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THE WHITE HOUSE

CONFERENCE ON INFLATION

THE EAST ROOM

9:32 A.M. EDT

THE PRESIDENT: Good morning.

It is a pleasure to be here with the distinguished Members of the Congress, both Democrat and Republican, and the very eminent group of economists and guests.

I look forward to a very beneficial and fruitful meeting this morning. This meeting marks the start of our national Conference on Inflation. I have called this series of working conferences in response to a bipartisan recommendation by the United States Senate and with the cooperation of concerned citizens representing all elements of our American society.

Our purpose is to find ways by which we, the American people, can come to grips with our economic difficulties and surmount them.

This has been called a summit conference. Maybe that title is a bit misleading. Recent summit conferences have been held between leaders of international adversaries with the hope of reducing their differences. Around this table there are no adversaries. We come together as allies to draw upon, or to draw up, I should say, a battle plan against a common enemy, inflation. Inflation is our domestic enemy Number 1.

Battle strategies are usually devised in secret. At my insistence this is a typically American open meeting. Some skeptics have warned me that putting 28 of our most distinguished economists and eight Members of Congress, both Democratic and Republican, on public display with live microphones would produce a spectacle something like professional wrestlers playing ice hockey. (Laughter) But I am ready to referee this opening match.

It is not widely known, but I started out in college very much attracted to economics. Later I switched to the law, probably because the legal profession seemed a better

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path to success in politics.

Having come this far, I can see why no economist would ever dream of wanting to be President.

But if we succeed in the job cut out for us, I can promise you there will be statues of each of you in every city park throughout the United States. Economics will never again be called a dismal science, nor will politicians, if we succeed, even dare again to hide behind the old alibi that the people just don't understand economics. The people understand economics very, very well and they are sick and tired of having politics played with their pocketbooks.

This Conference on Inflation is a joint enterprise of the Legislative and Executive branches of our Government which can become a monument to politics in the very best sense of the word. It unites Republicans and Independents and Democrats in an election year against a deadly enemy that doesn't recognize one political party from another.

The President cannot lick inflation. The Congress cannot lick inflation. Business, labor, agriculture and other segments of America cannot lick inflation. Separately, we can only make it worse, but, together, we can beat it to its knees.

These meetings are not going to be empty exercises in economic rhetoric, neither are they going to reveal any quick miracles. There is no quick fix for what ails our economy. I for one refuse to believe that the very best brains in America and the smartest, hardest working workers in the world cannot find a workable way to get the productive machinery of this great country back on the track and going full speed ahead.

Let me say, or set out, if I might, a few ground rules at the outset. We can't waste time stating and restating the problems. The problems are obvious, painful and perplexing.

What we want are some right answers, not a long list of the alternative answers, theoretical and hypothetical, good and bad. We need to have attainable answers sharply defined and carefully sorted out with the pluses and the minuses of each clearly stated.

We are looking for action that is practical, possible and as rapid in its effect as we can reasonably expect.

I don't have to tell all of you experts that there are many answers, most of which have been tried at some historic time. But before this conference ends, I would like to see and to have set before the American people a consistent and considered package of the most promising answers that you can find, some of which, or all of which will restore economic stability and sustain economic growth in these United States.

If our country is economically healthy, the whole

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world will be economically healthier. Inflation is a worldwide epidemic and we will quarantine it in collaboration with our friends abroad.

As you test your answers against the hard rock of economic law, as you discard beguiling instant cures for reliable remedies, as you try to treat the cause rather than the symptom, I ask you to bear in mind that no solution will work without a lot of willpower and individual sacrifice. America has plenty of both -- a capacity for both.

Sacrifice is easy to ask of others. It is harder to demand of ourselves. Burdens never fall equally on everybody's shoulders, but we must seek to share them as widely as the prosperity we hope will follow. The burdens of battle against inflation will be lighter if every American, all 210 million of us, lends a hand.

There will be ten more specialized meetings over the next few weeks culminating in a final two-day session on September 27 and 28. When we are done, there will be some things we can agree on.

I hope these areas of agreement will be greater than the areas of disagreement. But it is a fact that our economic system, like our political system, is based on competition in the honest conflict between different interests and different opinions. So there will be some things about which we cannot reach a consensus.

This would be a dull country without dissenters. But fortunately that is not a foreseeable danger in this case. Where we disagree, it will be necessary for the President and the Congress to make some very hard decisions. Our political system is designed to do exactly that, relying in the end on the ultimate good sense of the American people.

That is why these conferences must be open to the public. After all, it is their business we are really talking about.

So, ladies and gentlemen, let's get to work.

(Applause.)

At this point I would like to ask our new Chairman of the Council of Economic Advisers, Mr. Alan Greenspan, to give his judgment on the economy.

MR. GREENSPAN: Thank you, Mr. President.

I want to point out before I start that in my remarks the first part will be devoted to a discussion of the outlook. I have asked four of our major forecasting economists

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to participate in this and I will start off and, hopefully, we will get some elements of divergent agreements and the like from Otto Eckstein, Beryl Sprinkel, Walter Hoadley and David Grove.

I might say, however, that this is very unlikely, that the remainder of this meeting can conversely continue without remarks on the outlook from virtually all of you, because clearly policy recommendations, will be discussing, of necessity, some general view of what the future holds for us.

What I would like to do is focus on a specific area of the outlook, recognizing, that I am not going to be covering and cannot, in the time frame we have, more than just a central line. I know the others will cover a number of the areas which I would have covered and probably would have agreed with so there is no point in excessive duplication.

The issue I would like to discuss at this moment is the impact of a force which I believe is very significant and instrumental in creating the sort of turgid, very sluggish economic growth which we see and feel at the moment, and see how it tracks through various elements of the economy, and then raise some issues about its future.

The issue I am discussing is the continuous gripping of economic variables by inflation psychology. I think that after years of accelerated inflation we are finally beginning to see inflation anticipations actually affecting the decision-making process of both business and consumers.

The impact, as one might expect, however, is quite divergent. Consumers, as we can see, both in our own households and through the statistics, themselves, clearly respond to inflation in a retrenchment way. That is, consumers become terribly concerned about being able to make ends meet when they see a rapidly rising inflation. There is a concern about the ability to meet fixed costs -- rent, food, utilities and the like. And, as a consequence, there is a tendency, and we see it in the statistics, for people to hold back on so-called discretionary items and tend to save more and we are seeing this phenomenon at the moment and it is clearly one of the depressant factors in our economy because obviously consumer markets being such a huge sector of our economy what we find is that this is one of the major areas which is causing the extraordinarily sluggish growth which we perceive.

Obviously, we are also seeing similar events in home buying with rapidly rising interest rates over the last few years and extraordinarily high costs of building. This has similarly deterred home building and home purchases.

However, when you get to the other side, mainly, the business side, what we find, again not unexpectedly, is that the response to inflation psychology, the response to inflation anticipations, is precisely the opposite.

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It is fairly apparent that if you are setting up a capital appropriations operation for new plant and equipment, if you anticipate a rising price path; the usual calculations of rates of return on the typical discounted cash flow bases give you very extraordinary investment calculations which I think has been a very major element in the very large capital goods markets which we perceive and which I think we are going to see for the period immediately ahead.

We have a series of charts back there which I will get to shortly which I think are really in circumspect quite startling in their dimensions.

Secondly, as inflation expectations, as expected rising prices begin to move into the decision-making process, obviously inventory accumulation builds because there is implicit in the building action, so to speak, an expected capital gain and this has been a major factor in driving up inventory accumulation in real terms to fairly high levels.

We have a chart here, the first one here, and I will come to it, and we can see by these various measures we are already quite high. I will come back to that chart but it is fairly apparent that we have some pretty large inventory overhang at the moment.

Now, what this does clearly is it shows that it changes the distribution of the GNP in a way so that the ratios of consumer markets to the business plant and business investment markets generally are going down and, in a sense, this is as far as I can see the major element of why growth has been so stagnant in the most recent period.

I guess you would say that statistics are saying it is pretty much sideways. The reason I say that is that even though we tend to look at real GNP as the exact measure of what is going on in the economy, I think that looking at details and numbers at this stage, one, I think, should seriously question whether what we are observing is the true pattern of what is happening to real output in the last six months.

Obviously, the industrial production index, which is a direct measure of physical volume, is holding up a good deal better than the GNP. One looking at those real GNP figures is hard-pressed to find why the unemployment rate is so low.

Everyone is ready to repeal Okun's law, but my view is that it is a little premature. I suspect that actually what is wrong here is that the numbers which are reflecting the real GNP are a little bit more depressed than I think the real system is showing.

Obviously, another element implicit in all of this is that the financial system is working under strain. We are financing the growth in our current dollar GNP in part by reducing corporate liquidity and by running up the loan deposit ratios in the commercial banking system. I think that

this basically is the type of trend which exhibits the obvious strains that we see and yet what I find quite remarkable is how flexible, even under the tremendous pressure of our financial system, how flexible it remains. We see such things, for example, as small business, having difficulty paying some of the high interest rates; are finding their means of financing largely through the large corporations.

There has been a fairly marked rise in the receivables-payables flow within the large corporate sector which essentially means that the large corporations are borrowing to finance the smaller corporations, more so than they usually do.

What we are seeing is the extraordinary complexity of the mechanism under strain but actually responding to this in a mechanism which enables our system to rebalance and come under new equilibria in a fairly elaborate way.

Yet, even with the strain, it is fairly obvious that if all the credit firms that are involved in financing inventory, capital goods, receivables and other goods were fully accommodated, I think we would risk very significant acceleration in inflation because I think when we try to do that in this type of context the expansion of the money supply, I think, is wholly unacceptable.

Now, the general outlook, as I see it, is probably not terribly different from most.

What I would like to do is to use this series of charts to give certain general views.

First of all, what we are seeing is that of the two major areas where the strength has been considerable, mainly, inventory accumulation and capital goods, we are seeing some evidence that there is a peaking in the inventory process. It is showing up not only directly in the statistics but on indirect evidence that their lead times on delivery of materials of primary producers are beginning to shrink and backlogs are still holding up but, nonetheless, you get the sense that the sense that the pressure on inventory addumulation is easing and perhaps a not insignificant statistic is that salesmen are going out and making calls again after a hiatus of too long a period. They are now seeking business and this suggests that the pressure is easing.

I would suspect at this point that we are about to see some fairly evident easing in the rate of inventory accumulation.

Despite the fact that we see two of these measures that we find useful, namely, the ratio of inventories to final sales in constant dollars, and the ratio to capacity, despite the fact that both of these measures are quite high, I think

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the type of retrenchment in inventory investment that is about to occur will be quite limited largely because a very substantial part of our inventory system is supported by the capital goods markets. So long as the capital goods markets hold up, the amount of retrenchment that is feasible or capable really for our system is quite limited.

Although the data are not particularly easy to come by, I think we will find if we are able to get it that on a consolidated basis inventories that sort of support total equipment or capital goods markets probably run nine months to a year on a consolidated basis. As a consequence, when you have very substantial goods in process, the degree of change in these types of numbers can be substantial but, because the capital goods markets are still quite strong, so long as that very large sector holds up I think the extent of the decline tends to be limited. The reasons I think will be shown in the next chart.

We have heard a great deal, and I think there is evidence of it in the papers, that there has been some fairly pronounced curtailment in the capital goods markets. We hear a lot of stories about pulling back of a number of companies and industries and that is certainly true. Yet, when we look at the over-all figures, even remembering that there is a very large element of inflation in here, we still have the extraordinary spectacle both in manufacturing and, which I will get to momentarily, even in public utilities, of new commitments, that is, appropriations, plant and equipment starts running very much above the levels of expenditures, which means that unless there is some really dramatic curtailment, and I don't see any evidence of that even on the fringes at this moment, the capital goods markets are going to support an awful lot of economic activity.

This is a similar series on plant and equipment starts which basically confirms the appropriations data. As you know, it is a slightly different measure of the degree of backlog. Public utility figures are just really extraordinary. We may be getting very major cutbacks, and I think if you read the papers that is the impression everyone gets, but this is plotted through the second quarter and still runs very substantially above the rate of activity.

So, as it stands at the moment, I think that the capital goods markets are going to hold us up to a fairly good extent and it is really quite difficult at this point to envisage any significant real weakness in physical output.

My view at this point is that, so long as the capital goods markets stay together, we are not about to get a dramatic increase in economic activity. I think that even with this outlook what we are merely seeing is a relatively flat and turgid outlook but, nonetheless, even though this sort of outlook does imply increasing unemployment rates, although there are varying differences in people's judgments

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and estimates of where this goes, it is scarcely an outlook which can be described in some of the gloom terms that I have been hearing in the last recent days.

I am scarcely describable as a bull -- I haven't been for quite a while -- but I must say what I have been hearing as to what is apt to happen to the United States economy and the world at large is a bit overdone. More important, perhaps, is that we have to recognize that what is depressing the economic outlook, in my judgment, is the underlying inflation psychology. I think when one tracks it through the system it shows up in so many areas and is so pervasive that it leads to the conclusion that if by some means you can diffuse this inflation psychology you are removing a very major depressant on the system.

I think that policy should in all respects be focused on this particular point. However, psychology is not an irrational sort of thing which is caused by the whim of the neuroses of the people, or otherwise. It is based on people's perception of the real world. You cannot change psychology by any sort of set of gimmicks or the like. You can only do it if you are working in things which are real.

Now, what does happen is that if there is a set of programs which go into place which give a reasonable expectation that the underlying inflation trend which has gripped the American economy is somehow diffused we don't have to wait until the actual forces fully are reflected in the price level.

As you know, we have very large inflation premiums in the money markets in interest rates; we have some very extraordinary attitudes on the part of people which at this stage are quite rational. If we are successful in bringing down the rate of inflation and it is credible to the American people, I would not be surprised to find a good deal of this gloom which we now see dissipate fairly rapidly.

I think this is essentially what we should be focusing on. I certainly don't think it is easy. I am sure none of you thinks it is easy. Unless we can do this, I think we are going to stay with this particular turgid economy.

Now, Mr. President, economists always tend to speak more than they should. I think I should shut up at this moment.

THE PRESIDENT: Thank you very much, Alan.

Now I wish to reiterate what I said in part at the outset, how deeply grateful I am, and I am sure the American people are, that we have a spectrum in the Congress with us, House and Senate. I am also especially grateful for the 28 economists who are here, who will give us a broad overview.

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I know many of you made significant changes in your personal plans to attend this summit.

Let me express very emphatically my personal appreciation for the presence of each and every one of you.

Now, at this point, for his observation on the views or his views on the economy, Mr. Otto Eckstein of Harvard University.

MR. ECKSTEIN: Thank you, Mr. President.

Mr. President, my job here today is that of forecaster. My job is to analyze the economy, call the shots as I see them, and give you our best diagnosis of the prospects.

Now, the economy is moved by demands of consumers, of business, of the government and of the external world. Whether the economy is strong or weak is somehow determined in these four places.

The current outlook that my organization has published and that most other forecasters are pretty close to is one of an economy headed for a mild recession, a recession of the sort we have experienced five or six times in the post-war period. There is a risk that the economy can be worse; there will be recession as bad as 1958. I think very few serious analysts of the problems raise the specter of depression. Many people are afraid of that. So many changes have come to the economy since those days that that is not really what we should be focusing our attention on.

The question is whether we can avoid a recession as bad as 1958 or worse and whether there is a price that we must or must not pay to get out of the inflation.

Now, let me review quickly why we come to the conclusion that the recession looks almost inevitable and it is only a question of degree.

Let me say one other thing.

As forecasters, of course, we analyze what business does, what the consumer does. The most difficult part has been what government does.

In the last 10 years and perhaps in the last 30 years, the basic rhythm of the American economy, both in terms of employment and in terms of prices, has been mainly created in Washington. Business has been relatively stable. Consumers have behaved. The variations have originated here. So, the forecaster has to guess what you and your colleagues will do.

So, I have to give you some range of answers, to some extent. depending on the strategy you finally adopt.

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Now, in the consumer area, the consumer, of course, has suffered from a decline in real income. Today, his real income is \$20 billion less in total than it was a year ago. If all goes well, consumer income in the next year may rise one per cent. If things don't go quite so well, there will be a little further drop. His real wealth, even ignoring the tremendous drop in the stock market which is trying to tell us something, I think, his real wealth is down two and a half per cent this year, and will be down one per cent next year.

Automobile sales are now headed for about nine and three-quarters or perhaps 10 million units in the year.

As long as income does not grow at a substantial rate in real terms, and it is the inflation that has destroyed the income growth, the consumer will not be the great source of recovery. He will be cautious. The retail sales will not show significant real gain.

When we turn to business, we find a much more mixed situation. There are some industries like the automobile industry that has suffered from the energy difficulties and from the excesses of the previous boom when really the car sales were at an unsustainable rate. Of course, these industries are not planning on increases in investment but on a decline.

Electric utilities are suffering from a very difficult financial situation and are also suffering from a change in outlook. The consumer is economizing in the use of energy. As a result, the capital needs, expansion plans of utilities are reduced very significantly.

Now, no doubt before the summits are over, you will have to face the question whether some particular help is needed for financing of utilities. At this time, the outlook is going to be much lower than it looked six months or a year ago.

Now, in other industries, the steel industry, chemical industry, the glass industry, numerous others, we are struggling with shortages. They have not expanded sufficiently. They have suffered for years from the overvaluation of our currency. They only got a second chance a couple years ago to recapture their international position. These industries have tremendous capital needs. They will invest a lot. They will make these figures that Dr. Greenspan discussed look good in a while. That is one reason why our outlook is not altogether negative.

On the inventory, the situation is murky. The figures are confusing and not at all enlightening. Certainly, as the economy weakens and these forecasts are being lowered every month, the risk of an inventory accumulation becomes greater. We still feel that no massive inventory decumulation is in the cards because there are still a number of shortages in particular items and because business has seen it coming and they have been careful.

Nevertheless, there is certainly no plus in inventories. It will be a small minus going into next year.

Turning to the Government sector, the Federal part first, Federal spending rose tremendously in the early 1970's but in the last 18 months since the end of 1972 the real volume of all Federal spending, including Social Security, transfers to people of all sorts, welfare, including the grants to States, the real volume of Federal spending today is slightly lower than it was at the end of 1972.

Now of course we are going to have to be careful with the budget during this inflation but from a straight outlook point of view, this is not what has driven the economy up lately, and it gives no prospect, I am sure, of driving up the economy next year.

The Federal sector really looks for no real growth. The State and local sector which had been a bellwether of the economy, growing through thick and thin five percent a year, all of a sudden stopped doing it. The need for school construction is less because of population changes.

In terms of the employment implications, what this means is that unemployment which now is still running at a very modest 5.8 percent in the course of next year will go beyond 6 percent, and in our forecasting goes a little bit beyond 6.5 percent. The reason is that the labor force keeps growing and normally growing at two million people a year and this kind of economy simply is not creating more than one million jobs at best. So, the unemployment grows.

Now, the other side of the thing, the food price level. Of course, this is a terrible area of forecasting. The record of forecasting is poor, including our own, so we have to take with a large grain of salt whatever we say. The outlook on foods is always uncertain, and behavior of the commodity speculators is completely unpredictable. Our current best guess, which assumes that foods do about as everything else, not particularly good, not particularly bad, is at the end of this year the basic inflation rate is still 10 percent. At the end of next year it is about 8 percent. At the end of 1976 it is about 6 to 6.5 percent. That is a current middle-of-the-road, sensible inflation outlook which I might add is a very substantial improvement, and will make it clear to people some time next year that the very worst of the inflation is behind us.

Wages can be expected to rise at 10 percent in a bit of catch-up. They will slow down too as prices slow down. All of this is based on an economic policy which I will describe as middle-of-the-road policy. It is one where the budget stays at \$305 billion despite good efforts to cut it. It is also a more critical assumption, it assumes that the monetary policy of the Federal Reserve System does make a quick modest move to

ease interest rates, even beyond the modest move of last week. The short term rates are now 12 percent. If interest rates stay at 12 percent for another four to six months and if the budget were really cut in economic terms by \$7 billion to \$10 billion, then you simply have a weak real economy, the unemployment rate would go to 7.5 percent, the inflation rate by the end of 1976 might be better by half a point or a full point, and that is of course the alternative.

Now, the budget deficits in economic terms that would go with this would not be pleasing to us. It would be a calendar year economic budget deficit next year of \$11 billion. The unified budget because it benefits from certain categories of revenues might be five or six billion dollars less. Even in 1976 that policy would still show a modest deficit.

Now, if you pursue the tough policy, particularly if you combine it with a very tough money policy, then of course you drive down housing, gradually you get a second round of reduction in business investment, you don't have the automobile and electrics cutting back spending but they all get in a financial squeeze when they get panicky as the stock market is, and you get a second round of reductions in investment.

As a result of that the Federal budget suffers revenue losses. After all, you are a partner in the economy in the revenues you take. Consequently, the deficits would really be not significantly better. So, the fact of the matter is that we are sitting here with the worst peacetime inflation we have ever had, the economy heading for a middling recession, and what we as forecasters, to make our forecast come true, hope for is that you will concern yourself both with the employment objective and the price objective, take a middle-of-the-roadish kind of policy and let's get over the mild recession which is inevitable, and a year or two later the economy will go back to some kind of norm.

Thank you.

THE PRESIDENT: Thank you very much, Mr. Eckstein.

I would now like to call on Mr. Beryl Sprinkel of the Harris Trust and Savings Bank to give his views on the economy.

MR. SPRINKEL: Thank you, Mr. President, Members of Congress, ladies and gentlemen.

Mr. President, I am sure you will find shortly that economists looking at the same data are capable of coming to strikingly different conclusions. The best I can do is give you the truth as I see it.

Americans are understandably concerned about the health of our economy. Some fear a recession, some depression,

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some bankruptcy, while all recognize and dread a persistent reduction in the purchasing power of their money. Proper analysis in the current state of the economy and prospects is the first step in designing policies to alleviate our economic difficulties.

First, are we now in a conventional recession? My answer is no, based on the evidence up to the present. The decline has been too brief, too shallow and too concentrated to qualify as a recession. Real GNP apparently declined in the first two quarters of this year but in my judgment there are real difficulties with interpreting the price numbers, as I will later elaborate.

Industrial production declined only 2.4 percent for three months last winter and has subsequently risen. Major industries such as steel, paper, oil, aluminum, machine tools, chemicals and others are operating at or near capacity. Orders and backlogs continue to build. Civilian employment rose slowly by nearly one percent from November last year to the present. Weakness did indeed develop in automobile sales and housing. Automobile sales declined from about a 10 million annual sales rate in August of last year to about 7.3 million in February of this year, and now are back to over nine million annual rate of sales. Also, there was a change in the mix from the larger to the smaller and now back to the larger automobiles. The cause of this decline, in my judgment, was clearly fear about gasoline availability and of course subsequently concern about higher price of gasoline.

Thus, this energy-induced auto decline was analagous, in my opinion, to a strike with a subsequent snap back, not a recession.

Housing starts, however, have been weak and are continuing weak at about a 1.3 million unit rate of starts. The cause, in my judgment, has been very high inflation, inducing very high rates of interest and subsequently outflows of savings from financial institutions, thereby reducing mortgage availability. There is no near term improvement in prospect, in my opinion, and a near crisis condition does indeed exist. Only less inflation and much lower short term rates will solve this problem. It appears unlikely even that massive government subsidies will improve the outlook in this industry in the immediate months ahead.

Despite housing weakness, aggregate final sales as reflected at the retail and manufacturing level have remained strong this year. So long as sales remain firm, sizable inventory liquidation is unlikely, although I agree with Mr. Greenspan that less accumulation is probable.

Furthermore, the recent monetary situation does not suggest to me that pervasive demand weakness will develop in the months immediately ahead. Policies work with a six to nine

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months lag on final spending. The policies in the first half of this year, in my judgment, will likely determine final demand for the rest of this year, and into 1975, though mid-year economic policies were in my judgment highly expansive. The money supply in the last three years and through June rose at a 7.4 percent annual rate. This compares with a 6.8 percent annual average rate of increase for the four years '69 through '73.

There has been little growth in the money supply since June. Fiscal policies also in my judgment were expansive. Government spending accelerated in the past three quarters at a 14 percent annual rate compared to essentially no change in several quarters preceding that.

Finally, leading indicators as I view them have been moderately strong in recent months implying firm aggregate demands for the remainder of this year and into 1975. If current and prospective conditions do not justify the recession label, surely depression is neither here nor in the near term offing. Depression occurred in the past only following massive monetary contractions. The example that is most vivid is from '29 to '32 when the money supply declined by a third. Our recent problem in my judgment has been too much money supply, not too low.

But the mere fact we have no recession and no depression does not mean we have no problems. In recent months inflation was in the 2-digit range, the most serious peacetime inflation in our lifetime. Not only has our inflation penalized those on fixed incomes but also it has in my judgment resulted in a collapse of stock and bond markets as interest rates soared to new highs. Inflation has made it increasingly difficult for American business to finance job creating capital expansions. It has created strains in the banking system by encouraging loans when other sources of finance disappear.

Inflation has sharply reduced availability of mortgage money for home buyers. It has encouraged strikes as workers attempt to recoup loss in purchasing power. Inflation has reduced confidence in our financial institutions as high interest rates combined with imposed interest ceilings encourage savings outflow and, finally, high inflation has eroded public confidence in Government's ability to manage our financial affairs prudently.

The cause of this inflation, in my opinion, was classic in its dimensions. The large increases in the money supply averaging nearly 7 percent a year for four and a half years, and large Federal spending increases resulting in a cumulative five-year deficit of over \$75 billion. But those loose financial policies explain an inflation of only, in my judgment, 6 to 7 percent, the approximate average for the past three years when these policies were pursued.

The recent 2-digit inflation was due not only to overexpansive monetary fiscal policies but also in my judgment some special factor. Most important was the elimination of price-wage controls, which released pent-up market pressures that developed in 1972 and 1973 as controls suppressed stimulus and created shortages. Also to a lesser extent shortages of food and energy raised the prices. I know that basic inflation yields only slowly to reduced monetary fiscal stimulus, probably requiring one and a half to two years of moderate power. Yet special factors I mentioned are likely to be less important in the immediate months ahead.

I believe over the next six to nine months inflation will decline from the current 10 to 12 percent range toward, but not reaching, the 6 to 7 percent hard core inflation rate.

Now, Murphy's law, an important rule in economics, says if anything can go wrong it will. We have had a lot of that on the price fronts in recent years. Indeed, we might get more but my judgment about some decline in the rate of inflation is based on the expectation that industrial material prices reflecting a worldwide slow-down will be coming down. They will renew the decline that was under way.

Also, the post-control burst in my judgment should be mostly behind us. Certainly oil will not triple in price again. I would even hope it will go down.

Mr. President, it is my judgment that our economy is neither in a depression or recession. I project slow real growth of one to two percent in the last half of this year and into early 1975, accompanied by continued high but gradually declining inflation. In such an environment unemployment is likely to rise moderately to perhaps five and three-quarters, maybe at the worst 6 percent. Short-term interest rates should decline slightly. Economic policies yet to be adopted by your Administration will influence trends in '75 and subsequent years.

If we are to reap the longer run benefits of less inflation, and I think they are enormous, we as a Nation must be prepared to accept the short run cost of less expansive Government policies.

THE PRESIDENT: Thank you very much, Mr. Sprinkel.

Now I would like to call upon Mr. Walter Hoadley of the Bank of America.

MR. HOADLEY: Thank you, Mr. Chairman, Members of Congress, ladies and gentlemen.

My particular view of the coming year is not substantially different from what you have all heard. We have in prospect a basically strong economy but, nonetheless, a flat economy with relatively little change, and in my view inflation continuing substantially at the present rate, hopefully

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a shade lower.

Some of us at breakfast this morning, Mr. President, were talking about this meeting and we obviously agreed on one thing, namely, that we should preach humility, because the forecasting business has not been an easy one in recent years.

Alan Greenspan introduced this morning a theme which I would like to develop a little further, if I may. That is the theme of confidence. In my judgment the most pressing problem confronting the American economy and a great deal of the world is lack of confidence in the future. This is not to minimize the economic problems but I am concerned that there are far too many people in this country who are seeing only more trouble ahead and certainly not judging our basic strengths.

Now, unless this is reversed, we can see a worrisome breaking down and weakening of the venturesome spirit in this country which is vital to our future. If that continues for some period of months, or a few years, then obviously there will be erosion in capital expenditures. There will be an aggravation of shortage and a compounding of unemployment, all of which in my judgment, I am sure we will all agree, is intolerable.

But the doom and gloom, as it is called, is much more profound outside the United States than it is within our own country. Those who have been to Western Europe or Asia, but particularly Western Europe, in recent days come back uniformly saying that there is a great lack of confidence and that, in my judgment, is one of the prevailing concerns which must be an overriding consideration as you conduct your summit with the Members of Congress later this month.

My feeling is that if that summit does what we all want it to do it will restore some confidence. What must not happen, as has been happening in so many meetings on inflation, Mr. President, in recent months is that people come away feeling worse, being more fearful and being therefore concerned about waiting and seeing for something to happen.

This is a time, obviously, for not just positive thinking but for positive action. Why is there this malaise? Why have we had this problem? I am not sure any one of us can answer this precisely. But we can at least judge that the problems, while they may not be new, they seem to be more difficult, they seem to be more difficult because they deal with qualitative considerations as well as quantitative. They also, Mr. President, seem not to respond to traditional remedies.

I think there is a warning here for all of us in the policy area not to rely on conventional wisdom of what has happened in the past in response to policy changes. We are getting differences. There are changes in attitude and these

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are very significant.

We in the Bank of America, for example, have been tracking now for some time changes in behavior. I can say to you this morning that the vast majority of Americans are fighting inflation with great vigor. They are spending prudently. They are continuing to save diligently. They are borrowing carefully and they are investing defensively. But time may well be running out because we can see on the edges the erosion. We can see the inflationary psychology beginning to change spending habits, changing savings, changing things which traditionally have been very constant, and in the forecasting profession we have counted on it.

We have a potentially dangerous erosion in that if the American people respond increasingly to an expectation of more and more inflation, then they are very likely to follow the pattern of spending, investing, borrowing which we have seen in other parts of the world.

In my judgment, the current inflation is the result not of any simple set of situations or causes, but basically is the reflection of years, perhaps even 40 years of a great emphasis, concerted policy approved by the voters of this country to increase effective demand at a risk of inflation. But inflation did not come to the forefront, it was subsumed by the very slack which motivated all of our policy.

For the last several decades almost uniformly we have had a sole objective, and rightly so, to put idle manpower and idle resources and idle capacity to work. We have come a long way. I will say at the moment not only in the United States but in most of the developed countries we have a situation which may not be full employment but it is close to it. The slack is essentially gone. We have enjoyed, if I may so put it, the luxury of a policy over the last several decades of having slack which has in a real sense kept prices from rising. But those days are over. Therefore, in my judgment we have an economy which is basically out of balance. We have a great, strong demand but we have taken for granted the supply side of the American economy. Now we must come back to a better balance. That is why I certainly would applaud any effort to demonstrate to the American people that the shortages are not contrived but they are real.

Our tracking, again, in the Bank of America, says that over the last six to eight years when you eliminate inflation, eliminate the environmental requirements and allow for obsolescence, we have not added enough in net real capacity to sustain what we have all taken for granted as the normal growth rate in America. We can reverse that and we will need, as Alan pointed out, all of that investment to get some little extra to give us a basis for growth which is so essential an ingredient. WE can debate how much growth we want but certainly we need some. Then the outlook is relatively flat and the malaise is here. What can we do about it is

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obviously the whole point of this.

I think first of all we have to recognize, as Alan Greenspan pointed out this morning, that we are dealing with more than economics, we are dealing with considerations of political leadership. We are dealing with considerations of social change, of technological change. But above all, we are dealing with a matter of confidence. Sure, my colleagues around this table will smile at someone in the economics profession talking about confidence because that has always been the econometric bogle buried somewhere. In my judgment it is now a force by itself.

I think, Mr. President, first of all we have to recognize that the American people not only are concerned but they want to do something as we sense it, they want to be a part of your solution, not have a solution in Washington, as important as that is, we have to somehow get to the American people a job where they feel they are a part of this process.

As a starter, and obviously no one is going to change confidence overnight, I would simply suggest that we talk about basics. WE don't like the word efficiency because, after all, efficiency experts in my earlier days were hated and detested people. Productivity is a bad word in America because it is associated with speed-up. We need a new word. I hope somebody can coin it. Maybe we need an old word, value. Let's use value, what we expect to get and what we expect to give. We are already an efficient Nation but not nearly as efficient as we can be.

My first suggestion is that we rely on the common sense of the American people and get them in the act and get them out of the bleachers where I think they have been for some time.

Secondly, there is a great deal of will to make the tough political decisions, but can't agree on the objective that we want to protect, the real purchasing power after taxes of the American people and that means some flexibility, some very tough and new thinking with respect to fiscal policy, and not merely monetary policy but recognition of the casualties that take place.

I am not talking about fine tuning in the old sense at all. I am simply talking about a mix of fiscal and monetary policy that is very sensitive to the subtle things of confidence.

Then I would say next, Mr. President, that it is extremely important that we try to recognize that we as a Nation must see that we can not feed or police or finance the health of the rest of the world. We have seen that, much as we might have been kidded into believing it. The fact is that the American people know we can't. We also have to bring this

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home: What do we want to do in America? We can't do everything. Can we get agreement on priorities? Because if we can't get agreement on priorities we are going to kid ourselves we can do everything and that to me is a very critical part of your process, of your summit: what do we want to do in America.

On this matter of confidence, I think you and all of us should ask ourselves what has to happen in America to restore our confidence, and then will it happen and can it happen, and then screen those items out. We have a lot of doom-and-gloomers in this country who are not even thinking through the consequences of that gloom and doom because if we have those consequences they are intolerable. We don't want them.

I would also suggest, Mr. President, in closing, that you might want to invite a few foreign distinguished observers into the summit because, as I have said earlier, the people overseas are in a much more doom and gloom mood than America. They very easily tell us that our problems, however horrendous they seem to us, look small to them. Therefore, we can see a strengthening dollar. We can see things from abroad easier than we can see ourselves.

Then perhaps after the summit there is a need for a national commission to go back to the drawing board and take a look. I would simply say that an international summit, because of the financial trauma, is vital to restoring confidence in the world and in the financial markets they must work.

The mood as we see it is a constructive one in America of healthy realism, looking for leadership. I am very pleased with what I see and hear in Washington.

Thank you.

THE PRESIDENT: Thank you very much, Mr. Hoadley.

Let me reiterate what I said in part in the opening statement. We are going to tailor our plans and programs in collaboration with our friends and others around the world. We are not independent in this global problem. We are interdependent with others. We hope coming from this will be policies that will reflect that global difficulty we face.

I fully agree that from this we must have not only positive thinking but I hope we get some unvarnished truths on the table. The American people can not have positive thinking nor positive action if they are not told the truth, and truth is what we want from those around the table, and truth is what we want from others who will participate in the subsequent pre-summit gatherings. I happen to believe that the American people, if told the truth, will generate that

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positive thinking and that positive action, and their actions I think are the most important plus the policies that we can generate likewise from these gatherings.

Thank you very much.

The next forecaster will be Mr. David Grove of IBM.

MR. GROVE: Thank you, Mr. President.

Mr. President, Members of Congress, ladies and gentlemen, my forecast is not much different from some of the others you have heard. It shows very little growth in real output throughout 1975. From the fourth quarter of this year to the fourth quarter of next year there will be a rate of growth of about \$8 billion. This comes to a little under one percent annual rate on a quarterly basis.

Personal consumption expenditures will show only a very modest growth because personal incomes will still be adversely affected by the effects of inflation. Personal consumption expenditures in real terms may be up \$12 billion from the fourth quarter of this year to the fourth quarter of next year.

I believe that the investment boom will come to an end very shortly and that business financed investment will remain flat throughout 1975 and perhaps even may be trending downward very modestly.

I think that we will see a sharp deterioration in corporate profits as we enter 1975. The difficulty of raising long term capital with the high interest rates, the flakiness of many of the reported profits, the slow rate of growth of the economy, all of these will lead, I believe, to cancellation of some orders presently on the books and cutbacks in some present expansion plans.

One thing we should remember from experience in previous periods of economic slow-downs is capital goods industries can put orders on their books very easily but they can disappear very easily, too.

There is a term that we use in the company with which I am associated. It is called water in the backlog. I think that we should look very carefully at some of the backlog statistics that we see made available.

Residential construction will remain basically flat during next year at a lower level than that prevailing in the first half of this year. I would expect that the rate of inventory accumulation would taper off in real terms. Net exports of goods and services will be down probably about \$4 billion from fourth quarter to fourth quarter in real terms.

I am assuming, and this is the assumption that

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enters into this forecast, that Federal Government purchases of goods and services in real terms will remain essentially flat during calendar 1975. In other words, they will stay more or less very close to the level that will prevail in the third and fourth quarters of this year.

State and local government spending, on the other hand, will rise during the year and probably be up about four and a quarter billion dollars.

So if one adds up the various sectors one can see there is very little likelihood of pronounced strength in any part of the economy. I think the danger is that the economy slides into a serious recession. However, that is not the most likely forecast.

Now, what are the implications of this for prices? I think that the consumer price index will enter single-digit territory in the first quarter of next year. Beryl Sprinkel has pointed out that some of the special factors that account for part of the inflation probably have had most of their effect. The rate of inflation will taper but only very slowly. I would expect that by the fourth quarter of next year the consumer price index will still be rising at a rate of about 7.5 percent.

Now where will the impetus for the continued pronounced rise in prices come from? I don't think it is going to come from excess demand. It does not look as if there is going to be any sector of the economy that will be characterized by excess demand. I think that what is happening is that we are entering a period of wage push as labor attempts to recapture some of the erosion in the purchasing power of their take-home pay. Unfortunately this is going to happen at a time when we can expect very little growth in productivity. The upward push of wage rates which presently is in the two-digit area may with some sort of luck and with some sort of leadership from the Administration and cooperation from labor, private hourly earnings may barely break into the single-digit material in the first half of next year -- I mean 9.5 to 9.9 percent -- and perhaps stay close to that in the third quarter and then perhaps ease to somewhere in the area of 8.5 to 8.25 in the fourth quarter. I think that is really about the best that we can hope for.

The real danger I think is that we get a wage explosion that feeds on itself and then the inflation figures will turn out much worse than those I have indicated.

Now, because there will be little growth in productivity unit labor costs will rise at about a 9 percent rate in the first half year but then will taper off and perhaps in the fourth quarter of the year will be down somewhere in the 7 percent annual rate of growth area.

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There is very little that monetary policy can do to push down the rise in unit labor cost. Monetary policy can have an effect on the rise in unit labor cost but only after slowing down the economy further. I think most of us here will agree that the economy is going to slow down enough as it is and that monetary policy has probably contributed all that it can and from this point on more of the burden of fighting inflation has to come and should come from the side of fiscal policy that the high level of interest rates prevailing is creating a number of stresses and strains.

Many of these expose us to the operation of what has been referred to as Murphy's law and I think many of us have a great deal of concern about continued reliance as much on monetary policy as we have recently. I believe it is up to other aspects of government policy to share more of the burden from this point on.

It is clear from my remarks that I am concerned about the possibility of government policy pushing us into a recession. I think that we should all remember that monetary and fiscal policy can create inflation but they can also create recessions and depressions.

You have pointed out and others have pointed out there is not any easy solution, there is not any miracle. I think what is important is that all segments of our society contribute to a solution of the problem which means that everyone has to understand that no one can increase his share of national income and no group can increase its share of national income to any considerable extent over the next year or two.

Another concern that is uppermost in my mind, and others have touched on it, is that in our fight against inflation we have to be concerned about some of the capacity and supply problems down the road. If we don't see that capital continues to move into those areas where there are shortages, even during a period of general slow-down, we will have a problem with having normal economic growth a couple years from now without running into a new bout of inflation.

I have read in the paper that within the Administration a list is being made of a variety of programs of all sorts that would make a contribution to improving the supply situation, removing bottlenecks, impediments to downward movement of prices. I think this is all to the good. This is a period in which I think the sort of leadership that I am sure you will provide can make a contribution to inflation. I think that the Council on Wage and Price Stability can help you in this endeavor.

Wage and price controls, quantitatively expressed guidelines, however, would not work in the present circumstances, in my opinion.

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Finally, I think that we need to recognize that the present inflation has a very unequal impact on various segments of the society. While inflation certainly has to be fought and fought vigorously, some efforts should be made through tax measures or other forms of relief to soften the blow on those who are most likely to be affected by rising rates of unemployment and weakness in the economy.

I will conclude merely by saying that the unemployment rate that I have in my forecast hovers close to 6 percent, around 6 percent, throughout 1975. I feel this rate is a little misleading. The reason it will not be considerably higher is that the participation rate will decline. With a sluggish economy many people who would look for work will not look for work. Therefore, they will not appear in the labor force or appear among the unemployed. We should not take too much comfort from the fact that the unemployment rate will not get above 6 percent.

THE PRESIDENT: Thank you very much, Mr. Grove.

I especially thank the four forecasters who have contributed to the dialogue.

At this point the schedule calls for a 15-minute coffee break. At the conclusion of that, Alan Greenspan will call the meeting to order and will proceed as the chairman for the next session. Unfortunately I can not join you in that segment but I will see you later in the day.

I thank you again, and I look forward to seeing you and listening to you later in the program that has been outlined. So why don't we relax and take a few minutes and get back together in 15 minutes, or about five minutes of eleven.

Thank you.

(Recess)

MR. GREENSPAN: Ladies and gentlemen, I would like to reconvene this meeting. We are running a little late but that is to be expected with any economist group.

I think we have structured our program in such a manner as to put in dummy variables in the time schedule to be absorbed, and I have full confidence that they will be.

I have an organizational structure I would like to outline.

First, we will go around the table with short three-minute statements from every participant in line with the letter that was sent out which I hope all of you received. We probably won't make it by 12:30 when we break for lunch, but as soon as that is completed Roy Ash will spend some time directly after lunch discussing the budget situation, and then from that time until about 4:30, which will be approximately two to two and a half hours, I think it will be useful merely to open up the whole meeting to a general discussion.

Having heard all the various individual notions, ideas, policies, prescriptions and the like, I think it would be quite useful just to have a general discussion. I realize this is not easy with this large a group but we do have a considerable amount of time and I trust that our group will try to speak not more than two or three at a time. I hope that we will find, not necessarily some area of agreement, that as we know is most unlikely, considering our known divergent views, but I think really what is far more important than the question of agreement is merely ideas, because many of us may not agree with what others are saying but the notions that we keep playing back amongst us I think does generate a significant amount of new thought, new directions, and we may seemingly believe that as this session ends that all we have heard is everyone disagreeing with everybody else.

What always happens is that we go away with some, at least, new questions, and when we try to answer them I think new vehicles for thought clearly emerge.

Now, at approximately 4:30 the President will return. There will be a bipartisan ad hoc committee of a group of you whom I have already discussed this with who will sit down and decide who shall be chosen to sort of summarize the long discussion, and we will probably pick a fairly large group of people trying to represent all the various areas and lines of thought so that when the President returns at 4:30 we can give him some general view of what went on.

I trust that our distinguished Senators and Representatives will participate because, as you know, sometimes we get caught in jargon which is obscure, at best -- I would hate to say that it is at worst -- and we will begin to get some general notions of what the major problems that confront

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us are.

We are planning at this point to terminate the meeting approximately at 5:20 or 5:30. There will be, as you probably are aware, a reception following that and I trust that all will be able to stay around.

To start our around the table summary, Tom, are you the first one from that side?

Tom Moore will start. I think we will just keep going sequentially. Why don't you each identify your affiliation as you go around for people who don't know you. Obviously all the economists know you.

MR. MOORE: I am Thomas Moore, shortly to be of the Hoover Institution, Stanford University.

I would like to talk a little bit about some micro-economic solution which I think maybe this group could agree on. There are a number of areas where we could improve the supply picture and reduce costs and prices. The Government is instrumental in a number of ways of holding up prices. In particular transportation regulations is one of the most significant areas.

Here in the area of freight regulation results in a considerable amount of inefficiency and higher costs and higher rates. A reduction in freight regulation, the ICC regulations of trucking, for example, might reduce rates twenty percent or more, and freight rates underlie the costs of all commodities.

Rail rates can also be expected to decline given a reduction in regulations.

In the passenger area the CAB helps foster higher rates by limiting competition among the airlines. Again, reduced regulations there would pay large benefits in lower passenger rates.

The Federal Maritime Commission also works to maintain rates there through the conference system. Again some reduction in regulations or some change in direction of regulations would improve the rate picture for imports.

There are a number of other areas besides regulations or besides transportation where the Government works to keep prices up.

Quotas, for example, on dairy imports keep cheese and other commodities up. The informal agreements on steel help to keep prices up. In the agricultural area the regulations dealing with the size of agricultural products that can be marketed keep prices up. Milk price supports are a notable

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example of an area where the Federal Government maintains prices and without the prices could decline, again helping us with the price picture.

In the financial area there are a number of regulations dealing with controls on interest rates, the interest rates that savings and loan associations can pay, for example. This has had quite a direct effect on drying up the funds available for savings and loan associations and consequently reducing the amount of money available for mortgages.

The housing industry, as was pointed out a number of times this morning, has really been seriously hurt recently. I know that personally since I am trying to sell my house. The mortgage situation is terrible and it is at least partly due to these regulations on interest rates.

I don't have time to go on. There are more such programs. I think it would be desirable for this conference to endorse some changes in this area.

Thank you.

MR. GREENSPAN: Beryl Sprinkel.

MR. SPRINKEL: It seems to me there are four areas that need attention: budget constraints, slow money growth, activity to slow money growth, and income supports. I will cease with that.

MR. GREENSPAN: That is the most remarkable statement by an economist in this century.

MR. MATAMOROS: I will not belabor the numbers lest we be linked to those ancient theologians who speculated about the number of angels who sit on the head of a pin.

I am A. G. Matamoros with Armstrong Cork Company.

I am impressed with observations about aggregates. We talk about the consumer. It is our experience there are consumer groups each with its own aspirations, desires and patterns of buying behavior. We notice within the consumer market that there are in effect two markets at this point in time.

There is the family with earnings in current dollars of under \$15,000 a year and the 1972 statistics indicate there are about 70 percent of all American families earning under \$15,000. They for all intents and purposes are out of the market for discretionary items the purchase of which is postponable. Then there is of course that other 30 percent that controls half the income.

We now hear about a remarkable tendency to maintain spending patterns.

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It is common to talk about the high end market. The high end market, the market of the most expensive products we make, remains untouched essentially by the malaise that we talked about affecting the consumer markets. We have in effect discontinued low end products because of the drying up of the demand for those low end products. Our putput is not demand constraint, rather, key raw material constraint.

A level of output at this point in time could be higher if we had the raw material. I don't mean to dwell on our own personal experience but it is a reflection in terms of the consumer research we do of the existence of the two markets.

There is indeed a division of market with respect to age. There is an old market and there is a young market. The old, old market, the retired people's market, obviously is really depressed by the disproportionate impact of the inflation on those people with fixed incomes. But there is a new and dynamic segment of the consumer market that really defies explanation. This is the young market, the market headed by people 23, 24, 25 years of age up until the early 30's, people who have had no adult experience even with the '57-'58 type recession, not to mention depression. Here we have two wage earners, two wage earners and a complete, almost, indifference to the impact of inflation, a minor complaint here and there about, you know, "I paid 59 cents for my gasoline, isn't that a shame. It was 58 cents last week." But in a sense this is a bulwark in the consumer market for the high end merchandise I talked about before.

We notice an imbalance in inventory. Shortages of key raw material, surpluses of other materials that seem to be prospectively in short supply and more aggressively purchased at the end of last year. Similarly, as far as merchandise at the retail level, we see a real concern on the part of retailers to maintain their inventories at low levels.

We maintain records of our wholesale inventories and they are actually in good shape. There are other areas of retail inventories that have been troublesome. The apparel sales of recent weeks suggest there may be some oversupply of apparel inventory. In the building markets there is a 2-tier effect of a builder's market. There is again the high income, a not so prone to borrow group that has the money to put on the line to buy the homes. And then of course there are the low income people who might be considered the mobile home market who are essentially out of the market because the mobile home purchaser, relying upon essentially intermediate term credit is competitively out of the market. He is way down on the priority list.

When a prime borrower paying 12 percent has the compensating balance, gives the bank a yield of 13 or 14

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percent, that borrower on an installment basis becomes less competitive.

As far as the builders of homes are concerned, the small builders are essentially out of business. I think of the fellow with a hammer in his back pocket and pencil behind his ear, he is in trouble. But even the large builders are paying three, four, five, six percent points above prime.

It will be difficult for the housing industry to come back quickly even if we have relaxation in rates next year. The large publicly financed builder will emerge from the housing cycle with a larger share of the market.

What I guess I will address myself to is a concept of a 2-tier market both on the supply side and demand side with respect to consumer, with respect to the builder and builder market, and with respect in effect to inventory imbalance.

Would you prefer, Alan, that we save the recommendations for solution until later on?

MR. GREENSPAN: I would hope you would discuss it now but why don't you hold it.

MS. NORMA PACE: Earlier we heard forecasts of spending behavior, what consumers will do, what businessmen will do, but I would like to get a little bit behind that and talk about pressures. I divide my pressure story into two categories, what I call physical pressure and what I call financial pressures.

Now, the physical pressures are strong. We need new capacity in many industries and certainly the paper industry, which I represent, needs it badly. We have a large flow of people entering the 25 to 35 age and this suggestion that the consumption requirements of this group will grow rapidly.

As Alan Greenspan said earlier, our inventories are pretty much in balance. We have a little excess here and some deficiencies there, but overall we don't face a major inventory contraction.

Now, what is constraining us really are the financial factors and this is reflected in the fact that money is tight and it is expensive. We have once again entered into a capital shortage, and our concern is that if this persists for too long these physical pressures I have been talking about can not make themselves felt.

So, I join those who believe that this is the time to begin a moderate easing in Federal Reserve policy and the sooner the better.

Now, when it comes to discussing inflation we have

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built in inflation in our system over a long period of time. We did not recognize it because it appears in different facets. Right now we seem to have four combined at once and that is why it has become such an obvious force.

We have first a little bit of what we call demand-pull inflation. We know we have a concurrent worldwide demand, we have had shortages and the recent drought is an indication of how shortages can affect food prices because farm prices escalated right after that drought. Now the obvious way to cure this type of inflation is to apply monetary and physical restraint and to keep your demand relatively quiet for awhile but there is also something else that is needed. You need incentive to increase the supply.

So, it is a double-whammy program that we need to cure this type of inflation and it is only part of our inflation. The second part of our inflation is what I call negotiated inflation, and that occurs when labor gets wage increases in excess of the factor we call productivity or output per man hour. This part is beginning to escalate and is causing the concern for 1975 in particular and the way we handle this involves of course part of the Cost of Living Council's activity in jawboning, but I think we have to come to grips in a far more decisive fashion on this part of our inflation.

There is a third part I call legislated inflation. We do this to ourselves in the name of justice and good citizenship but in the end what we do is legislate a lot of cost for which there is no offset in productivity. The only thing that can happen with these costs is that they are passed on to the consumer. One thing we should do from here on in is to measure the cost of this new legislation to show and indicate to the public what it will cost to have this legislation in effect and then let the public tell us whether it is willing to pay this price. If it is willing to pay the price it should not be squawking about inflation. So this gets back to the matter Mr. ~~Moadley~~ talked about and that is establishing priorities.

Part of the establishing of priorities requires that we understand the cost of this new legislation. The fourth is imported inflation. Sometimes we export our inflation and sometimes we import the inflation of other countries. Obviously the Arab oil prices quadrupling has had an effect on our inflation.

Now, this one is pretty difficult to overcome but what has been suggested is that we ~~wepput~~ put our own house in order, that we show that we can eliminate most of thier inflation, and in that way perhaps set the pattern for other countries. I think we need an all-out campaign to increase productivity. We have to get union commitment and union involvement. If necessary, we may eve have to design intent in order to increase productivity. But this is an area where we had a

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commission set up but nothing has been done. I think we need more forceful action on that.

Very slowly I think we ought to begin establishing some incentives for investment. I incline toward favoring increased depreciation because I think that the cost of replacing new equipment is rising so rapidly. I certainly will do that with several safeguards, that is, I would not topple the budget balance and I would do it with safeguards that indicate that this money actually will be spent where it is needed.

Finally, I would just like to say as far as I am concerned the cost of living index consists of two pieces: The first is the free market cost, the cost of operating. The second is the part we build in which I call the citizenship cost. That is reflected in taxes and all of these legislated increases that we put in. It would be nice if we could get a measure of what the contribution of each of these is so that the public, itself, can be involved in what is being legislated for it.

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MR. NATHAN: I am Robert Nathan, head of the consulting firm bearing my name here in Washington. Let me be rather dogmatic to get a few thoughts across quickly.

First, I just happened to return myself on Monday from two weeks in Europe and caught a lot of this doom and the week before I returned, I went to Korea and I got a little of it in the Pacific. I think it is silly of us, frankly, to feel that these people abroad are just nervous nellys because they really are worried about the United States and a little change here has a big impact there. We ought to recall that, and we live in an intermedial world and what we do is of major importance in all parts of the world. I think there is a very real concern that we are not just importers of inflation but I think we are contributors to it.

Let me say, secondly, about the most important thing I guess we all agree on here is the fact that the inflation is serious. I certainly agree with that. I think the real question that we have is not whether the economic outlook is going to be rather stagnant over the next year, which seems to be pretty much the forecast, I don't know of anybody who came out with a very optimistic projection over the next year and a half -- but the real question is how do we settle the inflation problem and on this score, Alan, I must say I am considerably depressed and unhappy about the discussion up to now because I have grave doubts whether we have coped with it in a very hard way.

I think there is a very real gamble as to whether overall aggregate restraints on demand are going to do the job. Will those restraints bring about abatement of inflation with a tenable cost and within a reasonable enough time that we can accept it?

This, I believe, is where the major problem arises.

Now, we have talked a little bit about the monetary fiscal mix and I think there is something to be said about somewhat more constraint on the fiscal side in order to ease up somewhat on the monetary side, so you don't get quite the degree of interest rates you have. But the basic question I have in my own mind is whether or not this overall blanket restraint approach is going to do the job. I have very great doubts about it for a number of reasons.

First of all, I think we are assuming that we have a very necessary responsive free market. All I suggest is why don't we take a look at the automobile industry and see what has happened to automobile prices in a very depressed industry and then sort of answer ourselves, do we have confidence that if we suppress demand in moderate degrees that price increases will slow down significantly.

As far as that point is concerned, I have some very grave doubts. I think, myself, that six percent unemployment is going to do very little to abate the inflation. I think eight or ten percent unemployment for a couple of years would have a real impact.

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I am not sure who it is that is willing to pay that kind of price which over a couple of years might mean a \$200 billion or \$300 billion drop or loss in real GNP and deficits that would make past deficits look quite insignificant in terms of what we might encounter.

I, myself, am of the opinion, and I regret to come to this conclusion, I think we are going to have direct intervention. I don't believe that the overall approach is going to work.

Now this does raise questions of what do we mean by direct intervention. This may raise issues, and I like what Mr. Moore said because I think there are a lot of areas where we can do a devil of a lot to begin to curtail. There are a lot of areas in our economy where you have a lot of obstacles to free market functioning. The trouble is whenever we have inflation, we say that isn't the time to go break those obstacles and when we have a boom isn't that a time? When you have a depression, that isn't the time. You never want to do anything about intervening in connection with these obstacles to real productivity and improvement in competition.

I think we ought to go after monopolies and constraints of trade very, very vigorously. I think now is not the time to go for more conglomerates and larger scale and smaller number of units as has been expressed at times. I think we do need more selectivity in taxes and incentives and more selectivity in the credit area and I think we will have to have public service jobs in order to have some social conception of trying to abate the impact where the harms are the greatest.

Fundamentally, I do believe unless we do something in these kinds of selective areas, and that includes wage and price controls which I don't like on a continuing basis but which we may need to break this spiral, because what we are faced with now is not excess aggregate demand -- and we haven't had excess aggregate demand for quite a time -- what we have is a built-in vision, kind of a spiral of cost/push, cost/price, and just which one pushes the other is always hard to tell. I think it is the nature of this spiral that without some direct intervention, I don't think we are going to break the inflation spiral.

Let me end up with one final word and that is I would like to recall to everybody that we still have on the books the Employment Act of 1946. That Employment Act is legislated and that Employment Act is the law of the land and that Employment Act pushes upon the Government the responsibility to take positive responsible measures to try to solve these problems, including inflation.

I don't think that batting down the hatches and sort of crawling into our caves and saying somehow the storm is going to abate soon is going to work. I think that is why this move here, and the President in getting the group together and all of these people, in my judgment, is compatible with the Employment Act and really offers a hope that something constructive and positive will be done.



MR. GREENSPAN: Art Okun, who is affiliated with Brookings and many others.

MR. OKUN: Of the four forecasts we have heard, I think I can affiliate myself with Otto Eckstein's verdict that recession, yes, and depression, emphatically no. And, putting the depression in perspective, this is a kind of post-war recession that we have suffered through and survived on five previous occasions.

I would expect unemployment to grow rather sharply. I think, particularly, that is true in the light of a growing business recognition that the slump is here to stay for a while. I think in the early part of this year there was a feeling on the part of many, including the business community, that we were merely suffering a little, few month's period of energy crisis and that is not the environment in which business will stop hiring and certainly not one in which they will start laying off workers.

I think now the pressure on profits is greater, the recognition of a longer slump; we will see a sharper decline in employment and sharper rises in unemployment.

But, of the four forecasts, I don't really see a qualitative difference. The range ran from a very sub-par up to a very modest turn downward in a sagging but nonetheless flat economy. On none of these forecasts could I see a valid case for weakening the economy further by added doses of budgetary or monetary incentives, or for appeals for lower consumer spending. I think that job has been done.

Fiscal and monetary ease in '72 and '73 has been a contributory cause to the present inflation. But, that is only one contributor. Whenever I can agree with my friend Beryl Sprinkel I am happy to do so and he gave us some figures that suggests judgment. Less than half of the step-up in the inflation rate that we experienced from about three percent at the end of 1972 to 11 or 12 percent today, can be attributed to excessive fiscal and monetary stimulus.

I would fully agree. I think it is substantially less than half. I think the shift of the fiscal/monetary restraint has to be part of the cure but it can't be the whole cure, as Bob Nathan emphasized. So far it has been the main cure and I think we have to look for other cures. I think the major causal aspects in food and fuel costs have some cures that have to be applied to them and in this opening statement, I am not going to try to unveil any programs or policy panaceas of any sort but I do hope we will get back into the question of whether we do have some options for insuring adequate supplies of food for the U.S. consumer in the year ahead.

Indeed, if there is one threat that I see that would upset the uniform opinion of all of our forecasters that we will see some improvement in the inflation rate over the year ahead, that threat would lie in an unacceleration of a big jump of food prices in 1975.

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A lot of the confidence that the worst of inflation is behind us is predicated on the view that most of the energy price explosion is behind us, and I believe that is the case, but I would like to see if we can take some insurance to guarantee that that is the case and that we don't have further problems on that front.

I hope we will get into a number of other issues involving the appropriate ways in which the government can encourage price restraints and price competition by business, how it can convince the American worker that he is not going to suffer through another year of declining real wages, for I think any steps that give him confidence on that will help to achieve wage moderation.

Finally, as I see it, in an economy which really is plagued by cost inflation and no longer has serious problems of demand inflation, one can look toward some policy initiatives that would be bad medicine for demand inflation but could be good medicine for cost inflation.

I think we should be talking about the possibility of doing some cost-cutting through tax-cutting, working on excise taxes or payroll taxes, and I hope that these novel possibilities and others that other people may raise will come into our discussion of particulars this afternoon.

What I want to stress, as Bob Nathan so well put it, was that we do have to look for cures on many fronts, of which fiscal monetary restraint is one part of the cure, but certainly not the whole cure.

MR. GREENSPAN: I don't know whether I mentioned this, but we are having the September 23 meeting so that many of the issues which you are raising will probably spill over into more discussion at that time.

Next, Marina Whitman, University of Pittsburgh.

MS. WHITMAN: I think there are really four points I would like to mention, and in a way I am afraid perhaps they are more directed toward economists than toward policy-makers immediately because I don't see any instant miracle solutions on the policy front. But I think these points do have policy implications.

One, and this point has been made before, but I think it can be made again, we need very badly to focus more than we have in the past on the supply side. Postwar politics has been dominated by these considerations, and clearly now we need the supply focus which includes a strong focus on productivity, and includes a strong focus on the kind of macro-economic issues that Tom Moore was talking about, bearing in mind that I think is going to be politically much more difficult.

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The nice thing about broad-gauge monetary and fiscal policy is that, with some exceptions, one is not sure whose ox is going to be gored and, even when the ox gets gored, you can say that is the breaks of the game.

When you start focussing on micro-policies, you know precisely whose ox is going to be gored, and they know it, too, and it is much messier and more difficult business, but I think there is no way, if we are going to confront the inflation program, to avoid that.

A second point is I think that we are really on the brink, and we have to be terribly careful to try to avoid developing or at least exacerbating an allout fight in this country over the distribution of income. It is something that has happened in almost every other major industrialized country. We have to a very large extent avoided it here. If we don't find some ways of continuing to avoid it or of heading off what I think may be beginning, I think we are going to be in the same kind of sort of permanent inflationary process that this kind of squabble inevitably generates.

I think the reason we are on the brink is because there is a great deal of confusion, a great deal of lack of understanding, and a great deal of disappointment regarding how big the pie actually is, and who has gotten what share in the past.

If you look at actually what happened over the past year or two, it turns out that the increase in national income, in gross national product really went two places. One, there was a shift in the terms of trade between the farm sector and the urban sector; the farmers, of course, had been lagging for a long time, and there was some shift in their favor.

The other thing, of course, is that we had enormous sudden improvement in our trade balance. I think some 40 percent of the real increase in real GNP between the end of '72 and '73 went into that improvement in our trade balance. Obviously that is not a loss, that is capital formation, and that means we are increasing our claims on foreigners. But I am not sure whether this capital formation was all desired, and to the extent it may have been undesired, it is still likely to have been inflationary.

I think we have got to confront, and economists have avoided confronting directly and policymakers also like to avoid confronting directly, the problem of income distribution, of somehow building a mechanism whereby we can insure that people do get what is regarded as their fair share, where labor is permitted to catch up and where that catch-up does not turn into a permanent increase in the wage-price spiral.

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This problem again means more selective policies, policies directed to alleviate severe difficulties in certain particular sectors of the economy, but I think if we let it drift and simply let nature take its course, we could easily fall into the kind of distributional difficulties that one sees in countries like Great Britain and Italy, and if that happens, the fight on inflation becomes an impossible one.

The third point is I think it is terribly important right now to shore up our international trade and payments structure. This is a structure which has worked very well, quite surprisingly well, for a long time. It weathered the shocks of 1971 and subsequently, but I think there now is a serious danger of fragmentation. This is tied into the kind of gloom and doom of loss of confidence which many people have talked about, which particularly prevails in western Europe, and I think that probably the most fragile point, the point of greatest strain in our system right now is the financial structure which is basically sound but is taking a lot of strain, and I think the greatest strains there are in the international aspects of the financial structure.

I think that there needs to be a joint search, whether through an international summit or some other mechanism, there needs to be a joint search for solutions or for ways of avoiding a real danger of fragmentation.

I think there is one thing that has become clear, it is that we not only live in an interdependent world, and I think we need badly to try to get some knowledge of the international transmission of disturbances, in this case inflation, and also of recession, but not only is the world interdependent, but it has become two ways. It is not simply true that when the United States sneezes, Europe gets pneumonia. It is also true when Europe begins to have trouble, the United States also will feel it.

We cannot afford to isolate ourselves even by the most narrow economic calculus. I think this international area is a very fragile one and might need immediate attention.

MR. GREENSPAN: Thank you.

George Shultz, do things look different from the other side?

MR. SHULTZ: Well, the economy is in terrible shape, and I wish you guys in government would do something about it. I am sick of this business. (Laughter.)

It seemed to me that the forecasts that we heard were not all that different from one another; you could throw your hat over all of them.

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The more interesting thing to me is not the sort of general prediction of a flat or slightly rising real GNP, high or slightly declining rates of inflation, but rather to compare what forecasters have been saying over the last five or six months as I have listened to similar roundups.

It seems to me what has happened is not so much a change in the forecasts, but a change in people's ideas about where the risks are. We continue to identify the major risk as the risk of inflation, but at the same time I think there has been a growing sense of a risk on the unemployment and recession side.

Therefore, it seems to me, in terms of policy, that we need to certainly have a disciplined policy and regard inflation as number one problem, but not the only problem. I think we should be sure that there is a sense of balance in the policies.

Second, as many have said, I agree that we have a difficult problem that will take patience and somehow or other we have to get around the notion of having some policies put in place and then three months later when we still have inflation having a big buildup of feeling of what are you going to do because the policies haven't worked. They can't work that fast. There has to be, I think, in a very general way more patience.

I agree also with the comment that has been made by many that the problem we have comes from many sources and that we have, to a much greater degree than we have had before and certainly than we have realized before, a really tightly interrelated situation, including our relationship with international development. Therefore, it seems to me that a set of policies have to be multi-dimensional to deal with these problems.

Having said that, let me just touch the various elements of policy at least as I would propose them to you at the present time.

First of all, on the budget it seems to me the word has to be discipline, and discipline, and discipline, not simply because we have the extraordinary inflation problem that we have, but because, with it or without it, the budget is sort of a thing that is always veering on getting out of control, and anything you add this year you add forever, so that it is a constant battle, it seems to me, to keep control of the budget. I believe that strong discipline is in order, and I welcome very much the recent act of Congress that I think gives the Congress a better way to get at that problem. That I think is something that we can take some heart from.

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I don't think that we get anywhere with budget discipline by proposing things that at least I would regard as ridiculous. I saw a list the other day in the paper that included cutting unemployment insurance. I think any list that includes that discredits itself. What we need, the unemployment insurance system is a good system, and in times when unemployment rises, outlays rise, it has the great virtue that when unemployment falls, outlays fall drastically. So that is the system and we should not try to cut something out of it, but I believe improve it.

There are, I think, good proposals for improving the benefit levels of unemployment compensation and extending the durations where appropriate that have been languishing, I believe, Congressman Conable, before your committee, and I am mystified why Congress doesn't act on them, but I think that that is something that ought to get attention.

Second, in the area of monetary policy, again discipline is obviously called for, given the inflation problem. Here it seems to me that we are approaching, if we are not at a point, where there should be some easing of monetary policy. I say that in part because it seems to me if the downside risk really materializes, then we will have a much more substantial easing. At this point there can be a gradual move, and it seems to me that is more likely to give us what we want in a longer term sense.

Third, in the area of policies with respect to particular areas of the economy, I would have to confess I am a little distressed by the emphasis that seems to have emerged from the Committee on Wage and Price Stability because the emphasis is almost exclusively on the idea of monitoring labor and management.

I think it is worth noting that in the outlining of causes here, very few people have mentioned irresponsible behavior by labor and management. That really hasn't been the problem, I don't think. To put the President or his advisers in the position of preaching to labor that they should have a wage increase equivalent to the long-term productivity increase when the cost of living is going up 11 or 12 percent, they just think you are living in a different world than they are.

Furthermore, constant emphasis on that adds to the possible-controls bulge, a kind of anticipation bulge. And the more people in government, and the more people in the Congress talk about monitoring wages and prices or controls or what-not, the more the private sector feels that they just have to, as a matter of self-protection, put their prices up. A tight labor market puts up their wages. So it is very counter-productive.

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But I think there is a very important monitoring role to be performed by this committee or some committee, and that is the monitoring of government, along the lines that was suggested by Mr. Moore and by everybody, and it is probably one of the things that economists could all agree on, that there are all of these particular things in the situation that could be improved, and I think there is a real monitoring job to be done here. You don't have to dig away back to the old chestnuts to find things.

I will give three examples that are reasonably current.

When meat prices were going up, the industry involved felt that there shouldn't be any controls and the free market would take care of the problem, let supply and demand work. That was done. And prices went up, and there was a reaction and considerable reaction from consumers, and prices came down. As soon as that happened, really it shows how fast the Congress can act when it wants to, the Congress passed a \$2 billion bail-out bill for the industry.

Another example, I gather before the Senate today is a bill that passed the House, to require that 30 percent of the imports of oil which are increasing in quantity as we all know, be transported in American bottoms. Well, you don't have to dig away back to find something to do that will help on the inflation problem. If that bill passes and it is signed, we will add to the price of oil some substantial amount. So there it is.

Or, and I will look at my friend John Rhodes, to take another example: Why don't we let as many Valencia oranges be shipped as there are produced? Or, to put it another way, vigilance by some committee over the marketing orders of the Agriculture Department can do a lot to keep prices down. But I know this is in the category of President Ford said that no economist would aspire to be President, and certainly no economist could ever get elected President because these are the sorts of things that people talk about.

Fourth, in the area of the international deal, I think passage of the trade bill is very important, partly for its substantive content and partly because doing that helps us maintain our posture as part of a cooperative world trading system and, if we don't do that and the negotiations that have gotten underway fail and just fall apart, I think that will be a very bad thing, not only for ourselves, but for the world as a whole.

Beyond that, there is some interesting little-noted features in that bill. There is, for example, the ability of the President under that bill to suspend tariffs or quotas in the case of commodities which are in very short supply and have rising prices and so forth.

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In other words, there is some discretion to use our international trade policies in a way that will help the inflation problem.

Further in the international area the dollar seems to be getting stronger. In times past we have wanted to see the dollar become weaker in order for our trading position to improve. But it seems to me right now to the extent that we have the ability to influence this, and I think we do have a considerable ability as a matter of government policy, we are well off to let the dollar continue to strengthen if that is what it wants to do, and I believe that it will. At least it can come back to the Smithsonian levels

Finally it seems to me important as we work on short-term problems to have an eye on longer term matters and address them.

The energy problem is very much with us, and it is so easy to forget it when there aren't lines, but it seems to me we are in a bad position from a military standpoint and an economic standpoint to have such large imports of oil from so far away as seem to be coming, and the notion of developing our own capacity, I think, is very important, and we seem to be dropping it, and we are not dropping it, but it doesn't have the force behind it that people talked about before, and there are many illustrations of that.

I share the views that some expressed about work in the income-maintenance area as part of this problem and also work in the tax area, and I think there are some very interesting big ideas in the tax field that deserve exploration, and I think there are also some important do-able things in the area of tax simplification and tax reform that are worth doing and are do-able.

MR. GREENSPAN: Thank you, George.

Carl Madden, U. S. Chamber of Commerce.

MR. MADDEN: I would like to talk first about short-term matters, and I agree with those who believe that, first, the time is at hand for some slight easing of monetary policy in its relationship to interest rates, but the Chamber of Commerce supports the view with respect to a monetary policy rule that thereafter monetary policy should avoid extremes and move toward a gradual reduction in the rate of growth of the money supply until a sustainable monetary growth path has been achieved in order to avoid excessive unemployment and also to reduce interest rates.

With respect to fiscal policy, I agree that the new congressional Budgetary Reform Act offers great prospect for exercising more responsibility as well as discipline in the spending process. It certainly should be monitored and perhaps ways can be devised for that to occur. For example, we have an Office of Technology Assessment in the Congress today which

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is supposed to assess the secondary and tertiary effect of new technology. Why could we not also have a similar procedure to assess the secondary and tertiary effects on the economic and social system of major governmental programs in advance of their passage with a requirement that future costs and future year benefits be forecast as a part of the legislation?

Furthermore, it seems to us in the Chamber that we do not now have a fiscal policy rule in the same sense as we have a monetary policy rule. Therefore, it seems to us the first step for fiscal policy is to formulate corresponding fiscal policy goals and such a goal might start to be formulated from a proposition such as this.

A rule for a growing economy could be to hold increases in federal spending to no more than the increase in federal tax revenues. Such a rule would leave room for budgetary surpluses appropriate to economic conditions, and it would prevent the big bulges in federal spending and the attendant monetary over-expansion that a stop-go approach to monetary and fiscal policy has in the past contributed so often to boom-bust economic behavior.

Now, for long-term matters, many economists, notably Otto Eckstein, have pointed out the tremendous opportunities for economic growth in the near-term future. I believe Dr. Eckstein shows that if we attempt to achieve three objectives, energy independence which does not of course mean an absence of imports, but controlled imports, imports that are controllable and handleable, plus an adaptation of our capital plant to the environmental standards which the American people seem to want, plus the investment in that capital plant of modernization and expansion which others here have indicated is needed, then the proportion of investment to output will have to rise from its historical 10 percent to somewhere around 12 percent by the early 1980s.

This, therefore, gives a basis for the argument of concentrating on supply factors, competitive factors, and other such factors. In this regard the Chamber of Commerce has developed in a meeting of its executive committee last Friday a package, if you will, policies aimed at all of these matters. However, I should mention before describing those policies briefly that the Chamber also acknowledges and recognizes the importance of cushioning the impact of short-term anti-inflation policies.

It favors, therefore, a well designed public service employment program and an extension of unemployment compensation benefits for 13 additional weeks when the unemployment rate exceeds 5 and 1/2 percent, and it strongly favors providing more job opportunities for young people who make up a large portion of the normally unemployed by reducing or eliminating the minimum wage as applied to these teenagers and thus giving them the opportunity to learn the ways of the labor force.

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But with respect to these long-run matters now, one general heading is increasing our supply capacity and removing bottlenecks. We favor in this regard reforming the capital recovery system which in our country lags behind that of most industrial countries, achieving a better balance between environmental and safety objectives on the one hand and economic growth on the other, by recognizing the very rapid rise of costs for attaining the last few percentages of clean air or clean water, or the like, so that there is no abandonment of environmental objectives but more reasonable approach to their attainment in balance with economic growth, increasing the efficiency of the building industry by carrying out the mandate of the National Institute of Building Sciences, favoring uniform state building codes, improving the nation's rail transportation network by supporting the guaranteed loans, and by expediting reorganization of the northeast rail lines.

With respect to the productivity of the labor force, the Chamber favors improving opportunities for people to obtain better education and training in many ways which are already on the books, but in particular by emphasizing nationwide adoption of career education in schools and full implementation of existing work-study and cooperative education programs.

Second, the Chamber favors maintaining better health programs for the improvement of productivity in the country through support of a comprehensive national health care program along the lines of the National Health Standards Act.

Third, it favors helping the work force in maximizing its output by supporting legislation to outlaw restrictive work practices, such as in building codes, labor-management contracts, and the like, for the reinvigorating of the productivity council, and local branches which publicize and encourage the partners in the productivity process to achieve productivity gains.

We favor stimulating marketing competition by methods which have been described by others here, including appointing a Presidential blue ribbon committee to study all aspects of deregulation, but we do not favor mandatory wage and price controls nor specific guidelines in the wage-price process for the reasons that George Shultz just mentioned.

We do, however, favor self-restraint by business in its pricing policies and by labor in its wage demands, despite our strong opposition to mandatory measures.

We favor increasing government efficiency and economy by adopting some of the reorganization plans which would arrange for the federal government to be organized by a functional principle rather than the constituent principle which has caused, we think, inefficiency in the past.

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We favor improving the government's statistical information system by studying action to enhance its credibility and improve its accuracy. We favor reducing paperwork burdens on business which are imposed today at great costs.

Finally, we think a major portion of policy should be directed to breaking worldwide supply bottlenecks, by encouraging cooperative action both in governmental and private to deal with worldwide shortages, by encouraging an improved understanding of the positive role of multinational corporations as important instruments for increasing the availability of basic resources throughout the world, and finally, increasing the nation's energy independence and holding down energy costs by supporting increased research and development to find new energy sources, supporting active and public and private campaigns to conserve energy, supporting deep water port legislation and the deregulation of gas pricing at the well head.

MR. GREENSPAN: Thanks, Carl.

Everyone told me, when I said everyone can speak for three minutes, they all laughed at me, and I now understand why.

I appreciate we will have a chance to come back, and try to constrain, if possible, and I can only say that to Paul.

Paul McCracken, of the University of Michigan.

MR. McCracken: I was hoping you would change that rule to my left and not to my right.

Let me make quickly about three or four points here, and they would generally implement those which have come out here, that a program to deal with this problem inherently has to be a multi-dimensional program, and it has to be one of many elements. The problem is that type.

I would want to emphasize here something which particularly George just emphasized, namely, that is essential to any program of dis-inflation that central to it has to be monetary and fiscal discipline. As I read the record, I don't see any possibility of countering an inflation unless that discipline is central to the strategy, and moreover, if it is pursued, it will ultimately have an impact on the price level.

Having said that, I also want to say that I associate myself with those who believe that the time has come for taking some of the pressure off monetary policy. I would favor that for three reasons. One is that when you look at what has happened to the real money supply, we have already put an enormous amount of pressure on the economy.

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In the second place there is a good deal of tangible evidence that we have got serious financial strains in the economy and we look at liabilities of businesses in trouble, and the incidents of consumer credit delinquency are very high now.

Third, there does come a time in the dis-inflationary process when, even in the interests of stabilizing the price-cost level, you want to get more rapid expansion. Because it is during that phase that you get extremely strong gains in productivity, and since you are apt to be in what happens to be the cost-push phase, it is desirable to get these strong gains in order to minimize the impact on labor cost per unit of development.

Having said that, I want to touch on two or three other points very quickly.

A well-rounded strategy of inflation must have specific programs to deal with the casualties and the victims of inflation and of the dis-inflationary program. We certainly need to strengthen our income-maintenance systems. I would go for a systematic income-maintenance program, strengthening the unemployment compensation program, the utilities industries are in trouble. You are going to see very sharp cutbacks there in their capital expenditure program which carries with it unfortunate implications for down the way a couple of years.

I think the Administration might put some pressure on the Federal Reserve to put more force on the mortgage financing if it is more profitable to sell the short-term funds. Housing is going to be a long while, and we can't go out of business with this kind of an important industry.

The next point I would want to emphasize is that cutting across or interlaced with your conventional problem of dis-inflation is the importance of dealing with more basic structural problems.

I like this idea of having the cost of the new committee on wages and prices, or whatever it is, do a little monitoring of government programs as well as wages and prices. I think that is good.

We do need to come back again with an open mind on public service employment programs or something like that at least to deal with the long-term hard-core unemployment problem. The people whose problems would be apt to remain even if we had reached some sort of full employment. That is close to one million people.

Tom Moore and others have mentioned a lot of the cost-pricing sacred cows in government. We need to move there.

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The most fundamental point that I make here, however, is that this economy is short of capital formation. The stock of capital of this economy is in short supply relative to the labor force. We have seen some circumstantial evidence here that we, at fairly high levels of employment, seem to run out of capacity in our economy, and here is the basic reason for not easing up on fiscal policy. I would ease up on monetary policy but not fiscal policy because we need, through the budget, to continue to try to do what we can to relieve the pressure on the capital markets.

Beyond that, I would like to see the new Joint Committee on Budget take a large view of its responsibilities and look not only at the budget in the more conventional sense but monitor the claims on economic resources that are involved in some of the legislative and government programs that don't show up as such in the budget, but nonetheless cover government preemption of these resources.

Maybe a chapter, Alan, in the economic report this next time around would be a useful thing to do on that.

The next point is, I think, the Administration has a remarkable opportunity and probably a responsibility to take the lead immediately in the international economic area. I agree that we can't just write off the foreigners as nervous nellys. There are major problems. By and large, the climate is appropriate in the sense that only a few months ago many of the countries had extremely weak and uncertain governments. Some of them still do. But, in most of the key countries, or many of them, now that situation has improved.

I will emphasize only one thing beyond what has already been said, that this international economic cooperation ought to be concerned with domestic economic policy as well as the more conventional thing, trade policy and the international financial system.

Now, the final point that I would want to emphasize is that with all of the problems, and they are difficult, I think we need to avoid a kind of tidal wave of pessemism. We can handle these problems if we will define a balanced, multi-dimensional, coordinated program and, hopefully, this meeting can move that forward.

MR. GREENSPAN: Thanks, Paul.

Hendrike Houthakker, would you proceed.

MR. HOUTHAKKER: I would like to talk about structural improvement, not that I think fiscal and monetary policy is not important, but I don't have anything new to contribute to that particular subject.

By structural improvement I mean improvements in our economic system that will make our economy more efficient and less vulnerable to inflation in the future. A number of rigidities have been built into our economy, mostly by obsolete laws and they seriously impair the effectiveness of other anti-inflationary policies. Several people have mentioned some of these already in the areas of transportation, agriculture, energy, banking, government operations and others.

There are a number of things that have accumulated over the years all of which tend to give particular industries special status. These legislative measures enjoy considerable support. In many cases they are supported by campaign contributions. We know that the dairy industry and the truckers and several other groups spend large amounts of money furthering what they see as their particular interests. And I believe there has been a tendency to be too responsive to these pressures. Campaign financing reform would be part of the answer there but there has to be more attention to removing these particular factors which in the aggregate are quite poor. They are often unjustified by the fact that many of them individually won't make that much difference.

If, for instance, we got rid of marketing orders in agriculture, this would have some small effect on the Cost of Living Index. It might even be a sizeable effect. But the congressional and other considerations of such measures has often concentrated more on the effect on particular industries rather than the economy as a whole.

This leaves me to think that we have to take all of these things at the same time and not rely on piecemeal approaches. I must say I am a veteran of some battles to oppose the opening of particular markets and I know how hard it is to get anything even going beyond the subcommittee because the subcommittees do take a proprietary view of the particular measures, the same as departments in the Executive Branch. This leads me to think that they want to improve competition. We do have to think in terms of a more comprehensive approach and in particular, of an omnibus bill to improve the openings of particular markets.

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I have given some thought to what would be in such a bill, and I have come up with about 45 different areas where Congress and the Executive Branch together have made our economy more rigid than it needs to be and as a result introduced inefficiencies and have introduced circumstances where anti-inflationary policies are wholly or partially ineffective.

I believe that a bill to remove most of these things at the same time does have a better chance than a piece-meal approach which is likely to run into the same obstacles that they have run into before. I will be glad in the future to amplify this, but many of these items have been mentioned.

The number 45 is significant. There are some smaller, some bigger, and in the aggregate they will have two effects if they are removed. One is an immediate effect on the price level which would be sizable and in the second place, greater responsiveness of our economy to the future and to inflationary policy or indeed, to policies to overcome unemployment.

But at the moment we need a better balance between supply and demand, traditional policy addresses on the demand side and I believe it is very important that we have a definite policy to work on the supply side on a comprehensive basis.

I might add there are some things that can be done without legislation and I want to mention them briefly, too. Anti-trust activity by the Justice Department and the Federal Trade Commission's part of this. One supporter earlier mentioned the automobile industry. What happened there is large price increases in the face of very little demand.

This kind of behavior by itself, I believe, is an indication that the industries, the way it occurs, need more attention from the agencies to enforce the anti-trust laws. In the automobile industry we cannot be happy with the present structure. It may well be that we have to get started on a restructuring of the industry to make it more competitive.

A related area is the regulatory commissions. I don't believe that in the program for this anti-inflation conference, the regulatory commissions are included. I would hope that they would be included. Not only the regulatory commissions in many instances failed to recognize general interests, but also the appointments that have been made to these commissions have generally been weak in recent years.

I believe that the Executive Branch and the Congress should exercise more care in appointing to these commissions people who have the general interest at hand, who are not just merely acceptable to the industries which they have to regulate. Let me mention one final point. In the area of taxation, there are things that could be done to overcome the threatened capital shortage which a number of people have referred to. I think the corporate income tax, in particular, does need an overhaul.

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We hear a lot about the individual income tax and certainly things need to be done there too, but I believe from the point of view of safeguarding the adequacies of our capacity we do need some changes in our corporate income tax. In particular, there are two changes which I believe would be helpful, and I mention them as examples.

One of them is deductibility of dividends, putting dividends on the same footing as wages and interest; and another would be the introduction of an element of progress in the corporate income tax. It is graduation not by size of firm but rates by rate of return. There are many firms that enjoy high rates of return primarily because of excessive market power. The tax system could, to some extent, be used to overcome that fact.

MR. GREENSPAN: Thank you very much.

It is

It is 12:30, and rather than break into this I think we will wait until after lunch. Immediately after lunch, at 1:45, we will have a short presentation by Roy Ash and then we will start with Paul Samuelson and continue on. I would appreciate it if everyone would be back here promptly in about an hour. We will start at exactly 1:45 and hope we can keep this going.

Thank you.

(Whereupon, at 12:30 p.m. the conference recessed until 1:45 p.m.)



AFTERNOON SESSION

1:45 p.m.

MR. GREENSPAN: As part of all of the preliminary meetings that we are holding prior to the final conference on inflation, presentations will be held on, one, the economy. The CEA will be giving short presentations, and in fact, I might add that what we will attempt to do is incorporate in our subsequent presentations many of the views that we have heard here today. Secondly, the Office of Management and Budget will be making presentations basically on the budget, itself, and Roy Ash is here with a series of very interesting slides.

As soon as Roy is available and ready, I would appreciate his starting off.

MR. ASH: Thank you, Alan.

Welcome back. I trust the supply at lunch was equal to the demand, but at least the price was right. But, as all Economists know, there is no such thing as a free lunch, so now is the time to get down to work.

As a key part of the battle on inflation, the President has set a firm objective and is committing maximum effort to reduce Federal expenditures for Fiscal Year 1975 to a point below \$300 billion. As you know, the budget had been \$305 billion with revenues expected to be \$295 billion or so. But he cannot achieve this objective alone.

Under the law of the land, it requires Congressional support, and it requires Congressional action. Also, as the President has said, public support and even some burden sharing of the public is necessary to achieve the objective of getting the budget down.

I would be the first to say that the budget is only one of the many battlegrounds on the war on inflation. I do want to make it clear why it certainly is one of the important ones and why it is important to achieve the President's objectives.

First of course, to the extent that we reduce Federal expenditures by any amount, we will reduce the Government demand for that limited amount of credit that is available in the credit markets. Second, hopefully, we will, by getting the budget down, take some of the pressures off monetary policy, and together, these may help interest rates and certainly that is an important objective.

Another reason to concern ourselves with the budget levels and, particularly, with reducing them is the psychological one. If we are going to take a lead in a number of areas, we must start with what the Federal Government, itself, can do and set the example by actually doing it because we are going to be asking a number to share the burden.

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Then, of course, as some of you who have worked closely with the budget know, whatever we do, this year, particularly, sets the course for the other years. I think, as George Shultz has said, even small changes of course this year will have significant effects in the years 1976 and beyond, and we certainly will have to give our attention to that because that most of all is what the budget is all about.

So, let us look at the '75 budget and some selected background data. Such a look will give all of us an idea of what the issues are in achieving the President's objectives for Fiscal 1975. At this particular moment, I won't be discussing the off-budget activities. They, themselves, are very significant. I expect that we will be discussing them during the course of these conferences.

(Chart presentation.)

Let us look at the first chart. You notice that on the left-hand side, 1961, 15 years ago, the Federal Government was spending \$100 billion a year. Just to put that in some perspective, we ran the Federal Government of this whole republic from its beginning up through 1930 with a cumulative amount of \$100 billion. That is for 150 years. Yet, we spent that amount in 1961, and as you can see, we are now moving up to and are at the \$300 billion a year rate.

Obviously, the country is larger, the economy is larger, the role of the Government has changed, the value of the dollar is less. Certainly this is a vivid example of exponential growth at work, when we ran 150 years for a cumulated \$100 billion and now we have worked our way from \$100 billion to \$300 billion in just 15 years.

There is a different picture when this trend is seen on a constant dollar basis over the last 15 years. We may not exactly agree on which is the cause and which is the effect on the change in value of dollar and budget expenditure levels, but the data show something very significant when we express the budget on a constant dollar basis.

At this time, I have converted it to 1975 dollars so that we can make sure and keep that \$300 billion in front of us rather than showing it at some other year's constant dollar value. You will note here, the first half of the 15 year period had a very significant growth, almost 50 percent, expressed on a constant dollar basis from the 200 to almost \$300 billion level in that few years there.

The second half was virtually flat on a constant dollar basis. Yet, that is no consolation that the second half was virtually flat on a constant dollar basis because there were some large deficits at that time, largely arising because revenues did not keep up with the amount of outlays we were then incurring.

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Another way of looking at the same phenomenon is in relationship to the Gross National Product. The significance there is that, we were running at about 19 percent or so of Gross National Product for the first half of that 15 year period, but then we stepped up shortly in 1968 to a 20 percent plus of Gross National Product represented by Federal expenditures. Of course, this was affected by the Vietnam War. But then, of course, the significant thing is that, even as that War was winding down, the totals of Federal expenditures relative to Gross National Product continued.

Well, the product then, of course, and the next chart will show it, is the simultaneous change of mix. Even as we were winding down the expenditures for the Vietnam War, we were reallocating priorities in massive ways. Defense reductions were being supplanted by substantial program increases.

On a constant dollar basis -- and again, these are 1975 constant dollars -- you will note that defense expenditures in 1975 are actually less than they were in 1961. Just slightly less, but nevertheless, less. They have gone over to a peak, but they are down to a number that is even smaller than 1961.

The rest of Government, that is, that having to do with interest and other non-defense, itself, is a little bit less than it was in 1961. So, those items other than the social programs have been, except for that peak, less and relatively flat.

So, what did happen?

Well, what, of course, happened and what is most significant when considering the actions now necessary to achieve the President's goals is to look at that part called Payments to Individuals and Grants. The Grant Payments are payments to States and cities almost all of which flow through the individual. So, you can consider that big growth, a 300 percent growth, or growth of 300 percent of its 1961 number of Payments to Individuals and Grants to States and Cities, most of which in turn is passed through to individuals, is what has been happening in these last few years. That number is almost double from 1968, and you can clearly see then that, where defense and all other expenditures of Government have come down on a constant dollar basis, the Payments to Individuals and Grants to States and Cities passed through to individuals has filled up all the slack. That is what has been going on.

It is essential that we know that as we now look at ways in which we can deal with Federal expenditures for 1975. The role of the Government has substantially changed from earlier years. In earlier years, defense was a little less than half, and the defense and other government was really three-quarters of the total before we got the social type expenditures. But today, social type expenditures are more than one-half of the total.

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The Government is no longer running itself, running its government operations, including defense, but mostly, the Government has become a massive transfer agent, collecting dollars from some groups of people and then paying out those dollars to other groups of people. We can not ignore this phenomenon in looking at 1975 for the kinds of actions that have to be taken to deal with Federal expense control.

Most of all, this new class of government has a strong, built-in political momentum for its continued exponential growth just as has been going on now for a number of years and, particularly, has been going on since 1968.

With that background, let us look at the composition of the 1975 Budget as it now stands, not by agencies or programs, but by the type of actions possible, and for that matter, the type of action necessary if we are to achieve the goals that we have set out.

Let me call attention to the bottom number, which is the budget total, \$305.4 billion. It shows that we have in fact captured the whole budget and nothing has gotten away. From time to time, I hear comments when I propose various ideas of what might be cut. I get a response, "Don't cut this," and "Don't cut that; there must be something else."

I am showing there is not anything else. Here is what we have to look at. This budget was presented differently than the budget in the book. This was presented in the terms of the kind of program from the point of view of class of action needed in order to effect budget reductions.

Let us take the first group, called Contractual Obligations. In that particular case, the Federal Government has undertaken contracts with parties outside the Government to spend a total of \$81.9 or \$82 billion. Interest, of course, is a significant part of that.

We have, also, contracts with other people, whether it be to build a dam or a bridge or to subsidize housing or FHA insurance. We have obligations to parties outside Government that call for expenditure of \$82 billion out of this year's budget. The only way that we are going to reduce that this year is either by default on those contracts, or in some way renegotiating them with parties that have a claim against the Federal Government.

Both of them, either unique or very expensive, and therefore, a class of action that I think, for the moment, we should pass and look to others as to where we are going to save these amounts out of the budget.

Let us take the next big amount, \$142 billion for Entitlement Programs. I have already referred to that class of program. These are ones where individuals, or through States

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and cities individuals have certain claims, certain benefits, ranging all the way from Social Security to Food Stamps and Retirement Pay and have certain entitlement criteria.

If an individual steps up and meets those criteria, he has a claim against the Federal Government for a given amount of cash as long as the law remains as it is. In a sense, we have, again, a legal obligation to pay \$142 billion, assuming that the laws stay on the books as they now are, both as to what the benefits are and as to the entitlements to those benefits.

Legislative and judiciary is just a minor for the moment, \$1.1 billion. A rule of comity says that we will pay for the Congress to carry on its work and Judicial Branch to carry on its work. We consider that inviolable.

There is \$225 billion out of the three hundred that has one or the other form of contractual obligation of the Federal Government to pay out money under existing law and under existing contracts. Now, let us get down to what we call discretionary spending.

The first big amount is \$57 billion for Defense. The two component elements are personnel and the "All Other." This is not all the Defense budget. Some part of the Defense budget is above in prior year obligations. We have already entered into contracts to build ships or airplanes or to do something, and some parts of Defense -- Defense Retirement is another class of Entitlement Program. This is that part of the Defense budget that theoretically can be considered discretionary.

What about Defense?

First, I should say that, Defense today is the lowest percentage of Gross National Product for 25 years, since 1950. Secondly, Defense is down a third as we say in previous charts from its constant value amount of just a few years ago, 1968, it has been substantially coming down.

Third, of course, Congress has taken a very big piece out of it this year already. From the point of view of the Administration, we think that the combination of all of those suggestions that, except for the continual efficiencies that can be achieved in Defense by working them over and working them over, we are pretty much at the minimum for this year for Defense.

To go beyond that is to change the force structure of our defense establishment, change the whole security of the world and, particularly, the security of this country. At least this is one class of defense, but it has some separate points of view that should be expressed when we look at Defense.

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Now, we get down to non-defense, discretionary, \$35 billion, personnel, \$20 billion. We have already taken action on that \$20 billion that is personnel. The President has made an announcement that we are reducing personnel employment by 40,000 people. The problem is that it does not convert to a lot of dollars this year by the time you pay severance pay and other kinds of untaken leave and vacation and sick leave. It does not save a lot of dollars, but we are taking 40,000 people out of the non-Defense and Defense personnel and getting some out, and then we get down to \$15 billion.

Fortunately, we have offsetting receipts, primarily offshore oil receipts that will help reduce outlays, because, without going into it, as most of you know, that is considered a negative outlay rather than a revenue.

Only by way of pointing out that as we go about the process of reducing outlays from three hundred five to below three hundred, we have to say, from this chart, where will it come from?

Let me look at the two places, particularly, that we have to examine as to where it may come from. The first is that \$142 billion that is in Entitlement Programs. The second is the \$15 billion that we call non-Defense, discretionary.

Let us look at them in a little bit more detail and get an idea what the possibilities are, what the options are, for Fiscal 1975, not to suggest that there are not many things beyond that to be done for '76, '77, '78, '79 and '80.

This is a description of the \$15 billion and what comprises it. I am not sure you can read all those programs, but let me point out that, half of that \$15 billion, virtually half, are in programs in health, education and welfare, housing, those we consider social programs, not under entitlement formulas, but necessary social programs. But they are social programs. There goes virtually half of the \$15 billion.

So, we should look at those. Those are candidates. I am not going, at this time, to suggest what we offer be reduced. I am merely putting forth the universe from which we must select programs that need be reduced if in fact we are going to achieve our objective and merely to point out it is a very difficult universe.

If we take the \$2 billion of health research, most likely biomedical research, a big part of it in cancer research, there are a lot of people who believe we even should be spending more. If we take atomic energy, we are dealing directly with the issue of energy and that part of energy we are going to meet from nuclear facilities.

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Child nutrition, education, manpower assistance, unemployment benefits, veterans' medical care, highway programs -- you can see there are a number of problems in there. Yet, it is the shopping list. It is the finite shopping list from which we have to work if we truly are to achieve the objective.

Let me go on for a couple of minutes to show you the last one. That is the composition of the \$142 billion that represents the Entitlement Programs. This is where we have been increasing our expenditures at very rapid rates. This again, though, is where we have a legal obligation to pay out provided a person steps up, qualifies himself and makes claim to the benefits to which he is entitled.

\$142 billion -- Social Security, of course, is the largest single part. Civil Service and military retirement, veterans' benefits, supplemental security income -- you can read them, I am sure, as well as I.

We go down to Medicaid, unemployment insurance. You can see a couple of big ones.

General Revenue Sharing, the right-hand column shows the number of beneficiaries affected only to give you an indication of the political issues involved if one is to deal with the subject of Entitlement Programs.

Medicaid, 28 million beneficiaries -- a very interesting political issue, but all of these political issues have to be faced. I should say, there is overlap among those numbers of beneficiaries, so don't add them all together because you have a big portion of the population of the country. Nevertheless, this points out the problem.

I did not intend to put forth the solution here today, because we could argue forever over the particular solution. But I did intend to put forth the universe from which we must select the solution, and we are working hard to doing that. The President is committed to do that.

You have seen where areas of action are necessary if we are to achieve the President's goal. The President is committed to and is working with the Congress to select those areas where the Congress will join in actions that are necessary, because in each case, Congressional action or Congressional concurrence with Executive action is necessary to achieve these reductions.

We trust actions that will be taken by the President and by the Congress will have the full support of the people in making these hard choices. There is no question but that they are hard choices for the good of the 1975 Budget and for the benefit of all the years to come.

That is all I have to say, Alan. It is all yours.

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MR. GREENSPAN: Thank you very much, Roy. We will now return to our go-around. You may recall that we terminated the morning session with Hendrik Houthakker. Paul Samuelson is next.

MR. SAMUELSON: Chairman Greenspan and fellow citizenry searchers, let me say at the beginning that in order to be constructive what a summit conference like this might come out with.

I must voice my view as to what would not be the right thing for such a summit to come out with. I think that what we do not need is rhetoric. We have heard words about confidence. Confidence is not made out of language. Confidence is made out of events seen and events believed in.

So, I have to say at the beginning that the wrong thing to say is the number one problem the Nation faces is inflation. The number one problem that the Nation faces is stagflation. That involves inflation but it also involves what you have heard from the forecasters and I have brought out a half-dozen other forecasts from the best people with the best batting averages, which is poor enough.

In recent months the stagnation component has not been losing ground to inflation components. We have a much more complicated problem. So, I don't think it is a case where a President comes in Winston Churchill-fashion and says, "I bring you blood, sweat and tears." I ask for positive action in the hope that perhaps the stock-market will go up for two days running from positive statements that we are to hang in there with a high level of unemployment until the next year or the year after or if it takes two more years after that to do it.

I think the problem is more complicated. Now, let me express why. You have heard the general forecasts.-- I think five of them here -- the Chase Bank's, Econometric Unit, Dr. Eckstein's DRI, Albert Summers of the Conference Board -- if you will excuse the expression -- the Townsend' organization I have a forecast from and the Wharton School. Looking ahead for the next year, from mid-year to mid-year, They average out flat three out of five are a little bit negative, actual averaging.

The average of all of them is a little bit negative rather than flat. Now, that would not have been the case a month ago. It would not have been the case two months ago. It would not have been the case three months ago.

If you go to the year after that, which I think is the important period, then they do take courage and they have the rate of growth returning from the middle of '75 to the middle of '76.



Now on the inflation they also have become more realistic. Most of the inflation that we have is not made in Washington. Most of the inflation cannot be laid at the door of the Federal Reserve. Most of the inflation cannot be laid at the door of the Budget. We have seen the numbers. If you actually correct the numbers for what has been happening in terms of price, then you get an entirely different view of the situation.

Now, I do not want to go back to what happened between '64 and '69 when the basis was laid but that is one important lesson to learn. Inflation was not made overnight. We should be soberly realistic in the rate at which we can make progress. So what you have here is an inflation which continues against the half of the year -- the full year from the middle of '74 on. The average of the group is 9 percent, a little bit over.

Do you remember all the hopes that have been expressed at one-month intervals that we would be back to 5 percent by the end of the year, any year you can name; that there is a return to normalcy? The forecasters are still at it. If we look at another year ahead they are down with some agreement, not on the old 3 percent, not on 5 percent, but more realistically between the middle of '75 and the middle of '76, when the Nation celebrates its 200th Anniversary we can be enjoying -- if that is the right word -- about a 7 percent rate of inflation. On the unemployment we have heard the sad story. The unemployment rate according to the forecasters will be at the end of this year 5-1/2 percent from Chase -- by the way, that view was not represented here. That is a more optimistic view and ought to be put in the record -- but 5.9, 5.7, 5.9.

At the end of 1975, which is quite a way down the road -- and whatever we are suffering from whether you call it a recession or a growth recession -- that will have been a pretty old animal by then. The numbers are still 5-1/2 percent unemployment from Chase. That is the number I like best. I hope it will be right.

We have 6.7, 6.4, 6.9 percent. These are very high rates of unemployment.

With respect to profits, the profits after taxes hold up pretty well for a year and then pick up after that. When you deflate those it is not so happy a picture.

Now, the simplest and easiest crusade to announce at a meeting like this is that we are going to cut the Federal Budget by \$5 billion or \$15 billion. Now, if you reflect on what that means in terms of the actual forecast, it is small. But you may say it is in the right direction. In fact, I have

heard the argument. We will only cut \$5 billion off the Budget, then Governor Burns of the Federal Reserve can relent and give us an extra \$10 billion expenditure. That is two for the price of one.

But the simple argument, which I think by the way cannot be sustained by a jury of experts, is that you should also maintain tight money. Well, we have already learned, we will learn more, that it is thought of a group of 23-odd economists, probably 20 of them will say the Federal Reserve has been too tight. You know it has been extremely tight. If you can get 20 out of 23 economists to agree that it has been too tight, then it is very tight.

We have heard of interest rates of 12 percent. A lot of people in this land are finding it hard to get money at 19 percent. Two days ago we had in Minnesota and in the Dakotas, a frost. We had it all through Canada. That is having a serious effect on the grain crop out there. We had a bad monsoon in India. Is that a reason for Governor Burns and his colleagues at the Federal Reserve to tighten still further?

Now I submit, and the Federal Reserve understands this, that that in itself is not such a reason. Yet much of the deterioration in the rate of inflation which we have been experiencing in the last few months has not been new facts learned by demand-pull inflation. It has been from factors like those.

To save time in this first kick-off, let me simply say what it is that we can realistically aim at. We can realistically hope that low two-digit price inflation will a year from now be high one-digit price inflation. We can hope in the year after that we can be in the middle of one-digit price inflation with a little luck. I don't think the luck always has to go against us with respect to frost and other matters.

To attempt to have a crusade to end this thing overnight with the dramatic language that we are at the last stage, we are at the fork in the road, it is now or never -- I think will be counter-productive. It will simply result in greater expansion at a later stage.

I believe what we have to do -- now I speak as an economist -- we have to do a cost-benefit analysis. What does it buy you to tighten money by this-much? Everyone of these forecasters has forecasts like that. What they show is that if we were to succeed in cutting \$5 or \$10 billion from the Budget and if we were to keep money tight by any of the three definitions that come to mind, according to the forecasters -- and admittedly they have had a pretty poor record but they are the best piano players we have to go by -- you buy something like the following.

What would have been a 9-1/2 percent rate of price inflation will be a 9 percent rate of price inflation -- cost-benefit involves double-entry bookkeeping. What they show is simply what would have been a 6.2 percent unemployment rate would be a 6.5 percent unemployment rate or 6.7 percent unemployment rate.

Now, I have heard Congressmen ask Government witnesses what do you say to that, and I don't think it is an adequate answer to say that economics is not an exact mathematical science. Of course, economics is not an exact mathematical science. But what we have to do as reasonable people is use all the evidence there is and pragmatically do cost-benefit analysis at every step of the road.

We are still in very good shape in comparison with the 1930's and in comparison with other countries. This is not a gloomy diagnosis. What I have given you is a realistic diagnosis.

MR. GREENSPAN: Thank you, Paul.

Walter Heller.

MR. HELLER: Alan, you have bribed me to hold my comments to a minimum by the promise I will get a chance to revise and extend my remarks, so I will be very brief.

Paul has just made my job easier. I agree with everything he has said even though he is to the right of me and Milt Friedman is to the left of me today.

By the way, let me just say more generally that it is delightful to be here in this kind of atmosphere of candor and facing the facts, and openness. I, by the way, should warn you, Alan, that I will be looking for the first sign of divergence between Alan Greenspan of Washington and Townsend-Greenspan of New York.

MR. GREENSPAN: That may occur sooner than I would like.

MR. HELLER: It is clear that the forecasts that we have heard around this table, of rising unemployment, flat or falling GNP and stubborn inflation suggest that the present policies are really striking a rather poor bargain. We are squeezing a lot of the life blood out of the economy but very little of the inflation, very little of the inflationary water.

Now, that is true, sure. We have to stay the long course but even the forecasts suggest that we are not striking a very favorable cost-benefit balance in terms of present policies. So, we have to reexamine them.

I am glad to see how wide-spread the agreement seems to be that we are overdoing monetary tightness. I imagine we will get some dissent before the day is over but there does seem to be a rather wide-spread agreement on that point.

I think my main plea now, Alan, I will restrict to a broadening of our context, the broadening of our perspective on the inflation problem. Let me just list them and then perhaps have a chance to speak to them a little bit later on.

First and foremost, I think we have to recognize along with Marina Whitman that inflation is a question of fair-sharing of burden that crystalizes this issue and that we have been putting a double-whammy on the lower income groups and most working men and women. Both the explosion of food and fuel prices and the measures we have used to cope with them put the heaviest burden on those groups.

Second, I think we have to recognize the chilling fact that the price explosions of '73-74 are now being converted into a self-propelling price-wage spiral. There I do believe we have to build a circuit breaker into that spiral process. Not by putting on a new straightjacket of direct controls but at least by giving more clout to the Council on Price and Wage Stability in the form of powers to subpoena records, powers of inquiry, powers of suspension as our divergence calls for -- and I think in the case of certified outrages, to use Otto Ecstein's term, "powers of rollback."

You can't stop there. On the agenda has to be a broadening of context of price-wage moderation. You can't expect labor to accept a 5-percent drop in real earning power the last year without fighting to get it back at a bargaining table. You can't say we, the Federal Government, are going to pull in our belt to the tune of \$5 billion and that is our part. I think you have to look at novel possibilities on the tax front like perhaps cutting the payroll tax, increasing personal exemptions,

On the food fronts one should even think of the possibility of some sort of pledge of holding food prices constant even of tax subsidies -- and I am not talking about a new price freeze.

Fourth and related to that, graduated taxes on automobiles according to horsepower or gasoline mileage, maybe taxes on energy uses, and plough those proceeds into the kind of tax relief I have been talking about in helping the victims of inflation.

I think we have to recognize that discipline in the budget is important. Cutting out military, non-military fat is needed. But again, those savings should be ploughed back. I don't think there should be, in terms of this weak economy,

an addition to fiscal restraint.

Six, as some of the people around this table have stressed, we have to broaden our perspective from the demand side to the supply side. We have to slaughter many of those 45 sacred cows that Hank Houthakker has spoken about. It will lead to an excessive beefing but that is a balance of economic and political consideration.

I think also we need to look into the possibilities of allocating credit more selectively. First of all, we need a system to find out who is getting the credit.

We must recognize that several speakers have emphasized that the U.S. GNP is a third of the free world's GNP. Anything we do here has enormous repercussions overseas.

That is the agenda to which I will address myself at greater length later on.

MR. GREENSPAN: Milton Friedman.

MR. FRIEDMAN: I am going to try to really break the back of this inflation by keeping my remarks down to the allotted three minutes.

I want to join with those like George Shultz, Houthakker and others who have called for action on the micro-level to remove obstacles to the free market.

We have heard a lot of talk about the cost of stopping inflation. That is an important question. But it must not overcome the other question of what is the cost of not stopping inflation? The plain fact is that this country while fundamentally strong has a serious disease and that disease is going to take its toll. When we let it run unchecked or when we try to check it, the cost if we let it run unchecked will be a destruction of our system of society and government. The cure will have to be painful indeed not to be worse than that disease.

There is one and only one cure and we all know it. We have to slow down total spending. Only the Federal government can do that and it can do that only by slowing its own spending and slowing monetary growth which will slow private spending. Monetary growth today has slowed. There is no strong evidence that we have really had a shift toward a fundamentally tighter monetary policy. I hope we have. I trust it will continue.

In addition to the problem of cure there is also a problem of sedatives that will ease the cost of the cure and will ease the dangers and pains of inflation. Here I have three main proposals for sedatives.

Most important, we must follow our policy gradually and not try to jam on the brakes so fast that we send the passengers through the windshield.

Second, we need a wide measure of indexing of the cost of living, of escalatory clauses on all sorts of things and the Government can make the greatest contribution by introducing cost of living adjustments on Government taxes and on Government borrowing as well as encouraging thrift institutions to institute inflation-adjusted contracts.

Third, we need to reform and improve our present arrangements for welfare and for assistance to the long-term unemployed. Public employment which has been much touted here is a falacy. It simply substitutes public employment for private employment if it is noninflationary. It ought to be avoided. Wage and price controls are not a cure for the worst part of the disease.

Finally, no matter how well we conduct the cure, no matter how many sedatives we impose, we cannot avoid paying a substantial cost. We have to reconcile ourselves to the fact that we will not get out of inflation except by going through a temporary but maybe fairly prolonged period of slow economic growth and higher unemployment. I think the main requisite is the political requisite of our having the courage and ability to tell the American public that that is the case. I think the public is ahead of its leaders at the moment and that the public will recognize and accept that and is willing to bite the bullet and take the cure, provided we do everything we can to make the cost as low as possible.

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MR. GREENSPAN: Thank you.

Jackson Grayson.

MR. GRAYSON: As a price controller, my first remarks are don't do it. I heard words to the effect at this time and under these conditions, let us not go back to mandatory wage and price controls. I would like to see those phrases stricken from the record of people who make those remarks. I think it is something that should be affirmed, reaffirmed and reaffirmed again because I think it is popping the price level up and preventing price decreases we must have if we are to get back to a lower rate of inflation.

So, I will stop this part of my remarks by saying that I urge that there be no temptation to go back to mandatory wage and price controls or no statement made to indicate that under certain conditions, we will.

Now, I would like to shift my remarks to something I would like to urge as a part of these programs. I would urge that there be a movement toward increased productivity. Now if the words are just rhetoric, people will yawn and will say that is a do-nothing statement. I do not mean just productivity that is gained from the cyclical pickup. I mean a drive for productivity that is composed of four parts that I would urge be put together as a package. These are as follows:

Strengthen the National Commission on Productivity which has had a very uneven and low level life. I think it ought to be increased in its funding. It ought to be re-organized. Priorities ought to be set, some of which could be on the list of 45 items that were suggested by Hank and Tom Moore earlier and it could look at the structural blocks to productivity as well as the micro-blocks to productivity that exist. I think it should have much more of a contact with Congress than it has because some of the things that are blocking productivity exist in legislation.

Secondly, I would urge there be consideration of a private sector American productivity center formed. Japan has a very strong Japanese productivity center. Germany has one. Even Israel has one. I think there could be a similar center formed in this nation in the private sector funded by the private sector.

Its function would be to get business and labor to work together to increase productivity on both the capital and the labor side. Its functions could be public awareness and education, which is important too, which is partly rhetoric. It could be R and D. It could be in the training on the human factors side and on the capital factors side, a broad spectrum, but again something which is primarily taken as the obligation of the private sector.

I think the time may be right for both business and labor to agree that they will work together on this and work on the problems associated with that word 'productivity' which in some peoples' minds arouses a negative connotation.

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I think if the gains can be made it will be clear that they will be shared by both parties, by three; consumer, labor and business. I think this stands a chance of being accepted now when it may not have been accepted earlier.

The third would be to ask the Departments of Commerce and Labor to have national, regional meetings on the subject of productivity across the nation and invite in target groups, business, labor, consumer groups, service groups, professional groups, and ask them the question, "What is productivity to you?" "How do you define it?" "What are the blocks that exist on productivity as you see it from your profession?" "How would you increase it?" Go to the grass roots.

Again, involve the people and not make them sit up in the amphitheater on the outside. Collect these and forward them to the National Commission on Productivity, perhaps publish them as a national suggestions list and funnel back to the mechanisms that have a chance of implementing them. Finally, use the mechanisms that exist now.

The fourth suggestion is to organize an international conference on inflation, employment and productivity. You can call it a summit. I don't care. Get the people together and recognize what has been said earlier by several speakers that it is a global problem, it is interdependent. Get at that people who have a stake in the solution.

It is a worldwide modern nation disease. We ought to recognize it as such. Invite in the heads of the productivity centers, there are 31 around the world, in Asia and in Europe. Invite representatives of the States and heads of Government and invite the nations that have not heretofore been parties to these conferences, Arab nations, Russia, China and other people, and see if they cannot be worked on to recognize it as a global problem.

MR. GREENSPAN: Thank you, sir.

Kermit Gordon.

MR. GORDON: Thank you, Alan.

To save time, let me say I will associate myself happily, not happily but fully, with the Eckstein growth forecast. I do share the view that the time has come to reduce the degree of monetary stringency somewhat. I would strongly support the view that we need a comprehensive program of deregulation to spur competition and transportation, in certain sectors of agriculture and other sectors of the economy.

Now, I would like to comment on the proposals that Federal expenditures in the current fiscal year be cut by amounts of \$5 billion or, as some have suggested, by \$10 billion.

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In view of the forecasts we have heard, it is certainly not at all clear that these reductions in expenditures at this stage would be wise on fiscal grounds. I don't want to look at it from the fiscal point of view; that has already been done. I would like to look at it through the eyes of a defunct budget director.

The kind of expenditure reductions we can accomplish in the next ten months, well after the fiscal year has begun, are not the low priority wasteful programs which ought to be expunged from the budget. They are the programs that I think Director of OMB has told us are programs we can get our hands on. I think that probably consists largely of reductions in Federal civilian employment through attrition, through slow-downs in Government contracting and procurement and a variety of so-called accounting practices.

One-shot employment reductions will, as they have in the past, lead to increased overtime and contracting out for personal services. Much of the savings will be dissipated in inefficient ways, slow-downs and stretch-outs in procurement and contracting cut costs in the shortrun at the price of raising total cost in the longrun. The use of accounting devices will be described by knowledgeable journalists as phony cuts.

It is hard enough for the Federal Government to get a dollar's worth of value for a dollar expended without at the same time having to vary expenditures on short notice for economic stabilization reasons. The efficient tool for achieving fiscal restraints in my judgment as taxation is not expenditures.

There are also elements of waste and inefficiency in the Federal budget program. Judicious pruning of the budget is not accomplished by searching after the fiscal year has begun for activities which can be cut back quickly for short-term effect.

Secondly, let me say a word about outlook for further inflation. Earlier in the year there was general optimism about the prospect for a decline in inflation. This optimism appears now to have dissipated probably because of the disappointing news on our 1974 harvest of food and Federal grains. My own amateurish quantitative view is that the outlook for price is a bit less grim than the current consensus implies, that one can find solace by reviewing the present state of the main forces that converged to generate our present inflation. These forces which I mention are the main forces; without denying that past error in fiscal and monetary policy has played a part.

First, the devaluation of the dollar had a part in driving up the price level, but a further weakening of the dollar is most unlikely.

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Secondly, the exploration of world commodity prices in '73 was largely in response to booming demand in the major industrial countries all of which were operating at high levels of activity. Currently, the industrial world is in a slump and commodity prices are weakening the decline in world prices of metals in the last several months and it has been dramatic.

Third, we have absorbed the blow of the quadrupling of the price of oil and the effects of higher energy prices have already been felt in the prices of many goods and services in which energy is an important cost. World oil prices may not be headed down, as was freely predicted a few months ago, but at least there seems little likelihood of further increase.

If we continue to maintain controls on domestic oil prices, it seems unlikely that there will be much further pressure on price levels arising from this source.

Fourth, though domestic food production has been disappointing, this should not obscure the fact that grain prices are more responsive to world production and demand than to domestic production and demand. This seems to have been a reasonably good crop year for most of the world. Retail food prices are unquestionably headed up. Our Department of Agriculture sees food inflation at a lower rate in the months ahead than in the months past.

Taken as a whole, this picture seems moderately encouraging about the prospect for a slowing down in the inflation rate. On the other side, however, we still have the problem of isolated but important production bottlenecks in a slack economy, and these bottlenecks will continue to give us trouble. More important, however, is the danger that the inflation will be transformed into a cost/push inflation, in which companies and labor unions that possess considerable market power will become autonomous sources of inflationary wage and price increases.

I have no doubt that this kind of inflation is a reality, or that these forces can continue to drive up prices in an environment of economic slack. For that reason, I attach great importance to the reconstitution of the Cost of Living Council. I do not favor compulsory wage and price control, nor do I think that compulsion is necessary to the pursuit of a useful wage/price policy.

I regret that the Administration does not seek the authority to require the production of information or the authority to require the postponement of particular wage and price increases for a period long enough to allow time for a careful study of the relevant facts.

There are two circumstances now working in favor of an effective voluntary wage/price policy. First, the economy is in a slump and it is easier to make negotiations and persuasion effective in a weak economy.

Second, and more important, the moral authority of the White House has been restored. Also, moral persuasion on wage and price matters now has a better chance of being headed. The mounting of a vigorous and skillful voluntary wage/price program seems to me an essential element in the effort to wind down inflation.

Thank you.

MR. GREENSPAN: Thank you, Kermit.

Dr. Goldfinger, AFL-CIO.

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MR. GOLDFINGER: Thank you, Alan.

There are loads of comments I could make in terms of sharing some views that have been expressed and sharply disagreeing with others.

However, in these brief remarks, it seems to me that remedies should be based on a diagnosis of the illness.

At this time, I will emphasize the views that we in the AFL-CIO have of some of the major factors that have contributed to the problem, to a degree the nature of the problem.

The stepped-up rise of prices was set off in the second half of 1972 because from early 1971 on we had a much lower rate of inflation and then the thing began to shoot off. This was touched off by the Russian grain deal in July 1972. The price rise began to accelerate and has continued to accelerate.

This accelerated inflation was aggravated by the devaluations of the dollar and the vast export sales of agricultural products, food materials, and other goods in short domestic supply such as steel scrap, copper scrap, even waste paper and fertilizer.

It was aggravated further by the hectic speculation and profiteering in the essentially unregulated commodity exchanges.

Now the energy emergency in the autumn and winter of last year and early this year, with the extraordinary rise in the prices of oil and petroleum products added still further to the problem and aggravated the problem but did not cause it.

The reason thus far has been essentially a response of restrictive monetary policy with very sharply rising interest rates. The prime rate is up about 100 per cent from early 1973, up about 37 per cent from the first half of March. Now, these monetary policies and high interest rates could not possibly curb this rising tide of inflation based essentially largely on the factors that I described before. But they hit home-building first and hardest, beginning in early 1973, and drove residential construction into a condition of a depression at present.

These were a major factor in throwing the economy into today's continuing recession.

I want to emphasize here that, in our view, we are and have been in an inflationary recession. The inflation began to accelerate, as I said, in the second half of 1972. The recession started toward the end of 1973. Now the tight monetary and fiscal policy with high interest rates

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furthermore generated more inflation by directly raising costs and prices since interest rates are a cost and price measure. Furthermore, by creating slump conditions in the economy they are suppressing the rise of productivity and thereby adding to pressures on unit costs and prices.

Moreover, the continuation of these policies in their essential form now poses the threat of a deepening recession, the threat of widespread business failure and certainly the immediate threat and reality of high unemployment.

Now, as we look at it, here are some of the essential facts of great importance:

Inflation with its very marked effects on the prices of food and fuel which have been spreading through the system through prices of industrial goods, utilities and services, has had a particularly devastating effect on most retired people and on low and middle-income families with children, with the result that there has been an undermining of living standards and a decline in not only the purchasing power but also in real consumption.

The buying power of the average worker's weekly take-home pay has dropped to about the level of 1965 which was nine long years ago. In the month of July, that buying power was down 5.3 per cent from the year before, and it was down seven per cent from the peak which had been reached in October 1972.

The number of unemployed rose more than 750,000 between October 1973 and July 1974.

In terms of the kind of discussion around the table here of a further increase to a level of about six per cent some time in the relatively near future that would mean an additional 700,000, 750,000 unemployed aside from the hidden unemployment that has resulted and is resulting from the discouragement of many workers and the lower participation rates.

In recent months, the retail sales, after accounting for higher prices, has been four or five per cent or so below the same levels of last year.

We have a housing shortage developing while both housing starts and building permits have been falling sharply. Something like three-quarter of the American families now are priced out of the housing market.

Moreover, in terms of the immediate situation and the short-run outlook, confronted by the high interest rates, many cities and counties are postponing bond issues and delaying their investments in public facilities and services.

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In addition, public utilities, as has been mentioned here, are cutting back plant expansion programs, in good part because of the interest rate pressure, in addition to the pressures of fuel costs.

Now, these actions by local governments and by the public utilities mean cuts in heavy construction, reduced orders for machinery. They threaten reductions in inventories and they mean fewer jobs and increasing unemployment.

So that, the monetary policies with these high interest rates, in my opinion, and in the opinion of the AFL-CIO, have brought the American economy to the edge of disaster.

Now, among the remedies that we would suggest, and I would toss off very briefly:

First, the monetary policy, I think, has to be changed considerably. We not only need an easing which has been indicated around the table by some people but what is needed, of equal importance, is to allocate a significant portion of available bank credit at reasonable interest rates for priority purposes such as housing, community facilities, the expansion of public utility plants, and the regular operations of business, while at the same time to curb the flow of credit for such activities as gambling casinos, land speculation, commodity market speculation, and loans to foreign borrowers and for foreign subsidiaries of American companies.

Another thing that is needed is for the administration to move as rapidly as possible to implement the new housing legislation which the President signed, I think, about a week ago and to move in and to begin to stop this continuing sharp decline in residential construction and to lift the whole state of housing which not only is of economic importance but of social importance, as well.

Another thing that we think is needed is a complete revamping of the tax structure. To get at the budget problem through budget cuts and particularly the kind of cuts in areas such as health, education, housing, community facilities and mass transit, poses real dangers for the future of American society. Rather than to do that, the emphasis obviously should be on cutting fat but, in addition, a major emphasis should be on the elimination of at least major loopholes in the tax structure, in the Federal tax structure, and the adoption of an excess profits tax to get at the excessively high profits of some of the corporations and industries.

In addition, it is our opinion that the proposals for further tax cuts for business which have been suggested or hinted at around the table by some people should be rejected summarily.

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We also think that there should be export controls established on export sales of agricultural products and other goods which are in short supply. We think that the Government should rebuild the stockpile reserves of agricultural products and raw materials which have been depleted.

In our opinion, it is essential that we get substantial appropriations of funds for a large-scale public service employment program in a work-oriented culture such as ours. A paycheck even on a public service employment program is of far greater importance to the family and to the individual than a welfare check or any other kind of income maintenance program that may be suggested.

Furthermore, along the lines that George Shultz indicated, the unemployment insurance system should be substantially improved through adequate Federal standards and, in addition, I would say that a program of Federal grants to states and local governments is needed to accelerate short-term public works construction and repairs of public facilities and to replace the kind of weakness that is appearing, not only in terms of employment, but also in the investment area.

MR. GREENSPAN: Thanks very much, Nat.

Kenneth Galbraith of Harvard.

MR. GALBRAITH: Mr. Chairman, I will also respect your request to be brief because I believe you wanted to avoid repetition as much as possible in the summary.

I do regard the problem of inflation as a present and urgent problem, a view that I share with Professor Friedman.

Also, I would like to urge that, apart from the fact that the President has asked attention to that that we be aware of the temptation to go on from our concern with inflation to the much more pleasant task of treating recession.

Most of us around this table have spent our lives worrying about unemployment and depression. We are on familiar territory there. The things that one does against recession and depression are all pleasant, indeed lovely, cutting taxes, no controls, increasing expenditures, and there is a beguiling tendency, I think, to find wrong and disorder in the society which allows us to prescribe the most pleasant remedy.

We have had discussion here this morning and this afternoon of a great variety of causes of inflation. I would suggest that we can reconcile that discussion by assuming that they are all important, to an unknown extent. Indeed, inflation is caused in part by the pressure of business investment and inventory investment, associated expansion of

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borrowing and money supply. But it is caused by general excessive demand, including demand in the upper spending brackets as so well indicated by our colleague from Armstrong.

Wages do shove up prices and, as less often said, Nat, prices do pull up wages. There is a spiral there which, unfortunately, we cannot ignore. There is the possibility, as Alan Greenspan said this morning, that a very large volume of expendable assets that overhang a market at any given time can become loose and spent, that something of this sort has already taken place as regards business spending, and that we have had the particular bottleneck problems associated with fuel shortages and food shortages.

We should assume that they are all important and we should doubt that any economist here at the table knows quite what importance to assign to it all.

This being the case, then I would suggest that it is elementary common sense that we attack all of those causes, that we not assume that inflation can be brought to an end by dealing with any one of them, that we remind ourselves also this is not an ideological question but the remedies are about the same for liberals and conservatives, would be about the same for Bolsheviks and the devoted supporters of Dean Rand, if there are any such present.

The choice here is much less a matter of political preference than we like to imagine. It leads me to suggest that the remedies indeed are, first, that, for the moment we have no choice but to keep money tight. As long as we have a runaway inflation, I would think it is most unwise that we ease bank-lending; that we, second, use the maximum of fiscal restraint and it seems to me that Mr. Ash has given us a most persuasive indication of how that must be done. He has left us with no alternative but an increase in taxes. It should be at the \$15,000 to \$20,000 level.

The spending is now pressing on the market where we have expenditures by the rich competing with the spending by the poor. As well, I would also urge an increase in the corporate income tax. I am not quite as radical as my colleague, Professor Houthakker, in suggesting that this become progressive.

I would like to urge also a wide range of excise taxes designed in relation also to the bottleneck problem.

It wouldn't surprise anybody to know that I believe that in this kind of economy there is no alternative to wage controls, not across the board, but where the power already exists to fix prices, where the private power exists to fix prices, and for wages the public power to do so must be asserted.

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Otherwise, we have a spiral which is of such power that it can only be arrested by a volume of unemployment that is socially unacceptable, I venture to think even to those who are less concerned about unemployment than I would like to think that I am.

Furthermore, we must have a concentrated, energetic attack on the bottleneck areas.

Reverting to my one-time interest in agriculture, I would emphasize particularly the strongest measures to increase fertilizer supply but this is something which I won't press further.

If all of these things are done with energy, then one hopes also that one will have two further possibilities:

First, the belief by people and corporations that dollars are worth holding and one has the possibility, which I would certainly urge, of then taking the steps at the earliest possible moment to ease money supply, ease Federal Reserve policy which, I agree with my colleagues here, is the most unsatisfactory and, in some ways, the most dangerous of the instruments to use to fight inflation.

The reason that economists enjoy discussing monetary policy is that we don't know the results. Therefore, it is a fascinating thing to talk about. We do know there are dangers in this. This should be the first thing from which we escape.

Then I would also, with Professor Heller, hope that the next action be taken to relieve the pressures of inflation in the lower-income brackets. I differ with him in thinking that any tax reduction is possible as long as one has inflation as serious as now.

That leads finally to the matter of sedatives and social contracts with Professor Friedman. I would enthusiastically urge their use on employment, temporary additions to unemployment compensation, the extension of the time of unemployment compensation, the use of public service employment on the grounds that we should not load the costs of this policy unduly or in any avoidable measure on those who are least able to carry it.

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MR. GREENSPAN: Thank you.

Richard Cooper.

MR. COOPER: Several people have already observed that the inflation that we have been talking about is not limited to the United States. It is a worldwide phenomenon. It is even more than that I think. It is a link problem to an extraordinary degree, even the relatively self-contained U. S. economy has been subject to external influences during the last year. As has already been mentioned in connection with inflation, one can identify three important ones. We had currency devaluations, two devaluations, followed by depreciation, all of which pulled up the prices in dollar terms not only of our import goods but also of many of our export goods including those sold in the domestic markets because markets are linked.

Secondly, the world drought leading in turn to a world grain shortage. That did not arise in the U. S. but as the ultimate supplier to the world it affected prices in the U. S.

Thirdly, most recently the increase in oil prices.

All these three factors together account for more than half of the increase in consumer prices during the last two or three years. I regard these explanations by the way as complimentary to and not in competition with the monetarists' explanations for inflation. I think one needs to explain why it is that money supplies grow under present circumstances. That is a more technical issue. The major point it seems to me is that what we have observed in the recent couple of years has not been wage inflation. It has been inflation which has risen from other sources and in particular two of the sources are especially troublesome. The devaluation has worsened the terms of trade of the U. S. with respect to the rest of the world.

What that means is that for any given level of our output our real income has gone down. It is that an unfortunate feature of the worsening in terms of the trade is that there is nothing that we can do internally to restore the real income arising from the loss of real income arising from that source.

I think the real danger that the country faces at the present time is that the inflation that we have observed, which has not arisen primarily from wage increases, will try to be recouped by labor through higher wage increases and what started out to be a change in real relative prices including a worsening in terms of trade will be built into the wage structure as higher wages and then set off a wage-price spiral.

It seems to me therefore, that the most important thing the Government can do at the present time is to head off that possibility. It has already begun. Wage settlements were surprisingly moderate throughout 1973, even into early 1974. In the last six months they have begun to accelerate. I speak in the absence of further action that they will accelerate even further.

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I think there is still a possibility in this country, which unhappily does not exist in some of the other major economies of the world, of heading off a wage push inflation. I will come back in a moment to how I think we might do that. If we don't, I think we have five or six years of grief ahead of us while that works its way through the system and there is nothing we can do about it.

Before coming back to possible solutions I would like to mention another aspect of the global dimensions of this problem because I feel it bears importantly on how we see our own circumstances.

It is worth keeping in mind that all the major economies are going through the same kind of agonizing process that we are going through now. They have inflation, in most cases more rapid even than U. S. inflation, yet they are faced with weakening demand. I think there is a serious possibility that each of several large nations acting alone to deal with its own domestic problem, other things being equal, an assumption regarding the rest of the world, will drive the world into serious depression.

I don't mean by that like the 1930's, but but more than the post-war mild depressions that Eckstein referred to earlier.

Germany is maintaining very tight reins. Japan is still growing positively but very slow by its own standards. Germany and its ally both face major problems which they are gearing up their determination to deal with. If the Communists come into the Government in Italy they are likely to have a more restrictive policy than they have had.

I think therefore that while each country in each forecasting counts, I suspect the forecast we heard this morning calls for relatively modest changes in the trade surplus of the country, in fact there could be a substantial deterioration for this country if other economies turn softer than they are.

Financial markets abroad are already in bad shape. We heard from Walter Hoadley about the gloom that pervades Europe now. This is an especially bad time for financial markets to be in bad shape because we need them for recycling oil funds, a point to which I will also revert. For these reasons, I am somewhat more pessimistic on the outlook than the forecasts that we heard this morning. But I am also somewhat more hopeful than many other speakers about possible solutions.

Let me make a specific proposal and the rationale for it. I don't know what there was in the lunch, but I detect since lunch the consensus that seemed to be emerging this morning has broken down sharply. While Ken Galbraith urges a tax increase, I urge a tax reduction promptly on the order of magnitude of \$10 billion to \$15 billion.

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I am interested in tax reduction not merely or even mainly for the stimulus to aggregate demand that that would provoke, although I think that is an important part of it, but I see it as an important, indeed possibly a necessary, part of a social contract to be struck between government, business and labor in heading off the beginnings or the furtherance of wage generated inflation for the next several years.

Indeed the summit that President Ford has called for later this month is perhaps an ideal kind of forum for trying to strike or for publicizing the striking of such a social contract. In particular, I would concentrate the tax cut on middle to low-income employees, explicitly on the understanding that labor would moderate its wage demands and that business would cooperate in wage settlements with a view of cutting wage settlements back from something like 10 percent to 11 percent to something like 6 percent to 7 percent.

Six to 7 percent wage settlements are not non-inflationary but the difference between 7 percent and 11 percent is still substantial and will make a substantial difference in the amount of inflation we have in this country in the next several years. A tax reduction of about \$14 billion would provide for low and middle-income, would fill that 4 percent gap. The argument would be for increasing your real wages through an increase in disposable income through the tax reduction in exchange for an understanding that you won't ask for it over the bargaining table.

Now would this be inflationary, this tax reduction, is a natural question. I would argue that is not inflationary, that indeed by looking at the budgets that we saw this morning, at least we saw the expenditure side of the budget, we are not looking at the whole picture. What I would like to do, and I think it is appropriate for our purposes of macro-economic management, is to consolidate the budgets of the U. S., Saudi Arabia and the Persian Gulf States and Kuwait.

These countries impose a tax, if you like, an excise tax, through their price increase on all consumers of oil. They have no way to spend more than a small fraction of the proceeds of that tax. They are going to rechannel them into the financial market. It is very much as though the U. S. Government had its increased taxes and used the proceeds to retire the public debt.

If one does consolidate these budgets we are at the present time not in a moderately easy or neutral fiscal position. The rationale for tax reduction, if you like, is to move back toward fiscal neutrality from what is, I think, a tight fiscal position now. The wherewithal for the financing of the resultant budget deficit is precisely the proceeds of the oil tax. It is the funds which the Arab countries must invest in the financial market mainly from now on I think mainly in U. S. Treasury Bills. I see here the makings of a bargain which I think far from being inflationary, if it can be made to work, would head off a lot of inflation in the future.

Let me close by making one further reference to the question of oil revenues now, not in connection with the U. S. but in connection with the rest of the world.

Most of these funds are going to be coming into dollars. They are very substantial. Estimates vary, but all the estimates are large, anywhere from \$40 billion to \$70 billion per year. Most of these funds are going to be coming into dollars as the jitteriness of European financial markets increases they will come to the United States for safe haven.

Yet it is very important that other countries have access to these funds in order to sustain their level of economic activity and more importantly or more likely their foreign trade position. I fear that if some kind of provision is not made for recycling, some positive act on the part of government and or central banks to facilitate the recycling of oil funds, we may find other countries one by one feeling driven to the imposition of controls over trade and payments which not only will deliberalize the world economy as it were and undo some of our U. S. efforts over the last 25 years, but more immediately to our task at hand, have a negative feedback on our own balance of trade position and would lead, I think, to a substantial increase in the trade deficit.

That in itself is anti-inflationary, but I worry about the political response to a trade deficit that grows from what is likely to be, \$5 billion or \$6 billion, with our oil payments to \$15 billion to \$25 billion. Labor is running protectionist. That would give them them the ideal handle for doing that and protectionist moves are inflationary.

MR. GREENSPAN: Thank you, Rick.

Nancy Teeters, Library of Congress.

MS. TEETERS: As I look at the economic outlook in employment, the consensus around the table, we do face this unhappy prospect of rising unemployment and continuing inflation. Our perception as to which is the most important will vary as time passes and economic events unfold. However, I don't think we should lose sight of the possibility of rising unemployment as being a major problem in the U. S. Consequently I think it is very important that we have policies which will caution the effects of the unemployment in individual families.

The institution of public service employment has been suggested by many people. We would like, of course, to maintain the maximum flexibility that we can in our macro-economic policy and that is extremely difficult to do. Most Federal programs are initiated only after long and serious consideration by both the Executive and Legislative Branches of the Government. Perceptions differ as to what needs to be met immediately and what is deferrable. As a practical matter it will be difficult to reduce Federal expenditures. In the short run any attempts to balance the Federal budget at the level of recession induced receipts may well become self defeating.

I am sure that there will be expenditure reductions proposed. I would like to urge that these expenditure reductions take the form of deferrals rather than rescissions. If our economic outlook turns out to be wrong we can more quickly turn it around and increase our expenditure outlays.

The escalation of the fuel and agricultural prices has set off rather severe inflation but I think more importantly it has transferred more income into the agricultural sector and petroleum sector at the expense of everyone else. The distribution of loss in real income is one of the major problems we are going to have to solve in the next six months.

I think it is extraordinarily important that people feel they are being treated equally in taking the loss of income rather than have large corporations and unions recoup and not everybody else.

The need to do this is extraordinarily difficult to do. I am not quite sure how we go about accomplishing it. Perhaps the best combination is some sort of tax cut for low income offset by an increase in taxes on the upper incomes. However, I think we should continue to monitor that particular problem very closely.

I would also like to join with the people who have said that they feel that there are large numbers of areas of the economy where the level of competition is being restricted. I happen to like Hank Houthakker's suggestion that we put them together and put them through at one time and to eliminate them so that there is not a constant fighting about who is getting hurt at this particular point.

I would like to say this. If we do prove to be wrong in our economic outlook I think that we should be prepared to move relatively quickly to correct it and take whatever steps we can to offset the adverse effects not only in the U. S. but abroad.

One final point I would like to make. The food and fuel problem, as has been pointed out repeatedly, is not one which is confined to the U. S. I think it would help to have a worldwide conference on these and also to have some international agreement as to the allocation of scarce supplies. I would be very disappointed to see recurring in the fall and winter of this year the disappearance of our grain stocks without even knowing what was happening. I am not in any way advocating export controls. I am simply saying that we should have some idea of the worldwide size of demand and how we can best allocate among the various nations that have demands on that output.

MR. GREENSPAN: Thank you.

It has been suggested that we take a seven minute stretch. I hardily concur. Let us keep it short if we possibly can.

(Brief recess.)

MR. GREENSPAN: Ladies and gentlemen, can we please get started again.

Despite the fact that we are going to be here all day, our schedule is a bit tight.

Our next speaker is Arnold Weber of Carnegie-Mellon.

MR. WEBER: Thank you, Mr. Chairman.

As you have gone down the table, most of the succulent fruit has already been picked. I offered to sell my three minutes to Milt Friedman. He refused on the ground that I could not promise delivery, which seems to be an endemic problem in the economy today. However, I will try to identify four fruit, one orange, one apple and two lemons, which in part reflects my own thinking in reaction to some of the prior comments.

First, it seems to me that this occasion has been the site of an uncharacteristic display of modesty on the part of the economic profession. It is clear that they are better than they say and it is clear they know how to do two things. One is how to move prices up and, two, how to move prices down. This discussion has indicated that that is not really the problem. The problem is in dealing with the side effects or consequences of restraining inflation.

It is clear that we have three sets of priorities with which we have to deal. One is the price level, the second is growth and the third is the level of unemployment. Really, then, the problem becomes one of establishing values and priorities and it truly becomes a problem in political economy. So, the questions that we have to treat are in bringing down the price level, how long is it going to take, what is the tolerable level of unemployment in both the political sense and in the sense of resource allocation, and what does it mean to growth?

It seems to me that we have not given a great deal of attention to growth. I would underscore Marina Whitman's comment about the strains the flat growth rate puts on income distribution and beyond that, the social tension that it engenders.

I think it is important to remind ourselves that we are now completing the one decade in which one of the major thrusts of public policy has been to open up opportunity to people of all backgrounds and races. We have just about done this in the institutional sense. Now we have to put our money where our mouths have been. So, one of the consequences of a flat economic growth will clearly be to exacerbate social tensions, particularly as it relates to the racial problem.

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It is also important to note that demographically in this decade we will see a 40 percent increase in the number of people in the age bracket 25 to 34, which is the primary career forming stage of one person's life. Being a dean now, it would be a hell of a thing if we gave all these people MBA's and they end up as janitors in that sense.

It seems to me that the basic problem that a process of this nature can deal with is to try to establish what we use to call in the Labor Department when we were dealing with the Philadelphia Plan "goals and timetables". Do we want to bring prices down to eight percent, and when? By next July? What is the tolerable level of unemployment? Now we can do it. It is probably fair to say that it is unlikely we can reach a consensus.

I think it is a job of duly constituted government officials both in the Congress and in the Executive Branch. It seems to me that we now have adequate apparatus in the Congress through the new Budget Committee and the JEC, and we have a pronouncement of the four "C's" by President Ford and the development of such goals and timetables would be a good test of detente between the Executive Branch and the Congress. That is, how much are we willing to swallow and how long should it take in order to repair the patient.

So, I would propose that the Executive Branch and the Congress try to develop a time horizon within which they would reasonably expect the problem to be dealt with, and once there is an agreement on those goals and timetables, the fiscal and monetary policy could follow from that. It seems to me in looking back on our recent experience what we did in the policy area is identify a single goal and go flat out to get it.

Between '72 and into '73 it was the expansion of employment and output and we did a very good job of that. We paid the price in the middle of '73 and on through '74. Now we are saying we are going to slay the inflationary dragon.

Well, you know, to press my knowledge of mythology it is more likely to turn out to be Medusa, that if we press very hard there will be certain consequences in terms of unemployment, in terms of social tension, which will cause us to discreetly reverse our field.

Secondly, and this is the apple, it seems to me that the most critical political economic variable is what happens to unemployment. It is really misdirected, to say, that we are all going to sacrifice when clearly the sacrifice will fall unequally on different people. In order to develop an effective program through monetary and fiscal restraint, we have to have in place, it seems to me, adequate cushions to provide a tender that those persons who are casualties of this process of adjustment will be taken care of.

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I think we should have a public service employment program in place providing 500,000 jobs or thereabout, and the cost of that will probably be \$3 billion and obviously this would have fiscally distressing effects. One place to get it is from general revenue sharing which is \$6.2 billion.

The States and local governments are going to get it anyway. Their budgets are in surplus in aggregate. Otto Eckstein indicated that the capital demands are diminishing because of population changes. It seems to me that this is the place where you can get it which would violate the letter of revenue sharing but not the spirit in the sense that revenue sharing funds would not be identified with categorical programs, education and transportation, but would be associated with a functional objective and that is employment.

The first lemon is what is happening on the wage side. We have had indications from several oblique angles around the table that we are now on sort of the back side of the inflation. That is, monetary mischief and other human follies have done their job and how we have wages at inordinate levels and far beyond productivity and pushing up unit labor costs. Well, I suppose that is right as an empirical fact.

I will just mention two things. One, this is exactly the same sort of exposition that contributed to the imposition of controls in 1971 where you will recall it was largely from the business community, a concern over a 19 percent rise in construction wages, 15 percent in the steel industry, that said in order to quash inflation we have to do something about wages. The product of that was the imposition of controls so I would caution particularly some of our business colleagues who, I think, have most obstrusively stated that analysis, that as a matter of policy and as a matter of equity that sort of implication, it seems to me, is mischievous.

Now, the second aspect about wages is that we really have a fighting chance to do something about it. If you look at the bargaining calendar most of this bargaining round is completed. What we have left, and it is not inconsiderable but it tends to be less central, is coal, railroads and oil. In 1975 there is a relative hiatus. It is a light bargaining year. In '76 the heavy hitters come to the plate again. You know, the same fellows, trucking, electrical equipment, rubber, automobile, that we most recently heard from.

In looking back to the recent past it is interesting to note that wage increases were moderate into '73 and the early part of '74 because there is a lag in formation of expectations in wage strategy by unions. Once then caught on that inflation was here to stay, at least in the immediate future, they adjusted their sights accordingly. Now they are up on that plateau and unless we have real progress in the numbers in bringing down inflation, by about this time next year when, you know, the union leaders are starting to gather and talk about what they are going to ask for in '76, it will be very difficult to slow down the rate of wage increases regardless of any putative curve relationship.

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Those of you who would like to see some side evidence look at Canada where their structure of bargaining is somewhat different. In the United States we have had escalator clauses on top of 6 percent. In Canada they now have escalator clauses on top of 10 and 12 percent. So, the point to be made is that in establishing the goals and timetables, if you are concerned about wage effects there will be a corridor next year and how adroitly we exploit that will depend upon other measures and the power that we put into that.

Now, the last point I would like to make, and it is another lemon, is about productivity. Productivity is the all-purpose virtue; when we can't think of anything else we say let us increase productivity. I was in Government and it was always full of fellows riding around in limousines asking other fellows to work harder. Having been in both places, I would prefer to be in the limousine.

We know that productivity increases in the long run are a function of improvements in the quality of the labor force, technological change, and capital investment. In the short run it tends to reflect output effects. Many of these things we cannot control directly.

Now here we say let us do something about productivity. To the extent that you have identifiable barriers to productivity, they reflect the efforts primarily of unions to protect against unemployment and the insecurity associated with it. Yet, there are some voices that would propose that at a time when unemployment is rising we will ask them to link arms and disappear into the economic sunset with us.

It seems to me that that is infeasible and misdirected and that the major task will have to be carried forward with monetary and fiscal policy within a framework of reasonably identifiable priorities and with due regard for the major casualties of the process of adjustment.

Thank you.

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MR. GREENSPAN: Thank you, Arnold.

Professor Stein of Charlottesville.

MR. STEIN: Mr. Chairman, I believe that I am the 27th economist to speak or the 28th if you include the President. It seems to me that the most efficient use of my time might be to ask for a moment of silence in respect for the fallen veterans of the war against inflation.

I suppose nobody would join me in that observation so I will use my time to make a few comments.

Many things that strike me as needing to be said are that there has been justifiable emphasis here on the fact that the problem of inflation has a great many causes and that there are a great many solutions which need to be incorporated in dealing with it. But I think it would be unfortunate if we give the people in television land out there the idea that there are 10 or 12 things that can be done about inflation and you can pick any eight of them and they will be okay because there are some that will be absolutely essential -- if you don't do them nothing else will work.

I think that is what needs to be said about demand restraint as being the sine qua non about the thing. Other things being done will be helpful. They will ease the process, but they will not succeed if there isn't restraint on demand. implemented or carried out by fiscal or monetary policy. I think that is probably generally agreed around here. I think that is an important lesson.

Of course it is true that in implementing demand restraint, moderation is required. The old time religion does not call for self-immolation and justifiable emphasis has been placed here on the fact that we now confront a real danger of overdoing restraint.

I would recognize that and I would think that if what we have been having in the last three months is because of monetary policy that it is probably too tight. But we have to remember that at numerous points in the last 10 years we have made this judgment. We seem to have always made it wrong about what was too tight and it ought to induce a certain caution in us in saying now things are too tight and we have got to loosen up.

Of course, there are a number of causes of inflation other than excess demand. Reference has been made here to frost and droughts and oil embargoes and so on. These are all real factors in the world. But the fact seems to be that in a world which is where the general conditions are inflationary, all the random events are not inflationary. That is our experience. Nothing ever happens of a non-inflationary or anti-inflationary

character or if we get a good crop somehow its effects are like droughts of water in the desert sand, because they are swamped by other things. We have a basic condition which translates all random events into inflation.

It is a basic condition that I think needs to be dealt with and it is a condition of inflationary atmosphere and expectations and conditions generated by long periods of excess demand growth.

With respect to the budget, I think the important thing about the Fiscal '75 Budget is that it should be a step towards slowing down the rate of growth of the budget in the future. That will involve in the beginning some reduction in the Fiscal '75 Budget because if you don't produce Fiscal '75 reduction you will find that Fiscal '76 is already beyond your control.

My suggestion is that the thing you should be looking for in Fiscal '75 are those expenditures which affect the longer run trend of the budget.

I must say that I am uncomfortable at hearing the revival talk about budget balancing as a goal again. I have expressed that inside as well as out. It seems to be unwise to tie our expenditure policy to the quite unpredictable and uncontrollable variations of the revenue side of the budget. But that is a long, old story.

What I do feel about many of the recommendations that we offer to the Government is that they are like suggestions to a cripple to throw away your crutches and walk. That is, we are lecturing the Government about doing things which certainly are no surprise to the Government and which I think by and large, I would like to do but we have to deal with the problem of why Government has not done these things. Why has Government felt that it was not able to do them or actually was not able to do them? What are the conditions in the environment that kept Government from following the rather obvious elementary textbook policies that really constitute the sum of the wisdom that we have to offer to the Government?

Now, it may be that the Government has been too timid and the Government, as Professor Friedman has suggested, has not been sufficiently courageous to do the things that were necessary to do because it misunderstood the sentiment of the public and the willingness of the public to stand for the consequences of a truly anti-inflationary policy with consequences measured in unemployment, high interest rates and rejection of certain Federal expenditure programs and so on.

If that is the correct view, then it is a terribly important thing for the Government to learn. But even on a fairly generous interpretation of what the public would stand

for, I think it is important to try to expand public understanding and acceptance of anti-inflationary policy and its consequences. That seems to me is the rationalization or reason for having a summit and especially for having a summit that is open because it is an opportunity for the Government to learn what the public wants to tolerate and for everybody to try to influence the public understanding and acceptance of an anti-inflationary policy.

We may be in a situation -- I am not sure of it, but it is interesting. We talk so much about the influence of psychology and confidence and what the people will and will not accept. We do not really have any experts on any of those subjects here or around in the advisory process. I don't know if there are experts on such subjects.

It seems to me that we are in danger of being in a situation in which people generally do not accept the kind of system which will yield anti-inflationary results; that you can envision a system in which fiscal and monetary policy is bound by certain rules. Given those rules excessive increases of wages and prices will be disciplined by decreases in employment and loss of output and this will restrain the excess of increases and it will have obviously certain painful effects. That that is a system which, if accepted and tolerated, will restrain inflation.

It seems to me that there is only one alternative to that as a way of restraining inflation and that is the control system; that is a system of comprehensive price and wage controls which it seems to me could not be limited to the large companies or unions. It could not be temporary. There is no reason to think they could be temporary and which I don't think could operate by moral suasion.

In the end I think that if we want a noninflationary situation we are going to have to choose between those two systems and it seems to be obvious which is the preferable.

It is in this connection, it seems to me, there is a real basis for pushing the Moore-Houthakker program because if we are going to tell people that they should accept living by rules of the market then, of course, we must have a legitimate market and do everything we can to make it a true competitive market.

I think it is that political justification which is as important in the Moore-Houthakker kind of program as would any contribution we could directly make to productivity or efficiency or whatnot.

I would like to conclude with one word on the unemployment problem or the problem of cushioning unemployment which results from anti-inflationary policy. The public service employment business is very seductive. It seems to have a virtue that you provide people with employment opportunities which are sufficiently attractive to keep them off the unemployment rolls and to keep them from undercutting the political basis for the anti-inflationary policy but not sufficiently attractive to keep from slowing down the rate of wage increase.

I don't think that the jobs you can offer can do both of those things. It seems to me that if you offer a \$5,000 job or \$6,000 job in public service employment you will find that you have hired a lot of people at \$5,000 or \$6,000 for an attractive job and that the unemployed \$15,000 or \$20,000 worker will remain unemployed. The fact is, of course, that those unemployed \$15,000 or \$20,000 workers could become employed if they were willing to work for \$5,000 or \$10,000. They would build a lot of houses and they would produce a lot of automobiles.

I think the public service thing will founder on the question of what is the appropriate wage rate for the -- which is the same kind of issue which caused so much trouble in the WPA nearly 40 years ago. I think in that sense the unemployment insurance alternative is much better because the compensation is related to the normal or expected wage rate of the unemployed worker.

Thank you.

MR. GREENSPAN: Thanks, Herb.

Harold Carter.

MR. CARTER: I thought perhaps the original thing would be to offer a three-minute silent prayer for better crops. The outlook for 1974 crops becomes less rosy with time. It is something like our econometric forecasting models. Spring optimism for planting was dampened first in May and June and almost burned out in July. Now they seem to be threatened with frost. If one wants to look for the good news, I think we would say the bad weather is not a world-wide phenomenon as we experienced in 1972.

Similarly, as Kermit Gordon has pointed out, there are many other situations that have changed from the situation in '72 and certainly an effective demand is not nearly as strong or following a record-crop year and many other factors here are different. In addition we are now operating pretty close to capacity in terms of crop useage; something we weren't doing in 1972. Where does this leave us in terms of the global picture? According to the best estimates that we have now, which are certainly subject to revision, we are going to be down probably

2 to 3 percent in world grain production.

This is in contrast with not too long ago, a few months ago, when we were counting on something of the same magnitude on the plus side compared with the past year. So, instead of going into the crop year with a small stock build-up it is more likely that we are going to go into a slight stock decline, again looking at it on a global basis.

Again, I should indicate that enough is still not in. We still have not harvested that corn crop yet.

I think I will omit the discussion of individual commodities in the outlook. The picture is somewhat mixed, again in contrast to the '72 year.

The one of most concern, of course, is our feed grains which on a world basis, it looks like we are going to be down 3 to 4 percent largely due to our own situation in the United States where we are going to be down 15 percent from the past year.

Another contrast to what we had seen last year or the year before, the world beef situation has changed considerably. We now are in a situation where prices are down in producing and importing countries from previous levels. Of course, our feed-grain prices remain high. We have situations now where we have stockpiling of surplus beef. Supposedly there is something like 125,000 tons of cold storage in the common market countries.

The world inventory of livestock is up. In the U.S. the numbers are something like 6 percent increase over the previous year and a similar situation in other countries, although I should say on cattle are extremely poor. Statistics are not terribly reliable but on the best information we have the numbers are up -- so this is in contrast.

To get to the real payoff in terms of food prices, the relief that has been anticipated from the big corn crop that we were predicting in the spring has now pretty well disappeared. The extent of the relief, I believe, was probably overstated in any case. We have increases that are coming about in food prices this year more in terms of the margin, in terms of the spread between the farm and the retail level, much of the increase related to energy price increases that are now being cranked into the processing, the transportation and similar sorts of costs.

I think the disconcerting part about this is that these increases in the processing and transportation are not the types of costs that are going to be reversed; that they are built into the cost structure. The only thing we can say is perhaps as the energy cost increases at least they will be

repeated in terms of next year. But we have yet to see some of those costs show up or at least the full extent of these costs to show up. In terms of numbers and price increases, I think we will be indeed fortunate if we can come out with something as good as last year. I say that, of course, in quotes. The increases in food prices in '73 were something of maybe 16 to 17 percent and I think we are going to be pushing those figures for '74 over '73.

What can we do or what can Government do? There is little Government can do in terms of getting better crops unless we have some pipeline to the weatherman, the forces that create the weather. This is certainly an important factor in what we have seen here.

We can, as a Government, allow producers and processors to respond to food consumption needs. I think that by and large this type of program has been followed in the last two years. As I mentioned, we now have most all acreage that had previously been held out of production, in production and in terms of agriculture, operating close to full capacity.

I am told by authority that we probably have another 25 million acres that could come into production probably over the next 10 years. So, there is some slack and there is in some countries a certain slack and the costs involved in developing this can become available.

I think something else that we can do, and it has been mentioned a couple of times today, is help agriculture to assess in advance some of the needs of critical raw materials and possible bottle-necks. Fertilizer has been mentioned. There are others that we need to consider in terms of looking at the production potential to be able to come close to what the potential happens to be.

Another point has been mentioned, and I will just second the motion or third the motion, and that is reexamine institutional and legal requirements of producing and processing and transporting. Professor Moore, Houthakker and many others have discussed this point in more detail.

I think thirdly we can avoid dramatic or shortcut solutions like introducing export controls that may offer little short-run gain. I really feel that way will but certainly cause bigger long-run losses.

We have to keep in mind that U.S. agriculture is really geared to world markets. A fourth to a third of our agriculture is really geared to trade. I think it would be a bad precedent for us to take a head-in-the-sand approach in terms of viewing global problems and look at this point inwardly because I think it would signal to other countries what our stance would likely be in the times ahead. So, I would oppose



that.

Lastly, I would like to agree with those who have mentioned the inequities that develop from increased food prices. This certainly is the case of lower income groups bearing the greatest share of the higher food prices. I think that we need to consider programs and alleviate this. Food stamps are but one program but at least this offers some help to this particular group.

Thank you.

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MR. GREENSPAN: Walter Levy?

I don't know how to associate you, Walter, except that Walter is the best-known international petroleum expert.

MR. LEVY: Thank you for the advertisement.

Mr. Chairman, the President stated in his introduction that he is looking for answers that may lead to possible actions to restore economic stability.

I will shortly deal with two aspects in this all-pervasive field of energy.

One is Project Independence, and the second one is the need for international cooperation to ease world-wide repercussions over high oil prices.

In dealing with these two aspects, I repeat the answer which the President gave, himself, during his first press conference.

Let me first deal with Project Independence or what I feel would be a much better name, Project Self-Reliance.

Project Independence has two major aspects to it, conservation and development of added and new sources of energy supply. Conservation is perhaps as important, if not more, than the development of added supplies because this second one is a time-consuming effort which will not become really effective, perhaps, for five, six or seven years.

As far as conservation is concerned, we must have a tax policy that would encourage energy savings in terms of energy saving equipment as well as in terms of energy use. The guiding force, of course, for the presently low level of increase or declining demand was the higher price level. Obviously, the price for energy from now on must be in line with what the economists will call the long-run supply price.

At the same time, in the field of conservation we should follow a policy of letting the conspicuous consumer pay for his conspicuous consumption. That would involve not only perhaps that low performance motor car which is a high cost to the consumer in terms of purchase of the car, which was referred to before, as well as perhaps the over-all increase in gasoline costs, but it would also mean that the public utilities would no longer encourage high consumption by lowering rates in an accelerated fashion, the more you consume the less you pay per unit.

There are many, many aspects to it, and I don't need to waste your time to go into further detail.

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As far as support for energy development is concerned, there must be Government policies which will support basic and public interest research in the period of existing and new energy developments. There should be a crude oil price which would be in line with what is basically a low-run supply price for energy and according to whatever one can judge would be valid as of this time it would appear that a price for oil in the level of seven dollars, \$7.50 to eight dollars, \$8.50, would be an effective long-run supply price.

I do not believe that a \$12 or \$13 U. S. fuel price is necessary to encourage, under present circumstances, drilling efforts and/or even efforts to develop oil from shale or coal tars, and, secondly, I believe it is time that we get rid of this artificial system of one price for old oil and a completely free price for new oil. I think it would make a great deal of sense to have one price for oil, the long-run supply price as can be determined now is between seven-fifty to eight-fifty, with a tax system that would take care of windfall profits but would exempt the company from paying tax if it makes investments in further development of energy resources.

The gas price also should be competitive with the controlled fuel price at the point of consumption, which would mean that on a reasonable level one would have to determine what it would be at the field.

I might incidentally mention that we apparently still burn more than half of our natural gas production and oil which would appear to be, under present circumstances, perhaps wasteful.

Now, I said the price should be controlled, and I know that the general tenor here is free prices, but I wonder whether my colleagues would agree to free prices if it would mean that a domestic price for oil would have to follow a cartel-determined price abroad which at the moment is about \$10 to \$11 a barrel? In many countries, it is a 15-cent per barrel production cost, including depreciation, and I was wondering whether my colleagues in industry would agree that the price should be decontrolled and completely free if by any chance a foreign cartel brings the price down to a dollar a barrel.

So, I believe that a persuasive case can be made for one price for domestic oil, a long-run supply, it will not stay the same all the time, but not a price which depends on the decision of the Sheik of Kuwait, up or down.

Now, the Project Self-Reliance will be a major factor in terms of supply in the 1980's. However, the United States and even more so practically every country of the world would remain dependent on substantial imports of oil.

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Let me now come to the second rather miserable problem we face as of this time, and that is the problem of the extraordinary cost of oil, foreign oil imports, and the balance of trade deficit that is presently incurred by every country of the world except perhaps five or six oil producing countries.

According to best estimates, for the next year, beginning July 1, the trade deficit will amount to between \$50 billion and \$75 billion. This deficit is the same figure, of course, as the accumulation of liquid assets in the hands of four or five or six oil producing countries.

To put \$60 billion to \$75 billion into its true perspective, let me just state that this is three-quarters of net book value of the total foreign investment of the United States --- foreign investments accumulated over 50 years, and owned by hundreds of companies, not by three or four governments. It is far in excess of the total net foreign assets of the United States, public and private.

And, to give you one final comparison, within one year the liquid foreign reserves, gold and foreign exchange, in a handful of oil producing countries, some of them little sheikdoms with 60,000 inhabitants, these liquid foreign assets will amount to more than the liquid foreign assets of all the other countries of the world combined.

This is the picture as we face it now.

Now, the investment of these oil surplus assets and also the trade of the oil producing countries as it will develop over time, trade, services, and sale of military equipment, will be concentrated in a handful of countries, five or six. That means that the oil trade deficit of the rest of the world will, in fact, be channeled into five or six countries, perhaps only two or three, because these are the same countries, as was stated before, the liquid assets, by necessity, will largely be held. If that should happen, the United States will be the primary country, of course, where assets will be held and where we hope trade will be developed.

It would mean that if you want to avoid a large increase in the dollar value, and a decline in our overall exports as a result of it, inflationary pressures of all kinds, and if we want to avoid the bankruptcy of the other oil importing countries whose oil trade deficit we have, so to speak, taken in, it would mean that we have to come along and supply all the other oil importing countries with massive funds. I hate to call them credits. I am prepared to call them soft loans, and they will certainly, in many instances, turn out to be grants.

What it would really mean is that we accept commitments in Treasury bonds through sale of our assets

through exports, that we accept to exchange our economic wealth in return for fundamental debt obligations, say of India, Italy, to call countries by name, but this kind of situation will become endemic.

The difficult part of this problem is that the amounts are massive. It is not a one-year proposition but a proposition where the deficits will continue for a substantial number of years and increase because in five or eight years the interest burden on the debt, certainly at present interest rates, each year's interest burden will add a one-year oil import deficit to it. So, you get two years deficit for one.

It is also terribly important that whatever efforts importing countries would make, conservation and also development of domestic resources, so as to reduce their oil imports, would not lead to any reduction in the foreign bill because certainly, according to present policies of oil producing countries, they would cut their supply when imports go down so as to maintain their price level, and it is quite logical to expect that when oil production should go down as a result of the development of resources in oil importing countries they would protect their total revenue.

So, the unit price is more likely to go up rather than down.

In these circumstances, gentlemen, I believe, even if we like inflation, we will have a bear by the tail. It is therefore essential, ...

Now, I like the idea of Mr. Cooper to just incorporate Saudi Arabia in our budget but this, to me, looks like a statistical exercise. I don't know what real meaning it would have except that it allows us to reduce our taxation on an intellectual basis. But it is essential that we cooperate with the relevant importing countries, especially Germany, but probably also the UK, France and Japan, on an assessment of this financial strength.

Are we too much concerned, or is it real? And, there is every indication, unfortunately, that it is real. And then that we get together with the producing countries, especially Iran and Saudi Arabia, for the purpose not to combine our budgets but to establish in this dire predicament a new world oil financing organization to which the strong oil importing countries would make some contribution of cost, but the major contribution would have to come from the producing countries who, having insisted on this extraordinary cartel price, have been unwilling to cut it back, cannot have their price and have us finance it.

This proposal of this get-together, not quite the way I suggested it, but anyhow a get-together, was in effect

suggested by the Shah at a very early time. I don't think he had quite in mind that his contribution might be as high to that financing as I believe it would have to be.

I believe that the United States and Germany and two or three other industrialized countries cannot safely accept and politically handle the role of the main depository of surplus oil funds and be at the same time the main beneficiary of increased trade with oil producing countries. It just would not result either in an economy at home which could be sustained nor in a recycling of \$20 billion a year in the United States and Germany which would be politically and economically feasible.

If nothing else should work, and this is something one has always to keep at the back of one's mind, it is perhaps necessary that we, together with the major industrialized countries, those countries where the world banking centers are located, would try to limit the inflow of surplus oil funds to a level that would just be in line with their trade deficit. Now, this, I believe, is the only way out.

The producing countries may well decide under those circumstances to cut their production but if they should do so I believe the danger to the whole world system, including their own, would be too obvious that it need not be stated.

Thank you very much.

MR. GREENSPAN: Andy Brimmer, sort of halfway between here and there.

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MR. BRIMMER: Thank you very much, Mr. Chairman.

Since I am halfway between here and there, I should say that my comments must necessarily be somewhat circumspect in one sense, especially when I respond to some of the earlier suggestions that the time has come for easing monetary policy.

I assume I am about at the end of the line. I would also assume that I will not have an opportunity to come back today. That being the case, Mr. Chairman, I would like to say, on the central theme that emerged from the discussion that the economy is still poised on a narrow edge between severe inflation and a sizeable recession, I agree that the problem of unemployment is important, but it is still number two, and the main problem is inflation, which is number one, although the gap between the two may be getting more and more narrower.

I think it would be most unwise for this country to look down the road to end inflation in the next year or two. It has been too long in coming, almost four decades now. Consequently, I think it would also be unwise for the country to adopt a policy designed to restrict real growth at or below the rate of increase in population so that real per capita income in this country would fall. I think that is a policy that is unwise and unproductive, and as a minimum, we ought to try to avoid.

At the same time, I don't think we ought to design policies on the assumption that we have months to plan and further months for implementation. I can accept the conclusion that it would be unwise for the Government to launch major steps before the conclusion of these series of conferences or even before the turn of the year, but they are all the things that are in the pipeline, which I think ought to be done soon and which will be helpful.

After all, we already have some 51 cities in this country where the rate of unemployment is already six percent or higher. That number of areas is back to where it was at the high point in 1970. Now, I think it would be appropriate to proceed with a fiscal policy which would make it possible to find resources which I think would be necessary if we are to get a public service employment program of a size that counts here. Mr. Chairman, I think the bills that are already in the pipeline ought to be looked at again. I think it would be unwise to trigger such a program, for example, at a seven percent national unemployment rate. I have seen some suggestions of that. I think that would be unwise.

Moreover, based on the experience we had in 1971-1972 with the previous public service employment, I think it would be unwise to leave to States and local governments the decision to use whatever funds that are made available without Federal standards.

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The record shows that some of the wrong people got the jobs at the wrong time. Since this is a cushioning program and not a generalized subsidy program, I think the Government ought to look again at the question of guidelines and standards.

I would like to say that, if the budget in fact is cut by \$10 billion, some work I have done and some other work I have seen suggests that the impact on the employment rate five or six quarters out would be sizeable, and the impact on the rate of inflation over the same period would be very modest. There would be some effect, but it would not be particularly startling.

Moreover, the largest effect would have to come in purchases rather than in transfers. I suggest that the Office of Management and Budget might want to take a good hard look at some of the expected pay out from that program and then go back and get a trade-off.

Mr. Chairman, I would like to say a couple words about the earlier suggestion that the time has come to relax monetary policy. I should say that since I wasn't even aboard, I deliberately absented myself from the last two meetings of the Federal Marketing Committee, so I would not be in a position exposed to the direct comments on those activities, but at a modest distance, I would say that a generalized easing of monetary policy at this juncture or in the very near future would be unwise.

I do not think we ought to encourage the public to think that such an approach would be constructive and would make a sizeable contribution toward the moderation of the expected rise in unemployment and the moderation of inflation, since we have to pursue both objectives simultaneously.

We ought to recall that, not too many years ago, the Summer of 1968, the Federal Reserve did precisely that when the income surcharge was passed in the summer of that year the Federal Reserve hastened to ease monetary restraint substantially. I think it was a mistake. I don't think it ought to be repeated.

Instead, I think, while I believe I see in the evidence some modest taking of the edge off restraint -- the action yesterday I read in that way, although it may not have been explicitly intended as such, I see it as a modest taking of the edge off -- it contributes \$400 million or so to reserves. That will be helpful. Instead, I think it would be appropriate for the Federal Reserve -- and I have said this to my colleagues for a number of years now, which is no surprise to them -- to exercise a much greater degree of influence on credit flows.

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I personally have advocated for some time some marginal reserve proposal. That is a long-run policy. In the short-run, there is, on the books today, has been on the books since December 1969, a statute which would permit the President to delegate to the Federal Reserve Board or to the Treasury or to whomsoever he chooses, authority to influence, to set guidelines, however you want to describe it, the allocation of credit and high priority items.

If we are to be in this campaign to restrain the economy for some time and to conduct monetary policy with a view toward making a contribution in the campaign against inflation, I think there ought to be greater attention to this question of selectivity of credit rather than simply overall aggregated credit. I would hope the Board would have strong views in the opposite direction and might want to look at this again.

Thank you very much.

MR. GREENSPAN: Thank you, Andy.

Congressman Patman.

CONGRESSMAN PATMAN: Thank you, Mr. Chairman, I shall be very brief.

I have a statement here. If I just use excerpts from the statement, will you put the whole statement in? It is only two pages?

MR. GREENSPAN: Certainly.

CONGRESSMAN PATMAN: Thank you, sir.

I consider that the following steps should be undertaken to combat the nation's current economic problems. First, an immediate strengthening of the Antitrust Division of the Justice Department should be implemented, of course.

Second, the establishment of a Task Force on Competition. This should be accomplished by legislation to provide subpoena powers, and a Task Force should be empowered to investigate all aspects of the relationship of banking and business corporations within the United States.

Three, the establishment of a direct loan program for housing.

Fourth, consideration of tax incentives for savings to help finance low and moderate income housing and to prevent the large financial institutions from destroying the thrift institutions through the orders of the Federal Reserve if they are successful in getting them.

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Fifth, the immediate implementation of Public Law 91-951 by the President. The implementation should be accompanied by a directive to the Federal Reserve System to use a statute to allocate credit to areas of greatest need and away from inflationary activity.

Sixth, the immediate removal of economic advisers at all levels who have participated in policies which have led to the current problem.

MR. SHULTZ: Should the Congressman also be removed?

CONGRESSMAN PATMAN: The people will take care of that.

Seventh, the establishment of a public advisory administration designed to provide jobs in a volume sufficient to keep the nation's unemployment rate below five percent.

Eighth, the establishment of a program to supervise monetary policy to prevent the mistakes which have contributed to much of the current inflation. If the President is to be assigned the prime role in establishing a new economic policy, he must maintain and strengthen his power to supervise monetary policy. We should have one regulatory agency, not three or more, just one. The decisions of the Federal Reserve Board must be more open to the public and not conducted in secrecy if rational economic decisions are to be possible.

Nine, a review of all Federal credit programs with a particular emphasis on determining the validity and effectiveness of guaranteeing loans through private financial institutions. At the present time, the Federal Government is using its number one credit rating to guarantee the highest interest rates in the history of the United States, and this is doing nothing to provide incentives for reductions in such rates.

Tax reform, number 10, with the primary emphasis on providing relief for low and moderate income families who have borne the brunt of the inflation.

Eleven, utilization of the new Council on Wage and Price Stability and the Commission on Productivity to conduct an intensive survey to determine ways in which productivity could be increased and capital better utilized nation-wide.

Twelve, reexamination of exports and import policies to determine how much activity may be utilized to hold down prices and make better use of United States resources.

Next, may I add in conclusion, Mr. Chairman, that I am thoroughly convinced over a period of years and for many decades that high interest rates cause high prices and oftentimes the prices of the goods on the shelves are raised when interest rates are raised.

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High prices cause inflation. It is just as unwise to try to stop inflation by raising interest rates even higher as it would be unwise to try to put out a fire that is destroying your home by using gasoline instead of water. So, if you want to balance the budget for many decades to come, the Federal Reserve has \$80 billion of mostly United States Government Securities that they are paying on from five to \$6 billion a year now -- that is the extra the taxpayers are paying; they don't even know they are paying for that. That is \$5 or \$6 billion a year when those bonds have been paid for once. Mr. William McChesney Martin admitted that to me on the witness stand before the Banking and Currency Committee.

Having been paid for once, they should be cancelled. If they are not cancelled, when the different bonds become due, the Treasury will have to pay for those bonds with the interest. That will cost our Government \$160 billion instead of \$80 billion, having been paid for once, and they will pay for them again.

Therefore, if you really want to balance the budget for a couple of decades to come, just ask the President of the United States to have those bonds destroyed, cancelled, since they have been paid for people should not be required to pay for them twice. That would reduce the National Debt immediately \$80 billion. It would be the most wholesome thing I think that could be done.

Thank you, sir.

MR. GREENSPAN: Thank you, Mr. Chairman.

REPRESENTATIVE CONABLE: Mr. Chairman, I would like to ask what our plans are for the rest of the afternoon. I am sure there are members of Congress who would like to respond in one way or another. Yet, it seems a shame to spoil the opportunity for some interchange at this point now that the initial statements have been made.

We are planning to have another meeting of this group, I understand, on the 23rd. It would seem to me at that point that perhaps some time could be set aside early in the proceeding for some rejoinder by the members of Congress after some deliberation.

I don't know how much time we have left this afternoon, but I would hate to see the time wasted by our failing to use the opportunities to tap the talents in this room further.

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MR. GREENSPAN: Let me say quickly, Mr. Conable, that the President is due in momentarily. We are, of course, expecting to meet on the 23rd. Let me take a minute out to explain what I think we should be doing then.

Today, we have basically gone through individuals and everyone has had one or more chances to discuss his particular views. Hopefully, at the end of this meeting the Ad Hoc Committee which has been set up as a group of us will determine which of the issues would probably require considerably more work, thought and attention. At that point we will reschedule the meeting for September 23 with an agenda based on what has been missing today and at that point, what will be on the agenda are not people but issues and it will be opened up on that question, and I restrain myself, I would like to get involved in that if I may and I hope I can, and that will be basically what the 23rd meeting is about.

Clearly, there will be time at that point for members of Congress to join this question. I see no reason why that cannot be done if you are willing, sir, to leave until then.

REPRESENTATIVE CONABLE: I think it would be better.

MR. GREENSPAN: For the next few minutes, until the President comes in, merely to open up the forum, I recalled we had two and a half hours with a sort of dummy variable but I didn't realize that dummy variable was minus two and a half hours. Would anyone like to make some general comments prior to the President's coming on board? Is everyone too tired to talk?

SENATOR DOMINICK: Mr. Chairman, could I ask Mr. Levy a question?

I did not get your figure. I was intrigued with the statement that you made. Was the \$65 billion or \$70 billion for this country alone or for the world?

MR. LEVY: The oil importing countries as a group.

SENATOR DOMINICK: The oil importing countries as a group?

MR. LEVY: The oil importing countries probably \$25 billion.

MR. SHULTZ: May I ask Mr. Ash if the budget figures we saw, particularly on defense, include the impact of the cut that came about in the Congressional consideration of the budget?

MR. ASH: The budget figures shown for defense were those in the budget. The actions being taken now in the Congress will have the effect, depending on whether the House or Senate version is finally adopted, of reducing outlays, not budget authority, reducing outlays someplace between \$1.4 billion and \$2 billion from those that are in the budget.

So, when we talk about going down from \$305.4 billion to less than \$300 billion, therein lies a portion of the answer. Certainly not all of it. As I indicated, over and above the actions now being taken we clearly wouldn't want to recommend or support any further reductions in the defense budget than those that are now being contemplated by the Congress.

MS. PACE: We have been reading in the paper that the figure this year is more likely to be \$311 billion or \$312 billion. I think that creates some confusion.

MR. ASH: I should make a point that I didn't feel I had enough time to make earlier and that is in order to achieve the objective of getting below \$300 billion, one must be sure he starts from \$305.4 billion. Congressional actions going on even now could increase the \$305.4 billion not up to \$311 billion because it depends on how you count them, because there are all kinds of variations in what is going on, but certainly could increase the number to one above the \$305.4 billion starting number.

So, in order to start from the starting place, first the Congress should not increase the President's budget. Second, affirmative action of the Congress is required even to achieve the \$305.4 billion. That is, included in the budget were certain reductions which can only be made by legislation which has been proposed within the budget.

Thirdly, as the President submitted, or will be submitting very shortly, deferrals and rescissions. Under the new Congressional Budget Act, the Congress must concur with those because those deferrals and rescissions were also contemplated within the budget. So, it is important that the Congress take a number of actions merely to start from \$305.4 billion.

I could have elaborated on it but I am glad you brought it up because that is a big problem all by itself.

MR. FRIEDMAN: I want to propose a rule for the next meeting that nobody be permitted to use the words "tight" and "easy" for monetary policy unless he specifies what criteria he is using and what numerical value he attaches to that criteria. I believe all the discussion here about tight and easy money has been very difficult to interpret because of a failure to ---

(The President enters.)

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MR. GREENSPAN: Mr. President, we have had a rather long and elaborate discussion while you were away. At our luncheon meeting our ad hoc bipartisan group of economists unanimously elected Arthur Okun to summarize the areas of agreement and disagreement for you and a number of others will be filling in major areas that we have identified and I have this list here for you.

THE PRESIDENT: Are we at that point now?

MR. GREENSPAN: We are at that point, Mr. President.

THE PRESIDENT: Thank you very much for a long and I hope fruitful and beneficial day. I have heard nothing but good reports of what has happened and transpired. I am very pleased with the information that has come to me. So, without any further ado I think we will call on Arthur to give a summary.

We appreciate your willingness to stick your neck out with such a brain trust here. Would you mind proceeding on this occasion.

MR. OKUN: I am overwhelmed by this assignment. It is obviously an impossible job, but I don't think too much can be expected so I will plunge in.

I found, and all I can tell you is what I heard from my colleagues, I found a surprising area of agreement on the assessment of the outlook as I think George Shultz put it the forecasts were so close together you could put your hat over all of them. There really is not a wide disagreement. Qualitatively the range is from an outlook for a flat to a slightly falling real GNP for the next three quarters or so, followed by some modest recovery late in 1975.

All of those points, of rising unemployment, all of them point to some modest improvement on inflation, at least to the upper end of the single digit range. We will lose a digit but not very much more in the opinion of most people here on the basis of the present outlook. In assessing what ought to be done in writing a prescription I think the most wide spread advice volunteered by this group was in the area of monetary policy. At least half the group, as I counted them, expressed the opinion that we have reached or at least are rapidly approaching the time for a distinct change toward reduced stringency in monetary policy. Many people who made that statement explicitly said they were not talking about easy money, they were not talking about a relaxed monetary policy, they were talking about a reduction of restraint.

I should note there were three explicit dissent on easy money that I counted and I think you will hear from some of the dissenters subsequently. I must say that the breadth of the agreement on the timeliness of some shift away from extreme stringency was striking to me. A few of my colleagues mentioned the need for some kind of mechanical system to allocate credit or to insure that credit was being allocated to more socially productive uses quite apart from any change that might be made in general monetary policy.

A number of people commented on the other major tool of Federal economic policy, namely the Federal budget. I think the stress in discussing expenditures was on discipline, on real system and on long-term control. I heard no one put great emphasis on any particular number, on any particular target for Federal expenditures as such for the near term.

I think the feeling was that within the range of discussions of the possible amounts of Federal spending that we will have, the lower the figure the slightly better news on inflation and slightly worse news on unemployment, but not qualitatively a great difference there. I think the emphasis was on removing the area of Federal spending as a major source of instability and worry over the return of an inflationary environment and an excessive downward pressure on the economy.

One of the speakers did propose a sizable increase in taxes. Three or four people thought that we should be considering tax reduction for reasons I will speak of in a moment.

There was a concern expressed about the credibility of some budgetary proposals, a warning against the use of accounting innovations and ingenuity, or less kindly, gimmicks to achieve any particular target.

There was some concern expressed about the efficiency of very quick cuts in the budget in achieving the objective of the Federal program.

A few people mentioned that they feared it might be counter productive to make commitments to budget balance in the face of a deteriorating and uncertain prospect for Federal revenues that may emerge in a weakening economy. Again and again I heard the theme of a multidimensional approach, of going beyond fiscal and monetary policy to attack inflation on as many fronts as possible, to try to balance the economy as well as possible.

One approach might be called the administering of some pain killer. A great many people mentioned the need for legislation to improve our unemployment system and other aspects of our income maintenance system. Several favored and strongly supported the extension and creation of public service employment programs and a few expressed slightly skeptical views on how much if anything that could do.

A second category of proposals can be classified as perhaps structural or micro-economic reform to improve the pricing and cost performance of the economy. A whole set of these on which there was very widespread agreement among many people was an effort to reverse any number of ways in which the Federal Government now unwittingly raises costs and prices in its pursuit of other objectives. A number of examples were cited, transportation regulations, in the field of the import quotas and marketing orders on dairy products. Professor Houthakker has compiled a list of 45 sacred cows in Federal legislation which he thinks should be appropriately slaughtered to improve our price and cost performance.

Another area of a structural reform was the emphasis on the supply side of the economy, improving the environment for investment, for producing such key items as fertilizer.

There were quite a few people who addressed themselves to a possibility of a drive for greater productivity, some promoting it, others demoting it.

A few mentioned anti-trust as a useful tool which could be applied more vigorously in areas where prices don't respond to manifest market forces that would seem to point to price reductions rather than increases.

In this whole area of structural reforms I had heard lots of common sense, lots of enthusiasm. I think this is an area where our September 23rd meeting could produce more concrete proposals if we work on it and produce some papers, in the meantime perhaps be able to speak more specifically about what we think could be done in those areas.

Throughout the discussion there was a recurrent theme stressing the need for international coordination and cooperation, the United States role in the world, for our interest in abetting the recycling of the petroleum dollar and promoting liberal rather than protectionist trade and capital movement.

In the area of price and wage actions or price and wage pensions, several people talked about a major aspect of the problem being that of concern about the battle over income shares between business, labor and other producing groups in the economy. We are faced with a very understandable effort on the part of American workers to catch up from a position where they have been taking home a declining real income for each hour of work during the past 18 months, but the opportunities for them to catch up with larger wage increases are sharply limited. Those large wage increases if they emerge are bound to mean further price increases.

The question is how can labor be given any kind of assurance and incentive to moderate its demands through the wage route in an effort to produce some real income gains without inflationary wage settlements.

Three or four people stress this as a possibility where tax cuts might be applicable, where tax cuts aimed at the lower or middle income group might enhance the chances of wage moderation by assuring the worker that he would get that kind of gain in his take home pay. Related to that, of course, is the whole question of Government direct action to curb wage and price increases. That is an area where quite honestly this group is very far apart. There are lots of views.

There were a few explicit recommendations for mandatory price and wage controls in the area of business and labor power, in areas where there is a feeling that the market does not necessarily work automatically. No one that I heard was really talking about any kind of across-the-board control.



Three or four people inferred that the monitoring process that is envisioned by the council on wage and price stability goes too far in Government intervention in the wage-price process, particularly that it could worsen behavior of both labor and management by increasing fear of control.

In between were three or four people I heard urging simply a greater power and perhaps a beefed up program for the council on wage and price stability extending to subpoena power and power to suspend pending investigation of wage and price increases. These people expressed particular optimism that this, if you will, jawboning effort on wages and prices could work effectively, could have some moderation of the present environment because we do have a weak economy where demand pressures are not pushing up prices, and wages and one or two emphasized that it has a much better outlook now because of the restoration of the moral authority in the presidency, and that is something I think I can speak for all of us in expressing our gratitude for as citizens as well as economists.

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THE PRESIDENT: Thank you very much, Arthur.

After listening to that, I wish I had been here. I will get the opportunity to see the transcripts and I will read the comments made in the discussion.

Next, we are going to have the benefit of Kenneth Galbraith's observations and comments based on what he heard or what he thought he heard.

MR. GALBRAITH: Thank you very much, Mr. President.

I think I share with everyone the feeling that Arthur Okun has done an admirable job of summarizing, perhaps however exaggerating slightly the area of agreement.

I think, Mr. President, the question here that divides us is perhaps the question of how profligate one is in response to your instructions. There is a choice here between action in the short run and action in the long run, action immediately on inflation and action which, in the expression of many of my colleagues, involves requests to be patient.

I wonder whether we should not also be reminded of a famous observation of J. M. Keynes that in the long run we are all dead. This may not be true of all people but perhaps it has more poignancy for people who are running for election or re-election.

I would like to urge, and here, I think, I have the support of Bob Nathan and one or two others, the danger of unduly gradual action. I think there is a multiple of causes of inflation and they should be attacked now on a multiple front and in the long run even though you avow more than I do the sanctity of the market we will be better served by that action.

Specifically, I would not at the present time ease monetary policy. It seems to me with inflation running away as it is one cannot ask that. I would increase taxes. I admire Mr. Ash's optimism but he is not going to cut back any expenditures as a practical matter and, to the extent that he does cut them back, the effect is going to be very slow. This is not to deny the great effort which he is making, which, I am sure, is very great, or to discourage him entirely, but it is optimism which will not be justified by the facts.

I would certainly urge that you, yourself, in asking for the revival of the Cost of Living Council as it is now otherwise named conceded, in effect, the need for wage and price controls without endorsement, and they had better be enforced.

I, with some others here, am not terribly concerned about the damage you do in fixing prices that are already fixed, or even wages that are already established outside of

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the market on which we were once reared.

Finally, I would urge what I think everybody here urges, a very energetic attack on the bottleneck areas, going back to my earlier interest in agriculture, particularly on the fertilizer problem. This is in many ways decisive. I would urge that this be done with the energy which then assures people in the near short run and insures business firms that dollars are worth holding so that we do not have the added inflationary pressure from people wanting to spend, thinking that the dollar is something that they had better get rid of.

If this is done in a context where we are willing to pay people a compassionate level of income when they lose their jobs and provide public service employment to the extent that this is a possibility, I have no doubt that inflation can be brought to a reasonable level, three or four per cent, within a year or two, also, without great suffering.

Let us not be beguiled by the fear of recession and have that fear keep us from attacking inflation which is, after all, the source of a great deal of suffering at the present time.

If the energy is brought to bear, including the energy which admits there is a need for some squeeze on profits, some questions on higher incomes, my suggestion for raising taxes would be for people above \$15,000 to \$20,000 so you don't upset the wage structure.

If the controls are firm, accepting again some squeeze on margins, then I think we can work our way out of this in a relatively short time.

I have only one further comment.

Mr. Grayson and I are the gray-haired veterans of controls around this table. Mr. Grayson disagrees with me peaceably on the desirability of controls.

I would like to add what I am sure is a self-serving comment to Mr. Grayson. The difference is that I administered controls when they worked. (Laughter)

THE PRESIDENT: Thank you very much, Mr. Galbraith.

Under the schedule which has been handed me, we go from Harvard to Chicago and call on Milton Friedman.

MR. FRIEDMAN: Unaccustomed as I am to agreeing with Ken Galbraith, I agree with him on one point: We should not be beguiled on the danger of recession.

The United States economy is fundamentally strong but that strength is currently being eroded by the disease

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of inflation. If that disease is not checked it will take a heavy toll including, in my opinion, the very likely destruction of our personal, political and economic freedoms. Any cure would have to be painful indeed to be worse than letting that disease rage unchecked.

There is one, and only one, way to cure the disease, to slow down the rate of increase of total dollar spending, and only the Federal Government can effect that cure. It can do so by reducing its own spending and by slowing monetary growth which will reduce private spending. Wage and price controls are no part of the cure. On the contrary, as the past three years dramatically illustrate, they are part of the disease and one of the most damaging parts.

I therefore heartily applaud your determination to cut Government spending. That will not only contribute to curing inflation but it is desirable in its own right. The American citizen is not getting his money's worth for the roughly 40 per cent of his income that is being spent for him by Government, Federal, State and local.

I heartily applaud, also, the expressed determination of the Federal Reserve to slow monetary growth and even more the appearance of actual slowing of monetary growth.

However, despite the cries of anguish about this table and elsewhere about tight money, the slowing has so far lasted two or three months so we cannot yet be sure the Fed has really departed from the ever more inflationary path it has been following for the past decade.

A more subtle problem than how to cure inflation is how to devise sedatives that will ease the debilitating effect of the disease and the painful side effects of the cure. The disease produces widespread inequity and distorts the use of our resources. The cure inevitably involves a temporary period of low growth and relatively heavy unemployment in the process of transition from a high level of inflation to a low level.

These harmful effects cannot be eliminated but they can be greatly eased by appropriate Government policy. First, it is important to apply the cure gradually provided the gradualism does not mean inaction. Second, much of the harm from inflation and much of the pain of withdrawal comes from unanticipated changes in the cost of and return from doing business. These can be greatly reduced by the widespread use of escalator clauses.

The Government can help by inflation proofing its taxes and its borrowings and by encouraging thrift institutions to inflation proof their loans hereafter. The personal and corporate income tax can be inflation proofed by automatic cost-of-living adjustments and personal exemptions, low income allowance, bracket limits, the base for capital gain and the

base for calculating depreciation. No other single step that the Federal Government could take would, in my opinion, do so much simultaneously to reduce the damage done by inflation to promote an equitable sharing of the burden which we all agree is an important element and to encourage both saving by individuals and productive investment by business.

In addition, the Government should end the unconscionable bucket shop operation under which almost every purchaser of long-term Government securities over the past several decades has been taken to the cleaners. The Treasury should do its borrowing, except for very short-term borrowing, in a form that offers a return adjusted for inflation. That would provide the ordinary citizen of this country with some way to hold his modest assets that would promise him a real return.

Thrift institutions are faced with catastrophe. The political reality is that they will have to be bailed out. The right way to bail them out, I may say as a hard liner, with political considerations, if they were not there I would not bail them out. I would say, let the profit and loss system operate. But there are better and worse ways to bail them out if you need to do so and I believe you will have to do so. The right way to bail them out is to subsidize part of the excess of market interest payments to depositors over contractual interest payments on condition that all new lending be in an inflation adjusted form. That will assure that the subsidy is self-limiting and that you simultaneously improve the financial structure.

My third main sedative is to assure that the burden of inflation and the painful side effects of the cure do not rest on our most disadvantaged citizens. It is urgent that we improve our arrangement for welfare and for assisting the long-term unemployed.

Unlike many of the people at this table, I believe that the much-touted public employment program has nothing whatsoever to contribute to this objective. If they are non-inflationary, they simply substitute Government employment for private employment without altering the total level of unemployment. These sedatives will ease the transition but they will not enable us to get off scotfree. We will still suffer harm from the lingering disease. We shall still have the painful side effects of the cure.

More important, and this is a fundamental challenge that I believe faces you and the members of the Congress, they are not a substitute for the political courage and will that it will take to tell the public this hard truth and to persuade the public that the sooner we bite the bullet and take the cure, the better.

Thank you very much.

MORE.

THE PRESIDENT: Thank you very much, Milton.

We now go back to the East Coast and I would like to ask Paul Samuelson of MIT to give us his summary.

MR. SAMUELSON: Mr. President, my middle western credentials are excellent.

(Laughter.)

We have had a very good summary, I think, by Arthur Okun and you pretty much have learned that when you have 30 economists together that about 20 of them take a middle ground eclectic position and that about 10 of them spread toward one fold or the other.

Dr. Okun has concentrated upon the amount of agreement. I think that is proper. Let me say since I belong to the 20 eclectics, first I think it is important that the Nation know that a broad spectrum of opinion is being solicited for views. There is a naive notion which I think ought to be corrected that just because the previous administration was busy in other directions some easy cures for inflation were not done and you just need a smarter bunch of people. We are now getting proof that that is not the case.

In fact, speaking for about 20 out of 30, the emphasis was that we don't have a super, number one problem of inflation. We have a problem of stagflation. It is a two-sided problem and it has an eclectic approach. If I may say so in concluding, there have been times when the Head of State comes in and the people can speak of many miracles and perhaps in a measure, miracles can be done; perhaps at the bottom of the Great Depression in this country, perhaps in Germany at the end of World War II when the pricing system had broken down.

But, most of the time when new heads of state come in there are always people who urge on many, do something, act, be positive. Of course, do something; of course, act; and, of course, be positive. But there are a lot of things you can do that are harmful.

I think of Winston Churchill, a man of blood, sweat and tears, describing World War I where 500,000 English soldiers were lost for 15 yards at Passiondale. Then the question was, "General Robinson, why did you do it?" He said, "I had to do something." Well, that sort of a thing is not going to give courage to the stock-market.

I think what we can do, what I can do as a professional economist, is to point out the trade-offs and the complicated dimensions of the problem. We are in good shape compared with historical problems. Nevertheless, the message which so many of us have come to on the basis of studying the evidence

is that this two-digit, low two-digit inflation has been built up over a period of more than a dozen years. The attempt to end it now, to be overly dramatic, to say this is the last chance for the system as we have known it is not only going to be disappointing but I think will be counter-productive. You are simply going to press too hard and then the backlash is going to go in the other direction. There is hope that we can do better. I mean, by the way, not the public relations hope. I mean reasoned hope based on the evidence that the normal state of affairs is not two-digit inflation for the U.S. and not something worse.

Now, most of the people are very frightened on that and will have to be shown. But I don't think that we are going to get down in the next year or the next couple of years to 3-percent price inflation, no matter if we bite every bullet that is in sight. I think that this meeting has been a good meeting in airing the different dimensions of the problem. I am encouraged by today.

THE PRESIDENT: Thank you very much, Paul. I couldn't agree more that we have to act and we have to act predicated on some response and I think sound recommendations which I hope will come as we study the recommendations that have been made here. From what I have heard there is a minimum difficulty in the main, in the areas of where we are, where we can go and how we ought to go there.

Just like in the political arena, I think the main spectrum, Democrats and Republicans, is within a reasonable latitude from one end to the other. Some in both parties do fall into the far ends of the political spectrum. The American people fall in the middle and they want us to take those actions, I believe, that are within that center of the overall spectrum.

Now, we go back to the Middle West with Paul McCracken of my Alma Mater. Paul?

MR. MCCRACKEN: Well, Mr. President, I think Paul Samuelson sounded the note which is probably the most important, namely that while this is, of course, a very difficult problem and we must recognize the problem, that none-the-less we can see on the basis of the hard evidence the possibility of turning this rising trend in the rate of inflation around and starting it back down.

I suspect the single-most important thing is not to produce promptly a stable price level but to produce progress in that direction instead of seeming to have a situation that is deteriorating.

Since the summaries have been excellent, I would have only just a couple of specific comments to make. One of these is that in setting up the Council on Wages and Prices, it might

be wise to charge them specifically with the responsibility in their work, their analytical work and pronouncements, with monitoring the impact on the cost-price level of Government programs as well as pricing decisions and wage decisions in the private sector. That might be one way to get at Professor Houthakker's list of 45 which I take it is the lined successor to Senator McCarthy's list.

(Laughter.)

The final point that I would like to emphasize here is really an extension of Art Okun's comment about the emphasis that has been placed here on the international dimensions. To an extraordinary extent the U.S. economy, as Professor Cooper, I believe, mentioned, has found itself linked to the world economy generally for a variety of reasons -- the oil problem, the impact of devaluation and so forth.

It is important to have consultation and coordination on trade policy as a shaping-up of the new international monetary and financial system. One dimension of this which I would want to emphasize is that it is critically important to actively further consultation and coordination in the management of domestic economic policy in the key currencies of the world. Otherwise, there is going to be a tendency for each government to run for cover and try to balance out its own situation and produce cumulative deterioration.

THE PRESIDENT: Thank you very much, Paul.

It seems to me that for a Wolverine to recognize a Gopher is something that I am not accustomed to, but I will on this occasion recognize Walter Heller for his observations and comments from the University of Michigan.

MR. HELLER: Mr. Chairman, if you will accept my recommendations I will let you take home a Little Brown Jug.

(Laughter.)

MR. MCCrackEN: I might point out we already have it.

(Laughter.)

MR. PRESIDENT: Paul, I was about to say that but you can get away with it. I can't.

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MR. HELLER: Let me say, it is refreshing to be in a White House that once again is open to a little laughter, a little dissent and willing to face the unvarnished, and at the moment, rather dismal economic facts of life.

You heard before you left this morning that we are not facing a particularly happy situation for the next year. I don't mean happy just in terms of the recession we are in. I mean in terms of the trade-off between the recession and the inflation.

It seems to me, the forecasts around the table suggest a recession that will pull us down to maybe 6-1/2 percent unemployment. It is at least a 50/50 chance that the Gross National Product next year, when the second annual Summit Conference meets, will be below what it is today if present policies persist.

Meanwhile, inflation people are talking about dropping to nine, eight, seven percent at best. That is a tough trade-off. It does not strike me as an awfully good bargain. Yet, it is not really surprising because why should a policy that focuses on slinging total business, consumer and Government demand be very effective in subduing inflation that is chiefly propelled by food shortages, by oil cartels, by supply bottlenecks and by dollar devaluation and one that is now turning into a self-propelling price-wage spiral?

I think, to bring that kind of inflation to its knees, as you suggested this morning, by tough monetary and fiscal measures alone -- and I am not saying it will be the policy, but if you were to pursue the policy of just the old-time religion, suppressing effective demand, I think, in bringing inflation to its knees, we will put the economy flat on its back. I think this, essentially, just to hang this up, is not enough.

We cannot let inflation fill the whole field of our vision. We can't practice one-dimensional economics, and that has been emphasized by many of the participants today.

My major plea is to broaden our context, broaden our perspective on the inflation problem in several respects. First, recognizing this chilling fact that the price explosions of 1973 and 1974 are now being transformed into a new price-wage spiral. We have to build an effective circuit breaker in the spiral. That requires not a strait jacket of direct control, but, I think, it implies more clout on the part of the Council of Wage and Price Stability.

To give it the clout it needs, I would go along with the suggestion made that it have powers of subpoena. I go along with Arthur Burns suggestion that it have powers of suspension. You know, the case of really certified outlay in the case of where they really flout the public interest, I think you need the club in the closet, a rollback power.

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Now that may go against your free market grain, Mr. President, but it really shouldn't because monitoring would be focused on those powerful unions and those powerful units that wield excessive market power; in other words, in those areas of the economy where competition is a very poor policeman. This would be coupled with antitrust policy. The Government process would be a stand-in for the forces of competition. It would not be intervention in other words in a free market that is really functioning competitively. That is an attempt perhaps to sell it to you but I also think it is good economics.

Let me go on to just a couple of other points. I do think we ought to put the price-wage restraint panel into a broader context. It can't be just legislative. It has to be won partly by Presidential persuasion, partly by broadening the context of the policy of wage-price moderation. You can't expect labor to accept a five percent drop in real earning power without going to the bargaining table to get it back. What can the Government offer?

It seems to me it has to offer more belt-tightening than just a \$5 billion cutback in Government expenditures. It has to offer more than just that belt-tightening. It seems to me we have to be really free-wheeling in our thinking here.

On the tax front several people have suggested putting cuts either in the lower income brackets or cuts in the payroll tax, especially for the working poor. They should be relieved of the payroll tax entirely, if that could be laid so to speak on the national bargaining table between labor and business.

There are some other thoughts on that I hope you will look into further in our conference on the 23rd.

Then, I think another respect in which we ought to broaden the perspective is to realize the energy, the harm in the anti-inflation policy and other types of policies. For example, take energy. Balancing the energy budget is as important as balancing the Federal budget. Perhaps you can work the two into one basket. That is, perhaps trying to cut down on energy consumption partly by graduated taxes on automobiles, although that is a terrible thing to say to a man from Michigan, or on automobile horsepower, a tax on energy use, and tax relief for the group hardest hit by inflation and tax relief and expenditure programs that will help those who are the victims of inflation.

You have heard a lot about supply management and so forth. I won't repeat that. I will just wind up by saying that a truly balanced attack on inflation should start with a program of moderate monetary and budgetary restraint and should couple with that, measures that would regress the grievances of skyrocketing food and fuel prices. I urge you to consider as part of the integral part of a compassionate anti-inflation program not only more generous unemployment compensation, food stamps, housing allowance, but relief from payroll taxes for the working poor and an increase in personal income tax exemption of low income workers.

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I am not suggesting any cut in revenues. I am suggesting that be picked up from other sources, including budget cuts, including tax reform. I think that distributing the benefits and burdens of economic policy more fairly will facilitate a more sustained battle against inflation. If we just declare total war against inflation without taking care of the resulting casualties, we are going to invite a public backlash. This is a plea not to be soft on inflation but to strike a sensible balance between benefits and cost in anti-inflation program, thereby staying within the bounds of political and economic tolerance, thereby enabling you to win the war against inflation not only in economic terms but in human terms.

Just a final note. I realize, Mr. President, that if you follow the foregoing counsel it will enhance the prospect of your election in 1976 but in the belief that partisanship stops at the inflation door, that is a risk I will have to take.

(Laughter.)

THE PRESIDENT: Thank you very kindly, Walter.

I think to finalize it I would like to call on an old and dear friend of mine, a person who came to the Federal Government five plus years ago, served with outstanding success and, I think, respect in a number of posts and positions. I speak here of George Shultz who was Secretary of Labor and head of that very popular organization in the Federal Government, the Bureau of the Budget. He served as counselor, I think, with no portfolio but helped run in the broadest sense, the Federal Government as Secretary of the Treasury. I think his departure was a great loss to the country as well as to the White House.

George, would you wrap it up and give us the benefit of your observations and comments.

MR. SHULTZ: First, Mr. President, thank you for your most generous remarks. It is so characteristic of you and I think we are all affected by your sense of confidence in individuals, and one can't help but feel now that I have the perspective out there in the country, the sense that you trust the country and I am sure that feeling is reciprocated.

I think there is a very general view here, as has been summarized. Obviously, we have an extremely difficult problem and with whatever modifications of discipline and stringency anyone recommends, still the course that needs to be travelled is a fairly long one and the word is discipline for the budget and for monetary policy, exercised, of course, in a reasonably way. I don't think that sustained discipline can be exercised unless people do feel that they understand the problem and that the people giving leadership have taken the trouble to understand it and exposed themselves to a variety of views.

In that sense, I must say I think this meeting is a start and those that you propose are very good. I would confess to you that I came here this morning with some skepticism about what might happen in a room this full of people, with television cameras and so on. As far as I can see, people have said the same sorts of things they say in private and for most of them in public too.

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On the whole, I think it has been a very constructive day. I believe that a series of these will help to educate people, not only people generally who are watching but the people who participate in the process.

So, it seems to me, with all of the difficulties we have, we are going to get through these problems, and I believe that you have initiated a process that is a good one.

Having said that, let me make one comment of a critical sort about some of the things that have been said.

I am distressed to see the wage and price control head stick up again. I thought we had learned our lesson that it really didn't work out very well. But, at least a fair number of people here seem to want to return us down that road. I think it is a mistake. I think the more talk that comes from Washington about guidelines and controls, the more people in the private business sector raise their prices and, in cases where they anticipate a tight labor market, raise their wages and salaries. So, I think it can be quite counter-productive.

I would suggest that you follow Paul McCracken's suggestion and have the Committee on Wage and Prices focus some of its attention on monitoring Government and before taking the advice of economists on what to do to labor and management, I think we might consider forming a small labor-management committee of 10 or 12 people and listen to what they have to say about their problems and see what advice they have to offer before we start telling people how much wages they should ask for and how much price they should be charging.

In general, Mr. President, it seems to me that this process that you have organized has all of the earmarks of something that can be very successful in doing the main job, namely, letting everybody see the difficulty of the problem, letting everybody see the variety of possible things there are to do about it and to see that whatever course we take is going to be a difficult one but if we do have the patience to stick with a disciplined policy we can work our way out of this problem.

THE PRESIDENT: Thank you very much, George.

Let me reiterate my appreciation for all of you being here.

I must confess that when I first heard of the resolution that was proposed in the Senate, I was somewhat apprehensive about an undertaking of this kind. But in the first few hours of this Administration, I reanalyzed the suggestion in relationship to the economic problems that have been well

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displayed here. And it seemed to me, as I tried to say in the opening statement, this isn't a problem that only a President can solve. It is not a problem that only the Congress can solve and it certainly is not a problem that any one element in our society can solve.

So, in response to the recommendation of a bipartisan effort in the Senate, I determined that it should be undertaken, that it should be in the open so the American people could see firsthand the consensus as well as the divergencies. And this was the first group and I shared the apprehension that some have expressed, that men of high academic standing and great intellect couldn't sit in a gathering such as this and give a top flight presentation of the problem and some responsible suggestion.

But I think you gentlemen and ladies have set a very high example for those meetings that shall follow. And I happen to believe that with this outstanding gathering, and the things that have been done, those that will follow will likewise be of the same caliber and high quality.

So, I thank you not only for what you have contributed, but the performance that I think has been superb.

And with those words, I think we probably ought to conclude the afternoon session and the day's labors and retire for a bit of relaxation and a reception and I cordially invite you all to come to the dining room for such a purpose.

Thank you very, very much.

(Whereupon, at 5:32 p.m., the conference concluded.)