think this is a crucial point—once it is, New York City ought to be able to be restored to the basic financing independence, borrowing on its own, the same way that any other municipality does. And it is our basic view that, since that can be done over the next 4 years, it makes sense for the Federal Government to give New York those 4 more years as compared to a bankruptcy which we think would be cataclysmic.

Senator BYRD. You are not even going to require New York to balance its budget for 4 years?

Mr. ALTMAN. Well, Mr. Chairman, we would like for New York to balance its budget this afternoon, and I am sure you would too, but it is not possible for its budget to be balanced, or that $1 billion deficit to be eliminated, except on a multiyear basis.

Let me give you an example. New York City's budget is approximately $13 billion today. But of that amount, only $8 billion is its own funds. The balance is Federal and State aid.

Now, the city has a lesser ability, of course, to influence Federal and State aid and to get more of it, for example, than it does to raise its own revenues, through economic development or other matters. So it has a budget which is different than most in the sense that it is enormously dependent on third parties.

And that is also true for the expense side of its budget. So it is just not conceivable, unfortunately, that that $1 billion deficit could be eliminated, sir, in 1 year. It is going to have to be eliminated through a combination of city actions—which they have pledged to do, I might

say—a series of very difficult actions—attrition in the work force, et cetera; a series of State actions, where New York State has to take a greater responsibility for New York City——

Senator BYRD. All of those requirements were put on New York City 3 years ago. Now you are coming in here and saying that we have to have another 4 years.

Mr. ALTMAN. Well, Mr. Chairman, I was not there 3 years ago urging the Congress that 3 years would be it and the city would be back onto its feet. Frankly, I think that was wishful thinking, to a great extent, on the part of those who were urging that.

But I do think that if one looks at it retrospectively, or rather in particular perspective, it is a problem which is solvable over a number of years. It was not realistic to think that it could be solved in 3 years. That was not realistic, Mr. Chairman.

Senator BYRD. The problem is that you do not want to force the politicians to take an unpopular course of action in New York.

Mr. ALTMAN. I would beg to disagree just a bit, in this sense.

You can be assured that the purpose of our negotiations with the city and the State, now and during the last couple of months, and during the next 3 and 4 months, will be to win commitment from them. Commitments of major new effort on budget and on financing, without which we, ourselves, Mr. Chairman, we ourselves in the administration would not recommend that the Congress go forward.

So what I am saying is that our recommendations to Congress will be conditioned on a set of city and State actions which I think we can persuade you are major commitments and difficult politically. And it is only on that basis that we will recommend that Federal money of any type be extended.

Without the commitments, I agree. It is not an appropriate course of action for the Congress and the administration to take.

We think we will get them, and we think that we can persuade the Congress that they are sufficiently major as to end this overall financing crisis in New York over a period of 4 more years or so.

But I share your concerns and I share your implicit urgings concerning difficult political actions at the city and State levels; yes.

Senator BYRD. I am sure that your intentions are excellent. I do not question that at all, but it just seems to me that the longer we coninue to bail out New York the more that says to politicians everywhere:

> Do not worry about it. Make all the commitments you want to all of the pressure groups that you want in your community and, if you get in trouble, the Federal Government will take care of you.

I think that is a bad philosophy to have abroad in this country.

Mr. ALTMAN. I agree that that is a bad philosophy. My point is that we are essentially faced with a choice of, on the one hand, a New York City bankruptcy, which we think makes no sense at all——

Senator BYRD. Well, I think that you are just painting things too black and too white. If they were willing to cut some expenses, if they were willing to take some tough courses, I am convinced that the budget could be balanced in a lot shorter time than 4 years. Otherwise we will be dealing with this question for 7 years from the time that this problem first was brought to the attention of the Congress.

But anyway, go on up there now and do the best you can. But do not give away these Federal funds. They come out of the pockets of the taxpayers of the State of Virginia as well as the other 49 States. I do not

think that the Virginia taxpayer takes very kindly to having their tax funds used to bail out politicians in New York City, or any other city, for that matter. I would not want to vote for tax funds to bail out the politicians in any city in Virginia.

I think that the discussion of 4 additional years is not reasonable. I think that you ought to require a balanced budget long before any 4-year period, and I hope that you and Secretary Blumenthal will.

Thank you, sir.

Mr. ALTMAN. Let me make one comment—not on that, but I have done some quick research on your very first question about whether the $90 billion request is the largest that was ever asked for. And you are correct. It is the largest that has ever been asked for, and it is the largest increase in the debt subject to limit.

My point, which I respectfully suggest is worthwhile, is that the debt subject to limit is composed of three basic factors: The unified budget deficit, the trust fund surplus, and the financing requirements of off-budget entities.

It is only because the trust fund surplus for 1979 is much larger than for 1976, which is not the same type of characteristic borrowing need as a budget deficit, that the increase will be the largest.

You see, I tend to think, Mr. Chairman, and this is just as——

Senator BYRD. You mentioned the trust fund surplus for 1979. What is the trust fund surplus, around $14 billion?

Mr. ALTMAN. Yes; $13.9 billion.

Senator BYRD. Yes. Say $14 billion in round figures. Now how does that $14 billion break down?

For example, the social security surplus is what?

The highway surplus would be something like $7 billion, I would guess.

Mr. ALTMAN. While he is checking those for you—I do not want to belabor the point, but if you look at those three components of borrowing need, you see that the unified budget deficit and the financing need flowing out of that, which I know you are most concerned about, that part of our borrowing, that aspect of it is not as great in fiscal 1979 as in fiscal 1976.

The difference, and the reason why the fiscal 1979 request is the largest as compared to 1976—I do not want to belabor this because they are both too big; I think we all agree—is because of the trust fund surplus which increases much more—well, which is a much bigger component of the need in 1979 than it was in 1976. That is my only point.

Senator BYRD. Well, now, let me get one figure before you leave from Mr. Cutter as to the social security trust surplus.

Mr. CUTTER. Sir, we can give you the exact figures, but the social security trust fund, or more generally, the Federal old age survivors and disability insurance trust funds, which is putting several together—and I do not have the information here that would allow me to take the components of that apart, but that general trust fund is slightly—well, it is $3 billion in deficit in 1979.

Senator BYRD. Well, where does the $14 billion surplus come from? That is what I am trying to get.

Mr. CUTTER. The Federal employees' retirement fund, which is also a trust fund and which is included in that general calculation, is $7 billion in surplus in that same year. It is a netting-out of approximately 12 trust funds. That is where the $14 billion comes from.

Senator BYRD. Well, the large surplus is in the civil service retirement, is it not?

Mr. CUTTER. Yes, sir.

Senator BYRD. And that money is put in by individual Federal employee?

Mr. CUTTER. Yes, sir.

Senator BYRD. And that is $7 billion of the $14 billion. What other major trust fund is in surplus—the highway trust fund is in surplus is it not? $6 billion or $7 billion?

Mr. CUTTER. The highway trust fund is moderately—is not in deficit. It has a surplus of aproximately half a billion.

Senator BYRD. Only a half-billion for fiscal 1979?

Mr. CUTTER. Yes, sir.

Senator BYRD. So the bulk of trust fund surpluses are in the civil service retirement?

Mr. CUTTER. I can give you slightly more detail. The big negative is in social security, which is a deficit of $2.9 billion, and the positives, which are netted out against that, are the Federal employees retirement, which is $7.2 surplus; unemployment insurance, which is $5.2 in surplus; medicare, which is $2.3 in surplus; and highways, which is $600 million in surplus.

Senator BYRD. Now, the unemployment—that is from employer contributions, basically, is it not?

Mr. CUTTER. Yes, sir.

Senator BYRD. So that is not Government money. That is not from general taxation. That money was put into the trust fund as a payroll tax by the various companies.

Mr. CUTTER. Yes, sir.

Senator BYRD. Thank you, Mr. Altman.

[The prepared statement of Mr. Altman follows:]

STATEMENT OF HON. ROGER C. ALTMAN, ASSISTANT SECRETARY OF THE TREASURY

Mr. Chairman and Members of the Committee: I am pleased to be here today to assist you in your consideration of the public debt limit. The present temporary debt limit of $752 billion will expire on March 31, 1978, and the debt limit will then revert to the permanent ceiling of $400 billion. Legislative action by March 31 will be necessary, therefore, to permit the Treasury to borrow to refund securities maturing after March 31 and to raise new cash to finance the estimated deficits in the budget, as submitted to Congress by the President last month.

In addition, to permit the Treasury to continue borrowing in the long-term market, it will be necessary to increase the $27 billion limit on the amount of bonds which we may issue without regard to the 4¼ percent interest rate ceiling on Treasury bond issues.

Finally, we are repeating our earlier request for authority to permit the Secretary of the Treasury, with the approval of the President, to change the interest rate on U.S. Savings Bonds if that should become necessary to assure a fair rate of return to savings bond investors.

DEBT LIMIT

Turning first to the debt limit, our estimates of the amounts of debt subject to limit at the end of each month through the fiscal years 1978 and 1979 are shown in the attached table. The table indicates that the debt subject to limit will increase to $778 billion on September 30, 1978, and to $868 billion on September 30, 1979, assuming a $12 billion cash balance on those dates. These are the debt estimates and cash balances assumptions included in the President's January budget proposals. The usual $3 billion margin for contingencies would raise these amounts to $781 billion on September 30, 1978, and $871 billion on

September 30, 1979. Thus the present debt limit of $752 billion would need to be increased by $29 billion to meet our financing requirements through the remainder of fiscal 1978 and by an additional $90 billion to meet the requirements in fiscal 1979.

Our $781 billion estimate of the debt subject to limit on September 30, 1978 (which includes the $3 billion margin for contingencies) is $6 billion higher than the $775 billion approved in the second concurrent resolution on the Federal budget for fiscal year 1978, which was adopted by Congress on September 15, 1977.

The $90 billion increase in FY 1979 reflects the Administration's current estimates of a fiscal 1979 unified budget deficit of $60.6 billion, a trust fund surplus of $13.9 billion, and a net financing requirement for off-budget entities of $12.5 billion. The trust fund surplus must be reflected in the debt requirement because the surplus is invested in Treasury securities which are subject to the debt limit.

The relevant debt of off-budget entities consists largely of obligations which are issued, sold or guaranteed by Federal agencies and financed through the Federal Financing Bank. Since the Federal Financing Bank borrows from the Treasury, we are required to increase our borrowing in the market by a corresponding amount. This, of course, adds to the debt subject to limit.

BOND AUTHORITY

I would like to turn now to our fiscal 1979 need for an increase in the Treasury's authority to issue long-term securities in the market without regard to the 4¼ percent statutory ceiling on the rate of interest which may be paid on such issues. To meet our requirements next year, the Treasury's authority to issue bonds (securities with maturities over 10 years) should be increased by $10 billion from the current ceiling of $27 billion to $37 billion.

The 4¼ percent ceiling predates World War II but did not become a serious obstacle to Treasury issues of new bonds until the mid-1960's. At that time, market rates of interest rose above 4¼ percent, and the Treasury was precluded from issuing new bonds.

In 1971, Congress authorized the Treasury to issue up to $10 billion of bonds without regard to the 4¼ percent ceiling. This limit has since been increased a number of times, and in the debt limit act of October 4, 1977, it was increased from $17 billion to the current level of $27 billion.

The Treasury to date has used almost $20 billion of the $27 billion authority, including the $1¼ billion bond auctioned last week, which leaves the amount of unused authority at about $7 billion. While the timing and amounts of future bond issues will depend on prevailing market conditions, a $10 billion increase in the bond authority would permit the Treasury to continue its recent pattern of bond issues throughout fiscal year 1979. Thus, the Treasury would be able to make further progress toward achieving a better balance in the maturity structure of the debt and re-establishing the market for long-term Treasury securities. We believe that such flexibility is essential to efficient management of the public debt.

SAVINGS BONDS

In recent years, Treasury has recommended frequently that Congress repeal the 6 percent ceiling on the rate of interest that the Treasury may pay on U.S. Savings Bonds. Prior to 1970 the ceiling had been increased many times, but the current 6 percent statutory ceiling was enacted by Congress in 1970. As market rates of interest rose, it became clear that an increase in the savings bond interest rate was necessary to provide investors in savings bonds with a fair rate of return.

Mr. Chairman, we do not feel that an increase in the interest rate on savings bonds is necessary today. Yet, we are concerned that the present requirement for legislation to cover each increase in the rate does not provide sufficient flexibility to adjust the rate in response to changing market conditions. The delays encountered in the legislative process could result in inequities to savings bond purchasers and holders as market interest rates rise on competing forms of savings.

Furthermore, Treasury relies on the savings bond program as an important and relatively stable source of long-term funds. On that basis, we are concerned that participants in the payroll savings plans and other savings bond purchasers might drop out of the program if the interest rate were not maintained at a level reasonably competitive with comparable forms of savings.

Any increase in the savings bond interest rate by the Treasury would continue to be subject to the provision in existing law which requires approval of the President. Also, the Treasury would, of course, give very careful consideration to the effect of any increase in the savings bond interest rate on the flow of savings to banks and thrift institutions.

DEBT LIMIT PROCEDURE

Mr. Chairman, I would also like to take this opportunity to suggest that your Committee consider a more effective procedure for controlling the size of the public debt.

We do not think that the present statutory debt limit is an effective way for Congress to control the debt. In fact, the debt limit may actually divert public attention from the real issue—control over the Federal budget. The increase in the debt each year is simply the result of earlier decisions by the Congress on the amounts of Federal spending and taxation. Consequently, the only way to control the debt is through firm control over the Federal budget. In this regard, the Congressional Budget Act of 1974 greatly improved Congressional budget procedures and provided a more effective means of controlling the debt. That Act requires Congressional concurrent resolutions on the appropriate levels of budget outlays, receipts, and public debt. This new budget process thus assures that Congress will face up each year to the public debt consequences of its decisions on taxes and expenditures.

Moreover, the statutory limitation on the public debt occasionally has interfered with the efficient financing of the Federal Government and has actually resulted in increased costs to the taxpayer. For example, when the temporary debt limit expired on September 30, 1977, and new legislation was not enacted on the new debt limit until October 4, Treasury was required, in the interim to suspend the sale of savings bonds and other public debt securities. The suspension of savings bonds sales, in particular, resulted in considerable public confusion, and indignation, as well as additional cost to the Government. The cot of printing and distributing notifications to about 40,000 savings bonds issuing agents was $16,775. A much greater, but incalculable, cost is the loss of public confidence in the savings bond program and in the management of the government's finances.

Accordingly, we believe that the public debt would be more effectively controlled and more efficiently managed by typing the debt limit to the new Congressional budget process. We simply put this proposal on the table, Mr. Chairman, for you and the other members of the subcommittee to consider in the hope that we can work together to devise a more acceptable way to control the debt.

PUBLIC DEBT, SUBJECT TO LIMITATION
FISCAL YEAR 1978

[Based on: Budget receipts of $400,000,000,000, budget outlays of $462,000,000,000, unified budget deficit of $62,000,000,000, off-budget outlays of $12,000,000,000]

[In billions of dollars]

	Operating cash balance	Public debt subject to limit	With $3,000,000,000 margin for contingencies
Actual:			
Sept. 30, 1977	19.1	700.0	
Oct. 31, 1977	7.7	698.5	
Nov. 30, 1977	5.5	709.1	
Dec. 31, 1977	12.3	720.1	
Jan. 31, 1978	12.5	722.7	
Estimated:			
Feb. 28, 1978	12.0	738.0	741
Mar. 31, 1978	12.0	747.0	750
Apr. 19, 1978	12.0	750.0	753
Apr. 30, 1978	12.0	740.0	743
May 31, 1978	12.0	753.0	756
June 21, 1978	12.0	753.0	756
June 30, 1978	12.0	746.0	749
July 31, 1978	12.0	756.0	759
Aug. 31, 1978	12.0	772.0	775
Sept. 30, 1978	12.0	778.0	781

PUBLIC DEBT, SUBJECT TO LIMITATION
FISCAL YEAR 1979

[Based on: Budget receipts of $440,000,000,000, budget outlays of $500,000,000,000, unified budget deficit of $61,000,000,000, off-budget outlays of $12,000,000,000]

[In billions of dollars]

	Operating cash balance	Public debt subject to limit	With $3,000,000,000 margin for contingencies
Estimated:			
Sept. 30, 1978	12	778	781
Oct. 31, 1978	12	789	792
Nov. 30, 1978	12	801	804
Dec. 31, 1978	12	806	809
Jan. 31, 1979	12	809	812
Feb. 28, 1979	12	824	827
Mar. 31, 1979	12	837	840
Apr. 18, 1979	12	841	844
Apr. 30, 1979	12	828	831
May 31, 1979	12	846	849
June 20, 1979	12	852	855
June 30, 1979	12	839	842
July 31, 1979	12	848	851
Aug. 31, 1979	12	864	867
Sept. 30, 1979	12	868	871

Senator BYRD. Mr. Cutter, will you proceed in any way that you prefer?

STATEMENT OF W. BOWMAN CUTTER, EXECUTIVE ASSOCIATE DIRECTOR FOR BUDGET, OFFICE OF MANAGEMENT AND BUDGET

Mr. CUTTER. Sir, I will be very brief. I am here to support the Treasury's position with respect to its request for an increase in the debt limit, its proposals for improving the management of the debt, and its suggestion that the statutory debt be tied to the congressional budget process.

Rather than read my statement, I will summarize the first part of it, which has to do more directly with the budget, and brings forth some detail that Mr. Altman's testimony did not bring forth, and I will submit the rest for the record.

The debt figures which we have been discussing are derived from budget totals shown on the first table in my testimony. For fiscal year 1978, we are now estimating a deficit of $61.8 billion, with outlays of $462.2 billion and receipts of $400.4 billion.

For 1979, we are now estimating a deficit of $60.6 billion, and the President is asking for outlays of $500.2 billion and receipts of $439.6 billion.

Our outlays, speaking now to 1978, have changed little since my testimony in last August and September. Our estimate is $462.2 billion now; the estimate at the time was $462.9 billion.

The outlays for fiscal year 1979, we believe, reflect a prudent and a tight budget that resulted from a thorough zero-based budget analysis of agency programs.

Spending for 1979 has been held to an overall increase of 8 percent, which is the smallest increase since 1973. The deficit for 1979, it is true, is only $1 billion less than the deficit for 1978, but had no tax cut been

proposed, we would have shown a decrease in the deficit of $15 billion to $20 billion, and it was our judgment then, and it is now, that it is more important that we have a tax cut to help the economy continue to grow and to encourage the increased capital investment that will improve productivity and allow growth for the future.

The President's reductions also mean that Federal taxes will represent a smaller share of gross national product, and this, in turn, will provide an added incentive for both the Congress and the President to restrain the growth of spending.

We believe that this budget keeps open the option for a balanced budget in 1981; and in an effort to control the budget more effectively so that we can remain on this path, the President has asked each agency to prepare future budget requests within the context of a planning period that extends for 3 years beyond the budget year.

The multiyear planning system that we are developing will help to insure better control of Federal spending by identifying the long-term spending consequences of program proposals.

Turning to receipts, our estimate of 1978 receipts have declined by $1 billion since the August and September hearings on the debt ceiling, from $401.4 to 400.4 billion.

For 1979, the receipts estimates are $24.3 billion below those that would be produced under existing tax legislation and that decrease of $24.3 billion reflects the effects of the administration energy tax and tax reduction and reform proposals.

In the remainder of my brief written testimony, I discuss the budget by fund group, most of which you have already discussed with Mr. Altman, and, with your permission, I would simply submit that for the record and conclude by saying again that we support the Treasury Department's testimony and that I would like to call attention, briefly, to the point that Mr. Altman made as to the element of redundancy that exists between the process of setting statutory debt ceilings on the one hand and the establishment of appropriate levels for debt subject to statutory limitation that are contained in the congressional budget resolution.

In view of this, OMB supports the Treasury suggestion that because the public debt is being effectively controlled through the congressional budget process that the debt limit in the future be tried to the congressional budget process.

Thank you, sir.

Senator BYRD. Budget debt is being effectively controlled. Is that what you said?

Budget debt is being effectively controlled?

Mr. CUTTER. I said the public debt, sir.

Senator BYRD. The public debt is being effectively controlled?

Mr. CUTTER. Yes, sir.

Senator BYRD. Yet it has increased—it will have doubled, according to Treasury figures—at the end of fiscal year 1979 compared to the debt as it stood at the end of fiscal 1972. Frankly, I do not call that being controlled.

Mr. CUTTER. Sir, I think that there is a difference between whether one likes or dislikes the numbers and the process one uses to control, in a managerial sense, the numbers that we agree on, both the Executive and the Congress.

Senator BYRD. Well, I do not blame the executive branch for not wanting to have statutory debt ceilings. It is much easier, of course, and much more desirable to be able to operate as you think best without restraint. You do not have to have public hearings or anything approaching congressional review.

So I do not blame you, but I do not necessarily agree with you. If I were in your position perhaps I would want to have it that way, too.

Let me ask you for a couple of figures——

Mr. CUTTER. Let me say just one thing. We feel that the Executive's proposals are quite thoroughly aired——

Senator BYRD. Are quite what?

Mr. CUTTER. Are quite thoroughly aired, and that the new congressional budget process has been a helpful and important means of introducing some measure of overall congressional perspective to the setting of the Federal budget and consequently that——

Senator BYRD. I think you phrased it right, "some measure"—slightly, some measure. I see very little discipline in it, and I think that the figures show that.

But I agree with you that there has been some improvement, with the emphasis on "some." But that is mainly because nothing could have been worse than the old system, as I see it.

Let me get three figures from you, if I may.

I think the most significant figures are those dealing with Federal funds, rather than the budget on a unified basis, because that is what it costs to operate the Government exclusive of the trust funds to which revenue is paid for a specific purpose and cannot be used for the general operation of Government.

Now, what will be the receipts in the general fund for fiscal 1979?

Mr. CUTTER. Federal funds receipts would be $289.1 billion.

Senator BYRD. And the outlays will be what?

Mr. CUTTER. $363.6 billion.

Senator BYRD. And then the deficit will be what?

Mr. CUTTER. $74.5 billion.

Senator BYRD. And then, according to your estimated figures, the deficit for 1978 will be $72.1.

Mr. CUTTER. Yes, sir.

Senator BYRD. Now, in looking at these figures, the figure that impresses me is this deficit of $74.5, in looking at the table that I have before me, which goes back to fiscal 1959, will be the largest deficit in Federal funds in the history of our Nation, with the possible exception of World War II. There is no doubt about that, is there?

Mr. CUTTER. I think that is right.

Senator BYRD. And that is for fiscal year 1979.

Mr. CUTTER. Yes. sir.

Senator BYRD. Now. the runner-up year is the current year, fiscal 1978. That figure is $72.1 billion.

So, in so far as getting toward a balanced budget, it certainly seems clear to me, judging by the figures, that we are going in the opposite direction.

Mr. CUTTER. Sir, we have another point of view, which is that by introducing this budget and the Federal funds deficit, which you have pointed out—although we believe that the unified budget is an impor-

tant total to keep track of, and we pay more attention to the unified budget—but the President chose to introduce a tax reduction of $25 billion—$24.3 billion.

Had he not made that choice, this Federal funds deficit would have been somewhere between $15 billion and $20 billion less.

Senator BYRD. Regardless of the reason, the fact is, according to your own figures, this Government will have the largest Federal funds deficit in fiscal year 1979 that it has ever had in its history, and the second largest deficit in fiscal year 1978.

Mr. CUTTER. Sir, I have acknowledged that. What I am trying to explain the reason because it is important. Whether or not it reaches a balance in future years has a great deal to do with the way the economy performs, and it is the President's judgment that it is a far better course, and more in the public interest, to choose a tax reduction this year and accept the consequences of the higher deficit in order to continue the improvement in the economy and to insure that improvement in coming years so that we can have a stable balance in the future.

Senator BYRD. Of course, that has been the whole philosophy of every recent administration, and the deficits have gotten larger every time.

When President Johnson was President, the Secretaries of the Treasury would come in here with precisely the same argument. When President Nixon was President, Secretary Schultz had that argument. When President Ford was President, it was the same way. President Carter is President, and this administration says that the way to have good times in this country is for the Government to run higher and higher deficits.

But I want to point out that when President Carter was a candidate, when he sought the Presidency, he took an entirely different view. He took, in my judgment, the correct view: that it is very important to get back to a balanced budget. I regret the fact that the administration has changed its position in that regard and has eliminated the high priority which was given a balanced budget during the campaign and during the first 6 months of this administration.

Mr. CUTTER. If I could make a point, sir, I certainly have seen no single sign—nor do I think that the President has publicly stated—that his concern and commitment to a balanced budget has even diminished to the slightest degree.

I sat through—I cannot count the number of hours—dozens of hours of budget preparation with the President, with the current Acting Director McIntyre, and that was a concern that was constantly on the President's mind, constantly stated. It is our judgment, as an administration, that choosing this tax reduction—and therefore accepting the consequences of this debt—is the best way to reach that balance.

Senator BYRD. I think the American people have to judge by the figures. The figures show just what you brought out, that our country will have the largest Federal funds deficit in fiscal year 1979 that it has ever had, and it will have the second largest deficit in this current year.

Now, the Federal debt is estimated to be $786 billion at the end of fiscal year 1978 and $871 billion by the end of fiscal year 1979. Now, often this debt is dismissed on the basis that it is not important, since we owe the debt to ourselves. What is your view on that?

Mr. CUTTER. Sir, I think that Assistant Secretary Altman well expressed both his view and mine in saying that he did not agree, and I would add that I do not agree with that judgment.

Senator BYRD. How do you see inflation in 1979?

Mr. CUTTER. If I can glance for a second at our economic projections, in our budget document—we are projecting, in 1979, a rate of inflation of approximately 6 percent, fourth quarter over fourth quarter.

Senator BYRD. And that is the same figure, I think, as you project for 1978?

Mr. CUTTER. Yes.

Senator BYRD. You project it for both 1978 and 1979?

Mr. CUTTER. Yes, sir. Essentially.

Senator BYRD. Yes.

I am not totally clear on this matter. I am sure it is simple, if you could point it out to me.

You project a deficit of $74 billion in the Federal funds, but—for fiscal 1979—the administration is seeking an increase in that fiscal year in the debt ceiling of $90 billion.

Now, why would you need an increase of $90 billion if the Federal funds deficit will be $74 billion?

Mr. CUTTER. The principal difference between the $74.5 which we estimate as the Federal funds deficit, and the $90 that Mr. Altman has discussed, is in the deficit of off-budget Federal entities, and the principal off-budget entity within that general category is the Federal Financing Bank.

Senator BYRD. Is the Federal Financing Bank?

Mr. CUTTER. Yes, sir.

Senator BYRD. Now, would you give the committee a dissertation on what the Federal Financing Bank is and how it draws money from the Treasury?

Mr. CUTTER. I might say that it is by no means a simple matter, and my understanding of it is almost certainly no greater than yours. I can give you a very brif comment on its purpose and perhaps we could submit for the record anything beyond that, and any of your questions that I cannot answer.

The Federal Financing Bank was originally established, recently—but I am not certain as to when—to meet the problem that a number of Federal agencies have debt, go to the market——

Senator BYRD. Now, who established the Bank?

Mr. CUTTER. My understanding is that it was established in approximately 1973. It was established by the Federal Financing Bank Act of 1973, so it was established, I would imagine, by the request of the administration at that time, by act of Congress.

Senator BYRD. Go ahead, if you will.

Mr. CUTTER. One of its purposes was to assist Federal agencies in going to the market so that debt could be—so that all of the Federal Government's impacts on the market could be properly accounted for and assesed, and so that one effort by the Federal Government to go to the market would not be confused by another.

Our concern with it, as I think I mentioned earlier to you, is that it has also beome a means in conjunction with the use of guaranteed loans by which Federal guarantees of loans are converted, off budget,

into direct loans and as the result of the invention of a new form of backdoor budgeting.

That is a little bit off the point. On point, it is the largest single source of deficit among the off-budget Federal entities.

Now, precisely how its financial relationship with the Treasury is, I do not know. We could submit that to you for the record, or perhaps one of Mr. Altman's colleagues could answer that question for you.

Senator BYRD. Could one of Mr. Altman's colleagues answer that? Would you identify yourself, please?

Mr. CAVANAUGH. I am Francis Cavanaugh, the Director of the Office of Government Financing and I work for Mr. Altman.

Senator BYRD. Welcome, sir.

Mr. CAVANAUGH. I think the question had to do with the Federal Financing Bank's relationship to the Treasury? The Federal Financing Bank, in order to make loans to Federal agencies, and the purchase of loans guaranteed by Federal agencies, obtains its funds by borrowing from the Treasury, and the Treasury, in turn, borrows that much more in the private market.

Senator BYRD. Well, is this correct? The Federal Financing Bank borrows the money to supply the needs of various agencies of Government?

Mr. CAVANAUGH. Yes, sir.

Senator BYRD. So while the Federal funds deficit is listed in Mr. Cutter's statement, and in the budget, and presumably in the new budget document, at $74 billion, you really need to add to that another $16 billion for the deficit of the Federal Financing Bank? Is that the way it works?

Mr. CUTTER. No, sir. It is not $16 billion. I had said to you that the largest single factor in bridging between $74.5 billion and $90 billion was the Federal Financing Bank. The total deficit of off-budget Federal entities is $12.5 billion. I am not certain as to the fiscal year 1979 deficit of the Federal Financing Bank by itself. I do not think it is as high as $16 billion.

It is $12.5 billion. The others are small in net.

Senator BYRD. The Bank accounts for $12.5 in the deficit?

Mr. CUTTER. Yes, sir.

Senator BYRD. So would I be correct, then, in assuming that the real deficit of the Government is—leaving out the trust funds—the real deficit of the Government is $74 billion plus $12.5 billion?

Mr. CUTTER. There are some other minor adjustments, but that is basically the total increase needed in the debt subject to limit.

Senator BYRD. So those, of course, are expenditures of Government. It is a part of the cost of operating the Government, that $12.5 deficit?

Mr. CUTTER. It is part of the cost. It is also directly linked to our concerns and our interest in controlling credit, the credit transactions of the Government, and our interest, as I mentioned earlier, in developing a budgetary means of control over guaranteed loans. Because guaranteed loans and the Federal Financing Bank's later purchase of them, which, in effect, translates them into direct Federal loans, because they are seen as free goods, they tend, in our judgment—although one never has specific evidence of this—to be overly used.

I think we believe in the economist's dictum that there is no such thing as a free lunch, and would like to see those controlled directly

and to see limitations be put on them. And, were that to be done, we would be more confident about saying to you what the true "heeds" of the Federal Government were in this area.

The number $12.5 billion is that which is estimated to be required by the Federal Financing Bank in fiscal year 1979 under current conditions.

Senator BYRD. Well, the reason it arose is that you are testifying today on behalf of the Treasury's position that it will need an additional $90 billion for fiscal 1979?

Mr. CUTTER. Yes, sir.

Senator BYRD. That is, an increase in the debt ceiling of $90 billion.

So that would indicate to me that the Federal funds deficit would be roughly $90 billion, but the Federal funds deficit is $74.5 billion, and I take it that the reason the $90 billion is claimed to be needed is because you need to add to the $74.5 billion the $12.5 billion for the Federal Financing Bank.

Is that about right?

Mr. CUTTER. Yes, sir.

Senator BYRD. So your total deficit, then, would be $74.5 billion plus $12.5 billion, or $87 billion, which nearly reaches the $90 billion figure that you are seeking to increase the debt ceiling?

Mr. CUTTER. As I said, that is the total that the Treasury Department is requesting to be financed, and we are supporting that total.

Senator BYRD. I have had the feeling—maybe you could help us on this—that, in the past, the $12.5 billion figure did not figure into the debt ceiling, did it? Or else it was not a deficit at that point.

Mr. CAVANAUGH. That is correct, Senator. The Federal Financing Bank Act was enacted in 1973 and commenced in 1974. It did not have an impact on the debt ceiling limit until after that date, and the financing that is now in the Financing Bank, thus financed through the Treasury and in the debt subject to limit before was not affecting the debt subject to limit. It was financed by the agencies on the market outside the debt limit.

Senator BYRD. So the actual deficit for the general operations of Government would be $87 billion for this new fiscal year.

Mr. CAVANAUGH. Including the Financing Bank?

Senator BYRD. Including the Financing Bank because, as I understand it from you, that is to finance the general operations of various agencies of Government.

Mr. CAVANAUGH. That is correct, sir.

Mr. CUTTER. If I could interject, I think that an important point was just made for all of our understanding of this number, that it is, in many respects, a much more complete number than may have been examined in the past.

In this budget, and in these testimonies, you are being given, sir, the Federal funds deficit and the deficit of the off-budget entities of the Federal Financing Bank, and therefore, arriving at a total which is the total that we feel is necessary for Government operations in fiscal year 1979.

In previous years, prior to the Federal Financing Bank's operation, those agencies would have gone to the market, by themselves, and financed those same activities, but in a manner that was not subject to limit. And therefore the existence of the Bank and of this, I believe

open presentation, gives us, you and the public much better sense of what is being financed and what activities are costing.

Senator BYRD. I think it does, and I want to commend you and your associates for doing this. I think it does give the Congress and the public a much clearer picture, and it is a more candid way to present the facts.

Since the deficit of the offbudget entities has become a significant amount of money, why not include these in the budget? Why do we omit these entities from the budget?

Mr. CUTTER. There are a range of views about that, from, on the one hand, the argument that they should, of course, be included directly and, on the other, that they should not be counted.

I am, personally, somewhere in the middle, which is that what is most important is the development of some means of controlling the credit that gives rise to the financing necessities, that to count loan guarantees dollar for dollar is not quite accurate and that, therefore, we should develop, in a sense, a credit budget.

And, in my own judgment, this controls the program activities which give rise to the activities of the Federal Financing Bank, which then gives rise to this number more effectively than were we to simply put it on budget.

I can amplify on those remarks for your record, if you wish.

Senator BYRD. Who runs the Federal Financing Bank?

Mr. CUTTER. I do not know the gentleman who is in charge of it. My understanding is that it is a relatively small institution within the Treasury Department—small in the sense that it is not a large independent building or large, independent staff, but I am not certain.

Senator BYRD. Maybe Treasury could help us on that.

Mr. CAVANAUGH. Yes, sir. The Federal Financing Bank was established in the act as an agency under the direction and supervision of the Secretary of the Treasury, and the Chairman of the Board of the Bank is, in fact, the Secretary of the Treasury. The Bank is run by the Treasury and by Treasury officials who are serving, in effect, ex officio in addition to their other duties as officers and board members of the bank.

Senator BYRD. What individual has the responsibility for the Federal Financing Bank?

Mr. CAVANAUGH. The Secretary of the Treasury is Chairman of the Board of Directors for the Federal Financing Bank.

Senator BYRD. And who are the Directors?

Mr. CAVANAUGH. The Directors are other officials of the Treasury Department serving under the Secretary.

Senator BYRD. Well then, the Treasury has more to do with the general operation of Government and the Federal funds deficit than I had thought in the past, because if the Federal Financing Bank anticipates a deficit of $12.5 billion, that is a very signfiicant deficit.

Mr. CAVANAUGH. I should stress, Senator, that the Federal Financing Bank itself is not a program agency. It is not making any decisions with respect to the size of its activities, who gets which loans when. It is basically a debt management technique, so that after the Congress decides what the various Federal agencies are authorized to do, how much they are authorized to borrow or to guarantee, then instead of their going directly into the private market to raise this money, it goes

to the Federal Financing Bank which is a more efficient means of financing.

Senator BYRD. Yes; it seems to me it would be.

Federal guarantees have been previously mentioned. What is the total of our Federal guarantees?

Mr. CAVANAUGH. The total of guaranteed obligations—well, the net increase in the fiscal 1979 budget is $30.5 billion.

Senator BYRD. That is the increase?

Mr. CAVANAUGH. That is the increase in fiscal 1979. In the budget, under special analysis F, there is a total which shows the guaranteed loans outstanding as of the end of fiscal 1979 at $223.6 billion.

Senator BYRD. Now, that is not a part of the $871 billion debt, is it? Guarantees are separate from our public debt?

Mr. CAVANAUGH. That is separate.

Senator BYRD. So the total Federal guarantee is estimated to be, at the end of 1979, $203.6 billion, or an increase of $34.5 billion over fiscal 1978.

Mr. CAVANAUGH. Yes, sir.

Senator BYRD. Can you produce without too much difficulty the figure on the Federal guarantee total for previous fiscal years, say, going back to 1975 or somewhere around there?

Mr. CAVANAUGH. Well, that $223.6 billion figure for the end of 1979, we will provide that for the record, Senator.

Mr. CUTTER. We can provide that. We do not have that here.

Senator BYRD. Yes, if you would, thank you.

Mr. CUTTER. Yes, sir.

Senator BYRD. Do you have the figure for liquid liabilities to foreigners as of December 31, 1977.

Mr. CUTTER. No, sir, I do not.

Mr. CAVANAUGH. Are you speaking of the Treasury debt?

Senator BYRD. No, total liquid liabilities to foreigners.

For example, I have some figures here, as of December 31, 1970, total liquid liabilities to foreigners was $47 billion. Then if you get up to 1973, December 31, it was $92.6 and the next year it goes to $119. The next year, 1975, it goes to $126 and then for December 31, 1976, it was $151.

Now, I wanted to update those figures to get the figure for December 31, 1977.

Mr. CAVANAUGH. We could provide that for the record, sir, if we do not have that.

Senator BYRD. Yes; thank you.

[The material referred to was subsequently supplied for the record:]

[Outstanding primary guaranteed loans (adjusted)]

Fiscal year:	
1975	$158.7 B
1976	169.8
Transition quarter	169.8
1977	183.9
1978 estimate	200.4
1979 estimate	223.6

Senator BYRD. Thank you, gentlemen, very much. We appreciate your being here this morning.

Mr. CUTTER. Thank you, sir.

[The prepared statement of Mr. Cutter follows:]

STATEMENT OF W. BOWMAN CUTTER, EXECUTIVE ASSOCIATE DIRECTOR FOR BUDGET OF THE OFFICE OF MANAGEMENT AND BUDGET

Mr. Chairman and Members of the Committee: I am pleased to support the Treasury's request for an increase in the statutory debt limit, its proposals for improving the management of the debt, and the suggestion that the statutory debt limit be tied to the congressional budget process, which now gives the Congress more effective control over Federal taxation and spending. My statement will discuss the budget and its effect on the public debt subject to the statutory limitation.

BUDGET TOTALS

As shown in the following table, the fiscal year 1978 deficit is estimated at $61.8 billion, with outlays of $462.2 billion and receipts of $400.4 billion. The deficit for 1979 is estimated at $60.6 billion. The President's budget calls for total 1979 outlays of $500.2 billion, and receipts estimated at $439.6 billion.

BUDGET TOTALS

[Fiscal years; in billions of dollars]

	1977 actual	1978 estimate	1979 estimate
Budget receipts	356.9	400.4	439.6
Budget outlays	401.9	462.2	500.2
Deficit (−)	−45.0	−61.8	−60.6

OUTLAYS

Estimated outlays for 1978 have changed little since we testified on the debt ceiling last August and September: $462.2 billion now, versus $462.9 then. The outlays proposed for 1979 reflect a prudent and tight budget. It is the product of a careful zero-base review of agency programs.

Spending has been held to an overall increase of eight percent, the smallest increase since 1973. True, the deficit for 1979 is only one billion less than the deficit in 1978. Had no tax cut been proposed, we could have shown a decrease of $15 to $20 billion. It is more important now, however, that we have a tax cut to help the economy continue to grow and to encourage the increased capital investment that will improve productivity. The President's proposed reductions also mean that Federal taxes will represent a smaller share of our gross national product. This, in turn, will provide an additional incentive for both the Congress and the President to restrain the growth in spending.

This budget keeps open the option for a balanced budget in 1981. In an effort to control the budget more effectively so that we can remain on this path, the President has asked each agency to prepare future budget requests within the context of a planning period that extends for three years beyond the budget year. The multiyear budget planning system that we are developing will help to assure better control of Federal spending by identifying the long term spending consequences of program proposals. The 1979 budget requests together with detailed long-range estimates prepared in connection with this budget will form the initial elements of the new system.

RECEIPTS

Estimates of 1978 receipts have declined by $1 billion since the August and September hearings on the debt ceiling, from $401.4 billion to $400.4 billion. For 1979, the receipts estimates are $24.3 billion below those that would be produced under existing legislation, reflecting the effects of the Administration's energy tax and tax reduction and reform proposals.

THE BUDGET BY FUND GROUP

Table 1 shows our current estimates of the budget suplus or deficit for 1978 and 1979 by fund group. As the following table indicates, a decline in the estimated Federal fund deficit for 1978 since August has been offset by a decline in the estimated trust fund surplus.

SURPLUS OR DEFICIT BY FUND GROUP

[In billions of dollars]

	Fiscal year 1978		
	August estimate	Current estimate	Change
Federal funds	−74.6	−72.1	2.5
Trust funds	13.1	10.3	−2.8

Table 2 shows revised estimates of debt subject to statutory limitation, and explains numerically the derivation of the change in debt subject to limit in 1977, 1978, and 1979.

TABLE 1.—BUDGET TOTALS BY FUND GROUP

[Fiscal years; in billions of dollars]

	1977 actual	1978 estimate	1979 estimte
Receipts:			
Federal funds	240.4	267.9	289.1
Trust funds	152.8	168.5	188.0
Interfund transactions	−36.3	−36.0	−37.5
Total, budget receipts	356.9	400.4	439.6
Outlays:			
Federal funds	294.9	340.0	363.6
Trust funds	143.3	158.2	174.1
Interfund transactions	−36.3	−36.0	−37.5
Total, budget outlays	401.9	462.2	500.2
Surplus or deficit (−):			
Federal funds	−54.5	−72.1	−74.5
Trust funds	9.5	10.3	13.9
Total, surplus or deficit (−)	−45.0	−61.8	−60.6

TABLE 2.—DEBT SUBJECT TO LIMIT

[Fiscal years; in billions of dollars]

	1977 actual	Estimate	
		1978	1979
Unified budget deficit	45.0	61.8	60.6
Portion of budget deficit attributable to trust funds surplus or deficit (−)	9.5	10.3	13.9
Federal funds deficit	54.5	72.1	74.5
Deficit of off-budget Federal entities	8.7	11.5	12.5
Total to be financed	63.2	83.7	87.0
Means of financing other than borrowing, and other adjustments	.9	−5.7	2.6
Change in debt subject to limit	64.1	78.0	89.6
Debt subject to limit, beginning of year	635.8	700.0	777.9
Estimated debt subject to limit, end of year	700.0	777.9	867.5

STATUTORY DEBT CEILINGS AND CONGRESSIONAL BUDGET RESOLUTIONS

Let me conclude by touching briefly on the element of redundancy that now exists between the process for setting statutory debt ceilings, on the one hand, and the establishment of "appropriate levels for debt subject to statutory limitation" that are contained in the congressional budget resolutions. OMB supports the Treasury suggestion that because the public debt is being effectively controlled and efficiently managed through the congressional budget process, the debt limit in the future simply be tied directly to the congressional budget process.

Senator BYRD. We are pleased to have, as the next witness, the Vice Chairman of the Federal Reserve Board, Gov. Stephen S. Gardner.

We are very glad, indeed, to have you, Governor Gardner, before the committee today.

Mr. GARDNER. Thank you, Mr. Chairman.

Senator BYRD. I might say that I have a very high regard for the Federal Reserve Board and the vitally important work which the Board does; and contrary to some of my colleagues, I think it is very important that the Board remain independent of other branches of Government. I cannot imagine anything worse than having the Congress getting involved and attempting to handle the complex and difficult problems, many of a highly technical nature, that the Federal Reserve Board must handle.

Welcome, sir, and you may proceed, Governor, as you wish.

STATEMENT OF HON. STEPHEN S. GARDNER, MEMBER, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM

Mr. GARDNER. Under the congressional budget procedures adopted in 1974, increases in the Federal debt ceiling have become essentially a reflection of the Federal budget totals Congress sets with the help of its new budget committees. Debt ceiling hearings, nevertheless, provide an opportunity for review and reassessment of the broader economic implications of a large and rapidly growing Federal debt. My testimony today will, therefore, focus as requested on some of the financial implications of an expanding public debt.

The Federal budget document recently sent to Congress provides projections of expected increases in the Federal debt subject to ceiling, along with estimates of the likely dimensions of needed changes in the debt ceiling itself. While the outstanding Federal debt is expected to remain below the present temporary ceiling of $752 billion during the next 2 months, this temporary leeway expires on March 31. Since the permanent debt ceiling is still set at $400 billion, a new temporary ceiling will obviously be needed by that date.

The Budget document estimates that a new temporary ceiling of $781 billion will be needed to accommodate prospective Federal borrowing requirements through the end of the current fiscal year. Of this $29 billion increase, about $10 billion is needed to cover expected growth in agency holdings of Government debt, chiefly to fund future civil service retirement liabilities and unemployment compensation. A further increase in the ceiling to $871 billion is estimated to be needed to cover requirements through fiscal 1979, with about $15 billion of the $90 billion increase allotted to agency fund growth.

The projected need for a higher debt ceiling also reflects the administration's estimate that the Treasury will have to borrow $66 billion from the public during the current fiscal year, and then another $73 billion during fiscal 1979. These estimates include borrowing to finance so-called off-budget needs as well as regular budget requirements. Since off-budget needs add to Federal demands on financial markets, a borrowing figure that covers both types of operations provides a more comprehensive measure of the financial pressures being exerted by Federal requirements. It should be noted that the

$66 and $73 billion figures relate only to net cast borrowing from the public. Gross borrowing to refinance public holdings of maturing Federal debt will be several times the volume of net borrowing.

Successive fiscal-year cash borrowing totals of $66 and $73 billion are obviously large. However, their likely impact on conditions in financial markets will depend on the aggregate volume of savings available in the economy and the accumulated demand for funds from other types of borrowers. Moreover, the significance of given absolute dollar totals of Federal deficit financing must be kept in perspective, by also considering the growth in the overall level of economic activity.

In fiscal year 1976, net Federal borrowing from the public totaled over $83 billion, substantially more than the annual figures now being projected for the current fiscal year and for fiscal 1979. However, with the economy in fiscal 1976 still in the early stages of recovery from the serious 1974–75 recession, demands for funds from other nonfinancial sectors were relatively moderate. Businesses were making sizable net repayments of short-term loans at commercial banks, and demands for funds to finance multifamily housing and commercial properties remained slack. As a result, net borrowing by the Federal Government and other nonfinancial sectors, combined, amounted to about 15 percent of GNP—a reasonable total under the circumstances of the recovery taking place that year. Moreover, with credit demands moderate, commercial banks and other institutions were still actively rebuilding liquidity in the aftermath of the 1973–74 financial strains. Consequently, there was a strong demand for U.S. Government securities, and the unusually large net Federal borrowing need was readily accommodated at declining interest rates.

In the fiscal year 1977—which ended last September—net funds raised by sectors other than the Federal Government were more than $100 billion above the fiscal 1976 level. Even though Federal cash borrowing was about $30 billion lower, total borrowing by all sectors still showed a large increase and rose as a percentage of GNP. In bond and mortgage markets, financing outside the Federal sector rose by roughly 60 percent; consumer credit expanded sharply; and bank lending to businesses showed a marked recovery from the earlier cyclical slackness.

As their customers' demands for loans expanded, commercial banks sharply curtailed their acquisitions of Treasury securities; then during the final quarter of the fiscal year, they became sizable net sellers of such issues. Nonfinancial corporations were also sellers of Treasury debt on balance over the year as a whole.

Thus, changes on both the demand and supply sides of financial markets contributed to upward pressures on market interest rates during the latter half of fiscal 1977 as the economy continued to expand. Short-term interest rates rose the most, but some increases also developed in note and bond markets, particularly those for intermediate-term Treasury debt which absorbed a sizable volume of new offerings. Open-market operations undertaken by the Federal Reserve to counter the excessively rapid monetary growth that developed in the April and July quarters of 1977, contributed to the rise in short-term rates, although reserves available to the banking system expanded significantly during fiscal 1977 after remaining essentially unchanged in fiscal 1976.

Since the end of fiscal 1977, the current and prospective near-term volume of Federal deficit financing has expanded considerably. Pressures on Federal financing costs stemming from this expanded borrowing might have been greater had it not been for two special types of demands for Treasury debt that became particularly strong in this period. Foreign investors—chiefly central banks and other official institutions—invested a substantial part of their sharply increased holdings of U.S. dollars in Treasury debt. Also, State and local governments continued to acquire a large volume of special Treasury arbitrage bonds, and thus limited the volume of new debt the Treasury had to sell to other investors.

The Treasury has projected net Federal cash needs in the current quarter not too different from the large volume borrowed in the January quarter of fiscal 1976. During the May-June period, however, it expects the weight of Federal borrowing on financial markets to slacken—with some seasonal debt repayment. During the July-September quarter, although the Treasury is again likely to face a sizable deficit, net borrowing will probably be less than in the current quarter and possibly little different from the comparable period 1 year ago.

In general, the net impact of the Treasury's future borrowing requirements on financial markets will depend in large measure on the weight of other credit demands at the time. If rising Federal deficits occur in combination with a general strengthening of other demands, this might very well lead to further upward pressure on interest rates, particularly if inflationary increases in the monetary aggregates are to be avoided. In order to encourage the capital spending by businesses that is needed to maintain our Nation's economic growth and international competitiveness, it is, therefore, important to insure that the Federal Government does not unduly impinge on the financial and real resources that need to be channeled into business expansion.

Before concluding, Mr. Chairman, I would like to offer two comments of a strictly operational character. First, I think the early timing of this hearing in relation to the expiration date of the debt ceiling is all to the good, since it should help to avoid the unfortunate disruption of efficient debt management that invariably develops when the ceiling reverts back to its permanent level—even for a few days. Second, the Federal Reserve hopes that your actions will continue to provide the Treasury with the requisite statutory flexibility to place new debt in whatever maturity sector of the market will best implement its policy goals.

Thank you, sir.

Senator BYRD. Thank you very much, Governor Gardner.

Let me ask you if you would respond to the same question that I asked the other witnesses, concerning the Federal debt which is now quite large. It will be well over $800 billion by the end of fiscal 1979. Often this debt is dismissed on the basis that it is not important, since we owe the debt to ourselves.

Would you give your view on that?

Mr. GARDNER. My view may be somewhat specific, because I think that the important thing for our Government and our country to remember is that, as the Treasury borrows in the financial markets it competes with all private borrowers; therefore, the rate of increase

and the amount each year that has to be increased to the Federal debt seems to me to be one of the most significant facts.

If we reach a point where the Treasury is outbidding the private sector in any one particular year, or a combination of years, we can severely damage our economy.

Now, so far, as I have indicated in my testimony in 1976 and 1977, we got through two very significant deficit years. If we are to increase productivity, and provide for the capital investment that is necessary, we must hope that the Treasury's force in the marketplace is not so great that it cuts back the ability of the other borrowers' legitimate demands.

Senator BYRD. Well, in regard to the debt itself, would you take the view which is frequently expressed that it is really not important because the American people owe it to ourselves?

Mr. GARDNER. I cannot take that view. In the first place, the amount of interest that is included in the appropriate budget outlays which must be paid is a very large part of the deficit in any particular year. Surely it contributes to the deficit, so it is a cost.

Second, we do not owe it all to ourselves. Foreign governments buy our securities, and that literally, begins to negate the concept that we owe the Federal debt to ourselves.

Senator BYRD. Even for this country, those who own a part of the debt do not own it equally. For example, I do not own any Government bonds, so if the debt were repudiated because we all owe it to ourselves, I would lose nothing by it, but I assume that a great many people would lose a great deal by it. Certainly the banks hold a very substantial part of the Government obligations. Also, insurance companies, I believe do, along with banks own a great portion of the debt, do they not?

Mr. GARDNER. Yes, and pension funds and other trust funds of one kind or another that provide for retirements hold Government bonds and are indirectly owned by the beneficiaries of those plans although they have no voice in acquiring them.

I agree with you. As a matter of fact, when I came to the Treasury, Mr. Chairman, I learned very quickly that there is a specific law that the Secretary of the Treasury cannot own any Government bonds. As a result, I had to get rid of all of mine because I was his deputy.

Senator BYRD. I really do not know what that should be. I guess there was some reason for it at the time that the law was enacted.

Mr. GARDNER. I believe it came from a long ago concern about Andrew Mellon serving as Secretary of the Treasury.

Senator BYRD. You mentioned something in connection with the national debt that is almost never mentioned; namely, the interest charges. And yet, in the new budget, there is a total of $55 billion. Now, that figure is almost—not quite, but almost—as much as the total amount that we are spending on national defense for fiscal 1979.

It is a gigantic figure that must be paid, of course, by the taxpayers. I think the national debt is of great significance to the individual citizens of our country.

You mentioned a little earlier, I believe, that the total borrowing need of the Government in fiscal 1979 would be $73 billion. Now, does that include refinancing?

Mr. GARDNER. No, sir.

The rolling over of our existing indebtedness is an additional amount. It means that the debt has to be retired and replaced.

Senator BYRD. Do you happen to have the figure on what the refinancing would be?

Mr. GARDNER. I think it will be two or two and a half times as much, but that is an inexact answer and I would rather provide it for the record.

Senator BYRD. Would you provide it for the record?

Mr. GARDNER. I would be glad to.

Senator BYRD. That would be helpful.

[The following was subsequently supplied for the record:]

While I do not know how the Treasury plans to roll over maturing debt at the start of fiscal 1978, public holdings of outstanding marketable debt date to mature within the fiscal year totaled $161.3 billion—more than twice the $66 billion of net cash borrowing that occurred during the year. Of course, a part of this total consisted of 3-month and 6-month Treasury bills which had to be rolled over more than once within the year. The $161.3 billion figure counts these Treasury bill roll-overs only once.

Senator BYRD. What percentage of the lendable funds do you think the Government would need to borrow in fiscal 1979, including the refinancing?

Mr. GARDNER. I would have to calculate that, because I do not want to leave a wrong number. I am sorry, sir. I do not have it in front of me.

Senator BYRD. Maybe you would provide that for the record?

Mr. GARDNER. I will indeed.

[The following was subsequently supplied for the record:]

At this point any figure indicating the percentage of total lendable funds the Federal Government is likely to borrow in the fiscal year 1979 would, of course, be strictly a forecast. It would depend not only on the recently published Federal budget estimates, but also on projections of overall economic activity and the likely flows of funds available to the full range of lenders. For the most recent fiscal year, ending in September 1977, the share of total lending to non-financial borrowers absorbed by the Federal Government was apparently about 17 percent. While our staff has not yet made detailed projections of financial flows for fiscal 1979, it has made such projections for the year ending in June 1979. Over that period the share of total lending to non-financial borrowers absorbed by the Federal Government is projected to be a little higher than in fiscal 1977—possibly around 20 percent.

Senator BYRD. How do you size up the impact of this borrowing volume, both the new borrowing and the refinancing, as to the effect it might have on interest rates?

Mr. GARDNER. As I have said in my testimony, if we find a general increase in private credit demand, for which we are hoping due to a shortage of capital investment in this whole recovery thus far, the size of our Federal financing in the markets will be a very important factor.

I have strongly supported the theory that the Government can crowd out the private sector. You might remember that was quite a catch phrase a year or two ago, but, as I have indicated here, it did not happen.

Senator BYRD. But if the economy had been in a better condition, if businesses were investing more, which the Government wants business

to do, then you might have had an entirely different situation, might you not, insofar as the crowding out?

Mr. GARDNER. You could, which is why I commend the committee's attention to the debt ceiling and, as I have indicated, we must do our best to prevent the disruption that can occur when this develops.

Senator BYRD. Is the large recent increase in the debt inflationary? In the short space between the end of fiscal 1972 and the end of fiscal 1979, the debt, the national debt, will have doubled.

Mr. GARDNER. Yes, sir. Underlying that debt doubling was a substantial amount of budget deficit at the Federal level, and that has to cause all kinds of inflationary pressures on our economy.

Senator BYRD. Looking ahead to 1979, Mr. Cutter testified that the assumptions on which the new budget was based is that there would be a new 6-percent inflation rate. How does that inflation rate figure in your calculations? Do you feel that is an appropriate figure?

Mr. GARDNER. Our staff studies indicate that that is the general, supportable contention or estimate, and we make such studies when we are provided with the President's economic reports.

I do not want to dispute OMB's figures, because our own staff studies come close to those.

Senator BYRD. But your staff studies indicate inflation somewhat in the 6-percent range, I would assume?

Mr. GARDNER. Yes, sir.

Senator BYRD. Yet the Government, in the past week or so, has been paying 8 percent for money. Does that not indicate an inflationary condition?

Mr. GARDNER. I certainly agree with you that it does. There is a basic rate of interest necessary in an economy, and then there is an inflationary premium depending on how the Government's efforts are proceeding—inflationary pressures other than the Federal deficit. I am sure that Treasury is only paying what it has to pay in order to get money. So there is a real interest rate and inflationary premium over the real interest rate.

Senator BYRD. We were mentioning the cost of servicing the national debt. In arriving at a $55 billion figure for fiscal year 1979 for interest payments, two previous witnesses testified that the assumption was that the general average in interest rates, so to speak, would be about 6.1 percent.

But, with interest rates more recently having jumped up to 8 percent for the Government—when the Government pays 8 percent—that means that everybody else is paying a great deal more, I would assume. Would that not be a reasonable assumption?

Mr. GARDNER. That would be, but I have to say that the prior witnesses were dealing with the shorter term interest rates rather than the long-term rates.

Senator BYRD. Yes; but 3½ years, I think, was one of the issues last week that cost the Government 8 percent. That is not too short a term. The other was 7 years, as I recall, also at 8 percent.

Mr. GARDNER. Mr. Chairman, I really do not want to make an interest rate forecast since we at the Board have important monetary policy responsibilities.

Senator BYRD. No; I did not have that in mind. I was just getting you to help me in my thinking. If the Government has to pay more for money—and it has been, as I say, paying up to 8 percent—that indicates to be that interest rates are almost bound to go up.

Now, I do not believe that this would be inappropriate, though, to ask you this.

Are higher interest rates inflationary?

Mr. GARDNER. I am sorry, sir?

Senator BYRD. Are higher interest rates, in themselves, inflationary?

Mr. GARDNER. Yes, sir. They add to the cost of so much that we need—housing, capital investment, et cetera.

Senator BYRD. One of your predecessors for whom I, incidentally, have a very high regard, William McChesney Martin, had an interview in the New York Times recently in which he said that the biggest problem facing our Nation and, he said, the free world, is inflation.

That has been my view also. Is it your view that inflation ultimately produces higher unemployment?

Mr. GARDNER. Yes, sir, it does. It slows business development and consumer spending.

Senator BYRD. It seems to me, also, that it hurts most those on fixed income.

Mr. GARDNER. Surely.

Senator BYRD. And those in the middle and lower economic groups.

Mr. GARDNER. I would agree. We often hear the statement that they cannot protect themselves, and that is a very true statement. They do not have the means to avoid the inflationary costs that are visited on them as inflation is moving ahead.

Senator BYRD. I also think that the huge government debt and the continued, accumulated and accelerated Federal deficits are a major cause of inflation.

Would you care to comment on that?

Mr. GARDNER. I cannot disagree with that. The experience that the country has gone through since World War II probably illustrates that as specifically as anything can. It was not only the oil price quadrupling or quintupling, but the massive Federal outlays when we had Vietnam as a burden on the economy clearly aggravated the Federal deficit and, put more dollars into the economy than were appropriate at the time. Our taxes were not high enough to deal with Vietnam, and as a result, we built a strong disposition to inflation into our economy.

Senator BYRD. I was interested to note in last week's Washington Post, that Hobart Rowen on February 5, quoted statements Prof. Otto Eckstein made before this subcommittee. I quote:

The tipoff that "there is a real problem"—speaking now of the deficits and national debt—"comes from critiques by liberals, such as Prof. Otto Eckstein, a member of the Economic Council under Lyndon Johnson. Eckstein pointed out to a Senate committee the other day that the economic recovery since 1974–75 recession has not brought about the usual shrinkage of Federal deficits."

And most certainly it has not, because in this current fiscal year, the deficit will be greater than in the past, and the same will be true for the upcoming fiscal year.

And, to go back to this column:

Instead, they have ballooned to the point where the gross Federal debt will reach $837.7 billion by September 1979 and will pass $1 trillion by 1981—

according to this column.

Twenty years ago, most economists would have said it matters little because the interest payments are a transfer within the American people—

Eckstein said—

but today we can no longer say that we owe it to ourselves, because about $100 billion of national debt is now held by foreigners, and that figure increases by about $20 billion annually.

Again, it indicates to me the great importance of the Congress paying greater attention to the debt and the deficits, and the great impact that these accumulated deficits and the tremendous increase in the debt will have upon the American people.

Would that be in accord with how you understand the economics of it?

Mr. GARDNER. It certainly would, Mr. Chairman.

There was a recommendation in the previous witness testimony that we adjust the congressional budgetary process so that the debt ceiling might follow from that process. I explored this with my colleagues at the Board and I did not get a consensus of approval. They think that the process that we are going through here today probably does have some value. Some of us raised the question whether to support the idea that there be an addition to the budget procedures so that the debt ceiling flows automatically, and I found that more than a majority of my colleagues did not share that view at all. We should seize every opportunity to pay attention to the debt ceiling and deficits. And, as you know, these hearings in the past have focused attention on the size of the debt. Therefore, why take away a discipline such as we are going through here?

Senator BYRD. I am glad to get those observations, Governor Gardner. I have some hope that the American people are coming to be more concerned about Government finance, about the deficits and the debt. But it is a subject in which there is no political sex appeal. It is a hell of a dry subject; there is no political sex appeal to it.

And yet, it affects every man, woman, and child in our country.

Mr. GARDNER. Well, you are absolutely right that there is no political sex appeal. However, so much of our Federal spending is mandated by prior legislation—transfer payments to individuals, and such—that we should continue to focus attention on the subject. Once these programs are enacted by Congress and continue indefinitely, a rising share of our GNP and personal income or taxes on individuals are necessary to support programs which occasionally should be carefully analyzed because they make very heavy demands on the Federal budget. Now, that is a subject that has no sex appeal at all. In fact, opposition to programs of that kind generates great heat and discussion.

Senator BYRD. Indeed it does. Incidentally, Albert Sindlinger who is an economic pollster, you may know him, he operates from Media, Pa., not far from where you were president and chairman of the board of the Girard Bank. He testified before this committee last week.

23-544—78——11

I have been to his office and seen his operation. It is rather fascinating. He has been doing this for 20 or 25 years; I forgot which. He and his staff make phone calls every day—some 150 to 200 each night throughout the United States to consumers to find out what they are thinking about, what their interests are, what their level of confidence in the economic picture is. He told the committee, and has told me privately also, that he is finding more and more concern on the part of the public for the huge deficits of our Government. From his polling, he feels that the public generally is becoming more aware of just how bad the U.S. Government is in its financial matters.

If he is right about that—and I have no reason to think he is not—if he is right about that, I think that is the most hopeful sign that I have found in a long time. The only way that this uncontrolled spending by the Federal Government is going to be curbed is if the people themselves will demand that the Federal Government operate with some reasonable degree, some reasonable degree, of propriety and wisdom in the handling of tax funds and cease these huge deficits.

To me, it is just unbelievable—and I admit that I am in the minority. Most of my colleagues do not agree with me, and maybe they are right, but I am convinced that they are not right. These huge deficits and the debt it creates are in the long run, very detrimental to the American people.

Governor, I appreciate your being here this morning.

Mr. GARDNER. I have just critiqued the previous testimony in only one part, I urge that this committee consider two other recommendations: First, that the early timing of the hearing result in some action so that the unfortunate disruption of debt management in the Government that will occur if we revert back to the permanent level be carefully considered; and second, I think it is terribly important that the Treasury's recommendations to increase their long term borrowing capacity be adopted. This will help them manage the deficit and debt in the economy since we do not want to stop what is going well, such as housing, residential housing.

Senator BYRD. I want to second what you say, and what the other two witnesses said, about the importance of the Congress' acting with more promptness on handling the debt ceiling increase legislation. Usually it is put off until the last day or so before the old debt ceiling expires. I think that is unwise. Sometimes it has even gone beyond the point of expiration, and that is certainly undesirable.

I just, this morning, I urged the committee to arrange for early action, because, for one thing, the Congress will be in Easter recess on March 31, so if this legislation is to be handled before the Easter recess, it will have to be handled—and this hearing today will not take the place of a hearing that will be held on the precise legislation—that hearing should be held, I would think, the first part of the week of March 13. And that would give the Congress, then, about 2 weeks before it goes out for the Easter recess.

But I want to second your statement that Congress should act promptly on this matter.

Mr. GARDNER. Thank you, sir.

Senator BYRD. Thank you.

The subcommittee is recessed.

[Thereupon, at 12:20 p.m., the subcommittee recessed, to reconvene at the call of the Chair.]

[By direction of the chairman the following communication was made a part of the record:]

WILSON E. SCHMIDT,
Blacksburg, Va., February 11, 1978.

Senator HARRY F. BYRD,
Russell Building,
Washington, D.C.

DEAR SENATOR BYRD: Having just read Professor Otto Eckstein's testimony of January 30 before your subcommittee in which he refers to the problem of foreign ownership of our national debt, I wish to raise an aspect of that issue which he did not cover, one which is more immediate and compelling in my view.

Over half of the increase in 1977 in privately held public debt securities was bought by foreigners. A substantial part of the foreign purchases were made by foreign central banks. They bought dollars for the purpose of holding up the value of the dollar and holding down the value of their own currencies in the foreign exchange markets. After they bought the dollars, they employed them to buy U.S. Government securities. (See attachment for the data.)

This presents a dilemma. On the one hand, foreign central bank purchases of dollars and then their purchases of U.S. Government securities ease the drain on the U.S. private capital market imposed by the need to finance the Federal budget deficit. And it reduces the need for indirect recourse to the Federal Reserve System to finance the deficit with its inflationary consequences.

On the other hand, foreign central bank purchases of dollars, by keeping up the value of the dollar, stimulate U.S. imports because foreign goods cost less than they otherwise would. At the same time they retard U.S. exports because American goods become more expensive to foreigners than otherwise. In short, they worsen our trade balance.

If the purchases had been made by private foreigners in search of higher returns and safety, I would not be particularly concerned. But that is not the case. As a general rule, there is a strong presumption against the U.S. Government seeking to control or affect specific prices paid or received by Americans. There is an even stronger presumption against *foreign* governments doing so. Yet that is exactly what they are doing when they purchase dollars to affect the price of the dollar in terms of their own currencies.

I hope that you will agree that the issue deserves serious consideration by the Congress and the Executive. Your subcommittee would appear to be a logical place to start. As a former Deputy Assistant Secretary of the Treasury, I believe that there are some technically feasible policies available to ease the problem.

Sincerely,

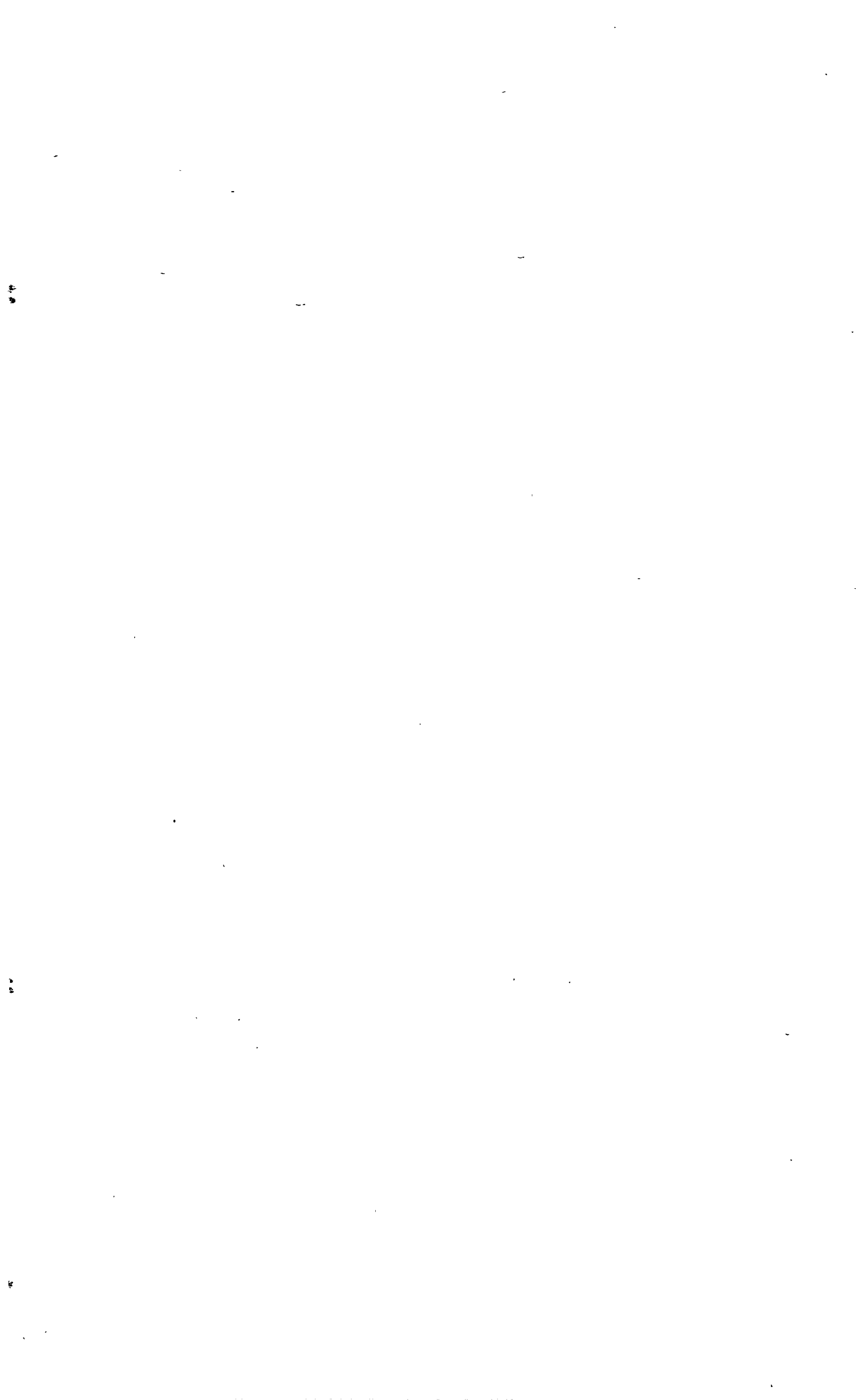
WILSON SCHMIDT.

Attachment.

According to the *Treasury Bulletin*, January 1978, Table OFS-2, the amount of privately held public debt owned by foreigners rose by $28.6 billion between the end of December 1976 and the end of November 1977 compared with an increment in all privately held debt of the U.S. Government of $48.1 billion.

According to the *Survey of Current Business* (September, 1977), Table B of the article on U.S. international transactions, industrial countries increased their foreign official assets in the United States by $7.2 billion in the first half of 1977. According to the Department of Commerce press release, BEA 77-95, December 21, 1977, in the third quarter of 1977 foreign official assets in the United States increased by another $8.2 billion; it explains that "Large intervention purchases of dollars in exchange markets by several major industrial countries accounted for most of the increase . . ."

Data for the fourth quarter are not yet available from the Department of Commerce on the change in foreign official assets of the industrialized countries. However, in the *Treasury Bulletin* mentioned above one can find, in Table IFS-3, that foreign official assets in the U.S. increased by almost $31 billion through November 1977 and that $22 billion of the increase was obtained by Western Europe.



APPENDIX

TABLES ON ESTIMATED GROSS AND NET GOVERNMENT AND PRIVATE DEBT

(1) Estimated Gross Government and Private Debt, by Major Categories
(2) Estimated Per Capita Gross Government and Private Debt
(3) Estimated Gross Government and Private Debt related to Gross National Product
(4) Estimated Net Government and Private Debt, by Major Categories
(5) Estimated Per Capita Net Government and Private Debt
(6) Estimated Net Government and Private Debt related to Gross National Product
(7) Estimated Federal Debt Related to Population and Prices
(8) Privately-Held Federal Debt Related to Gross National Product
(9) Changes in Per Capita Real Gross National Product

TABLE 1.—ESTIMATED GROSS GOVERNMENT AND PRIVATE DEBT, BY MAJOR CATEGORIES

[Dollar amounts in billions]

Year	Private[1]			State and local	Federal[2]			Total gross debt	Percent Federal of total
	Individual	Corporate	Total		Public	Agency	Total		
1929	$72.9	$107.0	$179.9	$17.8	$16.3	$1.2	$17.5	$215.2	8.2
1930	71.8	107.4	179.2	18.9	16.0	1.3	17.3	215.4	8.1
1931	64.9	100.3	165.2	19.5	17.8	1.3	19.1	203.8	9.4
1932	57.1	96.1	153.2	19.7	20.8	1.2	22.0	194.9	11.3
1933	51.0	92.4	143.4	19.5	23.8	1.5	25.3	188.2	13.5
1934	49.8	90.6	140.4	19.2	28.5	4.8	33.3	192.9	17.3
1935	49.7	89.8	139.5	19.6	30.6	5.6	36.2	195.3	18.6
1936	50.6	90.9	141.5	19.6	34.4	5.9	40.3	201.4	20.1
1937	51.1	90.2	141.3	19.6	37.3	5.8	43.1	204.0	21.2
1938	50.0	86.8	136.8	19.8	39.4	6.2	45.6	202.2	22.6
1939	50.8	86.8	137.6	20.1	41.9	6.9	48.8	206.5	23.7
1940	53.0	89.0	142.0	20.2	45.0	7.2	52.2	214.4	24.4
1941	55.6	97.5	153.1	20.0	57.9	7.7	65.6	238.7	27.5
1942	49.9	106.3	156.2	19.2	108.2	5.5	113.7	289.1	39.4
1943	48.8	110.3	159.1	18.1	165.9	5.1	171.0	348.2	49.2
1944	50.7	109.0	159.7	17.1	230.6	3.0	233.6	410.4	57.0
1945	54.7	99.5	154.2	16.0	278.1	1.5	279.6	449.8	62.2
1946	59.9	109.3	169.2	16.1	258.9	1.5	260.4	445.7	58.5
1947	69.4	128.9	198.3	17.5	255.4	.7	256.1	471.9	54.3
1948	80.6	139.4	220.0	19.6	251.6	1.0	252.6	492.2	51.4

1949	90.4	140.3	230.7	22.2	256.1	.8	256.9	509.8	50.4
1950	104.3	167.7	272.0	25.3	255.4	1.1	256.5	553.8	46.4
1951	114.3	191.9	306.2	28.0	258.1	.8	258.9	593.1	43.7
1952	129.4	202.9	332.3	31.0	266.2	.8	267.0	630.3	42.4
1953	143.2	212.9	356.1	35.0	273.8	.9	274.7	665.8	41.3
1954	157.2	217.6	374.8	40.2	277.2	.8	278.0	693.0	40.2
1955	180.1	253.9	434.0	46.3	279.1	1.5	280.6	760.9	36.9
1956	195.5	277.3	472.8	50.1	275.5	1.7	277.2	800.1	34.7
1957	207.6	295.8	503.4	54.7	274.2	3.2	277.4	835.5	33.3
1958	222.9	312.0	534.9	60.4	282.2	2.3	284.5	879.8	32.4
1959	245.0	341.4	586.4	66.6	288.7	5.7	294.4	947.4	31.1
1960	263.3	365.1	628.4	72.0	287.7	6.4	294.1	994.5	29.6
1961	284.8	391.5	676.3	77.6	293.6	6.9	300.5	1,054.4	28.5
1962	311.9	421.5	733.4	83.4	300.2	7.8	308.0	1,124.8	27.4
1963	345.8	457.1	802.9	89.5	306.0	8.1	314.1	1,206.5	26.0
1964	380.1	497.3	877.4	95.5	314.3	9.1	323.4	1,296.3	24.9
1965	424.6	551.9	976.5	103.1	317.2	9.8	326.9	1,406.5	23.2
1966	454.7	617.4	1,072.1	109.3	325.6	14.0	339.6	1,521.1	22.3
1967	489.1	672.9	1,162.0	117.3	341.8	20.1	361.9	1,641.0	22.2
1968	529.3	779.1	1,308.4	127.2	356.2	15.1	371.3	1,806.9	20.5
1969	566.2	912.7	1,478.9	137.9	367.4	13.8	381.2	1,997.9	19.1
1970	600.0	997.9	1,597.9	149.2	388.3	12.5	400.8	2,147.8	18.7
1971	667.5	1,087.8	1,755.3	167.0	423.4	11.0	434.4	2,356.6	18.4
1972	763.9	1,214.3	1,978.2	181.2	448.4	11.8	460.2	2,620.7	17.6
1973	854.4	1,390.5	2,244.9	196.1	469.1	11.6	480.7	2,921.7	16.5

See footnotes at end of table.

TABLE 1.—ESTIMATED GROSS GOVERNMENT AND PRIVATE DEBT, BY MAJOR CATEGORIES—Continued

[Dollar amounts in billions]

Year	Private [1]			State and local	Federal [2]			Total gross debt	Percent Federal of total
	Individual	Corporate	Total		Public	Agency	Total		
1974	$922.1	$1,546.4	$2,468.5	$214.7	$492.7	$11.3	$504.0	$3,187.2	15.8
1975	994.4	1,626.1	2,620.5	229.6	576.7	10.9	587.6	3,437.7	17.1
1976	1,106.8	1,781.7	2,888.5	246.4	653.5	11.3	664.8	3,799.7	17.5
1977					718.9	10.2	729.2		

[1] Private corporate debt includes the debt of certain federally sponsored agencies in which there is no longer any Federal proprietary interest. The debt of the following agencies are included beginning these years: FLB's in 1949; FHLB's in 1951; FNMA-secondary market operations, FICB's and BCOOP's in 1968. The total debt for these agencies amounted to $0.7 billion on Dec. 31, 1947, $3.5 billion on Dec. 31, 1960, $38.8 billion on Dec. 31, 1970, $78.8 billion on Dec. 31, 1975, and $81.4 billion on Dec. 31, 1976.

[2] Total Federal securities includes public debt securities and budget agency securities.

Source: Federal debt, Treasury Department; other data, Bureau of Economic Analysis, Commerce Department.

Note: Detail may not add to totals because of rounding. Real GNP is in constant 1972 dollars. Real per capita debt expressed in 1967 prices (i.e., Consumer Price Index for all items).

TABLE 2.—ESTIMATED PER CAPITA GROSS GOVERNMENT AND PRIVATE DEBT [1]

[Amounts in dollars]

Year	Private [2]			State and local	Federal [3]			Total gross debt
	Individual	Corporate	Total		Public	Agency	Total	
1929	$599	$879	$1,477	$146	$134	$10	$144	$1,767
1930	583	873	1,456	154	130	11	141	1,750
1931	523	809	1,332	157	144	10	154	1,643
1932	457	770	1,227	158	167	10	176	1,561
1933	406	736	1,142	155	190	12	201	1,499
1934	394	717	1,111	152	226	38	264	1,526
1935	391	706	1,096	154	240	44	284	1,535
1936	395	710	1,105	153	269	46	315	1,573
1937	397	700	1,097	152	290	45	335	1,584
1938	385	669	1,054	153	303	48	351	1,557
1939	388	663	1,051	154	320	53	373	1,578
1940	400	671	1,071	152	339	54	394	1,617
1941	415	728	1,143	149	432	58	490	1,783
1942	369	785	1,154	142	799	41	840	2,136
1943	356	804	1,159	132	1,209	37	1,246	2,537
1944	365	785	1,150	123	1,660	22	1,682	2,954
1945	389	708	1,098	114	1,980	11	1,990	3,202
1946	422	770	1,192	113	1,824	11	1,835	3,140
1947	480	891	1,370	121	1,765	5	1,770	3,261
1948	548	947	1,494	133	1,709	7	1,716	3,344

See footnotes at end of table.

TABLE 2.—ESTIMATED PER CAPITA GROSS GOVERNMENT AND PRIVATE DEBT [1]—Continued

[Amounts in dollars]

Year	Private [2]			State and local	Federal [3]			Total gross debt
	Individual	Corporate	Total		Public	Agency	Total	
1949	$604	$937	$1,540	$148	$1,710	$5	$1,715	$3,404
1950	685	1,101	1,786	166	1,677	7	1,684	3,637
1951	738	1,239	1,977	181	1,666	5	1,672	3,829
1952	821	1,288	2,109	197	1,690	5	1,695	4,001
1953	894	1,329	2,223	218	1,709	6	1,715	4,156
1954	964	1,335	2,299	247	1,700	5	1,705	4,251
1955	1,085	1,530	2,616	279	1,682	9	1,691	4,586
1956	1,157	1,642	2,799	297	1,631	10	1,641	4,737
1957	1,207	1,720	2,927	318	1,594	19	1,613	4,858
1958	1,275	1,784	3,059	345	1,614	13	1,627	5,031
1959	1,378	1,920	3,298	375	1,623	32	1,656	5,328
1960	1,457	2,021	3,478	399	1,592	35	1,628	5,504
1961	1,550	2,131	3,682	422	1,598	38	1,636	5,740
1962	1,672	2,260	3,932	447	1,609	42	1,651	6,030
1963	1,827	2,415	4,243	473	1,617	43	1,660	6,375
1964	1,981	2,592	4,572	498	1,638	47	1,685	6,755
1965	2,185	2,840	5,026	531	1,633	50	1,682	7,239
1966	2,313	3,141	5,454	557	1,656	71	1,728	7,739
1967	2,461	3,386	5,848	590	1,720	101	1,821	8,258
1968	2,637	3,882	6,519	634	1,775	75	1,850	9,003

1969	2,794	4,503	7,297	680	1,813	68	1,881	9,858
1970	2,929	4,871	7,799	728	1,895	61	1,956	10,483
1971	3,224	5,254	8,478	807	2,045	53	2,098	11,382
1972	3,658	5,814	9,472	868	2,147	56	2,203	12,548
1973	4,061	6,609	10,669	932	2,229	55	2,285	13,886
1974	4,352	7,298	11,649	1,013	2,325	53	2,379	15,041
1975	4,657	7,615	12,272	1,075	2,701	51	2,752	16,099
1976	5,145	8,282	13,428	1,145	3,038	53	3,090	17,663
1977					3,316	47	3,364	

[1] Per capita debt is calculated by dividing debt figures by population of conterminous United States. Beginning 1949, population includes Armed Forces overseas, Hawaii and Alaska.

[2] Private corporate debt includes the debt of certain federally sponsored agencies in which there is no longer any Federal proprietary interest. The debt of the following agencies are included beginning these years: FLB's in 1949; FHLB's in 1951; FNMA-secondary market operations, FICB's and BCOOP's in 1968. The total debt for these agencies amounted to $0.7 billion on Dec. 31, 1947, $3.5 billion on Dec. 31, 1960, $38.8 billion on Dec. 31, 1970, $78.8 billion on Dec. 31, 1975, and $81.4 billion on Dec. 31, 1976. on Dec. 31, 1976.

[3] Total Federal securities includes public debt securities and budget agency securities.

Source: Federal debt, Treasury Department; other data, Bureau of Economic Analysis, Commerce Department.

Note: Detail may not add to totals because of rounding. Real GNP is in constant 1972 dollars. Real per capita debt expressed in 1967 prices (i.e., Consumer Price Index for all items).

TABLE 3.—GROSS GOVERNMENT AND PRIVATE DEBT RELATED TO GROSS NATIONAL PRODUCT

Year	Gross national product (billions)	Ratios of debt to gross national product							
		Private [1]			State and local	Federal [2]			Total gross debt
		Individual	Corporate	Total		Public	Agency	Total	
1929	$103.4	70.5	103.5	174.0	17.3	15.8	1.2	17.0	208.1
1930	90.7	79.2	118.5	197.6	20.9	17.7	1.5	19.1	237.5
1931	76.1	85.4	131.9	217.2	25.7	23.4	1.8	25.2	268.0
1932	58.3	98.0	164.9	262.9	33.9	35.7	2.1	37.8	334.5
1933	55.8	91.4	165.6	257.0	35.0	42.7	2.7	45.4	337.2
1934	65.3	76.3	138.8	215.1	29.5	43.7	7.4	51.1	295.5
1935	72.5	68.6	123.9	192.5	27.1	42.3	7.8	50.0	269.5
1936	82.7	61.2	109.9	171.1	23.7	41.6	7.2	48.8	243.5
1937	96.7	52.9	93.3	146.1	20.3	38.6	6.0	44.6	210.9
1938	85.0	58.9	102.2	161.1	23.4	46.4	7.3	53.7	238.0
1939	90.8	56.0	95.6	151.6	22.2	46.2	7.6	53.8	227.5
1940	100.0	53.1	89.1	142.1	20.3	45.1	7.3	52.3	214.5
1941	124.9	44.6	78.1	122.6	16.1	46.4	6.2	52.6	191.2
1942	158.3	31.6	67.2	98.7	12.2	68.4	3.5	71.9	182.7
1943	192.0	25.5	57.5	82.9	9.5	86.5	2.7	89.1	181.4
1944	210.5	24.1	51.8	75.9	8.2	109.6	1.5	111.0	195.0
1945	212.3	25.8	46.9	72.7	7.6	131.0	.8	131.7	211.9
1946	209.6	28.6	52.2	80.8	7.7	123.6	.8	124.3	212.7
1947	232.8	29.9	55.4	85.2	7.6	109.8	.4	110.1	202.8
1948	259.1	31.2	53.9	85.0	7.6	97.2	.4	97.5	190.0

1949	258.0	35.1	54.4	89.5	8.7	99.3	.4	99.6	197.6
1950	286.2	36.5	58.6	95.1	8.9	89.3	.4	89.7	193.6
1951	330.2	34.7	58.2	92.8	8.5	78.2	.3	78.5	179.7
1952	347.2	37.2	58.5	95.8	9.0	76.7	.3	77.0	181.6
1953	366.1	39.2	58.2	97.3	9.6	74.8	.3	75.1	181.9
1954	366.3	43.0	59.5	102.4	11.0	75.7	.3	75.9	189.2
1955	399.3	45.2	63.6	108.7	11.6	69.9	.4	70.3	190.6
1956	420.7	46.5	66.0	112.4	12.0	65.5	.5	65.9	190.2
1957	442.8	46.9	66.9	113.7	12.4	62.0	.8	62.7	188.7
1958	448.9	49.7	69.6	119.2	13.5	62.9	.6	63.4	196.0
1959	486.5	50.4	70.2	120.6	13.7	59.4	1.2	60.6	194.8
1960	506.0	52.1	72.2	124.2	14.3	56.9	1.3	58.2	196.6
1961	523.3	54.5	74.9	129.3	14.9	56.2	1.4	57.5	201.5
1962	563.8	55.4	74.8	130.1	14.8	53.3	1.4	54.7	199.6
1963	594.7	58.2	76.9	135.1	15.1	51.5	1.4	52.9	202.9
1964	635.7	59.8	78.3	138.1	15.1	49.5	1.5	50.9	204.0
1965	688.1	61.7	80.2	142.0	15.0	46.1	1.5	47.5	204.4
1966	753.0	60.4	82.0	142.4	14.5	43.2	1.9	45.1	202.0
1967	796.3	61.4	84.5	145.9	14.7	42.9	2.5	45.4	206.1
1968	868.5	60.9	89.7	150.7	14.6	41.0	1.7	42.8	208.0
1969	935.5	60.5	97.6	158.1	14.7	39.3	1.5	40.7	213.6
1970	982.4	61.1	101.6	162.7	15.2	39.5	1.3	40.8	218.6
1971	1,063.4	62.8	102.3	165.1	15.7	39.8	1.0	40.9	221.6
1972	1,171.1	65.3	103.7	168.9	15.5	38.3	1.0	39.3	223.8
1973	1,306.3	65.4	106.4	171.9	15.0	35.9	.9	36.8	223.7

See footnotes at end of table.

TABLE 3.—GROSS GOVERNMENT AND PRIVATE DEBT RELATED TO GROSS NATIONAL PRODUCT—Continued

Year	Gross national product (billions)	Ratios of debt to gross national product								
		Private [1]			State and local	Federal [2]			Total gross debt
		Individual	Corporate	Total		Public	Agency	Total	
1974	$1,412.9	65.3	109.4	174.7	15.2	34.9	.8	35.7	225.5
1975	1,528.8	65.0	106.4	171.4	15.0	37.7	.7	38.4	224.9
1976	1,706.5	64.9	104.4	169.3	16.9	38.3	.7	39.0	222.7
1977	1,890.4					38.0	.5	38.6	

[1] Private corporate debt includes the debt of certain federally sponsored agencies in which there is no longer any Federal proprietary interest. The debt of the following agencies are included beginning these years: FLB's in 1949; FHLB's in 1951; FNMA-secondary market operations, FICB's and BCOOP's in 1968. The total debt for these agencies amounted to $0.7 billion on Dec. 31, 1947, $3.5 billion on Dec. 31, 1960, $38.8 billion on Dec. 31, 1970, $78.8 billion on Dec. 31, 1975, and $81.4 billion on Dec. 31, 1976.

[2] Total Federal securities includes public debt securities and budget agency securities.

Source: Federal debt, Treasury Department; other data, Bureau of Economic Analysis, Commerce Department.

Note: Detail may not add to totals because of rounding. Real GNP is in constant 1972 dollars. Real per capita debt expressed in 1967 prices (i.e., Consumer Price Index for all items).

TABLE 4.—ESTIMATED NET GOVERNMENT AND PRIVATE DEBT, BY MAJOR CATEGORIES

[Dollar amounts in billions]

Year	Private [1]			State and local	Federal [2]	Total net debt	Percent Federal of total
	Individual	Corporate	Total				
1916	$36.3	$40.2	$76.5	$4.5	$1.2	$82.2	1.5
1917	38.7	43.7	82.4	4.8	7.3	94.5	7.8
1918	44.5	47.0	91.5	5.1	20.9	117.5	17.8
1919	43.9	53.3	97.2	5.5	25.6	128.3	20.0
1920	48.1	57.7	105.8	6.2	23.7	135.7	17.5
1921	49.2	57.0	106.2	7.0	23.1	136.3	17.0
1922	50.9	58.6	109.5	7.9	22.8	140.2	16.3
1923	53.7	62.6	116.3	8.6	21.8	146.7	14.9
1924	55.8	67.2	123.0	9.4	21.0	153.4	13.7
1925	59.6	72.7	132.3	10.3	20.3	162.9	12.5
1926	62.7	76.2	138.9	11.1	19.2	169.2	11.4
1927	66.4	81.2	147.6	12.1	18.2	177.9	10.3
1928	70.0	86.1	156.1	12.7	17.5	186.3	9.4
1929	72.9	88.9	161.8	13.6	16.5	191.9	8.6
1930	71.8	89.3	161.1	14.7	16.5	192.3	8.6

See footnotes at end of table.

TABLE 4.—ESTIMATED NET GOVERNMENT AND PRIVATE DEBT, BY MAJOR CATEGORIES—Continued

[Dollar amounts in billions]

Year	Private [1]			State and local	Federal [2]	Total net debt	Percent Federal of total
	Individual	Corporate	Total				
1931	$64.9	$83.5	$148.4	$16.0	$18.5	$182.9	10.2
1932	57.1	80.0	137.1	16.6	21.3	175.0	12.2
1933	51.0	76.9	127.9	16.3	24.3	168.5	14.5
1934	49.8	75.5	125.3	15.9	30.4	171.6	17.8
1935	49.7	74.8	124.5	16.1	34.4	175.0	19.7
1936	50.6	76.1	126.7	16.2	37.7	180.6	20.9
1937	51.1	75.8	126.9	16.1	39.2	182.2	21.6
1938	50.0	73.3	123.3	16.1	40.5	179.9	22.6
1939	50.8	73.5	124.3	16.4	42.6	183.3	23.3
1940	53.0	75.6	128.6	16.4	44.8	189.8	23.7
1941	55.6	83.4	139.0	16.1	56.3	211.4	26.7
1942	49.9	91.6	141.5	15.4	101.7	258.6	39.4
1943	48.8	95.5	144.3	14.5	154.4	313.2	49.3
1944	50.7	94.1	144.8	13.9	211.9	370.6	57.2
1945	54.7	85.3	140.0	13.4	252.5	405.9	62.3
1946	59.9	93.5	153.4	13.7	229.5	396.6	57.9
1947	69.4	109.6	179.0	15.0	221.7	415.7	53.4
1948	80.6	118.4	199.0	17.0	215.3	431.3	50.0
1949	90.4	118.7	209.1	19.1	217.6	445.8	48.9
1950	104.3	142.8	247.1	21.7	217.4	486.2	44.8

1951	114.3	163.8	278.1	24.2	216.9	519.2	41.8
1952	129.4	172.3	301.7	27.0	221.5	550.2	40.3
1953	143.2	180.9	324.1	30.7	226.8	581.6	39.0
1954	157.2	184.1	341.3	35.5	229.1	605.9	37.9
1955	180.1	215.0	395.1	41.1	229.6	665.8	34.5
1956	195.5	234.1	429.6	44.5	224.3	698.4	32.2
1957	207.6	249.1	456.7	48.6	223.0	728.3	30.7
1958	222.9	262.0	484.9	53.7	231.0	769.6	30.1
1959	245.0	287.0	532.0	59.6	241.4	833.0	29.0
1960	263.3	306.3	569.6	64.9	239.8	874.3	27.5
1961	284.8	328.3	613.1	70.5	246.7	930.3	26.6
1962	311.9	353.5	665.4	77.0	253.6	996.0	25.5
1963	345.8	383.6	729.4	83.9	257.5	1,070.8	24.1
1964	380.1	417.1	797.2	90.4	264.0	1,151.6	23.0
1965	424.6	463.2	887.8	98.3	266.4	1,252.5	21.3
1966	454.7	517.8	972.5	104.7	271.8	1,349.1	20.1
1967	489.1	562.6	1,051.7	112.8	286.4	1,450.8	19.7
1968	529.3	653.0	1,182.3	122.7	291.9	1,596.8	18.3
1969	566.2	764.7	1,330.9	133.3	289.3	1,753.4	16.5
1970	600.0	836.1	1,436.1	144.8	301.1	1,881.9	16.0

See footnotes at end of table.

TABLE 4.—ESTIMATED NET GOVERNMENT AND PRIVATE DEBT, BY MAJOR CATEGORIES—Continued

[Dollar amounts in billions]

Year	Private [1]			State and local	Federal [2]	Total net debt	Percent Federal of total
	Individual	Corporate	Total				
1971	$667.5	$911.2	$1,578.7	$162.7	$325.9	$2,067.3	15.8
1972	763.9	1,016.7	1,780.6	178.0	341.2	2,299.8	14.8
1973	854.4	1,166.5	2,020.9	192.3	349.1	2,562.3	13.6
1974	922.1	1,299.4	2,221.5	211.2	360.8	2,793.5	12.9
1975	994.4	1,365.4	2,359.8	222.7	446.3	3,028.8	14.7
1976	1,106.8	1,496.1	2,602.9	236.3	515.8	3,354.9	15.4
1977					572.5		

[1] Private corporate debt includes the debt of certain federally sponsored agencies in which there is no longer any Federal proprietary interest. The debt of the following agencies are included beginning these years: FLB's in 1949; FHLB's in 1951; FNMA-secondary market operations, FICB's, and BCOOP's in 1968. The total debt for these agencies amounted to $0.7 billion on Dec. 31, 1947, $3.5 billion on Dec. 31, 1960, $38.8 billion on Dec. 31, 1970, $78.8 billion on Dec. 31, 1975, and $81.4 billion on Dec. 31, 1976.

[2] Borrowing from the public equals gross Federal debt less securities held in Government accounts (a unified budget concept).

Source: Federal debt, Treasury Department; other data, Bureau of Economic Analysis, Commerce Department.

Note: Detail may not add to totals because of rounding. Real GNP is in constant 1972 dollars. Real per capita debt expressed in 1967 prices (i.e., Consumer Price Index for all items).

TABLE 5.—ESTIMATED PER CAPITA NET GOVERNMENT AND PRIVATE DEBT [1]

[Amounts in dollars]

Year	Private [2] Individual	Private [2] Corporate	Private [2] Total	State and local	Federal [3]	Total net debt
1916	$356	$394	$750	$44	$12	$806
1917	375	423	798	46	71	915
1918	431	455	887	49	203	1,139
1919	420	510	930	53	245	1,228
1920	452	542	994	58	223	1,275
1921	453	525	978	64	213	1,256
1922	462	532	995	72	207	1,274
1923	480	559	1,039	77	195	1,310
1924	489	589	1,078	82	184	1,344
1925	515	628	1,142	89	175	1,406
1926	534	649	1,183	95	164	1,441
1927	558	682	1,240	102	153	1,494
1928	581	715	1,295	105	145	1,546
1929	599	730	1,329	112	136	1,576
1930	583	726	1,309	119	134	1,562

See footnotes at end of table.

TABLE 5.—ESTIMATED PER CAPITA NET GOVERNMENT AND PRIVATE DEBT [1]—Continued

[Amonuts in dollars]

Year	Private [2]			State and local	Federal [3]	Total net debt
	Individual	Corporate	Total			
1931	$523	$673	$1,196	$129	$149	$1,475
1932	457	641	1,098	133	171	1,402
1933	406	612	1,018	130	194	1,342
1934	394	597	992	126	241	1,358
1935	391	588	978	127	270	1,375
1936	395	594	989	127	294	1,410
1937	397	588	985	125	304	1,414
1938	385	565	950	124	312	1,386
1939	388	562	950	125	325	1,401
1940	400	570	970	124	338	1,431
1941	415	623	1,038	120	420	1,579
1942	369	677	1,045	114	751	1,910
1943	356	696	1,051	106	1,125	2,282
1944	365	677	1,042	100	1,525	2,668
1945	389	607	997	95	1,798	2,890
1946	422	659	1,081	97	1,617	2,794
1947	480	757	1,237	104	1,532	2,873
1948	548	804	1,352	115	1,463	2,930
1949	604	793	1,396	128	1,453	2,977
1950	685	938	1,623	143	1,428	3,193

1951	738	1,058	1,796	156	1,400	3,352
1952	821	1,094	1,915	171	1,406	3,492
1953	894	1,129	2,023	192	1,416	3,631
1954	964	1,129	2,094	218	1,405	3,717
1955	1,085	1,296	2,381	248	1,384	4,013
1956	1,157	1,386	2,543	263	1,328	4,135
1957	1,207	1,448	2,655	283	1,297	4,235
1958	1,275	1,498	2,773	307	1,321	4,401
1959	1,378	1,614	2,992	335	1,357	4,684
1960	1,457	1,695	3,153	359	1,327	4,839
1961	1,550	1,787	3,338	384	1,343	5,064
1962	1,672	1,895	3,567	413	1,360	5,339
1963	1,827	2,027	3,854	443	1,361	5,658
1964	1,981	2,174	4,154	471	1,376	6,001
1965	2,185	2,384	4,569	506	1,371	6,446
1966	2,313	2,634	4,948	533	1,383	6,864
1967	2,461	2,831	5,293	568	1,441	7,301
1968	2,637	3,254	5,891	611	1,454	7,956
1969	2,794	3,773	6,567	658	1,427	8,651
1970	2,929	4,081	7,010	707	1,470	9,185

See footnotes at end of table.

TABLE 5.—ESTIMATED PER CAPITA NET GOVERNMENT AND PRIVATE DEBT—Continued

[Amonuts in dollars]

Year	Private [2]			State and local	Federal [3]	Total net debt
	Individual	Corporate	Total			
1971	$3,224	$4,401	$7,625	$786	$1,574	$9,984
1972	3,658	4,868	8,526	852	1,634	11,012
1973	4,061	5,544	9,605	914	1,659	12,178
1974	4,352	6,132	10,484	997	1,703	13,183
1975	4,693	6,444	11,136	1,051	2,090	14,293
1976	5,145	6,955	12,100	1,098	2,398	15,596
1977					2,641	

[1] Per capita debt is calculated by dividing debt figures by population of conterminous United States. Beginning 1949, population includes Armed Forces overseas, Hawaii, and Alaska.

[2] Private corporate debt includes the debt of certain federally sponsored agencies in which there is no longer any Federal proprietary interest. The debt of the following agencies are included beginning these years: FLB's in 1949; FHLB's in 1951; FNMA-secondary market operations, FICB's and BCOOP's in 1968. The total debt for these agencies amounted to $0.7 billion on Dec. 31, 1947, $3.5 billion on Dec. 31, 1960, $38.8 billion on Dec. 31, 1970, $78.8 billion on Dec. 31, 1975, and $81.4 billion on Dec. 31, 1976.

[3] Borrowing from the public equals gross Federal debt less securities held in Government accounts (a unified budget concept).

Source: Federal debt, Treasury Department; other data, Bureau of Economic Analysis, Commerce Department.

Note.—Detail may not add to totals because of rounding. Real GNP is in constant 1972 dollars. Real per capita debt expressed in 1967 prices (i.e., Consumer Price Index for all items).

TABLE 6.—NET GOVERNMENT AND PRIVATE DEBT RELATED TO GROSS NATIONAL PRODUCT

Year	Gross national product (billion)	Ratios of debt to gross national product					
		Private [1]			State and local	Federal [2]	Total net debt
		Individual	Corporate	Total			
1929	$103.4	$70.5	$86.0	$156.5	$13.2	$16.0	$185.6
1930	90.7	79.2	98.5	177.7	16.3	18.2	212.1
1931	76.1	85.4	109.8	195.1	21.1	24.4	240.5
1932	58.3	98.0	137.3	235.3	28.5	36.6	300.3
1933	55.8	91.4	137.8	229.2	29.3	43.6	301.9
1934	65.3	76.3	115.7	192.0	24.4	46.6	262.9
1935	72.5	68.6	103.2	171.8	22.3	47.5	241.4
1936	82.7	61.2	92.0	153.2	19.6	45.6	218.3
1937	96.7	52.9	78.4	131.2	16.7	40.6	188.4
1938	85.0	58.9	86.3	145.2	19.0	47.7	211.8
1939	90.8	56.0	81.0	136.9	18.1	47.0	201.9
1940	100.0	53.1	75.7	128.7	16.5	44.9	189.9
1941	124.9	44.6	66.8	111.4	12.9	45.1	169.3
1942	158.3	31.6	57.9	89.4	9.8	64.3	163.4
1943	192.0	25.5	49.8	75.2	7.6	80.5	163.2

See footnotes at end of table.

TABLE 6.—NET GOVERNMENT AND PRIVATE DEBT RELATED TO GROSS NATIONAL PRODUCT—Continued

Year	Gross national product (billion)	Ratios of debt to gross national product						
		Private [1]			State and local	Federal [2]	Total net debt
		Individual	Corporate	Total			
1944	$210.5	24.1	44.8	68.8	6.7	100.7	176.1
1945	212.3	25.8	40.2	66.0	6.4	119.0	191.2
1946	209.6	28.6	44.7	73.2	6.6	109.5	189.3
1947	232.8	29.9	47.1	76.9	6.5	95.3	178.6
1948	259.1	31.2	45.7	76.9	6.6	83.1	166.5
1949	258.0	35.1	46.1	81.1	7.5	84.4	172.8
1950	286.2	36.5	49.9	86.4	7.6	76.0	169.9
1951	330.2	34.7	49.7	84.3	7.4	65.7	157.3
1952	347.2	37.3	49.7	86.9	7.8	63.8	158.5
1953	366.1	39.2	49.5	88.6	8.4	62.0	158.9
1954	366.3	43.0	50.3	93.2	9.7	62.6	165.5
1955	399.3	45.2	53.9	99.0	10.3	57.6	166.8
1956	420.7	46.5	55.7	102.2	10.6	53.4	166.1
1957	442.8	46.9	56.3	103.2	11.0	50.4	164.5
1958	448.9	49.7	58.4	108.1	12.0	51.5	171.5
1959	486.5	50.4	59.0	109.4	12.3	49.7	171.3
1960	506.0	52.1	60.6	112.6	12.9	47.4	172.8
1961	523.3	54.5	62.8	117.2	13.5	47.2	177.8
1962	563.8	55.4	62.7	118.1	13.7	45.0	176.7
1963	594.7	58.2	64.6	122.7	14.2	43.3	180.1

1964	635.7	59.8	65.7	125.5	14.3	41.6	181.2
1965	688.1	61.7	67.3	129.0	14.3	38.7	182.0
1966	753.0	60.4	68.6	129.2	13.9	36.1	179.2
1967	796.3	61.4	70.7	132.1	14.2	36.0	182.2
1968	868.5	60.9	75.2	136.1	14.1	33.6	183.9
1969	935.5	60.5	81.7	142.2	14.2	30.9	187.4
1970	982.4	61.1	85.1	146.2	14.7	30.6	191.6
1971	1,063.4	62.8	85.7	148.5	15.3	30.6	194.4
1972	1,171.1	65.2	86.8	152.0	15.2	29.2	196.4
1973	1,306.3	65.4	89.3	154.7	14.6	26.7	196.1
1974	1,412.9	65.3	92.0	157.2	14.9	25.5	197.7
1975	1,528.8	65.0	89.3	154.4	14.6	29.2	198.1
1976	1,706.5	64.9	87.7	152.5	13.8	30.2	196.6
1977	1,890.4					30.3	

[1] Private corporate debt includes the debt of certain federally sponsored agencies in which there is no longer any Federal proprietary interest. The debt of the following agencies are included beginning these years: FLB's in 1949; FHLB's in 1951; FNMA-secondary market operations, FICB's, and BCOOP's in 1968. The total debt for these agencies amounted to $0.7 billion on Dec. 31, 1947, $3.5 billion on Dec. 31, 1960, $38.8 billion on Dec. 31, 1970, $78.8 billion on Dec. 31, 1975, and $81.4 billion on Dec. 31, 1976.

[2] Borrowing from the public equals gross Federal debt less securities held in Government accounts (a unified budget concept).

Source: Federal debt, Treasury Department; other data, Bureau of Economic Analysis, Commerce Department.

Note: Detail may not add to totals because of rounding. Real GNP is in constant 1972 dollars. Real per capita debt expressed in 1967 prices (i.e., Consumer Price Index for all items.

TABLE 7.—ESTIMATED FEDERAL DEBT RELATED TO POPULATION AND PRICES

[Amounts in dollars]

Year	Outstanding Federal debt			Per capita Federal debt [1]			Real per capita Federal debt		
	Gross [2]	Net [3]	Privately held net [4]	Gross [2]	Net [3]	Privately held net [4]	Gross [2]	Net [3]	Privately held net [1]
1929	$17.5	$16.5	$16.0	$144	$136	$131	$281	$265	$256
1930	17.3	16.5	15.8	141	134	128	292	279	266
1931	19.1	18.5	17.7	154	149	142	354	342	327
1932	22.0	21.3	19.4	176	171	155	451	437	396
1933	25.3	24.3	21.9	201	194	174	513	492	443
1934	33.3	30.4	28.0	264	241	221	657	600	551
1935	36.2	34.4	32.0	284	270	251	688	654	607
1936	40.3	37.7	35.3	315	294	275	752	704	658
1937	43.1	39.2	36.6	335	304	284	776	706	658
1938	45.6	40.5	37.9	351	312	291	837	744	695
1939	48.8	42.6	40.1	373	325	306	893	780	733
1940	52.2	44.8	42.6	394	338	321	934	802	761
1941	65.6	56.3	54.0	490	420	403	1,059	909	871
1942	113.7	101.7	95.5	840	751	705	1,661	1,486	1,394
1943	171.0	154.4	142.9	1,246	1,125	1,041	2,388	2,156	1,995

1944	233.6	211.9	193.1	1,682	1,525	1,390	3,156	2,863	2,608
1945	279.6	252.5	228.2	1,990	1,798	1,624	3,653	3,299	2,981
1946	260.4	229.5	206.1	1,835	1,617	1,452	2,841	2,504	2,248
1947	256.1	221.7	199.1	1,770	1,532	1,375	2,522	2,183	1,960
1948	252.6	215.3	192.0	1,716	1,463	1,304	2,384	2,032	1,811
1949	256.9	217.6	197.7	1,715	1,453	1,320	2,427	2,056	1,867
1950	256.5	217.4	196.6	1,684	1,428	1,291	2,252	1,909	1,725
1951	258.9	216.9	193.1	1,672	1,400	1,246	2,109	1,767	1,573
1952	267.0	221.5	196.8	1,695	1,406	1,249	2,119	1,758	1,562
1953	274.7	226.8	200.9	1,715	1,416	1,254	2,131	1,759	1,558
1954	278.0	229.1	204.2	1,705	1,405	1,252	2,128	1,754	1,563
1955	280.6	229.6	204.8	1,691	1,384	1,234	2,102	1,720	1,534
1956	277.2	224.3	199.4	1,641	1,328	1,180	1,983	1,605	1,426
1957	277.4	223.0	198.8	1,613	1,297	1,155	1,892	1,521	1,356
1958	284.5	231.0	204.7	1,627	1,321	1,170	1,876	1,523	1,349
1959	294.4	241.4	214.8	1,656	1,357	1,207	1,881	1,542	1,372
1960	294.1	239.8	212.4	1,628	1,327	1,175	1,823	1,486	1,316
1961	300.5	246.7	217.8	1,636	1,343	1,185	1,820	1,494	1,319
1962	308.0	253.6	222.8	1,651	1,360	1,194	1,815	1,495	1,313
1963	314.1	257.5	223.9	1,660	1,361	1,183	1,795	1,472	1,279

See footnotes at end of table.

TABLE 7.—ESTIMATED FEDERAL DEBT RELATED TO POPULATION AND PRICES—Continued

[Amounts in dollars]

Year	Outstanding Federal debt			Per capita Federal debt [1]			Real per capita Federal debt		
	Gross [2]	Net [3]	Privately held net [4]	Gross [2]	Net [3]	Privately held net [4]	Gross [2]	Net [3]	Privately held net [4]
1964	$323.4	$264.0	$227.0	$1,685	$1,376	$1,183	$1,801	$1,470	$1,264
1965	326.9	266.4	225.6	1,682	1,371	1,161	1,764	1,438	1,217
1966	339.6	271.8	227.5	1,728	1,383	1,157	1,753	1,403	1,174
1967	361.9	286.4	237.3	1,821	1,441	1,194	1,793	1,419	1,176
1968	371.3	291.9	238.9	1,850	1,454	1,190	1,739	1,367	1,119
1969	381.2	289.3	232.1	1,881	1,427	1,145	1,666	1,265	1,014
1970	400.8	301.1	239.0	1,956	1,470	1,166	1,643	1,234	979
1971	434.4	325.9	255.1	2,098	1,574	1,232	1,705	1,279	1,001
1972	460.2	341.2	269.9	2,203	1,634	1,292	1,732	1,284	1,015
1973	480.7	349.1	268.6	2,285	1,659	1,276	1,650	1,198	922
1974	504.0	360.8	280.1	2,378	1,703	1,322	1,531	1,096	851
1975	587.6	446.3	358.2	2,752	2,090	1,677	1,655	1,257	1,009
1976	664.8	515.8	418.5	3,090	2,398	1,945	1,773	1,376	1,116
1977	729.2	572.5	470.8	3,364	2,641	2,171	1,810	1,422	1,170

[1] Per capita debt is calculated by dividing debt figures by population of conterminous United States. Beginning 1949, population includes Armed Forces overseas, Hawaii, and Alaska.

[2] Total Federal securities includes public debt securities and budget agency securities.

[3] Borrowing from the public equals gross Federal debt less securities held in Government accounts (a unified budget concept).

[4] Borrowing from the public less Federal Reserve holdings.

Source: Federal debt, Treasury Department; other data, Bureau of Economic Analysis, Commerce Department.

Note: Detail may not add to totals because of rounding. Real GNP is in constant 1972 dollars. Real per capita debt expressed in 1967 prices (i.e., Consumer Price Index for all items).

TABLE 8.—PRIVATELY HELD FEDERAL DEBT RELATED TO GNP

[Dollar amounts in billions]

Year	Gross national product	Privately held debt[1]	Ratio of debt to GNP	Year-to-year price changes[2]
1929	$103.4	$16.0	15.5	....
1930	90.7	15.8	17.5	−6.0
1931	76.1	17.7	23.3	−9.5
1932	58.3	19.4	33.3	−10.2
1933	55.8	21.9	39.3	.6
1934	65.3	28.0	42.9	2.1
1935	72.5	32.0	44.2	3.0
1936	82.7	35.3	42.7	1.3
1937	96.7	36.6	37.9	3.2
1938	85.0	37.9	44.7	−2.7
1939	90.8	40.1	44.2	−.4
1940	100.0	42.6	42.7	1.0
1941	124.9	54.0	43.3	9.8
1942	158.3	95.5	60.4	9.3
1943	192.0	142.9	74.5	3.2
1944	210.5	193.1	91.8	2.2
1945	212.3	228.2	107.5	2.3
1946	209.6	206.1	98.4	18.6
1947	232.8	199.1	85.6	8.7
1948	259.1	192.0	74.2	2.6
1949	258.0	197.7	76.7	−1.8
1950	286.2	196.6	68.7	5.9
1951	330.2	193.1	58.5	6.0
1952	347.2	196.8	56.7	.9
1953	366.1	200.9	54.9	.7
1954	366.3	204.2	55.8	−.4
1955	399.3	204.8	51.3	.4
1956	420.7	199.4	47.4	2.9
1957	442.8	198.8	44.9	3.1
1958	448.9	204.7	45.7	1.8
1959	486.5	214.8	44.2	1.5
1960	506.0	212.4	42.0	1.5
1961	523.3	217.8	41.7	.7
1962	563.8	222.8	39.6	1.3
1963	594.7	223.9	37.7	1.7

See footnotes at end of table.

TABLE 8.—PRIVATELY HELD FEDERAL DEBT RELATED TO GNP—Continued

[Dollar amounts in billions]

Year	Gross national product	Privately held debt [1]	Ratio of debt to GNP	Year-to-year price changes [2]
1964	$635.7	$227.0	35.8	1.2
1965	688.1	225.6	32.8	2.0
1966	753.0	227.5	30.3	3.4
1967	796.3	237.3	29.9	3.0
1968	868.5	238.9	27.6	4.7
1969	935.5	232.1	24.9	6.1
1970	982.4	239.0	24.4	5.5
1971	1,063.4	255.6	24.0	3.4
1972	1,171.1	271.1	23.1	3.4
1973	1,306.3	270.4	20.7	8.8
1974	1,412.9	280.1	19.8	12.2
1975	1,528.8	358.2	23.4	7.0
1976	1,706.5	418.5	24.5	4.8
1977	1,890.4	470.8	24.9	6.8

[1] Borrowing from the public less Federal Reserve holdings.
[2] Measured by all item Consumer Price Index, December to December basis.

Source: Federal debt, Treasury Department; other data, Bureau of Economic Analysis, Commerce Department.

Note: Detail may not add to totals because of rounding. Real GNP is in constant 1972 dollars. Real per capita debt expressed in 1967 prices (i.e., Consumer Price Index for all items).

TABLE 9.—CHANGES IN PER CAPITA REAL GROSS NATIONAL PRODUCT

Year	GNP in billions of 1972 dollars	GNP per capita constant 1972 dollars [1]	GNP per capita, change from year ago: Constant 1972 dollars	GNP per capita, change from year ago: Percent
1929	314.7	2,584	...	...
1930	385.1	3,129	544	21
1931	263.3	2,123	−1,006	−32
1932	227.1	1,819	−303	−14
1933	222.1	1,769	−50	−2
1934	239.3	1,894	125	7
1935	261.0	2,051	157	8
1936	297.1	2,320	269	13
1937	310.8	2,413	92	4
1938	297.8	2,294	−118	−4
1939	319.7	2,443	148	6
1940	343.6	2,591	148	6
1941	396.6	2,962	370	14
1942	454.6	3,358	396	13
1943	527.3	3,842	483	14
1944	567.0	4,082	239	6
1945	559.0	3,980	−101	−2
1946	477.0	3,361	−618	−15
1947	468.3	3,236	−124	−3
1948	487.7	3,313	76	2
1949	490.7	3,276	−36	−1
1950	533.5	3,504	227	6
1951	576.5	3,722	218	6
1952	598.5	3,799	76	2
1953	621.8	3,882	83	2
1954	613.7	3,764	−117	−2
1955	654.8	3,946	181	4
1956	668.8	3,960	13	...
1957	680.9	3,959	...	...
1958	679.5	3,885	−73	−1
1959	720.4	4,051	165	4
1960	736.8	4,078	27	...
1961	755.3	4,112	33	...
1962	799.1	4,284	172	4
1963	830.7	4,390	105	2

See footnotes at end of table.

TABLE 9.—CHANGES IN PER CAPITA REAL GROSS NATIONAL PRODUCT—Continued

Year	GNP in billions of 1972 dollars	GNP per capita constant 1972 dollars[1]	GNP per capita, change from year ago	
			Constant 1972 dollars	Percent
1964	874.4	4,557	167	3
1965	925.9	4,765	208	4
1966	981.0	4,991	225	4
1967	1,007.7	5,071	80	1
1968	1,051.8	5,241	169	3
1969	1,078.8	5,323	82	1
1970	1,075.3	5,249	−74	−1
1971	1,107.5	5,349	100	1
1972	1,171.1	5,607	258	4
1973	1,235.0	5,869	262	4
1974	1,217.8	5,747	−122	−2
1975	1,202.1	5,629	−118	−2
1976	1,274.7	5,926	297	5
1977	1,337.6	6,169	243	4

[1] Per capita debt is calculated by dividing debt figures by population of conterminous United States. Beginning 1949, population includes Armed Forces overseas, Hawaii, and Alaska.

Source: Federal debt, Treasury Department; other data, Bureau of Economic Analysis, Commerce Department.

Note: Detail may not add to totals because of rounding. Real GNP is in constant 1972 dollars. Real per capita debt expressed in 1967 prices (i.e., Consumer Price Index for all items).

O