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Info

THE WHITE HOUSE

WASHINGTON

April 12, 1976

MEMORANDUM FOR THE EXECUTIVE COMMITTEE, ECONOMIC POLICY BOARD

FROM: WILLIAM F. GOROG

SUBJECT: Update of Selected Economic Statistics Release

1. Money Stock Measures

Change in February from:	M_1 (%Change)	M_2
November 1975	+1.5	+9.3
August 1975	+2.5	+8.1
February 1975	+5.3	+9.5

2. Total Industrial Production (Real terms, seasonally adj.)

(Index: 1967 = 100)	Index	% Change
February 1976	120.1	+0.5
January 1976	119.5	+0.8
December 1975	118.5	+0.8
November 1975	117.6	-
(Febr. 1975-Febr. 1976)	-	+8.0

3. Retail Sales (Current dollars, seasonally adj.)

Total:	$ Billions	% Change
March 1976	53.87	+2.8
February 1976	52.41	+1.6
January 1976	51.59	-
(March 1975-March 1976)	-	+17.2

4. Housing Starts and Building Permits (Seasonally adj.)

Starts (annual rates):		Millions of Units	% Change
February	1976	1,555,000	+27.0
January	1976	1,224,000	-5.0
December	1975	1,291,000	+37.0
December	1974	940,000	-
Permits (annual rates):			
February	1976	1,127,000	-
January	1976	1,120,000	+9.0
December	1975	1,028,000	+49.0
January	1975	689,000	-

5. Employment and Unemployment (Seasonally adj.)

Civilian Labor Force (CLF):		Millions of Persons - 16 yrs.+
March	1976	93.72
February	1976	93.50
January	1976	93.50
December	1975	93.12
March	1975	91.88
December	1974	91.64
Employment:		
March	1976	86.69
February	1976	86.30
January	1976	86.20
December	1975	85.39
March	1975 (low)	84.11
December	1974	85.05

Unemployment:		Millions of Persons	% of CLF
March	1976	7.03	7.5
February	1976	7.10	7.6
January	1976	7.30	7.8
December	1975	7.73	8.3
May	1975 (peak)	8.25	8.9
December	1974	6.58	7.2

Unemployment:

Heads of Households:

			(% of Group)
March	1976	-	5.0
February	1976	-	4.9
January	1976	-	5.1
December	1975	-	5.7
May	1975	-	6.1
December	1974	-	4.6

6. Manufacturers' Shipments and Orders (current dollars, seasonally adj.)

		$ Billions	% Change
Total Shipments:			
February	1976	90.96	+1.9
January	1976	89.25	+1.9
December	1975	87.62	+1.1
November	1975	86.66	-
Total Inventories:			
February	1976	147.20	+0.1
January	1976	146.78	+0.1
December	1975	146.57	-
November	1975	146.67	-
Total New Orders:			
February	1976	90.37	+2.5
January	1976	88.19	+1.7
December	1975	86.75	+0.5
November	1975	86.35	-

7. Consumer Price Index

All Items - 12 mos. previous to:

		% Change
February	1976 (+0.1 for month)	+6.3
January	1976	+6.8
December	1975	+7.0
September	1975	+7.8
June	1975	+9.3
March	1975	+10.3
December	1974	+12.2

8. Wholesale Price Index

All Commodities - 12 mos. previous to:			% Change
March	1976 (+0.2 for month)	@	+4.8
February	1976		+4.7
January	1976		+4.4
September	1975		+6.3
June	1975		+11.6
March	1975		+12.5

9. Gross National Product (constant 1972 dollars)

Change from previous Quarter:		% Change
Fourth Quarter	1975	+5.0
Third Quarter	1975	+12.0
Second Quarter	1975	+3.3
First Quarter	1975	-9.2
Fourth Quarter	1974	-7.5

10. Real Spendable Earnings

12 Months previous to:		% Change
February	1976	+4.8
January	1976	+4.3
December	1975	+3.8
September	1975	+1.6
June	1975	+0.2
March	1975	-4.6
January	1975	-5.1

11. Personal Income (current dollars, seasonally adj.)

Annual Rate:		$ Billions	% Change
February	1976	1,327.9	+1.0
January	1976	1,315.0	+1.1
December	1975	1,300.2	+8.3
December	1974	1,200.4	-

12. Composite Index of Leading Indicators

Change from previous month:

		% Change
February	1976	+0.8
January	1976	+1.5 r
December	1975	+0.8 r
November	1975	+0.2 r
October	1975	-0.4 r
September	1975	0.0
August	1975	+0.9
July	1975	+2.5
June	1975	+3.0
May	1975	+1.9
April	1975	+3.0
March	1975	+0.9
February	1975	-0.8
January	1975	-3.4
December	1974	-2.2
November	1974	-3.1
October	1974	-3.9
September	1974	-4.1

(r = revised)

Info

THE WHITE HOUSE

WASHINGTON

April 9, 1976

MEMORANDUM FOR THE EPB/CIEP EXECUTIVE COMMITTEE

FROM: WILLIAM F. GOROG WFG

SUBJECT: Review of International Economic Policy Issues

Attached for your information is the planned Agenda for an EPB/CIEP review of international economic policy issues, tentatively scheduled for April 29-30, 1976.

Enclosure

EPB/CIEP INTERNATIONAL ECONOMIC POLICY REVIEW

Agenda

TIME	POLICY ISSUE	LEAD AGENCY
	SESSION I. April 29,1976; OEOB Room 208	
8:30am	A. WORLD ECONOMIC OUTLOOK	CEA
9:00	B. TRADE POLICY 1. Review of current and upcoming escape clause, antidumping and other safeguard issues 2. Multilateral Trade Negotiations 3. East-West Trade	STR
10:00	C. COMMODITY POLICY Review of proposed U.S. "Comprehensive Approach" relative to LDC Integrated Program	STATE/ TREASURY
10:30	Adjourn	
	SESSION II. April 30,1976; OEOB Room 208	
8:30am	A. FINANCIAL POLICY Review of short and long-term financial developments affecting U.S. relations with Western industrial nations, less developed countries and the nonmarket economies; including: 1. Balance of payments/current account projections: a) financial requirements b) implication of exchange rate fluctuations c) status of existing/potential financial mechanisms d) disposition of OPEC surplus 2. Capital needs for: a) sustained regional economic growth b) the development of alternative energy sources 3. Cooperation on domestic economic policies among developed nations	TREASURY
10:00	B. ACTION FORCING EVENTS Summary of upcoming activities and events requiring the consideration of the President	EPB
10:30	Adjourn	

ECONOMIC POLICY BOARD
EXECUTIVE COMMITTEE MEETING

AGENDA
8:30 a.m.
Roosevelt Room

STRICTLY PRINCIPALS ONLY

April 14, 1976

1.	Price Outlook for Food, Energy, and Manufactured Goods	CEA
2.	Tax Update	Treasury

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

APR 12 1976

MEMORANDUM TO: The Economic Policy Board Executive Committee

FROM: Charles M. Walker CMW
Assistant Secretary of Treasury for Tax Policy

SUBJECT: Tax Update

Friday morning, April 9, Secretary Simon, Mr. Seidman, Hal Eberle and I met with Senator Long to discuss the pending tax legislation. The highlights of the discussion were:

1. There was a consensus that the 10 percent investment credit would be made permanent and that the credit would be refundable in the year when unused credit carryovers would otherwise expire. The refundable feature would apply to property acquired in the future, but not to expiring credits on previously-acquired property. Because unused investment credits carry over to the seven years following the year of investment, there would be no impact from refundability on the five year budget projections.

Basis adjustment to accompany the refundable investment credit was discussed. We noted the Administration had proposed this some time ago (not among our current proposals), and that if asked about our support of the refundable credit we would say we do support if accompanied by the basis adjustment. Senator Long claims to have suggested such a measure himself, but now is opposed to a basis adjustment. We acknowledged a substantial view in the business community in opposition to the basis adjustment.

2. Regarding the tax shelter issues, there was general agreement that an alternative tax approach (such as the Administration's Minimum Taxable Income proposal or the New York State Bar Association and Arthur Andersen alternative tax proposals) is preferable to the minimum tax provisions of present law and the House bill.

3. Senator Long indicated that an Employee Stock Ownership Plan provision would be tied to the utilities tax package. As described by the Joint Committee staff, this would involve the contribution to an ESOP of the additional two percent investment credit (increase from 10 to 12 percent) and a matching two percent contribution out of the employer's own funds. The contributions would be made over a five year period as follows:

Year One (year of investment)	No contribution
Year Two	One percent (half of credit)
Year Three	One percent (half of credit)
Year Four	One percent (employer funds)
Year Five	One percent (employer funds)

The employer's contributions from its own funds would be tax deductible, so that the government would in effect pay three-fourths of the cost. And the stretch out of contributions over five years would give the employer interest free use of government funds for a period while deferring the employer's own cash contribution.

We believe the Senator accepted the principle that ESOP and the President's proposed Broadened Stock Ownership Plan are compatible and can go forward simultaneously.

4. There was a consensus for retaining the present DISC provisions. Secretary Simon will present the annual DISC report when he appears before the Finance Committee on Tuesday.

5. There was also discussion of the feedback or ripple effects of certain tax changes. Senator Long has been pushing for a reduction in the estimated revenue gains from the House bill DISC and tax shelter provisions on the ground that the estimates fail to take into account the impact on investment and jobs (and, thus, taxable income) in the affected economic sectors. Similarly, he has suggested that estimated revenue losses from tax relief provisions are too high because they fail to take into account increased investment and jobs and the resulting increase in income taxes from the benefited activities. We pointed out that while there may be such initial feedback effects in the particular affected sector, such effects are ultimately offset by adjustments elsewhere in the economy. In other words, the potential income or tax base in the economy is a function of the overall deficit and monetary policy. Limited tax changes do not change that tax base, as proponents of feedback analysis assert; they simply increase or lower the applicable tax rate. Our revenue estimates assume no change in the deficit or monetary policy and do not measure the effects of such limited tax rate changes.

COUNCIL OF ECONOMIC ADVISERS
WASHINGTON

ALAN GREENSPAN, CHAIRMAN
PAUL W. MACAVOY
BURTON G. MALKIEL

April 13, 1976

MEMORANDUM TO ECONOMIC POLICY BOARD

FROM: Paul W. PM MacAvoy and Burton Malkiel BM

SUBJECT: Wage Rates, Energy Prices, Fuel Prices, and Inflation

Recent collective bargaining decisions have raised questions once again about the outlook for price increases in the coming year. Similarly, proposals for price decontrol in refined petroleum products called for in the Energy Policy Act could have effects on the CPI, as could changes in OPEC prices and in prices of other fuels. The outlook for food prices is promising, but weather conditions and additional sales to the Soviets produce upside price risk.

These current conditions are reviewed here. The questions addressed are whether (1) the forecast of slightly less than 6 percent price level change for the CPI in the Calendar Year 1976 should be revised upwards, (2) whether there is substantial probability of further price increases, even if the forecast is not revised. The answers indicate that the forecast need not be revised at this time and, indeed, that there is both upside and downside risk. But there is a substantial probability of further price increases in energy and food, as great as one to two percentage points of CPI increase.

1. <u>Wages</u>

<u>The December 1975 Projections</u> wage developments have an important bearing on the overall price outlook since they are a major element of business costs.

In our last official forecast, during December 1975, we projected that compensation per man-hour would rise between 8 and 9 percent in 1976 over 1975 levels. We believed that such increases would be consistent with an overall inflation rate no larger than 6 percent. We anticipated relatively large productivity increases during the early stages of the recovery that would keep unit labor costs from exceeding the projected inflation rate.

Restating our December forecast in terms of changes during the year (that is, end of 1976 over end of 1975 instead of 1976 yearly average over 1975 yearly average), we looked for 9-1/2 percent increase in compensation per man-hour. This 9-1/2 percent rate represented a weighted average of the rates for three components of the private sector labor market; (1) the 15 percent of employees covered by major collective agreements, (2) the 12 percent covered by smaller agreements, and (3) the 73 percent not organized. Recognizing that each of the 3 sector estimates has a margin of error, the following ranges were identified:

10-11 percent increase in compensation per man hour under new and existing major agreements.

9-10 percent under smaller collective agreements.

8-9 percent in the unorganized sector.

Implicit in the 10-11 percent projection for new and existing agreements in the major union sector was an estimated 12 percent for first year wage increases in new agreements to be negotiated during 1976.

Evidence During the First Quarter of 1976. So far this year changes in major collective agreements have not exceeded the 12 percent level. Both the Teamsters and ILGWU agreements were for 10 percent for the first year, while at least some construction agreements have been lower. At the same time, the early evidence on the underlying trend in compensation of all private employees in 1976 indicates about a 7-1/2 - 8 percent rate, considerably less than in our December forecasts.

<u>Sensitivity of Estimates to Developments in the Major Union Agreements</u>. It is not possible directly to state the sensitivity of total wage changes to changes in the rate of wage increases negotiated in new major collective agreements. Beyond the direct effect on the total average there is some "demonstration" effect on other wages. However, this effect can be quite limited in a slack labor market. Very great disparities between major agreement wage changes and total wage changes occur, as in 1970-71 when first year changes under major agreements were 12 percent while total wage changes were under 7 percent.

In the absence of significant upward demonstration effects and with a general inflation rate of 5-1/2 to 6 percent, we now see no reason to believe that compensation per man-hour will exceed our forecast for 1976. Because of the large number of major agreements yet to come, which may average over 10 percent and the strength of the recovery, however, we prefer not to lower our estimated range published in January.

2. <u>Prospective Fuel Price Increases</u>

Fuel prices stabilized late in 1975 and then fell, moderating CPI increases. In the near future, these prices are unlikely to continue to play a moderating role. While explosive increases such as in 1974 are unlikely, an upward drift beyond the seasonal increase in these prices is probable beginning as early as late spring or early summer for three reasons:

(1) Crude prices will increase automatically because higher prices are scheduled under regulation and because a larger portion of crude will be imported, increasing the weight of the higher-priced imported crude in the total.

(2) Refinery and marketing margins may increase with product decontrol.

(3) The price of imported oil could increase due to OPEC actions.

The following three subsections are designed to assess these changes. The fourth subsection notes what is likely to occur in other fueld sectors and the final subsection offers some tentative conclusions.

FEA is in the process of making its final decisions on the timing and apportionment of increases in the regulated price of crude called for in EPCA. At this time, it is likely that the first upward adjustment will be retroactive back to March 1, and will increase the base price at a 9.8 percent annual rate. After June the increase will be somewhat less because of a lower inflation adjustment.

The current strong recovery is leading to increases in oil consumption while lower-48 production continues to decline. Consequently, a rising proportion of the oil will be imported over the indefinite future, drawing the average price of crude upward.

Petroleum Product Price Decontrol. The removal of downstream price and allocation controls on gasoline, jet fuel and distillate could lead to significant increases in their prices over the coming year. This will occur only if substantial quantities of products are imported because only then would the price received for products refined in the United States be influenced by the crude costs of foreign refineries rather than by the regulated acquisition cost of crude by domestic refineries. Product imports at such levels, in turn, are likely to occur only if domestic refineries are unable to meet product demand at operating rates lower than those at which costs rise steeply.

It is unknown whether such cost increases would occur at the levels of utilization predicted for 1976. Industry opinion is mixed and historical evidence provides no reliable guide. The prediction is that there will be no general movement to refined imports and thus to world price levels in the remaining months of this Calendar Year.

Even if overall petroleum demand and refinery capacity during 1976 are such that such costs do not rise in general, the price of specific petroleum products could increase depending on individual product supply and demand conditions. If conditions for a specific product are such that demand exceeds the amounts available from domestic refineries at existing prices, then the price of that product will tend to go to the imported price.

The three major products to be decontrolled are gasoline, jet fuel and distillate, and thus the issue is whether, at the level of refinery utilization expected, these products would be in such short supply that price increases would occur. For gasoline, the answer appears to be "no" because substantial flexibility exists to alter the output mix toward gasoline and because even though gasoline demand is now depressed, it still is likely to rise less than is refinery capacity. The situation for jet fuel is different because little "swing" capacity to produce more of it exists. Its demand growth is expected to be slow, but, unlike the case for gasoline, jet fuel imports are substantial. Consequently, refinery capacity does not exist to produce sufficient jet fuel to meet prospective sales at current jet fuel prices. Thus, production capacity constraints are such that if controls were removed, jet fuel prices would likely rise to world market levels.

The distillate situation is more complex. Distillate is the second largest product of U.S. refineries, with volumes about one-half as large as those for gasoline. Substantial flexibility exists in shifting output toward distillate. Its major uses include both motor fuel and heat applications. In its heat applications its closest large volume substitute is residual fuel oil. Because it is such a close substitute, possible rapid increases in the residual fuel oil price make it difficult to predict whether or not distillate would go to world market prices even in the event that overall refinery capacity constraints were not binding.

The demand for distillate is expected to grow rapidly even if there is no major substitution of distillate for residual fuel oil. This increase could possibly but by no means certainly, be handled by domestic refineries without substantially increasing distillate prices. A further increase in distillate demand would probably lead to its price rising toward world levels.

OPEC Price Increases. The cost of crude oil will, of course, rise if OPEC acts to increase prices July 1. Under the EPCA, however, an increase in OPEC prices will not affect prices for domestically-produced crude. Consequently, only about 40 percent of petroleum consumption could be affected by OPEC actions. Moreover, a July 1 increase would not show up at the consumer level until the first of October, so the presently steady price of imported oil will exert a dampening effect on the blended price of crude during most of this year.

Other Fuel Prices. Interstate natural gas prices will continue their increases through 1976, even if no decontrol action takes place. Intrastate prices, on the other hand, are likely to rise much less than in 1973-1975 because new uncontrolled contracts are now at approximately the alternative fuel price; much of the "catch-up" from contract renegotiation has already occurred.

Coal prices have fallen on the sport markets and, as with intrastate natural gas, much of the "catch-up" in the prices of long-term contracts has occurred. Coal prices, then, possibly will moderate the overall inflation rate, rather than exacerbate it during 1976.

The price of electricity will closely follow fuel prices in 1976 because rates have now more or less caught up wtih the previously unrecovered cost increases of 1973-1975. Higher output rates will lessen the drag of excess capacity in some areas. The major uncertainty as to electric rates in the near term has to do with nuclear power. Since nuclear power, based on historical costs, is now the low-cost energy on most systems, any action which lowers the utilization of nuclear plants will raise electricity prices. For this reason the result of the California, and other, nuclear power referenda can have effects on electricity prices in late 1976 and 1977.

Conclusion. There are many uncertainties covering the rates of increase in fuel prices for the remainder of the year. Likely conditions are (a) the full increases in crude prices allowed by EPCA, (b) no major increases from decontrol of product prices, and (c) no price increases in imports. These conditions would increase the CPI by less than one-half of a percentage point more than found already in the baseline GNP forecasts in Calendar Year 1976.

Less likely conditions would bring about substantial distillate price increases from downstream decontrol, and an early OPEC price increase. Taken all together, the sum of the probable and possible energy price increases is likely to be less than another three-fourths of a percentage point on the CPI in Calendar Year 1976.

3. Food Prices

Following the sharp increase in the food CPI in the third quarter of 1975, the rate of growth of food prices has been declining steadily. The February 1976 food-at-home CPI was a seasonally adjusted 1 1/2 percent below January, and 4.4 percent above a year earlier. This was the lowest year-to-year increase in over three years.

Two major food groups still show substantial year-to-year increases. Meats, poultry, and fish prices in February were up 12.5 percent from a year earlier, and dairy products were up 8.3 percent. Meats, however, have fallen sharply at both wholesale and retail levels since the beginning of 1976. The recent changes in meat prices suggest that the March food CPI may again decline on a seasonally adjusted basis. However, the year-to-year comparison may not improve because in 1975 food prices also declined between February and March.

The recent month-to-month declines are expected to end in April however. The basis for this expectation is the current level of futures prices. Futures prices for wholesale farm commodities, with wholesale-to-retail margins increased according to historical price relationships for each major food category, have been used to generate monthly seasonally adjusted food CPI estimates into the near future. For commodities without organized futures markets, spot prices are carried forward by normal seasonal factors. These estimates are obviously very tenuous for distant forecasts. Nonetheless, for the past five months futures prices have consistently been predicting substantial moderation in food CPI increases. Futures prices as of April 2 yield the following forecasts:

	Actual changes Sept. 1975 to Feb. 1976 (actual)	Forecast Price Changes Seasonally adjusted percentage change from: Jan. 1976 to July 1976	Jan. 1976 to Sept. 1976	Sept. 1975 to Sept. 1976
Food	1.8	1.5	2.0	3.8
Food-at-home	1.7	0.9	1.3	3.0
Cereals & bakery products	-1.0	1.5	1.3	0.3
Beef & veal	4.1	3.7	5.9	10.2
Pork	-2.4	-5.0	-5.6	-7.9
Poultry	0.4	-5.1	-6.1	-5.7
Dairy products	6.0	0.2	0.5	6.5
Eggs	7.9	-2.8	-7.7	-0.5
Fruits & vegetables	2.8	-0.1	0.6	3.5

Risks in the Outlook. Futures prices provide the best forecast - even though not always accurate in prediction, they are the result of use of all of the information and forecast talent available in the markets. But even if these forecasts were quite accurate given current information, new developments could easily make them obsolete. On the supply side, the main risk is weather-induced shortfalls in one or more crops. On the demand side, the level of upcoming export sales is uncertain - particularly because Soviet intentions to purchase are not yet clear. During the later months in 1976, foreign demand will depend on crops in both importing and competitor exporting countries.

The Soviets could enter the U.S. markets for the approximately 3-1/2 million metric tons of U.S. 1975-crop grain they may still buy under the 17 million ton limit. The price effects of such purchases would likely be minimal because such sales have probably already been anticipated by the grain trade. If, in addition, the Soviets buy 3 million tons of our 1976-crop wheat, there would be some upward pressure on grain prices. However, the effect may not be substantial because wheat exports continue to lag. USDA has recently reduced their 1975-76 wheat export forecast and will probably do so again. Moreover, July 1 ending wheat stocks consistent with current export and use estimates are already about 4 million metric tons over 1974-75 ending stocks.

Under these circumstances it would be reasonable to expect at most a 3 percent increase in the wholesale price of wheat for every million metric tons of additional wheat sold. Therefore, if Soviet-induced export demand on the U.S. wheat crop were unexpectedly to increase by 3 million metric tons (on the order of 5-1/2 percent of the U.S. wheat crop), the price of wheat would rise by about 9 percent. Using the current July price at Chicago of $3.55 per bushel, the 9 percent increase would yield a 32 cent per bushel price rise. At the retail level, this would increase the cereals and bakery products CPI about 1-1/2 percent, and the overall food-at-home CPI by about 0.2 percent as of the third quarter of 1976. (The underlying analysis for this forecast is given at Tab A.)

Upside Price Risk. Additional export sales could have larger price effects if poor weather further reduced the 1976 crops. The main dry region, the Southern Plains winter wheat area, has largely stabilized due to recent rain, with crop losses at approximately 5 million metric tons compared to last year. Current estimates from USDA and the private trade lead to forecasts of the total U.S. 1976 wheat crop at 53 to 55 million metric tons, which is 5 to 9 percent below last year. If further problems with wheat or other grains should cause the 1976 U.S. grain crop to be reduced a further 5 percent, stocks would be reduced to minimal levels. Grain prices would probably rise on the order of 10 percent, and the impact of additional export sales would be larger. In this case, a 3 million ton wheat sale could increase the wholesale price of wheat to $4.35, from a short-crop price base of $3.90 per bushel. With corresponding increases for other crops, this could increase grain prices to last summer's high price levels. The associated increase in the cereals and bakery products CPI would be about 3.2 percent and the increase in the food-at-home CPI 0.5 percent by the third quarter of 1976.

<u>Downside Price Risk</u>. There are substantial probabilities of price reduction as well. Recent developments in the world wheat markets tend to be bearish. The EC, especially France, is aggressively selling last year's crops in recent weeks at substantial discounts from U.S. prices. Expectations are that Canadian wheat acreage will be up by 20 to 25 percent this year, which could add 4 million tons to the 1976 harvest. The other principal food grain, rice, is in abundant supply after two years of record harvests.

It is sometimes argued that because of current tightness in the world grain market, downside risk is minimal because demand for stocks will absorb any excess of production over consumption at near current prices. However, it remains to be shown that the private trade will hold stocks with the intention of carrying them into the next crop year. If not, 1976 prices will have to fall so that 1977 futures prices over 1976 spot prices will essentially clear the market by making it worthwhile to carry over any excess.

<u>The Corn Crop</u>. While this discussion has dealt mainly with wheat because of the potential for Soviet sales this summer and the Southern Plains drought, the unpredictable element is even larger for the corn crop, which is not yet in the ground. In the past seven years, corn yields have ranged from 71 to 79 bushels per harvested acre with no trend, which gives a range of about 30 percent of mean yield.

A large-crop scenario is somewhat more likely than a short crop because acreage is expected to be up about 4 percent compared to last year. A short corn crop has larger domestic food CPI consequences than a corresponding shortfall in wheat because the importance of corn in consumer budgets (via meat animals) is greater, a smaller percentage of the crop is exported, and corn stocks are smaller than wheat relative to previous years. But the short-crop consumer price effects would not be felt for the most part until 1977. Conversely, the bumper-crop scenario would be felt by farmers in terms of lower grain prices this fall long before any beneficial effects reach consumers.

TAB A.

<u>CPI Effects of Soviet Purchases of 1976 Crop Wheat</u>

The possibilities for sale of U.S. 1976 crop wheat for shipment to the U.S.S.R. before October 1, 1976 range from no such sales to 4 million metric tons of sales above the 8 million tons of U.S. wheat and corn that the Soviets may import after the long-term agreement enters into force on October 1.

The Soviets may buy an additional 3-1/2 million metric tons of U.S. 1975 crop grain before reaching their limit of 17 million tons for the July 1, 1975 to October 1, 1976 period. If they do not import any additional grain from non-U.S. sources in this period, it would give them total imports from all sources of about 30 million metric tons.

Suppose they want to push this total to 33 million tons by buying 3 million tons additional 1976 crop wheat. What effect would this have on U.S. wheat and food prices?

The main considerations are: (a) what would be the effect of a 3 million ton sale on prices, and (b) to what extent would third-market purchases by the Soviets limit U.S. ability to control prices by means of constraints on U.S. purchases by the U.S.S.R.?

(a) Supposing that our policy could affect demand in the wheat market by 3 million tons, what would be the price consequences? This depends in part on the U.S. 1976 wheat crop. Although the Southern Plains drought has been broken in many areas, subsoil moisture remains generally deficient, so that vulnerability to further dry weather is greater than usual.

Results from regressions on futures prices indicate that price response to a quantity shift implies an elasticity of demand of about -2 to -5 if carryover stocks were 13 million tons (USDA's latest forecast). In this case a 3 million ton increase in demand for U.S. wheat, with a 53 million ton crop would produce approximately a 9 percent increase in the price of wheat, from a Chicago price of $3.60 (current futures prices) to around $3.92.

Under a worst-case scenario, with the U.S. wheat crop down 7 million tons from 1975 and the Soviet grain crop recovering only 40 million tons or so from last year, the price of wheat could be about $3.90 per bushel (even a 7 million ton U.S. production decline would be partially offset by the 4 million ton increase in July 1 stocks, and if 1976 crops looked worse, probably slightly more 1975 grain would be carried into the 1976 crop year). In these circumstances, the elasticity of demand for wheat would correspond to that in a low-stock situation, around -.5 according to last fall's regressions, so that a 3 million ton increase in Soviet demand could increase the price of wheat on the order of 12 percent, or from around $3.90 to $4.35.

To sum up, if we have both unfavorable weather and the Soviets enter the market for 3 million metric tons of U.S. wheat for early delivery, the price of wheat (July, Chicago) could rise to the $4.35 area from its current level around $3.60.

(b) Bilateral U.S. action with respect to the Soviets could not prevent all of the price increase due to Soviet wheat purchases for delivery this summer, but probably the price rise could be moderated. Stocks of wheat in grain exporting countries outside the United States are such that it would be difficult for the Soviets to buy 3 million tons additional wheat. But if the Soviets wanted to buy wheat, and the U.S. refused to sell, there is no reason why the Soviets could not pick up a million tons or two on the world market outside the United States. Thus, if the Soviets really wanted to add 3 million tons to world demand, we could not stop them completely. If a prohibition on Soviet sales reduced demand on U.S. wheat to 2 million instead of 3 million tons because of third-country effects, then the price impact would be about two-thirds of those estimated above.

With a wheat crop plus carryin of 2.4 billion bushels, a 75 cent per bushel rise in the price of wheat (caused by worsening drought plus additional sales) would mean an income gain to wheat farmers of $1.8 billion. With domestic wheat consumption at 700 million bushels, costs to consumers would be around $0.5 billion. The price effect to consumers would be entirely through cereal and bakery products. Wheat in animal feed is negligible and besides in the high-price scenario would probably be more than offset by increased planting of grain sorghum, a feed grain, in areas where winter wheat fails. The futures-price forecast is as follows with and without a wheat price increase due to additional sales and/or drought.

Seasonally Adjusted Food CPI Forecasts

	No add'l sales	Add'l 3 mil. tons sales generate wheat WPI increase of 9 percent (no worsening of drought)	Add'l 3 mil. tons sales plus serious drought generate wheat WPI increase of 20 percent
A. Sept. 1975 to Sept. 1976 Percentage Changes			
Cereals & bakery products	0.3	1.8	3.6
Food at home	3.0	3.2	3.5
B. Jan. 1976 to July 1976 Percentage Changes			
Cereals & bakery products	1.5	2.9	4.6
Food at home	0.9	1.1	1.3
C. Jan. 1976 to Sept. 1976 Percentage Changes			
Cereals & bakery products	1.3	2.8	4.5
Food at home	1.3	1.5	1.8