The Economic Club of New York

The Honorable Herbert Stein
Chairman, President's Council of
Economic Advisers

and

The Honorable Donald T. Regan
Chairman, Chief Executive Officer
Merrill Lynch, Pierce, Fenner and Smith

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Questioners: Milton W. Hudson
Vice President, Morgan Guaranty Trust Company

Douglas Greenwald
Chief Economist, McGraw-Hill Publishing Company

Introduction

Chairman Augustine R. Marusi

...who are known for plain, blunt talk. Outspoken is a good description for both Donald T. Regan, Chairman and Chief Executive Officer of Merrill Lynch, Pierce, Fenner and Smith, and Herbert Stein, the Chairman of the President's Council of Economic Advisers. As usual, a question and answer period will follow our two presentations. Our interrogators are Milton W. Hudson, Vice President of the Morgan Guaranty Trust Company, who will direct his questions to Mr. Stein, and Douglas Greenwald, Chief Economist of the McGraw-Hill Publishing Company, who will direct his questions to Mr. Regan.

I can't imagine that anyone in this room is having any problem with the president's economic stabilization program. But if anyone is, our next speaker is the man to complain to. As a member of the Council of Economic Advisers, Herbert Stein helped run the freeze and he headed the task force that drew up Phase 2. That must have been quite an experience for an economist who was known both as an ardent free trader and a disbeliever in controls.

Dr. Stein joined the Nixon administration after a distinguished career with the Committee for Economic Development. Today, he wears three hats. As Vice Chairman of the Cost of Living Council, he helps to administer the economic medicine we're all taking these days. As Chairman of the Council of Economic Advisers, he tells the president how we're progressing under the

treatment. And as one of the wittiest and most outspoken of the president's advisers, he has done an outstanding job of selling the program and keeping the public and press informed of his progress. Dr. Stein, how are we doing on the journey from control back to a free market? Gentlemen, Dr. Stein. (Applause)

The Honorable Herbert Stein

Chairman, President's Council of Economic Advisers

Mr. Chairman, gentlemen, it's a long time since I have seen such an unrelieved sea of gentlemen. I am quite sure I would not find it appropriate to attend or address such a meeting in Washington, and I hope the fact will be concealed that I have spent this evening with a thousand gentlemen unrelieved by any feminine presence. (Laughter)

I must say in response to the suggestions in the introduction that I am inhibited by the presence here tonight of the editor of the Wall Street Journal because back in February I gave a talk to the National Press Club at which I made some plain remarks about democratic economics which the Wall Street Journal interpreted as being humorous. (Laughter) And I was very sternly chastised in an editorial in that paper for not realizing that economics is not all fun and games. Of course, being a daily reader of the Wall Street Journal, I am quite aware of that fact. (Laughter) Although it does seem a little more fun and games on May 1 than it did on February 1.

I have been hearing about the Economic Club of New York for almost as long as I can remember. When I worked for many years with the Committee for Economic Development, I was always having to contend with erroneous ideas and misinformation which my trustees had picked up in this organization. But the thing for which this Club stands in my mind most of all is an address made here on December 14, 1962, almost ten years ago, by President Kennedy.

President Kennedy's speech to the Economic Club of New York on that occasion was probably as much as any other single utterance the enunciation of the new economics. It was in that speech that the president described specifically, although not in great detail, his program for stimulating the expansion and growth of the economy by cutting taxes. The speech was a great success, both with the audience present and with the press the next morning.

There was, however, a little disagreement about the import of what he had said and of the favorable reception. After the speech, President Kennedy called the Chairman of his Council of Economic Advisers, Walter Heller, to say, I gave them straight Canes and Heller and they loved it. However, an intimate of that regime, Theodore Sorensen, later said of the speech, it sounded like Hoover, but it was actually Heller. (Laughter) His implication was that the audience's happiness could be ascribed to the Hoover-ish sugar-coating at least as much as to the Heller-ish pill.

Another insider, Kenneth Galbraith, less happy about the whole thing, described the Economic

Club speech as "the most Republican speech since McKinley." (Laughter) And in a history of fiscal policy that I later wrote, I suggested that Mr. Galbraith had gone a little far and that a better reference would have been Andrew Mellon.

I recall all of this, not to show that I have a long memory, but to indicate how far we have come from that age of innocence called Camelot – and sometimes called that as if Camelot stood for sophistication and innovativeness. A single speech could be identified with the names McKinley, Hoover, Mellon, Canes, and Heller only on a certain view of the economic problem. The view underlying the speech was that the economic problem, not only in 1962 but also more or less chronically, was a deficiency of demand for output and labor. This was a technical problem suggested by the code phrases "growth dividend" and "fiscal drag" for which there was a technical solution – namely fiscal stimulus. But since there was a general deficiency of demand, the manner in which this fiscal stimulus should be generated raised no critical questions. There would be enough for everybody. So the Kennedy-Heller program of fiscal stimulus could include the distinctly Andrew Mellon-like feature of substantial tax reduction for the upper income brackets. And it was this, I believe, that made the evening so pleasant for all concerned.

At the christening of the new economics before this Club, there were two wicked witches lurking in the shadows. One was inflation and the other was the balance of payments deficit. While the parents of the new economics knew of the existence of these unfortunate relations, they did not consider them so important as to deserve a prominent place on that happy occasion. But it was

just about three years later that things began to fall apart. The most obvious symptom was the beginning of a rapid inflation. Intensified efforts by the Johnson administration to restrain the inflation by moral-suasion, jawboning, and arm twisting did not succeed but in fact collapsed.

The rapid inflation, as it turned out, was to survive a considerable period of high unemployment, or it might be more accurate to say that the rapid inflation was to cause a considerable period of high unemployment. The balance of payments deficit didn't go away, but instead got worse and worse. The techniques of manipulating the economy by fiscal policy didn't seem to work even when tried, or at least not with the precision once expected of them. And instead of a deficiency of total demand, and the pleasant problem of what to do with the fiscal dividend, we are faced as far as the eye can see with the unpleasant problem of dividing our potential output among worthy but excessive and strongly enforced claims upon it.

The contrast between the experience of the past seven years and the vision of the Kennedy speech before this Club raises two kinds of questions. First, what accounts for the difference? And second, and in a sense a more operational question, how are we making out and living in this new and more difficult economy?

Now it seems clear to me that a good deal of the difference is explained by the Vietnam War. The Vietnam War financed by enormously rising budget deficits and monetary expansion at a time of full employment caused a classical inflation. The inflation continued after the budget

deficits had been removed, the monetary expansion reduced, and full employment had given way to considerable unemployment. This in itself was not surprising. But what was surprising was the durability of this condition which is still operative two and a half years after the excess demand was brought under control.

One cannot be sure that there was nothing else in the picture but the impetus given by the Vietnam War. The candidate usually cited for this role of something else in explaining the persistence of inflation is the power of labor unions. I have never found this an easy explanation to accept because it is not at all clear that the power of labor unions has increased as compared with 10 or 20 years ago. And it is hard to see why unchanged power should produce radically changed results. What seems more likely, although still speculative hypothesis, is that the use of this power has changed and that it is being exploited much more aggressively than heretofore.

There is a great deal of speculation about this subject which afflicts countries here and abroad. But what seems to be a summary statement of the possibility is that there may be an increasingly insistent demand for rapidly rising incomes which people are trying to satisfy not by offering more productive services but by threatening to withhold productive services. A parallel and more obvious development has been going on in the form of an increasingly insistent demand for more income and services to be obtained, not through the market process but through the political process. This gives rise to the phenomenon of excess claims on the national output, a phenomenon of which governments all over the world are well aware.

It has always been true that people have, in the aggregate, wanted more of the economic system than it has been capable of delivering. However, when these wants are exercised through the private market process, they either induce the supply of more resources which increase the economy's potential or they run into a limit set by the means of payment. But neither of these things is true when the claims are exercised politically.

Why the demands on the economy expressed through government have risen so rapidly in recent years at home and abroad is a difficult question. The common answer is that needs have greatly increased for the kinds of things that government is supposed to have a special ability to provide such as health, education, and improvement of the environment. These things are often summed up in the phrase "quality of life" as if the goods and services obtained from the private sector subtracted from the quality of life or at best yielded only some vulgar quality.

However, I doubt that this is a real explanation or a sufficient explanation of what is going on. The explanation must include the fact that what government provides seems to be free and that the temptation for politicians to exploit this fact is enormous. The question really is why it didn't all happen sooner.

To recapitulate, the classical excess demand initiated by the Vietnam War generated a rapid inflation which is capable of explaining the continuation of rising prices and wages for some time after the original excess demand was eliminated. We may also have been suffering from an

intensified pressure of powerful groups to raise their private incomes more rapidly without supplying more productive resources. And we probably also suffer from a chronic tendency to excess demand through the political focusing of claims upon the economy. All of this adds up, furthermore, to the likelihood of balance of payments difficulties. Although the rest of the world has been suffering from our difficulties also, but in a less acute way because they didn't have the war and for other reasons.

Now what can be said about the record and prospects of policy for dealing with this situation which seems to be so much more difficult and complicated than the one underlying President Kennedy's speech here in 1962. The story is a long one – much longer than I can deal with in the time allotted me here – and I shall only run briefly through some aspects of it in order to get to the questions that are now regarded as most interesting. Namely, the combination of stimulus and controls to produce more recovery with less inflation.

But I think it should be said that the administration tackled the nation's economic problems at their root in excess demand from the time it took office in 1969. The administration has never believed and does not now believe that there is any substitute for the elimination of excess demand as a remedy for inflation, although it obviously came to believe that this policy could require supplementation.

Under the policy we have laid out, we do not see the economy experiencing excess demand in

the period for which policy has been defined. Of course, the administration is not the sole determinant of the fiscal policies which affect total demand. In an election year, it is easy to visualize forces in the Congress which might create excess demand. However, the administration's commitment to resist them is clear.

The administration has also devoted substantial effort to the longer run problem of exercising reasonable restraint over the claims on the economy and forced through the political process. For one thing, the administration has tried to establish the principle that the budget should balance at full employment as a guide to fiscal policy. I have been greatly disappointed that some people in New York talk as if in doing this, we were killing the idea of the honest to God annually balanced budget. In fact, of course, that idea has been dead for decades and the idea of balance at full employment is the only presently active candidate for the role of expenditure disciplinarian.

To look briefly at our international problems, by closing the gold window and achieving a major realignment of international currency relations, the administration has taken fundamental steps to bring our balance of payments into adjustment and to reconcile our domestic objectives with our international obligations. It has also set the stage for international negotiations seeking mutually beneficial reform of the international monetary system.

I shall not go into these matters in detail, but since I have just returned from meetings in Paris where the international economy was discussed at length, I might report the consensus that was

obvious there. Confidence in the international financial situation was at a very high level, undoubtedly the highest in many years. The strength of the dollar was generally noted and there was common approval of the domestic economic policies being followed by the United States. Evidence was seen of some return flow of dollars to the United States. It was taken for granted that we are on the course to constructive negotiations about the system.

Now let me turn to what seems to me the heart of today's concern. Namely, the prospect for success in the effort to achieve recovery while reducing the inflation and the further prospect of retaining the combination of high employment and reasonable price stability once it is achieved. The evidence of the last few months has strengthened our expectation which was the common expectation that there would be a strong recovery in 1972 and early 1973.

The rise of business investment expenditures and the reports of surveys indicating future increases, the beginning of a quicker pace of retail sales, the continued high level of orders received by manufacturers, the fiscal stimulus which apparently still lies ahead of us, and the prospect that we will almost certainly at some time get a rise of inventory accumulation, all of these point to an accelerating pace of expansion during the year.

I am encouraged at the number of people who are saying that the recovery side of our problem is in the bag. However, I would not say that myself, and not only because I have been burned several times and I'm superstitious about it. The basic fact is that recoveries come in various

sizes. And what we want is a recovery sufficient to reduce the unemployment rate significantly. I am confident we are going to get that, but we haven't seen it yet. And until we do, we must remain alert to possibilities that might interfere with it.

Still, I would agree with the common view that for the present, the problems and questions are on the inflation side. But here too, the evidence in my opinion justifies confidence. I am constantly amazed at the people here and abroad who, when we were undecided and reluctant a year ago, urged an incomes policy upon us, but who now express skepticism about its effectiveness. Of course, I shouldn't be amazed. Many of the advocates of incomes policy a year ago did not have in mind any real thing run by real flesh and blood people in a real world of politics and ignorance. Instead, they were dreaming of some magic wand, some abracadabra, which would painlessly and instantly solve all our problems. Naturally, they would be disappointed in the real thing when it appeared. This would be especially natural for those who are professional critics of this administration.

When we get beyond this built-in disappointment, we do have to contend with some facts. One is that we had a pretty substantial rate of inflation in the first months of Phase 2 – that is from November to February. We had, as is well known, always predicted a bulge of prices after the freeze ended as some wage and price increases deferred during the freeze would have to be permitted to occur in a short period. We got that bulge. But we also got two others that we didn't expect. One was the bulge in meat prices, and the other was a bulge in industrial prices,

apparently resulting from miscalculation of costs when the initial decisions were made by the Price Commission.

We now seem to be running beyond the period of this bulge. As far as we can see, the rate of price increases granted by the Price Commission has been lower in more recent weeks than earlier. Some of the excessive price increases allowed earlier have been detected in the quarterly reports about profit margins and they are being rolled back. Meat prices have declined both at wholesale and retail. As you must all know, the Consumer Price Index seasonally adjusted did not rise at all in March and the Wholesale Price Index rose by only one-tenth of 1%.

During Phase 2 as a whole, the rise of the Consumer Price Index has been at a slower rate than before the freeze. If foods are excluded, the rise has been much less. And we have reason to think that the rise of food prices that we had in the early part of this year was non-recurrent. I would not want to suggest that we are now on a track which leads certainly to our goal of a 2 to 3% rate of inflation at year end, but I do think we are on our way to a lower rate of inflation and that it is within our capacity, and within the capacity of the system, to adapt to achieve the goal if adaptation is necessary. The steps announced this morning should be interpreted as such an adaptation. Millions of small business units have been exempted from controls so that better surveillance can be maintained over the more significant ones.

On my recent trip to Europe, I was repeatedly presented with the suggestion that the departure of

labor from the Pay Board meant the breakdown of the system. I had to remind them that all the labor leaders had not walked out – only four out of five. (Laughter) More importantly, labor had not walked out in the really significant sense. Working people are continuing to work and abide by the rules of the system. There are now no strikes in opposition to the system. In fact, we have been having the lowest level of strikes in years. A tripartite board including labor leaders is not necessary, although it may be helpful, for the main point which is to assure workers that they are being fairly treated.

The facts should be convincing on this score. During Phase 2, real hourly earnings rose at an annual rate of 5.3% compared to 2.6% before the freeze. And real spendable weekly earnings rose at an annual rate of 8.7% compared to 1.3% before the freeze. When these figures are read in conjunction with the big increase in total employment, it is clear that workers are benefitting greatly from the system.

I have the impression from the press, since I've returned, of some anxiety in the business community over the more rigorous application of the Price Commission's standards and the possible effect of this on profits. I hope businessmen will not leap to conclusions about what is going on. The standards for price increases always included provisions for limitation of profit margins. This was an inevitable part of the system. And the specific standards chosen were reasonable in general, although it is in the nature of such systems that they may cause trouble in particular cases. But there is nothing in the system to prevent a prosperous year for business. For

business to become frightened at this moment would not only be entirely without foundation, but could also precipitate controversy which would really undermine the system and impede the recovery.

Does the confidence I now express in the control system indicate a belief that we have now found a permanent answer to the problem of inflation? Not at all. I believe we have found a limited temporary answer that works in a particular historical context. It was interesting that in our Paris meetings last week, the countries that had decades of experience with price controls were most skeptical whereas the newcomers were more optimistic. I think this means that the period over which controls can be useful is not zero, but it's not long. One participant in the meeting, and not I, said that price and wage controls work best when managed by people with little confidence in them. (Laughter) I found this encouraging and significant. One implication is that in countries where there is little confidence in controls, they will be used only rarely and only in circumstances where they have the best chance of working.

What will be the nature of the problem of maintaining price stability after Phase 2 is over, no one can now say. However, I think it extremely unlikely that the problem, if it exists, will be solved by a permanent system of controls. With respect to the inflation problem, as with respect to many others, we may be in a period of search for many years. It is certainly to be hoped that the search will be conducted by people with a lively appreciation of the contribution the free economy has made to the welfare of Americans. Thank you. (Applause)

Chairman Augustine R. Marusi: Thank you very much, Dr. Stein, for a very interesting talk. Many of you may remember the November 1970 speech before this Club by Stock Exchange President, Robert Haack, when he outlined the troubles then facing Wall Street and suggesting some solutions. Don Regan was the first industry leader to come out publicly in support of the reforms that had been suggested. Mr. Regan has not hesitated to criticize the SEC when he thought it was moving too slowly on needed reforms. He has come out strongly in favor of abolishing fixed commission rates on grounds that capitalists should practice what they preach. By his willingness to discuss publicly the problems Wall Street faced in 1970-71, he raised the quality of public debate on solutions to those problems. By his service as a board member of the Federal Securities Investor Protection Corporation, he has helped to shore up investor confidence in the marketplace. Mr. Regan has put together his own unique account of the recent crisis on the street and his thoughts on Wall Street's future in a book, *A View from the Street*, which was released just this past Friday. I'm delighted that he is here tonight to share some of those thoughts with us. Mr. Regan will discuss the capital formation needs of the country during the next three decades. Thank you. (Applause)

The Honorable Donald T. Regan

Chairman, Chief Executive Officer

Merrill Lynch, Pierce, Fenner and Smith

Mr. Marusi, Dr. Stein, gentlemen on the dais, members of the Economic Club, their guests,

gentlemen, I have to interrupt this talk for a moment, Gus, just to say thanks for the plug. Us struggling authors always appreciate that sort of thing.

The ultimate purpose of capital investment is to increase the income of individuals. Capital investment not only brings economic returns in the future, it also makes important contributions to total spending in the present. Thus, it concerns both present and future use of resources. These economic terms may sound cold and abstract, but they describe the most basic human activities and inspirations. Capital investment is the engine of the economy and the key to individual well-being. That, after all, is the ultimate social goal expressed in simple terms. But there's nothing simple about what I am trying to sketch, and I'll shall try to do this in just a few moments, as to what the future costs of capital investment in America will be.

The figures themselves, which I'll come to presently, are complicated enough, and the variables are enormous. And the time span is long – the end of the century is my horizon. Given such a span, very deep social considerations come into play. Indeed, you find the questions about capital investment in the long run become questions about the nature of our society. What kind of a society do we have the capacity to become? Or what is more important, the will to become? What is the proper role of the free market economy and the public sector? How do we define our various needs? How can the economy marshall resources to meet our needs while at the same time respecting the proper concerns of those words "zero growth" to conserve resources?

To discuss capital investment through the year 2000 is to face a very spacious canvas. I shall use very broad strokes of the brush to fill it in. I shall start with a few comments about the social climate required for the growth of capital investment. Just as a man can't swim in a pool of sharks, so capital investment cannot survive – much less thrive – in a hostile social context. Then I'll move along to some numbers – what we have spent, what we shall spend, what we want to spend, what we as a nation can afford. Finally, I'll suggest how we can achieve what we want to achieve. But I warn you that the toughest part of that equation lies with the definition of what we want. What indeed?

My first point then concerns the social climate. Few of us here are content with it. Even fewer of those who are not in some way or another represented here are content with it. Judging from the labels, we're a society of opposites. Rich versus poor. Middle Americans versus rich and poor and each other. Black versus White. Young versus old. Hawk versus dove. And if you want to continue it, maybe Knicks versus Rangers...Knicks versus Lakers, Rangers versus Bruins, you name it.

Yet you see this is much too simple for a pluralistic society. Whether we call our era technological or post-industrial, one of its most significant features is our increasing inter-dependence. In the 18th century in France, the followers of Saint-Simon wore long garments that buttoned down the back. Each man always required the help of another to dress – a daily reminder of inter-dependence. The same point was recently brought up to date by an American

professor, Jack Burnham, who remarked that when we buy an automobile, we no longer buy an object in the old sense of the word. But instead we purchase a three to five-year lease for participation in the state-recognized private transportation system, a traffic safety system, an industrial parts replacement system, a costly insurance system, and he might have added some responsibilities for the environment which demonstrates another kind of inter-dependence. No individual can go out and buy clean air for himself no matter how much he's willing to pay for it.

The adversary labels are too simplistic. They obscure the fact that to improve the condition of the poor is also to benefit those who are more fortunate. To help slum dwellers escape poverty is to make a better and a freer city for all. To improve air and water improves all of our lives. Our common interests outweigh our apparent antagonisms. And only within the boundaries of such broad political consensus can capital investment grow and do its vitally important job. Economic development cannot take place against the drift of social and political events.

That judgment about consensus forms the platform from which we may launch into the heady atmosphere of projections. I have conflicting emotions about these projections – a bit like a proud father looking at his two-year old son. He feels pretty confident about what the boy will look like and act one year from now. He isn't exactly sure about five years from now. And ten years out, well, I've got two sons myself and I can tell you that no matter what that father expects, he's apt to be wrong. So after ten years, these projections probably have the certainty of what? Off-track betting.

The safest place to begin explaining the future is in the past. As you know, even past figures are subject to revision, as well as for changing concepts. For example, seasonal adjustment. You know if you were to make seasonal adjustments for the weather in Alaska, I think you could prove it's never winter there.

Nevertheless, with those caveats, let's look back and then forward. Business spending for fixed investment on an annual average from 1970 through 1972 – by the way, our economists take averages over such periods to avoid distortions present in almost any single year – should amount to some $149 billion per year. It stood at $73 billion in the 1960 - 1962 period. That means an average annual growth rate of just over 7.4% for the past decade. By 1980, the figure for fixed investment will be around $306 billion which means a growth rate between now and then of 8.4% in the next ten years as compared with the 7.4% for the past ten. That's a substantial rate of increase.

But as you no doubt expected to hear, the government has plans that far outstrip these projections from the private sector. Over the past 25 years, total federal spending grew at the rate of 8.2% – faster than the business sector. State and local spending grew at a 10% rate for the past 25 years. It will grow at a 10.4% rate between now and 1980 and then it may taper off, it says here. (Laughter) The aggregate figures are enormous. In 1980, the federal government will be spending over $500 billion in current dollars or over 30% of the gross national product. By 1980, state and local governments will be taking almost as much. They'll be spending $375 billion for

goods and services. By the year 2000, state and local governments will be well ahead. They will be spending over $2 trillion as compared with the federal government's outlay of almost $2 trillion for that same year. The whopping total spending in the public sector will be over $4 trillion.

You may well ask, what will the various governments collectively be spending those huge sums on? Interestingly, programs just taking shape will take the large percentage of these expenditures. Welfare spending will go up almost 16% a year between now and 1980, reaching at least $40 billion a year at that time. A new welfare bill, H.R.1, now before the Congress, may add costs of at least $4 billion in its first year. And after that, the figure is anybody's guess and all guesses are sensible as long as they start with $4 billion. Health costs could be running at $77 billion per year by 1980. So the general category of social welfare including education, housing and urban renewal, and Social Security will reach $300 billion by the year 1980. That will be 60% of the total amount that the federal government will then be spending.

Now perhaps you can already guess the category of the next macro numbers I'll be talking at you. They concern debt which we once shunned and now is our ubiquitous companion. Let's assume a healthy economy that will generate steadily growing revenues. Real growth in the gross national product of 4.3% a year. Inflation kept down to 3.5%. Unemployment at 4%. It sounds like heaven, doesn't it? Even then, we can expect a $60 billion federal deficit in current dollars in 1980, at present tax rates. And just to strike a bit more terror into your hearts – and by the way, I

hope there will be no cases of cardiac arrest in the audience tonight – the increase in the U.S. government debt will be $125 billion in the year 2000, for that year alone. Current outstanding debt totals around $430 billion today. The new government agency debt will be $100 billion. As for state and local governments, you remember how they were gradually lapping all the other speedsters in this race; their debt will increase by a horrendous $190 billion.

It seems hardly necessary to add that the financing gap, or shortfall, the difference between the billions raised on one side and the new money provided on the other, will widen very sharply. It will reach $150 billion per year in 1980 and $390 billion per year in 2000. The shortfall is based on the assumption that we'll be raising revenues by taxation at the same rates that prevail today.

Of course, you can always increase taxes from the private sector to finance the public sector. Theoretically at least, I suppose, the tax rate could go to 100%. Everything could be taxed and overtaxed – our income, our property, even our patience. (Laughter) But the merits of doing that in the general good are, to say the least, questionable. Because the sad fact of our economic life now becoming fully understood is that government spending slows capital formation. Capital can grow only when the total consumption is less than total income. The difference that is savings is what remains available to pay for the new capacity. To divert capital indefinitely and in ever-increasing amounts from the private sector to the public sector is a sure prescription for slowly smothering the economy.

Governments do pay for some capital goods such as roads, schools, hospitals, but there's a lot of room for doubt about the productivity rates at which such government building is carried out. Furthermore, a much greater part of what the government spends goes to what we must call consumption – payments for which no services are given in return. These payments are made from taxes which reduce savings by deficit financing with the consequences that huge sums go to pay interest on debt.

So I repeat, government spending slows capital formation. The general growth of government and the relative shrinkage of the private sector means a shift unfavorable to capital investment, especially the most productive forms of it. The consequences of ever-expanding government are becoming clearer and clearer to the public as well as to responsible politicians. Governor Nelson Rockefeller recently declared, what we're trying to do is to help people, but there's just one unfortunate thing that has happened. We are running out of money at all levels of government.

TIME magazine recently asked a very acute question on its cover. Is the U.S. going broke? A paradox can be detected here. The cost of government at all levels is swelling like a balloon. But public disillusionment and skepticism about what government can accomplish and how well are also swelling. The so-called taxpayers rebellion is merely symptomatic of a deep and widespread loss of public confidence in remote, unresponsive, and too often ineffective government, no matter how noble its declared intentions.

The citizen who feels connected to government only through his taxes, who has no voice or sense of participation in decisions affecting his life or his community, has only a limited opportunity to make known his discontent. Being human, he takes that opportunity whenever he can, even though it may have oddly distorted consequences that he really doesn't want...(Audio ends...then continues on next side of tape)...of all bond issues last year – twice the rejection rate of the 1960s and almost ten times the rate of the early post-war period.

But since the overall tax burden on every American man, woman, and child has almost doubled since 1960, that propensity to reject is not hard to understand. So I'd like to offer a respectful amendment to Governor Rockefeller's remarks. Government is not exactly running out of money. Government is running through money, and is running through money at an accelerating rate. And unfortunately for those politicians who are also demagogues, and I do not mean Governor Rockefeller, the rich just cannot be soaked enough to pay for it all. Thomas Jefferson had a vision of a country made a paradise by the contributions of the rich alone. Whether we as a nation like it or not, the vision cannot, on the numbers, become reality.

Now thus far I've stated that we need a proper social and political climate in order to go forward economically. I've argued that capital investment is the key to economic growth. Out of hand, I dismiss the arguments for zero growth, for it cannot happen as a practical matter. And if it were to happen, you would be for all time freezing the poor in place which is unthinkable.

Finally, I hope I've shocked you with the anticipated figures for the future which clearly show that present trends and methods, or lack of methods, cannot continue. So I'm left now with the difficult task of offering some suggestions on how can we meet all our needs. How can we ensure an adequate increase in capital investment? How can we resolve the dilemma of growing government expenses to be financed by a diminishing private sector? How do we answer the question, is the U.S. going broke? The answer has to be no. The U.S. continues to be a sound and a bankable proposition provided that we can sharpen our vision and our perception about what is necessary and what is merely desirable. We must accept the reality that there is and always will be a capital shortage in the sense that the supply of real capital available for investment can never be adequate to meet all the demands for capital.

Early in our nation's history that wise visitor, Alexis de Toqueville, applied to America a word that described more than physical aspect of the New Wilderness Republic. It also described the mood and the spirit of the new people. The word was boundless. In this generation we have come to realize with considerable pain that our power and influence are bounded and that we cannot proceed heedlessly any longer as the spoiled child of an always plentiful, always forgiving nature. We have discovered, even as we add a second trillion dollars to our gross national product in the space of this decade, that even our fantastic abundance is limited alongside our desires. Suddenly we are confronted with a new, unexpected, and somewhat unnerving sense of limits.

So we come to the thorny question of priorities. To give order to this final point, let me divide it into the needs for priorities in the public sector, the proper way to assign priorities, in what I like to think of as the still free business world, and the likely outcome of the process. We certainly need to improve the quality of our society. And the way to do that is to set ambitious targets for achievement in Social Security, education, welfare, medical care, and the proposals for revenue sharing. We're setting high social standards and objectives. Every society needs this endless unfolding of expectations to keep it moving and striving. And while the Constitution guarantees the pursuit of happiness, it doesn't guarantee to finance the chase.

The trouble is that all the causes clamoring for scarce resources are worthy and all the costs are very high. We cannot catch up with these rising expectations in a single decade. Let us concede what may be debatable, that a few other countries have met the expectations of their citizens better than we have. The fact still remains, with characteristic American haste we want to meet all our needs tomorrow. But to the question, what can we afford; no answer can be ventured today because in the era of change, we have no longer adequate means of matching up our social goals against each other and against the cost, and then making intelligent decisions. We have no clear idea of the tradeoffs involved in spending a public dollar here and not spending a public dollar there. In short, we cannot say what the U.S. can afford because at bottom we lack a coherent and generally accepted set of national priorities. We do not know how to make the visionary and the realistic consonant.

The point is not new, but it has never penetrated very deep. Now we can wait no longer. The patchwork of the past cannot cover the needs of the future. We have an Office of Management Budget in Washington and we have an especially able public servant at its head. But much of the budget has simply escaped anyone's control. A wide area for decision making on the economy and social priorities lies with the Congress. That is an honorable body, but even some of its members express the view that especially in even-numbered years it's a body subject to momentary passion, seizures, fits of temper, and temptation to dip into the pork barrel.

We may fairly conclude that neither the Executive nor the Legislative branch alone is fully equipped for long-range planning and policymaking in the field of social priorities. We face the obvious necessity to ration our resources. Every chief executive officer of a large corporation knows his corporation could not exist without planning. Every board of directors knows the importance of the establishment of priorities. I cannot imagine a board that wouldn't call to account a chief executive who did not insist on plans, budgets, controls.

Perhaps we could make a national beginning with the establishment of a National Planning Council. I envisage a council of perhaps the same size as the Cabinet. It should be established by an act of Congress. Suggestions on its makeup are welcome. But to start the dialogue, I'll propose that the council should include representatives of the Executive branch through the Director of Office of Management and Budget and perhaps a Cabinet member or two, representatives of the Legislative branch, perhaps through the Chairman and Ranking Minority

Member of the Joint Economic Committee, the Senate Banking and Housing and Urban Affairs Committee, and the House Ways and Means Committee. And also should be represented, the public, including carefully selected groups concerned with conservation and consumer issues, as well as spokesmen for business, labor, and agriculture, a top educator, a talented economist, and an expert in the social impact of technological change should also be included.

The function of the council initially would be to draw up a capital budget for a five to ten-year period evaluating the sources of income and assigning priorities to government projects and programs. No overruns would be permitted. What was not in the budget would have to wait until next year. Upon the council would be imposed the authority of the office of the president. It would function under presidential mandate with an obligation to publish its formal plans at the end of every year and to put out a progress report at mid-year. The board would have high visibility and I hope considerable celebrity. Of course, the reporting and planning processes would be complicated and could be upset by the uncertainties and disasters that are part of human condition.

The creation of a body such as the council I have described is certainly not impossible. Indeed, it is essential, an essential beginning to the path of rationalizing our society's use of limited resources. We must match up our priorities and resources or goals will allude us. This is not the usual sense of managing the economy, but it would be in a sense directing the economy, giving it a sense of purpose. The council should also have the right to insist on better productivity in

government. Right now, that's what government is demanding of business. Turnabout is fair play. The Social Security system currently delivers the most beneficial dollar at low cost, but it's in the fields where our government does not have a great deal of experience, such as health and welfare where costs are going to rise most sharply. There we had better beware. There is evidence that the cost to deliver the welfare dollar to a recipient is unsupportably high. Efficiency will serve us all well and serve those in need most of all.

Now let's turn to the private sector. What about the priorities there? I'm afraid part of what I'm about to say is expected. Nevertheless, it does not spring out of what Reinhold Niebuhr called entrenched predatory self-interest. My conviction is that the marketplace is the most efficient allocator of resources yet devised. The freer the marketplace, the more efficient it becomes. This does not deny social goals or responsibilities. It merely defines the most efficient and effective way to generate the revenues to meet them. Our capital markets should be freer than they are. The present capital gains tax schedule should be made less restrictive. That would probably come at the sacrifice of some revenue to the government today but at the gain of much more revenue for the government tomorrow.

My general view is that revisions in the capital gains tax structure should be designed to give more encouragement to the free flow of investment, especially towards new ventures – critically important, if we are to remain innovative. More incentives should be given to the investor to keep his capital invested instead of spending it.

Now you may say that this would constitute a break for the rich. I say that's demagoguery. One hundred million Americans at least are investors in our economy. One hundred million are capitalists. Capitalism takes capital. The measures I'm proposing would produce the capital and put it to rational use. A series of other measures would also help such as correcting the depreciation rates for inflation and eliminating discriminations in the tax system that discourage savings. The resultant generation of more capital, once begun, is a process that feeds on itself. Each year's success makes easier next year's growth.

Now I do not deny that the establishment of a planning council and some unlocking of capital would help business people. But those actions would also help old people, poor people, sick people. They would help labor. They would start us on the way to becoming the consensus society. For their part, businessmen should look on these measures as a stimulus to managing capital better. We should heed the urgings of the new Secretary of Commerce to create better work environments and introduce new techniques of job rotation, reduction of boring tasks, retraining programs and so on. That kind of innovative management will help us on the way to better productivity and thus the country will become more attractive to foreign capital by offering more profitable opportunities for investment. In that way too, success will breed success.

All this requires a radical reversal of the cardiac arresting trends that I mentioned earlier. But the

result will move us toward our social ideals. U Thant, for so long Secretary General of the U.N. and a selfless world servant, made this point beautifully. Said Mr. Thant, the central stupendous truth about developed economies today is that they can have, in anything but the shortest run, the kind and scale of resources they decide to have. It is no longer resources that limit decisions. It is the decision that makes the resources. This is the fundamental revolutionary change – perhaps the most revolutionary that man has ever known. Thank you. (Applause)

QUESTION AND ANSWER PERIOD

CHAIRMAN AUGUSTINE R. MARUSI: Thank you, Mr. Regan, for your thoughtful words. We now come to the period of interrogation. And we first have, we will alternate between Mr. Hudson and Mr. Greenwald. And Mr. Hudson will begin by interrogating Dr. Stein.

MILTON W. HUDSON: Thank you Gus. I'm tempted to first begin by asking Mr. Regan where I can get tickets to that Knicks-Rangers game. Dr. Stein, during the course of your talk, you put a considerable emphasis on the improvement that's occurring in business, the recent evidence of improvement. But actually, isn't it a fact, if you go back and look at the projections that you were making at the beginning of the year, that the economy is off to a considerably slower start than you had anticipated. I believe that from the fourth quarter of 1971 to the fourth quarter of 1972, the implied rate of real growth for GNP by your projections is about 7%, almost 7%. And, of course, the first quarter has started in a much more muted way. Are you prepared now to, are

you thinking in terms of downgrading your projections for the full year and perhaps your unemployment rate reading for the end of the year? Or are there reasons that cause you to think that you can do better than 7% from this point on and make your projections come true?

THE HONORABLE HERBERT STEIN: Well, our projections for the year, although we never published any quarterly projections, always implied an acceleration in the rate of real growth during the year. That is, we expected that the third and fourth quarters of the year would show more real growth than the first and second quarters, especially than the first. But I think some of the things that have happened have given us reason to think that this acceleration during the year will be steeper than we envisaged at the outset. For example, we did not obviously envisage the full extent of the over-withholding to which the economy would be subject this year. And this is a factor which has been some restraint in the early part but which will be a diminishing force as the year goes on. Furthermore, we did not anticipate so rapid a rate of business investment expenditure as we now foresee. And we also expected the resumption of a higher rate of inventory accumulation to come earlier. So that I think we have had a quite strong first quarter despite the absence in that first quarter of some of the stimuli that we did foresee. And we think that many of these stimuli are still ahead of us so that we do envisage somewhat more rapid rate of increase. To answer your question most directly, we are not about to reduce our forecast for the year or for the end of the year. And I observe that many people who shared our initial forecasts or were in our initial general neighborhood are now raising, not reducing their forecasts.

MILTON W. HUDSON: One of the things that everyone has counted on to help moderate the inflation has been productivity gain, improvement cyclically in productivity gain. And, in fact, we got that last year and we have the increase in unit labor cost. The first quarter figures on productivity which were released last week indicate a significant slowdown in the quarter to quarter gain in productivity. In your judgment, is that just an erratic quarterly fluke in what is still a basically strong productivity trend? Or are you a little bit troubled by what's happening?

THE HONORABLE HERBERT STEIN: Well, of course, we're not comforted by it but we don't regard this as an indicating that we are not going to get the usual cyclical expansion of productivity during the cyclically strong expansion that we foresee. We're not quite sure, and you know when you annualize these small quarter to quarter changes, very little differences make a great, come to a great deal. And we're not quite sure that the first quarter figures will stand up as they now look. For one thing, we do know that the estimates of the increase in the deflator or the increase in prices in the first quarter GNP were made before we had the March Consumer Price Index numbers which showed no change. And it may turn out, for that and some other reasons, that the increase in real output in the first quarter may have been understated in which case the increase in productivity would probably also have been understated. But we cannot go about measuring the course of the economy by these tenths of a point per quarter. I think it's quite clear that we are on a path of rapid increase both in total output and in total productivity.

MILTON W. HUDSON: One of the things that makes for better productivity, of course, is capital investment. And recently the Federal Reserve Board has made a recommendation that the 7% investment tax credit which of course is a stimulant, and many businessmen hoped a permanent stimulant to capital formation, be made variable at the president's discretion, so as to provide assurance that housing will be adequately financed and will not be closed out of capital markets by business demands during periods of tight money. That suggestion that's made by the Federal Reserve Board that the tax credit be varied at presidential discretion, is that one that you think would be good or bad?

THE HONORABLE HERBERT STEIN: Well, the administration hasn't taken any position on this proposal and I don't think any of you need to worry about it for 1972 or probably for 1973. I do believe our experience indicates the need for some more flexible instruments of fiscal policy. And I think we are inclined to be open-minded about this proposal, probably more open-minded than we would have been in our purer days of our initiation to this process. But I'm not about to endorse this particular one.

DOUGLAS GREENWALD: Mr. Regan, the federal corporate income tax rate at 48% is clearly punitive and has a dampening effect on capital expenditures of U.S. corporations. If you were asked for advice by President Nixon or Secretary Connally on the corporate tax rate, what arguments would you offer for a significantly lower rate?

THE HONORABLE DONALD T. REGAN: When is the last train for Stamford? We may be here the rest of the night. As far as the corporate tax rate is concerned, it is true that particularly for the newer, more venture-some companies, the 48% rate has much of a dampening effect upon their capital formation. They need encouragement in that. I am suggesting that there should be a lot of thought given to this by the National Planning Council to the effect that how can we go about, how would we spend this money? You can't obviously just give people a tax break and then have them spend the money as they will. If we're going to try seriously for tax, for additional capital, then we have to reduce taxes and insist that the additional capital be used, not just be held in the company treasury, nor distributed in the form of dividends. It has to be used for capital formation. I think a lot of thought could be given to this and then a reduction given in that way.

DOUGLAS GREENWALD: George Meany, our old friend, has been asking for an excess profits tax. What arguments would you offer against this notion?

THE HONORABLE DONALD T. REGAN: The mere fact that there are no such things as excess profits. (Laughter) I don't understand the term. (Applause) Next question. (Laughter)

DOUGLAS GREENWALD: In view of the economic situation that you've described in your paper, what would you consider an ideal tax program to stimulate capital investment?

THE HONORABLE DONALD T. REGAN: Well, again, I don't wish to get into taxes too heavily on the basis of just these initial remarks of mine concerning the need for capital formation. But obviously the things that I was talking about, the fact of you hear people now talking about there should be an entire Capital Gains Tax; there should be no difference between capital and any other type of income. Obviously, this would push capital gains into the neighborhood of the 50% income at the higher levels and so on. It would also mean that in the form of estates, that you'd get additional taxes. It would mean that you would penalize people for daring to risk their capital. Now I'm suggesting in my talk here this evening that we have to give greater stimulus to the private sector. Were this needed, you probably would have to reduce initially capital gains taxes in order to increase activity. But, of course, once the person consumed his capital, then he should be taxed on it at an income tax rate. The capital gains tax would only apply when you went out of one thing and into another that was still in the capital formation area. That's the type of innovation I'd like to see.

MILTON W. HUDSON: Dr. Stein, you sort of stressed in your talk that inflation had been more durable, perhaps more surprisingly durable this time around than in the past. Without really embracing the thesis of structural change in the economy by way of explanation of this greater durability in severity, you seem sort of to be acknowledging that that thesis might have some merit. Does this mean that you now, perhaps more so than in the past, are leaning to the idea that some form of permanent incomes policy, monitoring of price and wage behavior, may have an appropriate role in the American economy? And sort of as a sub-theme there, have you begun to

suspect that maybe 4% isn't really a realistic unemployment target?

THE HONORABLE HERBERT STEIN: Well, I suppose it's fair to say that I at least and many other people are less certain of a lot of things than we were a few years ago, and the experience; the economy has not behaved in the way that we expected. And one naturally looks for possible explanations. I don't feel inclined, however, to embrace now with full warmth and enthusiasm all alternatives to the ones which I formerly held. I think it is still a quite conceivable possibility that we will end the Phase 2 program by executing the theory which underlies it which is that we will wring out of the economy the inflationary expectations built up during the '65 -'69 period, and will be able thereafter to have a reasonable period of, to have a period of reasonable price stability and fairly high employment. But one must say that he can be less certain of this than he might have been a year ago or two years ago. And it is our business certainly in the Council of Economic Advisers to consider the possibilities and the alternatives. I don't mean in what I have said today, this evening, to be embracing the notion of a permanent dilemma in the United States making full employment and reasonable price stability incompatible in the present structural situation or to be embracing some kind of permanent control system. I thought I made it clear that I don't think a permanent control system is a viable alternative. If we have the problem, we will have to find some other kind of solution. Now with respect to the 4% thing, I think there we also have to be very pragmatic. I was here when 4% first became a common number and it didn't stand on any very firm foundation then. It probably stands on a less firm foundation today. I think our only position at the moment is that we believe it is possible during this year to make a

substantial reduction in the rate of unemployment, say to the neighborhood of 5% without reviving inflationary pressure or accelerating the inflation again, but we will see during the course of this year how the economy responds and this will give us some clue to the future possibilities. I don't think we should be locked in at this moment to some number, whatever its historical origins may be, as the goal to be sought at any price for all time in the future.

MILTON W. HUDSON: You mentioned, Dr. Stein, that businessmen, I think you implied that businessmen had some reason to be a little bit more apprehensive in recent days and concerned about the degree of attention that Mr. Grayson and others are showing to profit margins. And you said in the course of your comments, you reminded people that those profit margin criteria had been there right along. But one of the things that puzzles people, I think, is that in your own economic projections which you made last January, you forecast a rise in corporate profits this year to $99 billion. I was astonished to do a little slide rule calculation this afternoon and discover that that projection would imply a rate of growth from the fourth quarter of '71 to the fourth quarter of '72 of 25%. Now we're clearly not getting anything like that rate of growth in profits. Is it possible that your calculation made last January, which came after the profit margin criterion had been set down, that your calculation really wasn't compatible with what the Price Commission had established by way of a set of criteria? Or is maybe what we're seeing now just an isolated, not particularly widespread instance of violation that is causing a great more hubbub than really should attach to it? Is there a basic need for reconciliation here?

THE HONORABLE HERBERT STEIN: Well, I don't think I said that businessmen were justified in more apprehension. What I said was that as I read the newspapers businessmen are more apprehensive. But I think they are more apprehensive without justification. That is, I don't think that what is going on now is going to prevent a very substantial rise of profits during this year as volume expands and as the profit margin increases which are allowed by the system are realized. I believe, although I wouldn't be able to reconstitute the arithmetic at this moment, that the profit forecasts we made for this year are consistent with the standards of the price control system and we see no reason at this moment to change them. I have a feeling that your slide rule only works on straight lines. (Laughter) However, I think there's a little more to this than we've said so far. I am reminded of some remarks I made at the Business Council back in October which I meant very sincerely. I think the business community, more than almost anybody else, wanted an incomes policy. They felt, I think more than anybody else, kind of deserted by the government for our failure to help lead them through this difficult period or guide them or assist them, hold them by the hand, as we went through this difficult period. And it was in considerable measure because the business community felt so dependent on it that this incomes policy was introduced. And I think the business community has a certain obligation, if I can say that, or at least it's in its interest, to try to live with the system and not to be carving at it if in certain moments it seems to squeeze them a little, because they have a great deal at stake in its success, they have a great deal at stake in the general public feeling of its fairness. And I think that what has been happening recently in these few rollbacks, and I don't think we're going to have large scale general rollbacks of prices, and I am quite sure that the Cost of Living Council and the

Price Commission and everybody else concerned are aware of the role that the rise of profits during this cyclical expansion plays in this recovery and that we are all totally devoted to having this recovery. I think all these things need to be said. And I think that the businessmen have an obligation to remain a little calm and tolerant and confident about this thing because there is so much at stake in not making it a battleground as it could easily become.

DOUGLAS GREENWALD: Mr. Regan, capital investment is, as you said, a key factor in economic growth. Of course, it's a major source of productivity gain. Our McGraw-Hill survey released last Friday, and that's a plug, shows a significant step-up in capital spending for this year and increases over the next three years. What will be the impact of this new wave of investment on productivity and economic growth in the private economy over the next decade?

THE HONORABLE DONALD T. REGAN: Well, obviously I don't have numbers at my fingertips to answer that because I haven't had time to study the McGraw-Hill study. But my general impression would be that any increase of this magnitude in capital investment given the good will of labor to go along with it in the next year or two must result in a much greater productivity here in the United States. Obviously something that's needed as far as our balance of payments and other things are concerned to make us much more competitive than we are now in the world economy.

DOUGLAS GREENWALD: Do you believe the growing share of unproductive equipment in

our total investment today, that is, for example, you know, pollution control, safety devices, etc., will result in a lower rate of gain in productivity and economic growth in the future?

THE HONORABLE DONALD T. REGAN: Oh, no. It may result temporarily, particularly in some industries, in a lower rate of profit, but I don't think it has anything to do with productivity. Theoretically, if you make a better world, you have better workers living in that world, the workers are more productive. I would hate to think that were you to clean the air and clear the streams, things of that nature, the workers wouldn't appreciate this and the rate of productivity would decrease rather than increase. My guess would be that given a better environment, workers would respond intelligently to it. At least I've always found the American public does respond in that manner.

DOUGLAS GREENWALD: In the past, labor unions have generally opposed the introduction of labor-saving devices in plants. And with the continued threat from foreign competition and its impact on U.S. jobs, are unions likely to become more amenable to the expansion of automation in industry?

THE HONORABLE DONALD T. REGAN: Oh, that's a hard one. And I don't think that any generalization will work in this particular case because obviously we have things such as the Burke-Hartke Bill which is being supported by certain elements of labor that very definitely indicate that labor is going to put up with nothing of the sort. They want protection so they can

continue along the same lines that they always have been. You see the strikes at the General Motors plants in the newer automated plants where labor is protesting vigorously. But at the same time, as Dr. Stein has pointed out, productivity is increasing in this country. So I think we have diverse elements in labor itself as to whether they should accept this or not. I'm very hopeful that labor will come to its senses and realize that greater productivity is the answer to more jobs and better prosperity for the United States.

MILTON W. HUDSON: Dr. Stein, the administration's budget policy as was formulated after last August 15 called for a considerable amount of fiscal stimulus in the latter part of this year, the latter part of last year and the first part of 1972. But then by mid-'72 the peak of that fiscal stimulus was supposed to be passed and we were to get progressively smaller deficits as the economy itself was coming back and the gap between potential and actual output was narrowing. Now as things have actually developed, and largely because of the over-withholding which you referred to earlier, there's seems to be a distinct possibility that the budget deficit for fiscal '73 will be larger than the budget deficit for fiscal '72. Now this has a lot of people worried that maybe we're getting too much too late by way of fiscal stimulus, and even on your cherished full employment basis, we could be in substantial deficit next year – so say a lot of people. My question comes down to has fiscal policy really misfired in this go-around? And does some adjustment, is some adjustment indicated now?

THE HONORABLE HERBERT STEIN: Well, I think it is probably true that the peak of the

fiscal stimulus has been lagged by possibly a quarter or two. The peak that we expected to come in the first or second quarter of this calendar year may come in the second or third quarter. I think you have to be careful about a slavish translation of the budget numbers into fiscal stimulus and effect on the economy because some part of what is happening is a transfer of fund movements between quarters and even between fiscal years without any very significant effect on the timing of the economic impacts. For example, we had expected that, or in the original budget projections, that there would be, that revenue sharing would be enacted in time to make a retroactive payment to the states in this half of the calendar year. But we never expected, in making our economic projections, that that retroactive payment in this half of the calendar year was going to have much economic impact in this half of the calendar year. Well, now it appears that if we do get revenue sharing, the retroactive payment is more likely to come in the next fiscal year, that is, in the second half of the calendar year than in the first half. But I don't think this would much affect the timing of the economic effect. Now the over-withholding thing is a little more complicated because we really don't know how people react to the diminution in their cash flow as compared with what is obviously happening to their real incomes. I should think that by now people are quite aware of the fact, or at least an awful lot of people are quite aware of the fact, that they are, they're a little better off, some of them much better off than they thought they were, or than would appear from their paychecks. And that their economic behavior may respond to this fact so that one shouldn't necessarily assume that because the big refunds are paid in the first half of calendar 1973 possibly, that the total stimulus will appear at that time as compared with some earlier period. So my own belief is that the path we are on is still one in

which we get the maximum stimulus around the middle of this calendar year and diminishing thereafter in terms of economic impact.

MILTON W. HUDSON: But apart from the economic impact, in financial terms I gather what you say is consistent with the need for a very substantial amount and a larger amount than we expected not too long ago in terms of government financing. Now if that develops and if at the same time foreign central banks are liquidating U.S. government securities instead of helping to finance our deficit, aren't interest rate prospects rather bleak for later on in the year? We're already beginning to get some up trend as compared with a couple of months ago in underlying interest rate trends. And my question really comes down to this. If, in fact, interest rates continue to inch up, will there come a point, if any point, at which Dr. Burns should, his colleagues on the Interest Control Commission, should move to control the upward trend of interest rates?

THE HONORABLE HERBERT STEIN: Well, I'm not authorized to speak for Dr. Burns. (Laughter) And I'm very hesitant to do so. But you referred to him; of course he has two hats. One is Chairman of the Board of Governors and of the Open Market Committee, and on the other hand, Chairman of the Committee on Interest and Dividends. I would think that if we get a rise of interest rates during this year as a consequence of an expansion in the demand for credit and as a consequence of the expansion in the economy, that the policy of the Federal Reserve would be and ought to be to allow this rise of interest rates to occur. But that it should not be the policy of the Federal Reserve to generate a rise of interest rates that is not produced by the

system itself for the sake of our international balance of payments or for some other reason. And with respect to the Committee on Interest and Dividends, I think its chief function, as I've heard it described and it was initially conceived, is to see that the interest rates are responsive to market conditions and not to set limits to interest rates contrary to those that market clearing conditions would bring about. I'm not sure whether I have answered your question or whether I have intervened into Dr. Burns' territory. But in any case, I think I'll stop there.

CHAIRMAN AUGUSTINE R. MARUSI: We have time for one more question.

DOUGLAS GREENWALD: All of us here now know that Merrill Lynch is bullish about America's future. (Laughter) If we had to exist, though, under a partially controlled or planned economy for the next decade or so, would you be so bullish?

THE HONORABLE DONALD T. REGAN: It depends upon who is controlling the economy. Had we anything to say about who is controlling it, we might be very bullish. Seriously, I can't see that, after listening carefully to what Dr. Stein had to say tonight and my own reading of the press, that we should or have to remain in a controlled economy. And I would certainly hope that we wouldn't be in a controlled economy for the rest of the decade. And accordingly, that makes us even more bullish. (Applause)

CHAIRMAN AUGUSTINE R. MARUSI: Thank you, Dr. Stein and Mr. Regan, for a very

wonderful evening. Gentlemen, we stand adjourned.