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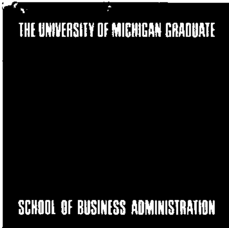

Graduate School of Business Administration · The University of Michigan · Ann Arbor 48104

PAUL W. McCRACKEN
Edmund Ezra Day University Professor of Business Administration

December 24, 1974

acknowledge

The President
The White House
Washington, D.C.

Dear Mr. President:

You were most gracious about seeing Max Fisher and me that Sunday afternoon, and I appreciated it deeply. It occurred to me that, as you ponder the major decisions of economic policy to be announced in major messages next month, a few further comments might be helpful.

The economic situation has been deteriorating so rapidly that current developments are outrunning the inevitably tardy basic statistics. The deterioration of sales has been severe enough so that businesses are now taking actions to cut back on outlays to improve and enlarge their production facilities, and these capital outlays have been the lone remaining source of strength in the private sector.

What is now needed is a major program to turn the economy around and to turn thinking around. This will have to mean thinking outside the usual boundaries of moderate policy adjustments. Major moves are now in order and needed.

The principal objection to a major program, that it would set off a new inflation, is without merit if the expansion is handled well. Disinflation occurs because the balance of power in markets is altered, and buyers rather than sellers are in the driver's seat. Policies already pursued assure further weakening of markets until roughly mid-year, since the visible effects of policy changes show up in the economy with a long lag. Moreover, even with the turn-about and improving business conditions, slack in the economy will assure buyers' markets for a considerable period thereafter.

Finally, history suggests that once the overheated-demand phase of the inflation is over, as clearly it now is, renewed expansion actually helps to stabilize the price-cost level. With rising output, the resulting improvement in output per man hour makes for smaller increases in labor costs per unit of output, helping to relieve the pressure of costs underneath the price level.

If this analysis is correct, it leads to some suggestions for policy.

1. Fiscal policy should include some actions to increase take-home pay. A tax cut is the one way to do this without also increasing costs. The

next tax cut should be in the zone of $15 billion, or about 1 percent of GNP. With a deficit already, this may seem irresponsible, but as the economy returns to reasonably full employment the deficits will decline to manageable proportions. The yield of the present revenue system at high employment would exceed outlays by roughly this amount now. (While the "full employment" budget concept has limitations, it is useful in a recession to have some idea of revenue flows as the economy returns to par.)

2. Monetary policy should have the money supply as conventionally defined (so-called M.) on a path rising at something like an 8 percent per year path, and leaning toward the generous side of the zone. This is too much for the long pull, but we must rectify the deficiencies from excessively tight monetary policies after the early part of 1974. Without this easier monetary policy a tax cut would simply intensify the Treasury's competition with potential private borrowers for funds in the capital market.

3. Oil policy and the economy. It would be helpful to have a clear declaration that our oil policy will be designed to serve well vital American interests, including resumed economic expansion. A self-imposed import ceiling would be counter-productive because the shortage-plagued market would invite a further OPEC price increase, and such a brute-force created shortage would further weaken and demoralize the economy.

Given time for adjustment, however, we can make substantial energy savings without economic disorganization. The most effective approach would be a crude oil tax combined with a tariff on oil imports. You were right that gasoline users should not have to carry the full burden of conservation. Users of the other half of the barrel should be encouraged to conserve also. In this way we get the aggregate of millions of businesses and consumers intensifying their search for ways to save, and the aggregate of these savings will be far greater and far less traumatic for the economy than such heavy-handed approaches as rationing, quotas, shortages, and such arbitrary rules as Sunday closing.

In summary you can now pursue a vigorous policy of expansion without fear of re-activating inflation.

Best wishes for the Holiday Season and the New Year.

Regards,

Paul W. McCracken

PWM:gb

THE WHITE HOUSE
WASHINGTON

Date 1/6/75

TO: ROLAND ELLIOTT

FROM: JERRY H. JONES

The attached was returned in the President's outbox with an indication that it should be acknowledged.

Would you please prepare an appropriate response.

Thank you.