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JOINT COMMITTEE PRINT

AN ACTION PROGRAM TO REDUCE INFLATION AND RESTORE ECONOMIC GROWTH

INTERIM REPORT

OF THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

(Pursuant to S. Con. Res. 93)

SEPTEMBER 21, 1974

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I. MAJOR RECOMMENDATIONS[1,2]

In his address to Congress on August 12, 1974, President Ford expressed the hope that the Joint Economic Committee of Congress could present recommendations on economic policy within 6 weeks. This report has been prepared in response to that request. It is of necessity an interim report. As directed by S. Con. Res. 93, which calls for "an emergency study of the economy . . . with special reference to inflation," the Committee will file a more complete report of its findings and recommendations on or before December 31, 1974.

The economic situation is grave. Prices rose at an annual rate of nearly 11 percent during the first half of this year. The rate of price increase may diminish little, if at all, in the remainder of this year. Real output fell at about a 4 percent annual rate during the first half, and it now appears that output may continue to decline or, at

[1] Senator Fulbright states: "I am in agreement with the general emphasis of this report and consider it most timely in view of the economic problems facing the Nation. However, because of other demands on my time I have not been able to participate fully in the hearings and discussions underlying this report. In the circumstances, I do not believe it would be appropriate for me to take a position on all of the recommendations contained therein."

[2] Representative Widnall states: "In recent years, I have spent a great deal of time, as a member of both the House Banking and Currency and the Joint Economic Committees, investigating the problems caused by inflation. I have examined and explored many aspects of inflation in great detail."

"While I support many of the recommendations in this report, I believe that neither those recommendations nor economic programs offered elsewhere are capable of dealing with our present inflation in a comprehensive, effective way. Adjustments to our economy which will act to reduce inflation 3 or 5 or even 10 years from now are simply inadequate. The present inflation is exacting a terrible price from the American people, especially from those on low or fixed incomes, such as the elderly, retired persons, the disabled, etc. Certain sectors of our economy, such as housing, have been devastated. Inflation cannot be permitted to continue at anything like its present rate.

"I have most reluctantly concluded not only that an adequate program for fighting inflation has not yet been offered to us, but that there are really no new programs which we can expect to appear in the near future. Therefore, I think that the President and the Congress should consider most carefully the reimposition of comprehensive price and wage controls in our economy, in order to allow some of the other recommendations for fighting inflation which have been made to be implemented and take effect in the medium to longer term. I raise the possibility of controls only after long and serious thought on this matter, having borne in mind my own previous record or opposition to controls and efforts to bring about their end, rather than introduction.

"I am well aware that price and wage controls both are difficult to administer and lead to certain inequities. However, the present raging inflation is itself causing extreme difficulty and severe hardships for a large number of Americans. Income and wealth are being transferred within our economy in a most arbitrary manner. People are being thrown out of work by inflation. If inflation continues and credit remains tight, the number of unemployed persons will grow at a most unacceptable rate.

"For these reasons, I believe that 'across the board' price and wage controls may prove to be the only effective weapon available to us against inflation in the short run. If such controls are to be reimposed, it should be clear that they will be effective when passed as of the time that the President proposed them to the Congress, in order to avoid what will be the otherwise inevitable runup of both prices and wages during the period of debate in the Congress. The President and the Congress should reconsider controls in this context."

best, remain essentially flat for the rest of the year.[3] The unemployment rate has risen from 4.6 percent last October to 5.4 percent in August and can be expected to rise further. Credit scarcity, record high interest rates and uncertainty regarding the economic outlook have created a situation of great stress in financial markets.

Members of the Joint Economic Committee have participated in the White House meeting of economists on September 5 and in other meetings summoned by the President in the past few weeks. We plan to participate in the further discussions with economists on September 23 and in the "summit" meeting on the economy on September 27 and 28. We believe that the recommendations in this report constitute a sound action program for the economy and hope that they will form part of the basis for discussion at those meetings.[4] We recognize that other participants in these meetings will be putting forward a variety of other suggestions, and it is our intention to give these suggestions full consideration.

The current series of meetings on the economy is providing a valuable opportunity for views to be considered and consensus to emerge. It is vital that these meetings be followed by action. Quick action to deal with a deteriorating economy is essential. The Congress and the American people are ready to cooperate with the President in developing and implementing an action program. The program must be a realistic one. It must not hold out false hope that there is any one simple policy for dealing with inflation and stagnation or that a sick economy can be restored overnight to a path of healthy, noninflationary growth.

Of fundamental importance to designing a program to deal with the present inflation and stagnation is an understanding of the anatomy of this particular inflation—both its past causes and the present forces which, if unchecked, will cause it to continue.

The present high rates of inflation are not the result of excess demand. There are strong demands in individual industries, such as steel, paper, and fertilizer. However, no major sector of domestic demand has pushed against productive capacity over the past year. Consumer spending has fallen 2 percent in real terms during the past 4 quarters, residential construction 25 percent, Federal purchases 2.5 percent. Business fixed investment is up, but less than 2.5 percent. State and local purchases are up less than 4 percent.

If this is not primarily an excess demand inflation, neither is it a cost-push inflation as that term is commonly understood. Throughout the

[3] A detailed assessment of the economic situation and outlook, prepared by the Committee staff, will be found in the appendix to this report.

[4] Representatives Brown and Blackburn state: "At least two members of the Committee believe that the recommendations in this report represent a rehash of the same old belief in the omnipotence of government over the private sector for the purposes of manipulating social/political policy by the use of deficit spending. It is precisely this kind of Federal fiscal policy which has created our inflationary problems. In the past 41 fiscal years the Federal budget (even the misleading "unified budget" of recent years) has enjoyed a surplus only nine times for a total of $35 billion, but has been in deficit 32 times for a total of $364 billion. And in the process our Federal budget has grown to where it now plays an overwhelming role in national spending and a dominant role in national borrowing. This report offers little encouragement of any return to economic 'old time religion' by the Federal Government or by those who have dominated its policies for so long."

control period wage increases lagged behind price increases. Even with the more rapid wage increases since the controls were lifted at the end of April, real average hourly earnings are more than 3 percent below year earlier levels. Large wage increases certainly threaten to become an inflationary factor in the months ahead as workers struggle to recover lost ground, but wage-push does not explain the price increases already experienced.

Poor crops, the quadrupling of international oil prices, the devaluation of the dollar, high world prices for a variety of raw materials and industrial products each form part of the explanation for current inflation. However, even these extraordinary factors do not explain why wholesale industrial prices have risen at an annual rate of 35 percent in the past 3 months; why iron and steel prices are up 44 percent in the past year, nonferrous metals 45 percent, industrial chemicals 62 percent; why at a time of reduced demand and production cutbacks, automobile prices are up by $700–800 and more within a single year.

Wholesale prices of crude petroleum in this country are up 79 percent in the past year. The sharp increase in the cost of imported oil explains part of this rise. However, after-tax profits equal to 21 percent of equity in the first quarter of this year—as compared to 12 percent in the late 1960's—surely indicate that price increases have far exceeded cost increases. Similarly, in the primary nonferrous metals industry the return on equity was 17 percent in the first quarter, compared to 12 percent in the late 1960's, and in the chemical industry 18 percent as compared to 14 percent. These comparisons are with the relatively high profit years of the late 1960's, not with the depressed profit levels of the early 1970's.[5]

Increasingly, a significant part of the current inflation can be understood only in the context of administered prices in concentrated industries which typically increase despite falling demand. Some part of this phenomenon can be explained by adjustments to overcome distortions created by the control program and some part by an upward adjustment to high world prices. However, a substantial part appears to be unexplainable except in terms of the ability of concentrated industries to resist competitive forces and to achieve a target return on investment in good times and bad.

In addition, there is an abundance of evidence that structural distortions in the public as well as the private sector are a major contributing factor to our current economic problems. Together they hamper the free flow of goods and services, both domestically and internationally; restrict and in some cases totally eliminate competition; impose high costs on the consumer and the average businessman; and retard technological progress. While it is not possible to precisely measure the additional costs imposed on consumers by structural distortions, estimates range as high as tens of billions of dollars annually.

Three deceptively simple proposals for dealing with the economy

[5] The Minority Members state: "We feel it necessary to point out, with regard to the 1974 profit figures in this paragraph, that one quarter is a very short period to use for comparison with other profit levels. Additionally, because of the high rate of inflation in 1973–74, present profits must be discounted both for inventory profits and the differences between capital consumption allowances and the replacement cost of the capital goods consumed in production. The profit comparisons in the paragraph are somewhat misleading in the absence of such adjustments."

have at times emerged in recent public discussions. One is to halt inflation through the use of severely restrictive fiscal and monetary policies; the second is to impose mandatory price and wage controls over the entire economy; the third is to let inflation rage but to "index" all forms of income and wealth to the inflation rate.[6] We believe the Administration should and will emphatically reject each of these simplistic approaches. The first—severe fiscal and monetary restraint—would impose intolerable social costs and run serious risk of creating a real depression.[7] Unemployment rates in excess of 8 percent over a period of 2 or more years would probably be required to bring the inflation rate to 4 percent by this means.[8] The second—comprehensive price and wage controls—would not be workable at the present time because of the distortions already present in both the wage and price structure, the disparities between U.S. and world prices, and the impracticality of controls in the Agricultural sector.[9] The third suggestion—indexing of all incomes—is similarly not a workable proposal. A democratic society with a free market economy contains no mechanism for imposing quick adjustments on all forms of incomes. Inflation would continue to create cruel inequities and serious market distortions.

While none of the three approaches listed above is workable in its extreme form, each contains elements which should form part of a

[6] Representatives Brown and Blackburn state: "The authors of this report seem to have missed a fourth 'deceptively simple' proposal which is the one our constituents most often suggest to us: Control Federal spending, balance the budget and stop the deficits which cause government borrowing—which in turn send up interest rates and cause funds to flee the thrift institutions (housing), the banks (where consumer loans and private investments are financed) and the stock market (where major business expansions which create jobs are financed). We would agree that such a 'deceptively simple' proposal may not totally resolve the complex problems we face today, but it should not be ignored either."

[7] Representatives Brown and Blackburn state: "The Nation faces the risk of a real depression if inflation is not brought under control. The Federal Government, according to Secretary of the Treasury William Simon, is borrowing, directly and through debt which it guarantees, 62 percent of all the funds being borrowed today. In spite of the 'guaranteed' nature of Federal debt (because the Federal Government owns the printing presses which print the dollars by which the interest can be paid off), the interest Uncle Sam is paying today has exceeded 9 percent on short-term obligations. The disintermediation this has caused is massive and so are the social costs—because the economic costs are so high. Under the unified budget, the increase in Federal debt indicated in fiscal year 1974 was only $3.5 billion, which does not seem much on an almost $300 billion annual budget. But Federal Reserve Board Chairman Arthur Burns has testified that the actual Federal debt increase was closer to $21 billion. when the Federal borrowings necessary to finance Government guarantees are added in. These include federally guaranteed home mortgages, educational loans, etc. To eliminate such deficit-causing programs would indeed have its social costs to the people who benefit from them. But the existence of such programs cannot be overlooked as the cause of inflation which generally has had tremendous social costs to the low-income people (who some of these try to assist) and the middle-income citizens who pay for practically all Federal programs but are directly benefited by few of them."

[8] Representatives Brown and Blackburn state: "No one finds any pleasure in an increase in unemployment as a result of the need to control inflation by the mechanism of maintaining a stable money supply. But considerable political pride has been taken over the years in the 'cheap money' expansion of the monetary supply which has laid the base for inflation by pushing debt off on future generations."

[9] Representatives Brown and Blackburn state: "This statement should be recalled later in the report when credit controls are recommended."

comprehensive action program.[10] Reducing inflation and restoring economic growth will require responsible fiscal and monetary policies; it will require a firm—but largely voluntary—price and incomes policy; it will require equity adjustment to assist those hurt most by inflation and high unemployment. Furthermore, combating inflation will require intense new efforts to develop sector-by-sector policies for each problem area of the economy. Both private and government practices which restrict competition, raise costs and prices, or create barriers to employment must be reformed.

The needed policies can be summed up under four headings: fiscal and monetary policy; price and incomes policy; help for those hurt most by inflation; and the restoration of an efficient market economy. Our recommendations for steps which should be taken quickly in each of these four policy areas are summarized below. The body of this report explains these recommendations in greater detail and also identifies a number of areas of longer run concern in which further study and policy formulation should go forward on an urgent basis.

Our recommendations on fiscal and monetary policy, on market efficiency, and on help for those hurt worst by inflation fall within the consensus demonstrated at the White House meeting of economists on September 5. The emergence of this consensus is most encouraging, and we are happy to give it our support. In the fourth broad policy area—price and incomes policy—the consensus is less clear. We believe our recommendations in this difficult area are imaginative and constructive. We urge that not only Congress and the Administration, but also business, labor, and consumer leaders give them full and thoughtful consideration.

Fiscal and Monetary Policy

The Nation is looking to its government for a demonstration that Congress and the Administration can cooperate in exercising control over Federal spending both this year and in the future. Exercise of such control will do much to restore public confidence and will permit monetary policy to follow a more moderate course.[11] At the same time, care must be exercised that Federal spending is not slashed so drastically as to interrupt the efficient delivery of vital public services or to plunge the economy deep into recession.[12] Federal tax receipts fluctuate sharply in response to changes both in employment and in the inflation rate. A firm rein on spending is essential, but a commitment to tie

[10] Representatives Brown and Blackburn state: "A balanced Federal budget, has not been tried as a consistent policy (or as a matter of Keynesian policy which requires it under certain circumstances) for the last generation, even though many States require it by law and no business or private citizen could survive without it."

[11] Representatives Brown and Blackburn state: "This appears to be as close as the Committee can bring itself to endorsing fiscal responsibility."

[12] Representatives Brown and Blackburn state: "One generation's 'vital public service' is the previous generation's frill and the next generation's debt—paid for by inflation. For instance, the Nation's first $300 billion expenditure budget will hit this fiscal year. It is hard to assess all that spending as being for nondeferrable 'vital public services' when one considers that the Federal Government was managing to meet a lot of 'vital public services' by spending only $200 billion for the first time just 4 years before in fiscal year 1970 and spent only $100 billion for the first time in fiscal year 1962 on things that were then considered 'vital public services.'"

future spending to this uncertain level of receipts, regardless of the state of the economy, would unwisely limit the Government's ability to respond to changing economic conditions.

Federal outlays in the current fiscal year should be held to $300 billion. Both defense and civilian outlays should be scrutinized to determine the areas where cuts can best be made. Total outlays should be cut sufficiently to permit initial outlays for a new public service employment program to be included within a $300 billion total.[13]

Strenuous efforts should be undertaken to restrain the year-to-year increase in Federal spending from fiscal 1975 to fiscal 1976.

Given the expectation that Federal outlays this fiscal year will be held to $300 billion, there should now be a moderate shift toward less restrictive monetary policy.

To assure that sectors such as housing, agriculture, public utilities, small business, and State and local governments can borrow badly needed funds and that funds flowing to corporate business go into productive rather than speculative uses, a system for channeling credit is required.[14] [15]

Price and Incomes Policy

During the past year declining output, devaluation, and increased payments to foreign oil producers have left the United States with a smaller total volume of real goods and services to be distributed among its citizens. The great majority of our citizens perceive, quite correctly, that their standard of living has been slipping. The resultant struggle over the distribution of income is intense and threatens to become more so. If unchecked, this struggle will be characterized by increasingly large wage demands and work stoppages and will result in a wage-price spiral which will vastly intensify and prolong the

[13] Representatives Brown and Blackburn state: "This recommendation seems inconsistent with stated objective of maintaining 'the Government's ability to respond to changing economic conditions.' The Joint Economic Committee could serve the current circumstances better by establishing the many areas where cuts in spending can be made and establishing priority for those cuts, rather than figuring out what new programs there should be and how they should be financed."

[14] Senator Percy states: "Although most Members of Congress would agree that certain sectors of our economy, such as housing, are having severe credit difficulties, I do not believe that there is general support for, and I do not support, establishment of any mandatory system for allocating credit to be administered by the Federal Government. I do not think, given the great complexity of our economy, that effective and equitable administration of such a system would be possible. Additionally, I do not believe that a voluntary credit allocation scheme could make any meaningful contribution in the present difficult credit situation. I am afraid that our only practical recourse is to the slow process of responsible Federal fiscal policy, which will enable that moderate easing of monetary policy sufficient to generate a greater flow of credit to hard-hit areas in our economy."

[15] Representatives Brown and Blackburn state: "The Committee, having sworn off wage and price controls, embraces credit controls. Without the specifics of how this can be accomplished and the rationale for why it will work when wage and price controls didn't and won't, the recommendation seems flimsy."

inflation but will not increase the real volume of goods and services to be divided among our citizens.

In order to head off this wage-price spiral, business, labor, consumers and government must join together in a social contract under which business and labor agree to exercise restraint in price and wage demands, government undertakes to enact tax changes to achieve more equitable distribution of the costs of fighting inflation, and both government and consumers actively bring pressure to bear against unjustified price and profit increases.[16] The present series of White House meetings on the economy provides an opportunity for the elements of this social contract to be worked out by the interested parties. The newly established Council on Wage and Price Stability can provide the mechanism for monitoring the social contract and resolving difficulties as they arise.

If workers are to be expected to continue to show needed restraint in their wage demands, they must be offered an alternative means of restoring part of recent losses in real purchasing power. To accomplish this, Congress and the Administration should work together to develop and enact tax changes which provide immediate relief to low and middle income persons without reducing the overall revenue potential of the tax system. Reductions in the social security tax or in the lower brackets of the income tax coupled with the elimination of unjustified tax subsidies, an increase in the minimum tax on those in the highest income brackets, and the introduction of new taxes designed to encourage the conservation of energy would meet this objective.[17] [18]

[16] Representatives Brown and Blackburn state: "An absolutely essential part of this contract should be spending restraints by government, particularly with a view to reducing deficits."

[17] Senator Proxmire states: "I strongly disagree with the practicality of this nebulous 'social contract.' The only record from a labor spokesman which the Committee has had on this issue is the testimony of Leonard Woodcock, head of the United Auto Workers—one of the most public spirited and socially oriented unions in the country. Mr. Woodcock flatly opposed such a tax proposal as a basis on which labor should moderate its wage demands. Furthermore, the tax changes proposed here would probably be going in the wrong fiscal direction—aggravating the Federal deficit—because of the practical unlikelihood of any revenue raising tax reform in the near future. Also, attempts to counterbalance tax revenue losses by increasing taxes on higher bracket incomes or corporations would be likely to reduce the investment which is essential for fighting inflation by increasing supply. I emphatically favor tax reform but this 'social contract' seems likely to push the Federal Government into a much bigger deficit."

[18] Representatives Brown and Blackburn state: "'Unjustified tax subsidies' should probably be eliminated and tax credits to encourage energy conservation should probably be passed, in any event. To try to relate them to tax reductions for low- and middle-income taxpayers is specious. No significant tax reductions for low- and middle-income taxpayers can be accomplished without reductions of Federal spending—unless we are to have inflationary deficits. And no tax breaks can be given in the private sector for energy conservation or business expansion to reduce shortages without either increasing taxes elsewhere or cutting Federal spending. The failure to resolve that question at all is what has led to deficit and inflation. It should be resolved in favor of the taxpayer having more control over spending his own resources and against the Federal Government taking taxpayer dollars either in taxes or inflation."

To fulfill its role in monitoring the social contract the Council on Wage and Price Stability should:

(1) Consult fully and regularly with business, labor, and consumer groups.

(2) Recommend appropriate non-inflationary behavior for prices, wages and executive compensation on a specific industry-by-industry basis.

(3) Conduct a systematic and continuing review of all practices or procurement policies of the Federal Government which may contribute to inflation.

(4) Recommend actions to eliminate inflationary bottlenecks by increasing supplies of scarce materials or of skilled labor, to increase productivity, and to strengthen competition.

(5) Hold public hearings on particular private or government actions the inflationary consequences of which would damage the national effort to restore price stability.

(6) Request from both public and private parties all cost, price and profit data or other information necessary to the execution of its responsibilities.[19]

(7) Send formal public notice to both Congress and the President whenever the national effort to restore price stability is seriously threatened by either private or public failure to comply with the Council's guidance or to supply essential information.

In order that the Council on Wage and Price Stability be equipped to carry out these vital tasks:

(1) The Chairman of the Federal Trade Commission and the Assistant Attorney General in charge of the Antitrust Division should be made members of the Council.

(2) The appropriation for the Council should be increased substantially.[20]

Consumer groups should adopt a watchdog function on the wage-price front. Their influence should be brought to bear selectively against price increases based on scarcity or market power and those imposed by cartels. The Council on Wage and Price Stability should solicit the help of responsible consumer groups.

We believe that, with the cooperation of business, labor and consumers, the above recommendations form the basis for a price-incomes

[19] Representatives Brown and Blackburn state: "The Government surely requires data when it must make the decision; but one wonders about the invasion of privacy, which the Government appears to oppose—when others do it."

[20] Representative Moorhead and Senator Javits state: "The collection and analysis of accurate and verifiable information on wages, prices, sales, costs, profits and productivity is essential to the effectiveness of any voluntary price and incomes policy. The Council on Wage and Price Stability should be given the power of subpoena to assist the Council in carrying out its vital task."

policy which will make the needed contribution to reducing inflation and improving distributional equity. If cooperation is not forthcoming and if these policies fail to have their hoped-for effect, then consideration must be given to strengthening the powers of the Council on Wage and Price Stability through provision of subpoena power and the power to delay price increases and even to roll back prices in situations in which clearly unjustified price increases in concentrated industries threaten to undermine the overall effort to restore price stability.

Helping Those Hurt Most by Inflation

The tax relief proposed as part of the price-incomes policy described above would benefit many lower income persons hurt by inflation. However, not all those most in need of help are on the tax rolls. Two groups especially hard hit either by inflation or by the policies which have been adopted to fight inflation are the poor and the unemployed.

A new program of public service employment adequate to create about 150,000 additional jobs should be activated when unemployment reaches 5.5 percent. Should unemployment rise to 6 percent the program should be expanded to a total of 500,000 to 650,000 jobs.[21]

The unemployment insurance system should be strengthened by raising the maximum weekly benefit to two-thirds the average wage in each State, with each individual recipient receiving at least 50 percent of his weekly wage, up to the maximum. The duration of benefits should be extended an additional 13 weeks nationwide as soon as the seasonally adjusted insured unemployment rate reaches 3.5 percent (roughly the equivalent of an overall unemployment rate of 5.5 percent).

The coverage and payment scales of the food stamp program should be adjusted every 3 months for food price changes. The Supplemental Security Income program should raise its income standards to a level which would eliminate poverty among the elderly. Enactment of a just and dignified comprehensive Federal income maintenance system to replace the present hodgepodge of cash and in-kind programs should receive priority attention by Congress and the Administration in 1975.[22 23 24]

[21] Representative Reuss notes: "Unemployment is already at 5.4 percent. The sooner a program of public service jobs is activated, the greater our chances of containing any further rise in unemployment. A program to provide 500,000 public service jobs is needed at once."

[22] Senator Proxmire states: "The cost of these three programs: Public service jobs, unemployment compensation increases and supplemental security income increases could be so great that they should be approached cautiously. The public service employment trigger should be kept at 6 percent. Other Federal spending must be reduced to offset the cost of these programs or the country will be plagued again with the nightmare skyrocketing deficits of recent years.

[23] Representatives Brown and Blackburn state: "The Committee seems to devote most of its attention to added Federal programs, rather than to how to eliminate Federal spending to reduce inflation and its inevitable follower, depression. The problem is how to make real employment more productive, not how to make unproductive employment appear to be real. Current unemployment

(Continued)

Restoring Market Efficiency

Administrative and legislative action to break up private market power and to eliminate the Government regulations and practices which restrict competition and interfere with the efficient functioning of the economy are the key to a successful long-run effort to restore healthy noninflationary growth. The list of restrictive practices which need to be eliminated is familiar to every economist and policymaker. A few remain in effect through inertia, but the majority remain because they are of benefit to powerful and vocal groups in our society. In each case, the benefits need to be reassessed in comparison to the costs to society as a whole. Where the costs exceed the benefits restrictive practices and inefficient regulations must be eliminated. If Congress and the Administration fail to exhibit the political courage to take needed actions in this area, the people will surely have a right to question the seriousness of their government in fighting inflation.[25]

A number of structural problems are discussed in Chapter V of this report and specific recommendations are made with respect to the energy and agricultural sectors and with respect to increasing productivity in the economy as a whole. The Committee plans to continue its investigations of structural problems and make further recommendations in December. However, the detailed examination of many different rules and regulations which is required goes beyond what this Committee alone can hope to accomplish.

A Commission should be appointed jointly by Congress and the President to recommend comprehensive legislation to eliminate both governmental and private barriers

(Continued)
is spotty and there is a need for pub'ic service employment in some areas right now. In recent weeks, in spite of increases in unemployment, the duration of unemployment does not seem to be increasing—although that bears watching. Simple national triggering devices really are not adequate to the complex issue of unemployment, welfare and social security supplements. While prompt and effective employment programs are extremely important, the best part of this recommendation is that which asks enactment of a better program that is just and dignified. Any such program would surely not let welfare rolls expand in boom times and fail to meet individual and public needs in poor economic times."

[24] Representatives Conable and Widnall state: "We would like to emphasize the need, referred to in this recommendation, to replace the food stamp and other in-kind programs presently in effect with a unified welfare program as promptly as possible. The in-kind programs require multiple layers of complex administration to implement numerous qualifications and phaseouts. We have supported such replacement in the past in the Congress. We have not seen any evidence since then that in-kind programs can work in a desirable way over the long term. The present uncertainty and instability in our economy only heighten the distortions which maintenance and expansion of these programs cause. We need comprehensive welfare reform to have a program more simplified, intelligible and equitable."

[25] Representatives Brown and Blackburn state: "Powerful political and economic interests are involved in business, labor and government, as where monopoly control is essential to continued political and economic power. The recommendations below should include them as noted."

to an efficient market economy.[26] In making its legislative recommendation the Commission should carefully consider the elimination, retention, or modification of:

Federal subsidies.
Production quotas and marketing orders.
Price supports.
Excess stockpiles.
Prevailing wage determinations.
Excessive or inept regulation of transportation and communication.
Import quotas and voluntary agreements to curtail imports.
Retail price maintenance,

and other similar governmental impediments to economic efficiency.[27]

The Commission should also consider the strengthening of private competition through actions such as:

Divestiture and reorganization.
Improved antitrust laws and administration, including the transfer of enforcement responsibility to an independent agency.
Removal of artificial barriers to employment.

The Commission should in addition consider the provision of adjustment assistance for groups of workers severely affected by the transition to a more competitive economy.

[26] Representatives Conable, Widnall and Senator Javits state: "We are particularly interested in the many opportunities to make structural changes to improve the efficient operation of the free market economy by altering or eliminating some of the large number of Federal laws and regulations in specific areas of our economy. The Minority Members of this Committee have referred to some of the opportunities in this area, especially in the field of transportation, in the Minority Views to the Committee Annual Report during the last several years.

At one of the Economic Summits within the past several weeks, Dr. Hendrik Houthakker of Harvard University, formerly a member of the Council of Economic Advisers, referred to forty-five areas in which the Federal Government presently exercises some degree of control and, in his opinion, affects adversely the operation of the free market in allocating resources. As Dr. Houthakker suggested then, inflation and other of our present economic problems are long-term problems which require a long-run attempt at solution. In our opinion, although many of the distorting Federal policies and regulations have powerful defenders, now is an especially appropriate time to undertake a comprehensive review in this area."

[27] Representatives Brown and Blackburn state: "Tax benefits and restrictions should be mentioned here. Among the burdens to economic efficiency should certainly be added the amount of paperwork and the excessive controls under existing law as well as new laws to protect the environment, safety and health of employees, consumers, etc. The purposes are worthy, but they certainy add to the unproductive costs of business—particularly small or new businesses which can ill afford to carry such burdens."

The Commission should report within six months of its establishment. In appointing the Commission the President and the congressional leadership should make an advance commitment to introduce the Commission's recommendations in Congress immediately in the form of omnibus legislation and to give it prompt consideration.

The General Accounting Office should be directed to conduct investigations of violations of the antitrust laws and other anticompetitive practices in the Government or the private sectors, and to report its findings to the Antitrust Division of the Justice Department, the Federal Trade Commission, and Congress. Such investigations should supplement and not replace the activities of the Antitrust Division and the Federal Trade Commission.[28]

Oil Prices

The Emergency Petroleum Allocation Act should be maintained throughout the present inflation emergency. Price ceilings on domestic crude oil should not be raised for the present.

The U.S. Government, without fanfare, should strengthen its efforts to bring world oil prices down.

The Government should launch a renewed campaign to conserve energy. Other consuming countries should be kept informed of our conservation efforts and urged to intensify their own.

Agriculture

Strong world demand for foodstuffs and a greatly reduced level of reserves mean that, in the absence of new policies, farm prices will continue to fluctuate sharply around a rising trend. Bumper crops next year are necessary if the United States is to meet domestic demands, replenish stocks, and fulfill its traditional role as a world supplier.

Increased efforts must be made to reduce the constraints on farm output currently imposed by shortages of fuel, fertilizer, and farm machinery and equipment. Investigation of such bottlenecks and ameliorative action—including allocation programs where necessary—should be undertaken on an urgent basis by the Council on Wage and Price Stability.

Congress should pass legislation establishing a system for managing exports of critical food and feed

[28] Representatives Conable and Widnall state: "We are opposed to involving the General Accounting Office in the Federal antitrust process for several reasons. First, we think that the General Accounting Office, which has performed an excellent job for the Congress for a number of years, is in danger of being requested to take on too many responsibilities, which could impair the Office's ability to do a first-rate job on all of its tasks. Second, we are opposed to fragmenting the Federal antrust effort. We are in favor of greater support in the antitrust area, however, and believe that greater resources should be made available to both the Antitrust Division of the Department of Justice and the Federal Trade Commission. Such added support would be far preferable to involving another Federal agency, in this case the General Accounting Office, in antitrust enforcement."

when projected market supplies are inadequate to meet domestic needs without drastically increasing prices. The Secretary of Agriculture should be authorized to (*a*) set up an export licensing system for agricultural commodities determined to be in critically short supply; and (*b*) require prior approval of such exports when necessary. If allocation of scarce exports is necessary, the highest priority should be given to countries needing food aid and the next priority to regular export customers.

The Committee strongly supports reorganization of the Commodity Exchange Authority and increases in its personnel strength and in its authority. The Committee recommends that the regulation of the commodity exchanges can be accomplished most effectively by an agency completely independent of the Agriculture Department and headed by a full-time Commodity Exchange Commission similar to the Securities and Exchange Commission.

Agricultural research and development, especially research efforts directed at improved crop yields and production efficiency, should be strengthened.

International Cooperation

Inflation and stagnation are not faced by the United States alone. In 1972 and early 1973 unusually rapid growth in a number of major countries developed into a worldwide boom that contributed to the current inflation. Similarly, recessions in several major countries could touch off a cumulative worldwide downturn.

The United States and other industrialized countries should cooperate to avoid excessively restrictive policies that could produce a serious worldwide recession.

International negotiations are also needed regarding specific products, especially food and fuels.

The United States should initiate negotiations to reach multilateral understandings regarding the availability of basic commodities and raw materials. We should seek assured availability of essential materials imports. In exchange the United States should offer potential recipients of food aid and our regular export customers assured access—given prior satisfaction of minimum domestic needs—to supplies of U.S. agricultural products and raw materials.

The restoration of healthy noninflationary growth will not come easily or quickly. At best, the Nation faces several more years in which both the unemployment rate and the inflation rate will significantly exceed levels previously regarded as acceptable. However, it is urgent to initiate an action program so that things can begin to get better instead of continually growing worse. We believe the measures outlined above and described more fully in subsequent chapters would constitute a good beginning.

II. FISCAL AND MONETARY POLICY

Most analysts agree that neither fiscal nor monetary policy can be singled out as the primary cause of our present high rate of inflation. Many factors, including extraordinary events in the food and energy sectors, the delayed domestic price impact of substantial devaluations of the dollar since 1971, simultaneous strong economic expansion by the world's leading industrial nations, and wage and price pressures released following a period of wage-price controls, have contributed to the rapid rise in prices in 1973–74.

Nonetheless, the fiscal and monetary policies of the Federal Government have rightly occupied a central place in the debate over inflation. It is clear, in retrospect, that these policies have at times been too expansive and have contributed to the unstable price and wage climate. Steady and responsible monetary and fiscal policies must form the foundation for a program to combat the present combination of inflation and stagnation.

The Federal Budget

Today the President and the Congress are faced with difficult questions regarding the appropriate course for Federal budget policy during fiscal years 1975 and 1976. Deciding on appropriate policy requires more than determining some magic number for overall governmental spending. Careful consideration must be given to analyzing the components of governmental spending with regard to the impact of various mixes of spending on both economic activity and price and unemployment levels. It is also imperative to eliminate waste in all areas of governmental spending. In the present atmosphere of rapidly increasing prices, the Federal Government must do more than pay lip service to the need to reduce nonproductive and inflationary spending in its various programs.

The latest official outlay estimate for fiscal 1975 is $305.4 billion. Since that estimate was made, Congress has passed legislation cutting $420 million from regular appropriation bills. The Defense appropriation currently in conference will probably reduce outlays another $2 billion or more. Mandatory spending authorizations approved by Congress will increase outlays about $1.9 billion, but congressional inaction on requested legislation would save nearly $400 million. Legislation yet to be considered by Congress could, if all of it is enacted, add a further $1 billion to outlays.

On balance these congressional actions will probably not change 1975 outlays very much. Various other influences on outlays, including higher than expected costs of unemployment compensation, higher than expected interest costs, the release of previously impounded funds, and the upward pressure on all prices the Federal Government must pay as a result of inflation, threaten to increase the official esti-

mate. Savings may be achieved in some programs, but nonetheless it will be difficult to hold outlays to $305.4 billion. To achieve a further reduction will be even harder but such a further reduction is a key ingredient of an effective anti-inflation program.

Federal outlays in fiscal 1975 should be held to $300 billion, as the President has recommended. Both defense and civilian outlays should be scrutinized to determine the areas where cuts can best be made. Total outlays should be cut sufficiently to permit initial outlays for a new public service employment program to be included within a $300 billion total.[1]

While it might be possible for the President to bring about the necessary reductions in Federal outlays through Executive action, it is far preferable that the necessary budget changes be worked out in cooperation with the Congress. We welcome the initiatives which the President has taken to consult with Congress in this area.

By themselves, reductions in Federal spending offer little immediate dividend in reducing the rate of price increase. It must be emphasized that such reductions in spending are no substitute for governmental action in other areas in the fight against inflation. However, the reduction in Federal spending from the originally projected $305 billion to $300 billion is important for several reasons. First, a smaller government deficit will reduce Federal demands on credit markets, making more funds available for private investment. An important part of our present inflationary problem lies in capacity shortages and supply bottlenecks, and, therefore, an important part of the solution lies in making funds available for productive private investment. Second, a firm fiscal policy will permit an easier monetary policy than would otherwise be possible, thus further supporting private investment and also relieving the stifling effects of tight money on areas such as housing.

Finally, while only limited outlay reductions are realistically possible within the current fiscal year, the impact of budget decisions made now is often far larger in future years. In examining the budget for possible further savings, special attention should be paid to those programs—defense and civilian—which, though small at present, threaten to explode in future years.

Furthermore, it should be noted that the budget measures only part of the Federal impact on credit markets. In addition to the $11.4 billion budget deficit presently estimated for fiscal 1975, Federally sponsored and Federally guaranteed borrowing not included in the budget, such as that incurred by the Export-Import Bank and the Federal Home Loan Banks, is expected to total more than $15 billion this fiscal year, far in excess of the official estimates made last February.

Along with the effort to contain the overall level of spending, the composition of outlays should be changed. Dramatic changes cannot realistically be expected in the current fiscal year. However, areas of "fat" in both the defense and civilian budgets can be cut sufficiently to allow room for the initiation of a new program of public service employment, the cost of which in the current fiscal year might be about $2 billion, and for some additional outlays on other high priority areas which have been badly squeezed by inflation.

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[1] See footnote of Representatives Brown and Blackburn, p. 6.

For the same reasons that we support restraining Federal expenditures in fiscal year 1975, we believe that strenuous efforts should be undertaken to restrain the year-to-year increase in spending between fiscal 1975 and 1976.

Fiscal 1976 does not end until almost 2 years from now and it is impossible to predict what economic conditions will be during that time or precisely what governmental policies will be appropriate. If the forecasts are correct, receipts may slump badly due to higher unemployment. New programs, such as extended public service employment, referred to in greater detail elsewhere in this report, may become necessary and appropriate. Both the Executive and the Congress will of course have to be ready to adjust both programs and levels of expenditure as changing economic conditions warrant. The recent establishment of the new Budget Committees will greatly strengthen the ability of Congress to respond to changes in fiscal policy requirements.

A number of further questions relating to the Federal budget and its impact on prices and employment will be under study by the Joint Economic Committee over the next few months. We hope to address them in our complete report in December. Among these are:

- An examination of the controllability of the mandatory spending programs which now make up such a large proportion of the budget.
- The impact on the economy of federally sponsored credit agencies and the desirability of reincorporating them into the budget.
- The impact on the economy of the combined government sector—State and local as well as Federal—and the importance of developing and systematically utilizing combined budget totals.
- The impact of the composition as well as the total level of Federal taxing and spending on prices, employment, and economic growth.

Monetary Policy

During the past year, the money supply has grown between 5 and 6 percent. Within that period there have, of course, been variations. During the third quarter of 1973, the money supply did not grow at all; since last October it has grown at an annual rate of about 7 percent. While no great importance should be attached to month-to-month variations in the rate of monetary growth, a 5–6 percent growth rate over a 12-month period might in normal times be regarded as a rather expansionary monetary policy.[2]

However, during the past year, the economy has experienced severe inflationary shocks from outside sources such as international oil prices and sharply higher farm prices. Since it was not realistic to expect that other prices would fall sufficiently to offset higher prices for

[2] Representative Blackburn states: "It is erroneous to consider for this purpose the money supply on an annual basis. From early 1971 to mid-1974, the monetary aggregates grew at the roughly constant rate, with erratic deviations, about a trend of a 6.7 percent annual rate for M1 and a 9.6 percent rate for M2. These are extremely high rates—higher than for any other equally long period since World War II, which goes far in explaining why inflation has also been higher. At a time of a negative growth in the real GNP, this rate of monetary growth is inexcusably high and consequently, inflationary."

oil, farm products, and other internationally traded commodities, a neutral monetary policy would have required sufficient expansion of the money supply to accommodate these unavoidable price increases and also to accommodate a growth of real output close to the economy's potential growth rate of about 4 percent per year. This would have required monetary growth considerably exceeding that which actually occurred. Thus, monetary policy has not been neutral, but restrictive, reflecting the decision that real output growth should be brought below potential in order to reduce inflationary pressures. Furthermore, our financial markets are characterized by institutional rigidities which prevent all sectors from competing for funds on an equal basis in periods of tight money. Thus, not only has the total growth of real output been held in check, but certain sectors—most notably residential construction—have been thrown into severe decline. Housing starts in July were 38 percent below year-earlier levels.[3]

For the months ahead, monetary growth must be adequate to accommodate the price and wage changes still needed to adjust to the inflationary shocks already experienced and to permit the private investment needed if the economy is gradually to return to a rate of growth in line with its potential. If, as we have recommended, outlays are held to $300 billion, the Federal budget will not be a source of stimulus to the economy, and it is therefore all the more important that monetary policy permit business investment plans to be carried forward, housing to recover, and municipal and agricultural needs for credit to be satisfied. Otherwise, the current sources of strength in the economy will be weakened and real output will decline further instead of recovering. Furthermore, the choking off of business investment through continued tight money would do great long-run damage to the economy by limiting our future potential to produce in line with consumer demands.

Given the expectation that Federal outlays this fiscal year will be held to $300 billion, there should now be a moderate shift toward less restrictive monetary policy so that productive private investment—including housing, agriculture and small business—and State and local investment can support gradual expansion of real output.

Even with some easing of monetary policy, competing sectors will continue to vie for limited available loan funds. If announced capital investment plans are to be realized, business demands for credit will remain strong.

To assure that sectors such as housing, agriculture, public utilities, small business and State and local governments can borrow badly needed funds and that funds

[3] Representative Blackburn states: "The basic causes of our endemic inflation have been excessive monetary expansion over a number of years, in addition to governmental deficit spending. It is erroneous to state that the monetary policy has been restrictive at any point during the past 4 years because the fact is that it was expansionary and primarily responsible for our present rate of inflation. Therefore, we must move gradually to conquer inflation. One of the surest ways of accomplishing that would be by moderation in monetary growth, namely, by bringing annual monetary supply growth to about a 4 percent rate."

flowing to corporate business go into productive rather than speculative uses, a system for channeling credit is required.[4]

The Credit Control Act of 1969 provides that the President can authorize the Federal Reserve "to regulate and control any or all extensions of credit" whenever he determines "such action is necessary or appropriate for the purpose of preventing or controlling inflation generated by the extension of credit in excessive volumes." Implementation of the Credit Control Act could lower the pressure on interest rates while reducing the inequities in the ability of various sectors to obtain funds by channeling credit away from speculative endeavors which are inflationary into productive investments. It is important to recognize that even a moderate easing of monetary policy will not entirely relieve the uneven competition for loanable funds. For the longer run, financial reforms are required to enable different types of borrowers to compete more equally for credit, and we will discuss this further in our December report. For the present, some form of credit channeling would allow the Federal Reserve to maintain a moderate restraint on the money supply while aiding the sectors most strapped by monetary restraint.

Without endorsing any particular approach, there are several measures which the Federal Reserve could consider as a means for channeling credit:

- A capital markets committee could be created to advise the Federal Reserve on the selective extension of credit. To assure that the needs of various economic sectors are given an adequate hearing, this advisory committee should be composed of representatives of the Federal Reserve, other appropriate government agencies, the financial community, business, labor and consumer groups. Such a committee could have a strong impact on lending practices even without any authority to require changes in these practices.
- Under specific criteria established by Congress, the Federal Reserve could pursue a policy of variable reserve requirements. In order to make funds available for housing, for example, the Federal Reserve could lower the reserve requirements for those banks which increased construction or mortgage loans over and above the amount during some base period. A similar reduction in reserve requirements could also be made if bank loans were increased for public utility investment, for small business or other high priority uses determined by Congress.

Housing Credit

In lieu of or in addition to more general approaches to the channeling of credit, the following steps to provide support for the housing industry should be considered:

- The Federal Home Loan Banks, the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation could increase their level of activity in order to channel more funds to the residential construction industry. These federally sponsored agencies, established specifically to redirect capital from other purposes into the housing sector, can quickly serve to partially offset the effects of disintermediation.
- The Federal Reserve Banks, the Social Security Trust Fund and the Civil Service Retirement Trust Fund could increase their purchase of securities issued by the Government-sponsored housing agencies in order to reduce the interest rates these agencies must pay.

[4] See footnotes of Senator Percy and Representatives Brown and Blackburn, p. 6.

Each of the Government-sponsored housing agencies (Federal Home Loan Banks, Federal National Mortgage Association and Federal Home Loan Mortgage Corporation) was created to provide a source of credit for housing to augment the resources of private financial institutions.

When the Government-sponsored agencies were established it was contemplated that they would be able to borrow funds at almost any time because of the resemblance of their securities to the Treasury's. However, in periods of credit tightness, investors differentiate these agency securities from Treasury securities to the extent that the agencies have to pay as much as one percent more in interest, as compared to the interest rates on Treasury securities of similar maturity. The resultant higher interest rates which government-sponsored housing agencies must pay have contributed to the slowdown in housing starts.

This Committee has long urged that the Federal Reserve Banks purchase Federal agency securities as part of their open market operations. Recently, the Federal Reserve Banks have been acquiring Federal agency securities, so that at the end of June 1974 they held $3.1 billion, or 4 percent of the total outstanding. The Federal Reserve should continue its support for agency securities and the trust fund accounts could increase their purchases of them also.

These two steps would by no means solve the multiple problems of the housing industry today. However, together with our general monetary and fiscal policy recommendations, they would at least start the housing industry on its way upward out of its present slump.[5] In its December report, the Committee hopes to make further recommendations, especially with respect to the provision of both rental and owner-occupied housing for low and moderate income persons.

[5] Representative Carey states: "While I agree that one of the problems is certainly tight money, I also believe that careful consideration must be given to low- and middle-income housing construction and rehabilitation to insure that those on limited incomes, particularly the elderly, will be able to find decent, affordable homes, and deteriorating areas will be salvaged. Some form of government subsidy is necessary to encourage low- and middle-income housing construction.

III. PRICE AND INCOMES POLICY

In developing a comprehensive and workable price-wage policy, it is important to recognize that during the past year there has been a transfer of income out of the domestic nonfarm economy. Sharply higher energy prices resulted in higher payments abroad for oil. A significant part of the real income decline in the domestic nonfarm economy can be explained by this and it is largely beyond our control. Further, there was some transfer to the farm sector as a result of higher farm prices. Farm income had remained at low levels for a number of years, and to a considerable extent the increase in income going to the farmer during 1973 was desirable both on equity grounds and to provide incentives for increased production.

As a result of these transfers of income—first to foreign producers of oil, and second, to the farmer—there is a smaller pie, so to speak, which must be divided among the rest of the economy. In proposing price and wage adjustments, business, labor and government must recognize this circumstance and understand no sector can realistically expect to recoup at once all the losses suffered during the past 18 months.

Reducing the rate of inflation will require a social contract between business and labor to exercise restraint in their price and wage demands. If each sector raises its prices or increases its wages to reflect fully the losses in purchasing power during the last year, the economy will be placed on a treadmill of dangerously spiraling inflation.

A return to price stability necessitates a willingness on the part of both management and labor to accept price and wage increases somewhat less than what would be necessary to compensate them completely for inflation plus productivity increases.

Changes in Tax Policy

Government can help make this social contract possible by using the tax system to compensate workers, especially low-income workers, for part of the loss of real income they have recently experienced.

Congress and the Administration should work together to develop and enact a set of tax changes which provide immediate relief to low and middle income workers without reducing the overall revenue raising potential of the tax system.[1]

The tax relief aspect of this package could be achieved in one or more of the following ways:

- Reduction in the social security tax rate or exemption from the social security tax for those below a certain level of income.

[1] See footnotes of Senator Proxmire and Representatives Brown and Blackburn, p. 7.

This offers the advantage of reaching workers whose income is too low to be subject to the income tax. If the employer share of the social security tax were also reduced this would have a direct cost cutting, anti-inflationary effect.
- Allowing taxpayers the option of substituting a $250 tax credit for each $750 personal exemption to which they are presently entitled. Families with annual incomes between $5,000 and $20,000 would be the primary beneficiaries, the overall effect being to increase the progressivity of the tax system.
- Raising the low-income allowance from $1,300 to $1,800 while increasing the standard deduction ceiling from $2,000 to $2,400 and the rate from 15 to 20 percent.

The cost of this tax relief could be offset by:
- Eliminating or reducing some existing tax subsidies such as the oil depletion allowance and foreign tax preferences.
- Strengthening the minimum income tax on those in the highest income brackets.
- Enacting new taxes to discourage wasteful energy use, such as a tax on automobile engines which exceed a certain horsepower.

Council on Wage and Price Stability

The Council on Wage and Price Stability, President Ford's first legislative request, was passed overwhelmingly by the Congress and signed into law August 24, 1974. The Congress has clearly demonstrated its opinion that reimposition of controls, across-the-board, is not advisable at this time. The Council should not be perceived as a first step back toward a rigid controls program. Its power lies not in mandatory authority, but rather in the public's support for the fairness and competence of its findings. We believe that if the Council exercises its mandate with skill and imagination it can make a major contribution to the restoration of price stability.

To fulfill its role in monitoring the social contract the Council on Wage and Price Stability should:

(1) Consult fully and regularly with business, labor and consumer groups.

(2) Recommend appropriate noninflationary behavior for prices, wages and executive compensation on a specific industry-by-industry basis.

(3) Conduct a systematic and continuing review of all practices or procurement policies of the Federal Government which may contribute to inflation.

(4) Recommend actions to eliminate inflationary bottlenecks by increasing supplies of scarce materials or of skilled labor; to increase productivity; and to strengthen competition.

(5) Hold public hearings on particular private or government actions the inflationary consequences of which would damage the national effort to restore price stability.

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(6) Request from both public and private parties all cost, price and profit data or other information necessary to the execution of its responsibilities.[2]

(7) Send formal public notice to both Congress and the President whenever the national effort to restore price stability is seriously threatened by either private or public failure to comply with the Council's guidance or to supply essential information.

In order that the Council on Wage and Price Stability be equipped to carry out these vital tasks:

(1) The Chairman of the Federal Trade Commission and the Assistant Attorney General for antitrust should be made members of the Council.

(2) The appropriation for the Council should be increased substantially.[3]

In some sectors of the economy pressures for wage and price increases threaten to run out of control. One area where the problem is especially severe is health care. During the past 4 months, health care prices have skyrocketed, increasing at a considerably faster rate than the overall Consumer Price Index. From May to July 1974, medical care prices rose 17 percent at an annual rate; hospital rates rose 18 percent; and physicians fees 19 percent. Some of these increases can be explained as a catch-up for past cost increases in food, fuel and wages. However, it is widely assumed that when a national insurance plan goes into effect some restrictions will be placed on hospital and physician fees. A significant part of the current price increases may be explained by the health industry's anticipation that these restrictions will be imposed. If health care prices are allowed to rise even after higher costs have been covered, a national health insurance program will either have to be far more costly than now anticipated or the level of benefits will have to be reduced.

Health care costs must not be allowed to rise in anticipation of a national health program. The Council on Wage and Price Stability should move quickly to develop standards for appropriate price changes in the health care industry.

As we stated earlier, the Council on Wage and Price Stability should develop an incomes policy with the cooperation of business, labor and the public. However, there are several conditions under which Congress should consider an expansion of the Council's authority. These include a worsening of inflation or a continuation for some period of time of the high prevailing rates of inflation.

Further, a refusal of the parties involved to provide data or to cooperate with the Council would signal the desirability of additional legislation. If it becomes necessary, the following options should be

[2] See footnote of Representatives Brown and Blackburn, p. 8.
[3] See footnote of Representative Moorhead and Senator Javits, p. 8.

considered by Congress as a means of strengthening the Council's effectiveness in dealing with inflation:

- The Council could be given the power to subpoena pertinent information on wages, prices, sales, costs, profits, and productivity.[4]
- The Council could be given the power to delay for 30 or 60 days wage or price actions which it wished to examine further or which would be clearly inflationary. During this period, the Council could hold hearings on the prospective increases to arrive at a reasonable, noninflationary adjustment.
- The Council could be given the power to roll back clearly unjustified price increases in concentrated industries when those increases pose a major threat to overall progress toward price stability.

Consumer Action

Pressures of inflation affect all consumers. On the one hand, the consumer is faced with continuing increased costs of food, energy, clothing, and almost all of the items which he consumes. He feels helplessly frustrated by the rising prices. On the other hand, he feels blamed for his demand for commodities in short supply, such as oil, which permit the producers to push the price up further. Recent requests that the consumer should save more out of his already overstrained budget only heighten his sense of frustration.

In the past, consumers and consumer groups have demonstrated that under suitable leadership they could exercise considerable muscle in the marketplace. During the energy shortage of 1973–74, consumers cooperated in the national effort to curtail wasteful consumption by turning down thermostats, extinguishing extra lighting, and driving less and at slower speeds. Consumers also cooperated in reporting violations of price ceilings on gasoline and diesel fuel during the embargo period.

Until now, however, consumers have not been mobilized systematically against excessive prices or other commodity shortages. A proper appeal and organization would give individual consumers a sense of being able to participate personally in a meaningful way in the public interest.

Consumer groups should adopt a watchdog function on the wage-price front. Their influence should be brought to bear selectively against price increases based on scarcity or monopoly power and those imposed by cartels. Government should solicit the collaboration of responsible consumer groups and regard them as allies in wage-price policy.

[4] See Representative Moorhead's and Senator Javits' footnote, p. 8.

IV. HELPING THOSE HURT MOST BY INFLATION

Inflation, especially when it is concentrated heavily in the prices of food and other essentials, is particularly damaging to low-income groups. Unemployment, too, tends to be concentrated among lower income groups. Through its political leaders, the American public has expressed its willingness, however reluctant, to tolerate temporarily above-normal rates of unemployment if that is necessary to bring inflation under control. This being the case, the Federal Government has the responsibility to see that the costs of this unemployment are borne by all and not just by those who are the poorest and least able to defend themselves.

The tax measures discussed in Chapter III would help to share equitably the burdens of fighting inflation. But the poor and the unemployed are often not on the tax rolls. In this chapter we discuss other equity measures needed to aid some sectors of our society until the time when full employment and reasonable price stability can be restored.

Unemployment Compensation

In view of anticipated high unemployment, action should be taken to increase the benefits and extend the duration of existing unemployment compensation programs. In fiscal 1973 a significant number of claimants received less than 50 percent of their average weekly wage. This level of benefits is not adequate to cushion the effects of unemployment. The high rates of inflation which we are now experiencing reduce even further the income maintenance provided to the jobless. Furthermore, existing standards provide for 26 weeks of benefits to the unemployed. An additional period of benefits, up to 13 weeks, is triggered when the insured unemployment rate is 4.5 percent, which corresponds to a national unemployment rate around 6.5 percent. The trigger for individual States may be lower, a seasonally adjusted insured unemployment rate of 4.0 percent. Given the expected increases in the unemployment rate in the next several quarters and the resultant rise in the duration of unemployment, the trigger for extended benefits should be an insured unemployment rate of 3.5 percent (which corresponds to a national unemployment rate of 5.5 percent).[1]

The maximum weekly unemployment benefit should be raised to two-thirds the average wage in each State, and each individual recipient should receive at least 50 percent of his weekly wage, up to the maximum. The duration of benefits should be extended 13 weeks nationwide as soon as the seasonally adjusted insured unemployment rate exceeds 3.5 percent (a national unemployment rate of 5.5 percent).

[1] For a further discussion of this subject, see p. 34 of the 1974 Joint Economic Report.

Public Service Jobs

The experience under the Emergency Employment Act of 1971 has demonstrated that transitional public service employment can be an effective counter-cyclical job training and public service tool without becoming a "make-work" or "dead-end" program, and with an effective transition to "regular employment" thereafter.

The use of public service employment under current and prospective circumstances has already been endorsed by economic policymakers within the Administration, as well as by many independent economists.

Some public service employment programs are already funded under CETA, the Comprehensive Employment and Training Act of 1973, which provides under title I that State and local prime sponsors may fund public service employment programs and provides under title II for a special program for geographic areas having unemployment rates of 6.5 percent or greater for 3 consecutive months.

For fiscal 1975, the Administration has requested $1.3 billion for title I—an undetermined amount of which may be used for public service employment—and $350 million for title II; these funds are currently being considered as a part of the HEW-Labor Appropriations bill for fiscal 1975.

Additionally, the greater part of $620 million appropriated by the Congress under the Comprehensive Employment and Training Act for public service jobs in fiscal 1974 made available this past June will be principally used during fiscal 1975.

The President indicated on September 11 that he had instructed the Secretary of Labor to distribute in September the aggregate of these funds from fiscal 1974 and fiscal 1975 specifically for public service employment. These funds total approximately $1.0 billion for use in fiscal 1975. About 200,000 jobs could be created under this program, if one assumes the Administration's estimated wage of approximately $4,900 per job.

However, looking ahead to a rate of growth in the economy that is well below potential, current funds being channeled into public employment are insufficient to offset the impact of unacceptably high levels of unemployment which now appear probable.

In light of economic forecasts which predict unacceptably high rates of unemployment over the next four quarters, and in view of the President's Economic Summit goal "to define hardship areas requiring immediate action," a program for expanding public service employment should be enacted immediately by Congress.

We believe that a program to create between 500,000 and 650,000 jobs is required. The full year costs of this program might be $4 billion. If enacted immediately, the program could be in effect throughout the last half of fiscal 1975. Outlays in fiscal 1975 would run about $2 billion. If economic conditions warrant, the program may be required through fiscal 1976. As discussed above, total Federal spending should not exceed $300 billion for fiscal 1975; any increased costs of public service employment should be financed through a reordering of spending priorities within the confines of such a budget.

It should be noted that the number of jobs created by labor-intensive programs such as public service employment is significantly greater than when equal expenditures are made for capital intensive purchases such as public works construction or defense procurement.

In the Congress and elsewhere, several proposals for a supplemental public service employment program have been suggested. Clearly, a public employment program should be triggered automatically whenever the national unemployment rate is 6 percent or above for 3 consecutive months. Furthermore, we believe these funds should become available when unemployment is below 6 percent if the President or Congress determines, after reviewing forecasts of economic activity, that unemployment will reach unacceptable levels.

Current forecasts of economic growth and unemployment for the next year are sufficiently pessimistic to warrant an immediate concurrent resolution by the Congress that the public employment program become effective when the unemployment rate reaches 5.5 percent.[2]

To minimize the impact on inflation, the Committee recommends that a system of phased funding be used to implement this public employment program. When the national rate of unemployment reaches 5.5 percent, funds should be made available to create an additional 150,000 jobs.

If the employment rate rises further, to 6 percent or more for a 3-month period, the program should be expanded to a total of 500,000 to 650,000 jobs.[3]

It is important that the public employment program contain safeguards to minimize any substitution of public service jobs for regular unsubsidized State and local jobs. The purpose of the program is to create *additional* jobs. Further, the Committee believes, in keeping with prudent fiscal policy, that it is necessary to establish a means of winding down this new program as the unemployment problem eases and making arrangements for public service employment participants to move into regular employment.

The net, one-year cost of this program is substantially less than its $4 billion gross cost due to the fact that there are significant offsets to the program's outlays. First, an estimated $300 to $350 million will be saved in unemployment compensation. Second, Aid to Families with Dependent Children (AFDC) payments and expenditures for food stamps and Medicaid would decline in proportion to the number of public job holders drawn from the welfare rolls. Finally, additional tax revenues of between $175 and $325 million would accrue to the Treasury because of the higher level of employment and personal income.

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[2] See Representative Reuss' footnote, p. 9.
[3] See Senator Proxmire's footnote, p. 9.

The Distributional Impact of Inflation

Inflation rates during most years since 1946 were sometimes bothersome but largely unnoticed or ignored. Annual increases in prices of 1 to 3 percent do not alter people's values or lifestyles. However, today's inflation rate cannot be ignored. Every American is confronted with price increases which force, to varying degrees, changes in standards of living. Knowledge of the specific impacts of inflation on various groups, such as the poor or the elderly, is essential in any consideration of policy measures to cope with inflation.

In light of this need, it is unfortunate that there is a virtually complete lack of detailed, empirical studies on the distributional effects of inflation. Many studies do exist on the distribution of income but a comprehensive study specifically examining the differential impacts of the recent severe inflation is still lacking. The Joint Economic Committee hopes to undertake or sponsor some studies of this question as part of its mandate under S. Con. Res. 93 and to make the results an integral part of the Committee's final report to Congress at the end of 1974.

But some equity questions deserve the immediate attention of the Administration and the Congress. For example, food prices have increased about 15 percent in the past 12 months and are expected to continue to rise rapidly during the remainder of this year; moreover, food expenses in a poor person's budget occupy a disproportionately large share, ranging from 30 to 65 percent. Prices of staple items in a poor person's diet, such as bread, potatoes, rice, and dried beans, have risen even more than prices of most foods. These increases can be contrasted with the 5.3 percent increase in the average monthly AFDC payment per recipient and the 9 percent increase in the average food stamp bonus value between December 1972 and December 1973.

At present, the food stamp program is adjusted every 6 months to take care of increases in the cost of the "economy food plan." The most recent adjustment was made on July 1, 1974, when the economy food plan for a family of four with two school age children was raised from $142 per month to $150 per month, based on price increases through February 1974. The next adjustment is not scheduled until January 1975 and will be based on food price increases through August 1974. Because of these time lags in the adjustment process, the rapid food price increases expected in the remaining months of this year will not be incorporated into the program until July 1975. On a food budget of approximately $1.25 per person per day, these lags in adjusting to rapidly rising prices can mean serious hardship.

The other group which seems to have suffered more than the average from inflation is the elderly. Food, housing, transportation, and medical care comprise 80 percent of the BLS intermediate income budget for a retired couple. From September 1972 to July 1974, social security benefits increased 11 percent. During the 2 years since September 1972, consumer prices have gone up 18 percent, and living costs for the elderly have probably gone up even more. More specifically, even with the 11 percent increase, the average social security benefits for a retired couple ($3,720) are only equivalent to about two-thirds of the modest standard of living implied by the BLS intermediate budget—(approximately $4,980).

Even though social security benefits have been raised almost 70 percent since December 1969, as many as 4.5 million elderly persons, approximately one-fourth of those over 65 years of age, live in poverty. Because social security retirement benefits for Blacks are, in effect, much lower than those for Whites, the poverty rate for the 2 million elderly Blacks is approximately twice as great as for the elderly White population.

In contrast to the substantial cost-of-living increases for those receiving social security payments, private pensions typically contain no cost-of-living adjustments. This is a particularly severe problem for those elderly who receive no social security and thus depend almost entirely on their pensions. Furthermore, the elderly are the group whose wealth is most vulnerable to inflation in that they hold a high proportion of fixed yield assets. They also find it difficult to supplement their income through part-time work especially in the current job market. Poverty among the elderly will not be substantially reduced even with the Supplemental Security Income Program begun in January 1974, for the SSI income standards in 1974–$149 for individuals and $219 for couples—are still below the poverty indexes.

Enactment of a comprehensive Federal program of income support to replace the present inefficient and inequitable welfare system is long overdue. The Joint Economic Committee's Subcommittee on Fiscal Policy is just completing an exhaustive study of this question and will soon be making comprehensive recommendations. Legislative action in this area should be placed high on the congressional agenda for next year.

The coverage and payment scales of the food stamp program should be adjusted every 3 months for food price changes. The Supplemental Security Income Program should raise its income standards to a level which would eliminate poverty among the elderly. Enactment of a just and dignified comprehensive Federal income maintenance system to replace the present hodgepodge of cash and in-kind programs should receive priority attention by Congress and the Administration in 1975.[4]

[4] See footnotes of Senator Proxmire and Representatives Brown and Blackburn, p. 9, and Representatives Conable and Widnall, p. 10.

V. RESTORING MARKET EFFICIENCY AND DEALING WITH INTERNATIONAL COMMODITY PROBLEMS

Governments exist to serve the interests of their people. Economic systems must meet the same test. When consumers, workers and businessmen alike are subjected to serious inflation because of structural distortions in the economy, such distortions must be removed. To do otherwise creates doubt about the ability of the economy to respond to the needs of the people.

There is abundant evidence that structural distortions are a major contributing factor to our current economic problems. These distortions exist in both the public and private sectors. They hamper the free flow of goods and services both domestically and internationally, restrict and in some cases totally eliminate competition, impose high costs on the consumer and the average businessman, and retard technological progress. While it is not possible to measure precisely the additional cost imposed on consumers by structural distortions, estimates run into billions of dollars annually.

Omnibus Legislation To Strengthen Competition

This chapter discusses a number of specific structural problems requiring attention, especially in the energy and agriculture sectors. It is scarcely possible, however, for us to review all the myriad reforms needed. Special machinery must be set up, not only to identify these reforms, but to insure that the administrative and legislative action necessary to implement these reforms is not delayed.

In the public sector, Federal policies, regulations, subsidies, import quotas, tariffs and price supports pose innumerable obstacles to a smoothly running market economy. For example because of Interstate Commerce Commission [ICC] regulations, a truck, after carrying goods from one city to another, may be required to return empty. Partly as a result of other ICC rules, railroad cars travel about 50 percent of their mileage with no freight. Costly building codes need to be eliminated and could be if the proposed National Institute for Building Sciences were funded. Federal bailouts of large corporations with financial difficulties discourage efficient business practices. Government procurement practices encourage waste and increase costs. Federal subsidy programs, including tax subsidies, were estimated to have cost more than $63 billion in 1970 and have almost certainly grown appreciably since then.

In the private sector, industrial concentration, collusive practices, administered prices, exorbitant profits and anticompetitive behavior must bear a large part of the responsibility for the current inflation. The price increases in the industries where there is a high degree of concentration have been steep. Wholesale prices rose in the past 12 months by the following amounts: fuels and related products and power, 67 percent; chemicals and allied products, 43 percent; rubber and plastic products, 27 percent; metals and metal products, 39 percent; machinery and equipment, 18 percent. Individual industries within these commodity groupings, such as petroleum, coal, and steel raised their prices at even higher rates.

Artificial barriers to employment—age, sex, and race discrimination, excessive formal education requirements, difficulties in obtaining union membership—also push up costs in the private sector. Many of these practices are already illegal under Federal law, but some laws may need strengthening and there certainly needs to be more adequate enforcement.

There is a connection between concentrations of economic power and government laws and regulations which subsidize inefficient operations and interfere with competition. Structural problems in the public sector and those in the private sector are related. Moreover, concentrations of economic power, together with the misuse of political power, have frustrated most efforts to enforce the antitrust laws.

A Commission should be appointed jointly by Congress and the President to recommend comprehensive legislation to eliminate both governmental and private barriers to an efficient market economy.[1] In making its legislative recommendation the Commission should carefully consider the elimination, retention or modification of:

Federal subsidies.
Production quotas and marketing orders.
Price supports.
Excess stockpiles.
Prevailing wage determinations.
Excessive or inept regulation of transportation and communication.
Import quotas and voluntary agreements to curtail imports.
Retail price maintenance,

and other similar governmental impediments to economic efficiency.[2]

The Commission should also consider the strengthening of private competition through actions such as:

Divestiture and reorganization.

[1] See footnote of Representatives Conable and Widnall and Senators Javits and Percy, p. 11.
[2] See footnote of Representatives Brown and Blackburn, p. 11.

Improved antitrust laws and administration, including the transfer of enforcement responsibility to an independent agency.
Removal of artificial barriers to employment.

The Commission should also consider the provision of adjustment assistance for groups of workers severely affected by the transition to a more competitive economy.

The Commission should report within 6 months of its establishment. In appointing the Commission, the President and the congressional leadership should make an advance commitment to introduce the Commission's recommendations in Congress immediately in the form of omnibus legislation and to give it prompt consideration.

The General Accounting Office should be directed to conduct investigations of violations of the antitrust laws and other anticompetitive practices in the Government or the private sectors, and to report its findings to the Antitrust Division of the Justice Department, the Federal Trade Commission, and Congress. Such investigations should supplement and not replace the activities of the Antitrust Division and the Federal Trade Commission.[3]

Improved Economic Management

The inflation of 1973–74 has given us new evidence that the Federal Government is not properly organized to deal with an extremely complicated economy. The private sector is today about twice as large as it was 20 years ago and infinitely more complicated. The public sector has also grown and now profoundly influences the private sector through its subsidy programs, procurement and stockpiling policies, credit programs, and regulatory activities. Furthermore, the U.S. economy is now more closely linked to the world economy as a result of the growing internationalization of production and global competition for scarce resources.

Yet this changed environment in which U.S. economic policy must operate has not been matched by changes in the ability of the Federal Government to formulate policies to deal with it. The Government is surprisingly ignorant about what is actually happening in particular sectors of the economy, the impact of its actions on each sector, and the relationship between the U.S. and world economy. In those cases where

[3] See footnote of Representatives Conable and Widnall and Senators Percy and Pearson, p. 12.

adequate information is available, it is often utilized in a fragmentary way, without a systematic effort to pull available data together in time to formulate appropriate policies. There has also been little effort within the Federal Government to develop any long-range economic forecasting capability to anticipate future problems.

Related to this lack of adequate information is widespread duplication and lack of coordination in the organization of economic policy making. Virtually all Federal agencies presently have some significant role in economic policy. Yet their activities often work at cross purposes, such as when the import quotas were maintained in the face of declining domestic petroleum production, and as when food production restrictions were continued with food shortages developing in 1972. Even when programs and policies are not working at cross purposes, there is no single Federal agency or office to coordinate economic policy.

The President should initiate a major review of this area, utilizing an independent commission if necessary, to determine: (*a*) what new information systems are needed to understand economic developments both at home and abroad; (*b*) how bureaucratic duplication in the formulation and execution of Federal economic policy can be eliminated; and (*c*) in which ways the Council of Economic Advisers' role can be expanded to facilitate the coordination of economic policy.

Increasing Productivity

Increasing productivity (output per unit of input) is by definition the key to increasing our national standard of living. Strong productivity growth will ordinarily translate into increased real wages, whereas sluggish or negative productivity growth implies that any wage increases will tend to show up in higher prices.

Output per man-hour in the total private economy for the second quarter of 1974 is 1.5 percent below the index for the fourth quarter of last year, and almost 2.2 percent below the first quarter of 1973. Although some of this decline can be attributed to the peculiarities of current business conditions, the United States productivity performance has shown a disquieting trend over the longer term. Since 1947 the average rate of productivity growth in the total private economy has been 3.2 percent. However, for the past 20 years the figure is 2.9 percent, and for the past 10 and 5 years, the figures are 2.8 and 2.4 percent respectively.

Economists identify two particular factors contributing to this trend. First, the increases in agricultural productivity which resulted from the substantial migration of labor out of the farm economy during the 1950's and early 1960's can no longer be sustained. Second, the gradual transformation of the United States into a predominantly service economy means that productivity improvements are not as easy to come by, or to measure, as in a goods-oriented economy.

There is also reason to believe that the mechanistic, mind-deadening nature of assembly-line production methods reduces efficiency. While the findings are not conclusive, there are sufficient instances where attention to the human aspects of the workplace has resulted in productivity improvement. Therefore government policies aimed at improving productivity should address both the human as well as the purely economic and technological aspects of the problem. Accordingly, we submit the following recommendations for a national program of productivity improvement:

The President should initiate a nationwide effort to foster increased productivity growth, through the establishment of labor-management councils at the plant, community and industry levels. This effort should include emphasis on the quality of work.

Such an effort would parallel the endeavor made to increase production during World War II, when many thousands of councils were set up in factories and communities across the country. Although the present circumstances do not exactly correspond to the economic situation of the early 1940's, the fact of materials shortages, serious inflationary pressures and a potential national emergency are similar. Such councils would also provide an appropriate and practical follow-through on the consensus for action which we hope will be developed at the September economic summit.

The President should implement a system of productivity incentives in the Federal Government.

Elsewhere in this report we recommend reductions in Federal outlays as part of a total anti-inflation program. If adequate public services are to be maintained, these cuts in spending must be coupled with a hard-nosed effort to improve government efficiency. Studies conducted by the General Accounting Office, together with the Office of Management and Budget, the Civil Service Commission and the National Commission on Productivity, have already identified many areas of Federal Government activity where productivity can be readily measured and enhanced. Several far-reaching approaches to improving productivity, such as the establishment of a revolving capital account, have also been analyzed. This effort, still in the study stage, should be given immediate priority and an improved staff capacity. The use of bonus pay, productivity councils mentioned above, and other techniques for halting creeping bureaucracy should be vigorously implemented.

The President should direct the National Commission on Productivity to conclude its work on the health, transportation, and public administration sectors, and to submit concrete recommendations for productivity improvement at the earliest possible opportunity. Emergency funding should be provided, if necessary.

The Productivity Commission has rightly approached the productivity issue on a sector-by-sector basis. It is necessary, however, to expand the work of the Commission into other sectors (e.g., highly concentrated industries such as autos, steel, nonferrous metals) and to provide comprehensive policy recommendations in the areas now under study. The health area, in particular, deserves special attention. The President should also immediately make public the Commission's recent study and recommendations on the food industry.

While other parts of this report contain recommendations which foster productivity, and additional recommendations which would affect the long run may be made in our final report, we believe that the above recommendations form an effective short-term productivity policy aimed at the immediate inflationary problem.

The Adequacy of Profits and Industrial Investment

Expansion of supplies in bottleneck sectors is an important aspect of any counter-inflation strategy. In the past year, several basic sectors including metals, energy, chemicals and paper have been operating at very high utilization rates. Their prices have risen sharply. This situation reflects mainly the demands of the worldwide economic boom now ending, but also a lag in the expansion of these particular sectors.

It goes without saying that high capacity utilization and the accompanying profits are themselves strong incentives to expand productive facilities. In money terms, profits after tax have jumped to an all-time high; for nonfinancial corporations they were up 28 percent in 1973 and, based on unofficial survey data, they were up another 22 percent on an annual basis in the first half of 1974. The shortage sectors mentioned above enjoyed greater increases, while other industries did less well. These factors have sustained a relatively high level of plant and equipment investment, despite a softening in other spending categories.

Nevertheless, there is much debate about whether profits are sufficient to induce needed future investments. Several witnesses before the Committee have contended that inventory valuation profits should not be counted in judging the adequacy of business incomes, arguing that they are absorbed by the increased cost of replacing the inventory and thus are not available for capacity expansion or distribution to stockholders. They argued also that higher depreciation charges should be deducted from stated profits to take account of the increased replacement cost of facilities. Both of these propositions are debatable. The Committee has asked its staff to investigate further the entire question of profit measurement in an inflationary period. The Committee hopes to address this question in some detail in its December report.

Nevertheless, if inventory profits are excluded, one finds that internal business cash flow in 1973—retained earnings plus depreciation and depletion allowances—still is at an historic high. Deflated for the rise in prices of business fixed investment goods, the purchasing power of 1973 cash flow in basic industries is 12 percent higher than in 1968, the last year of the previous business expansion. Cash flow for 1974 is expected to be greater.

Investment in new plant and equipment also is running at high and rising levels in money terms. Relative to industry's growing output, this investment represents about the same rate of modernization and expansion as in the boom period, 1966 to 1968. Given the widespread assumption that the economy will be growing very slowly for some time to come, it may be that capacity expansion already started will go a long way toward relieving present supply bottlenecks. Investment is exceptionally high relative to cash flow in the utilities sector and in mining. The reverse is true for transportation. (The special problems of certain electrical utilities will be dealt with in the energy section.)

In summary, it is unclear at present whether business cash flow and plant investment are deficient in comparison with past norms and whether long-run capital needs will strain the Nation's financial capacity without legislative changes.

In general, we feel that no special tax incentives are warranted at this time to overcome existing capacity shortages. Any realignment of corporate taxation should be accompanied by corporate tax reform and not carried out at the expense of noncorporate taxpayers.

Agriculture

The present agricultural situation presents difficult challenges for both domestic and international economic policy. Strong world demand for foodstuffs and a greatly reduced level of reserves means that, in the absence of new policies, farm prices will continue to fluctuate sharply around a rising trend. The following facts stand out:

- Disappointing 1974 crops, especially of feed grains, will lead to a new round of sharp increases in food prices. The Department of Agriculture now estimates that retail food prices in 1974 will average 15 percent higher than in 1973. This implies food prices will be rising at a rate of 18 to 19 percent during the second half of this year.
- Benefits to farmers from the recent increases in food prices, although substantial, have been unevenly distributed and, in many cases, only temporary. Net farm income approximately doubled in 1973. For 1974 as a whole, *gross* farm income may exceed the very high 1973 level, but sharply rising production costs are expected to cause *net* income to drop. Even so, net income will likely remain above pre-1973 levels. Not all farmers will share in this continued prosperity however. Drought conditions have caused losses for many grain farmers. Many small livestock producers face severe economic distress.[4] [5]
- High grain prices and uncertain marketing conditions have caused and are continuing to cause disruption of normal meat production. Several years may be required to restore equilibrium in the supply and demand for meat. During this period prices and supplies are apt to fluctuate sharply.
- Worldwide population growth and rising real incomes are creating a strong underlying growth of demand for foodstuffs. In recent years part of this demand has been satisfied out of reserve stocks rather than current production. These reserves have now been substantially depleted.
- Shortages of certain production inputs, especially fertilizer, are intensifying the difficulties of expanding production to meet growing world food demand, especially in developing countries.

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[4] Additional data on food prices and farm income will be found in the appendix to this report.

[5] Senator Proxmire states: "Real farm income in the second quarter of 1974—the latest period for which figures are available—dropped right through the floor, falling from more than $9,000 per farm (in constant 1967 dollars) in 1973 to a bare $6,000. There is no assurance that 1974 farm income will be above the pre-1973 level in real terms."

Intense demand has caused world prices of some types of fertilizer to more than triple during the past year. Two years or more will be required to complete the new plant capacity required to produce enough fertilizer to meet increased demand.

- The sharp reduction in reserve stocks of grain has created a situation of instability in world markets, such that prices fluctuate sharply in response to even small changes in current crop expectations. Until recently, it has been hoped that reserves could be rebuilt from good 1974 harvests. Due in large part to poor feed grain harvests in the United States, these hopes have now evaporated.

Immediate Policy Needs.—With reserves already low and the outlook for this year's crop disappointing, further increases in food prices seem inevitable in the short run. But important steps can be taken both to limit the magnitude of these increases and to ameliorate their most damaging effects. One immediate need is for continued discussions with the West Europeans, the Japanese, and the Russians to insure that their purchase of U.S. food grains this year are held well below the unusually high levels of the past two years. This is discussed further in the section on international trade.

Bumper crops next year are necessary if the United States is to meet domestic demands, replenish stocks, and fulfill its traditional role as a world supplier. Not only must sufficient acreage be placed under cultivation, but a comprehensive program must be undertaken to assure the availability of fertilizer and other scarce inputs. Such a program will impinge on other sectors of the economy. For example, natural gas may have to be diverted from other uses in order to keep fertilizer production at a maximum. Or steel companies may have to be asked to increase their production of products needed on the farm at the expense of other steel products. The Council on Wage and Price Stability is in the best position to evaluate the competing claims of various sectors. The Council should be provided with the authority and the staff resources to carry out this responsibility. S. Res. 289, passed last February, provides Congressional guidance regarding priority allocations for fertilizer production. For fertilizer and other productive inputs which move in world trade, international allocation agreements are also needed. As discussed below, this is an appropriate matter for the World Food Conference in November.

Increased efforts must be made to reduce the constraints on farm output currently imposed by shortages of fuel, fertilizer, and farm machinery and equipment. Investigation of such bottlenecks and ameliorative action—including allocation programs where necessary—should be undertaken on an urgent basis by the Council on Wage and Price Stability.

Improved Efficiency in Food Marketing and Production.—The emphasis of this interim report is on short-term policies, but it also seems appropriate to indicate areas where work can go forward on policies designed to be of long-run benefit in providing adequate supplies of food at reasonably stable prices. In some of these areas we will make more complete recommendations in our final report in

December. One longer run policy which we strongly support is the establishment of food reserves. This should be done on an international basis and is discussed in the section below on international trade.

Export Licensing.—With respect to each of its three major export crops—wheat, corn, and soybeans—the United States has found itself on at least one occasion in the past 2 years in a situation of uncertainty regarding its ability to meet fully export demands. On one occasion an export embargo had to be imposed with consequent damage to our overall relations with major trading partners. Plans should be made now to forestall future repetition of such situations. In this regard, we repeat the recommendation made in our Annual Report last March:

Congress should pass legislation establishing a system for managing exports of critical food and feed when projected market supplies are inadequate to meet domestic needs without drastically increasing prices. The Secretary of Agriculture should be authorized to (*a*) set up an export licensing system for agricultural commodities determined to be in critically short supply; and (*b*) require prior approval of such exports when necessary. If allocation of scarce exports is necessary, the highest priority should be given to countries needing food aid and the next priority to regular export customers.

Commodity Market Regulation.—The futures markets for agricultural commodities serve a valuable economic function. At most times, future trading contributes to price stability. At a time of acute shortage, however, commodity speculation, if not adequately regulated, can further exacerbate price increases. Recent investigations have found that due to inadequate monitoring and regulation, illegally manipulated markets in wheat, eggs, and meat have cost the consumer millions of dollars in inflated prices.

Although the commodity exchanges have grown to a $500 billion annual operation, they are largely self-regulated. Truly amazing is the fact that the fiscal 1972 figure was only $148 billion. The Commodity Exchange Authority of the Department of Agriculture exercises some general supervision, but it has a totally inadequate staff of 160 which has increased only 12 percent since fiscal 1972. In contrast, the stock exchanges, with annual activity of $157 billion from July 1973 to July 1974, are regulated by the Securities and Exchange Commission with a staff of 1,860. As an example of the lack of serious regulation of the commodity exchanges, it took the Commodity Exchange Authority nearly a year to uncover a conspiracy to manipulate the price of egg futures that inflated the retail price of eggs as much as 10 cents a dozen. Legislation to strengthen the Commodity Exchange Authority has now passed both Houses of Congress and been sent to Conference.

The Committee strongly supports reorganization of the Commodity Exchange Authority and increases in its personnel strength and in its authority. The Committee recommends that the regulation of the commodity exchanges can be accomplished most effectively by an agency completely independent of the Agriculture De-

partment and headed by a full-time Commodity Exchange Commission similar to the Securities and Exchange Commission.

Agricultural Research and Development.—The existence of agricultural surpluses during the late 1950's and most of the 1960's created a situation in which little need was felt for research designed to improve crop yields and increase productive efficiency. Now that the need for better yields and increased production is more apparent, it will be necessary to rebuild a strong research capability in this area and to provide adequate funding for a sustained period in order that agricultural research and development can again make the contributions to efficient production which have been so important in the past. The 3-year research program proposed by the Director of U.S. Agricultural Research Stations represents a constructive beginning to restoring a U.S. research capability.

Agricultural research and development, especially research efforts directed at improved crop yields and production efficiency, should be strengthened.

Market Spreads.—Market spreads, the difference between the price paid to the farmer and that paid by the consumer, have grown considerably in 1974. Increases in pork and red meat spreads have been studied by the U.S. Department of Agriculture. While there seems to be no simple explanation for the higher market bill, several issues play a role.

Inefficient marketing structures for several commodities, including the existence of unnecessary middlemen, are key problems. Another problem is inefficient operation by the food marketing industries. Included here are empty backhauls by the transportation companies, unused loading pallets due to inconsistent crate dimensions, and few centralized beef-cutting operations. These are among the questions which should be examined by the Commission on Structural Reform which we have recommended above. They are also questions which this Committee intends to examine further prior to filing our complete report in December.

Energy

Increased energy prices are one of the major contributors to the overall price increases of 1974. It is estimated that oil price increases and their pass-through account for up to one-quarter of the total rise in the price level this year. Even so, the blow to the U.S. economy has been softened by price controls on some domestic crude oil which have suppressed about one-third of the potential increase in oil prices in this country. If and when the oil prices are decontrolled, the price of "old" domestic oil will jump to a level commensurate with world prices. This would send new shock waves through the U.S. economy similar to those emanating from the tripling in world oil prices in the last quarter of 1973. It would probably mean another increase averaging 10 cents per gallon for gasoline; prices of fuel oil and other products also would rise. Such increases would permit the U.S. fuels industry to reap large, new windfall profits.

In addition to forcing up the prices of goods and services containing oil, the higher administered world price for crude oil also is

forcing the prices of coal, gas, and electric power to adjust toward parity with oil. This adjustment is not yet complete. Pressure on prices of these other energy sources will persist as long-term contracts expire and regulatory commissions adjust rates.

Therefore, an important contribution toward stemming U.S. inflation could be made by reducing oil prices. Chairman Burns of the Federal Reserve Board testified before the Committee, moreover, that such a reduction is essential for world financial stability. Yet the producing countries appear to be moving to sustain present prices and even to increase them. There is much evidence of a growing surplus in the world oil market but much more is needed before the negotiated prices will be likely to drop. Reducing U.S. demand for imported oil through a serious conservation effort to eliminate wasteful uses could have a beneficial effect. The following steps are required as part of an effort to reduce oil prices:

The Emergency Petroleum Allocation Act should be maintained throughout the present inflation emergency. Price ceilings on domestic crude oil should not be raised for the present.

The U.S. Government, without fanfare, should strengthen its efforts to bring world oil prices down.

The Government should launch a renewed campaign to conserve energy. Other consuming countries should be kept informed of our conservation efforts and urged to intensify their own.

To expand long-term supply, government should encourage industry to proceed with new techniques to extract energy from conventional and nonconventional resources. While protection for high-cost, experimental projects from future underpricing by foreign producers may be considered on an individual project basis, under no circumstances should the Government guarantee a minimum price for all energy resources through a tariff or other import restrictions.

Many gas and electric utilities are suffering for the first time in history from declines in sales due to big rate increases for fuel costs. These declines automatically boost their unit capital costs and create a case for further rate increases. Interest rates substantially above the utilities' approved rates of return make it difficult to raise the large sums needed for capacity expansion and for increased working capital needs. On the other hand, the cost of facilities expansion to meet future demand growth has risen dramatically.

Prompt analysis should be done to ascertain the reasons for the rapidly rising cost of generating capacity. Any financial assistance to electric utilities should be combined with a requirement to move toward rate structures that constrain peak-period power demands. This would mean

lower average prices per kilowatt hour of power consumed at the cost of spreading consumption more evenly over time.[6]

Inflation Across National Boundaries

Much of the inflation occurring in the United States last year was the consequence of external economic forces. The most notable of these events were the near quadrupling of the price of imported oil during 1973, the massive sales of wheat to the Soviet Union negotiated in 1972, the decline in the foreign exchange value of the dollar that began in 1971 and continued into 1973, and the high level of world demand for a wide spectrum of raw materials.

The inflationary impact of the increase in oil prices imposed by the cartel of foreign producers is obvious. Wheat sales to the Soviet Union decreased the supply available for domestic consumption and for regular export customers. Already high global demand for U.S.-produced soybeans as animal feeds was intensified by the failure in 1973 of the Peruvian anchovy catch.

A fall in the external value of a nation's currency is inflationary in two respects. First, all imports tend to become more expensive. Second, reducing the foreign-currency price of a nation's products tends to stimulate overseas demand for exports. Unless ample unemployed resources are available in export industries, costs and prices tend to rise in response to increased overseas demand. But massive U.S. payments deficits could not be reduced or eliminated without a substantial decline in the foreign exchange value of the dollar.

In 1974 the after-effects of these earlier events still are being felt.

The increase in oil prices especially has produced consequences that will continue for many years. Foreign oil-producing nations, particularly the Arab states, are accumulating revenues in excess of their ability to spend this income on imports and to invest it in productive enterprises overseas. These excess revenues are therefore being placed in a variety of financial investments, but especially in highly liquid, short-term bank deposits and securities. A large proportion of these financial investments are being placed in the United States. While not causing exceptional problems for the conduct of domestic monetary policy, these investments do place a heavy responsibility on the United States to recirculate funds into the international financial system.

American financial institutions are not likely to be squeezed for funds nor is this country likely to suffer severe balance-of-payments strains resulting from the inability to meet the cost of oil and other imports. Financial institutions overseas and foreign countries will, however, not all be so fortunate. Some institutions and some nations will

[6] Senators Javits, Percy and Pearson state: "The huge predicted investment requirements of public utilities indicate that at the least the 4 percent investment tax credit accorded utilities be raised to 7 percent, the level which exists for other industries. Both public and private witnesses have emphasized to this Committee the severe capacity constraints on public utilities, constraints which have already shown up in summer brownouts and which are likely to be repeated with increasing severity even if conservation measures are implemented immediately."

experience severe liquidity shortages. To what extent should the United States aid foreign institutions and entire nations in living with or overcoming these difficulties? To what extent are we willing to run the risk of default by other industrialized oil-importing countries whose imports the United States has financed? These issues will be addressed in our final report.

In addition, the final report will attempt to measure the extent to which inflation in the United States during 1973 and 1974 has been the consequence of external economic events rather than domestically generated price increases. Moreover, we will try to assess the degree to which future inflation in the United States is likely to result from outside events, and what this country can do either to help lower global rates of inflation or to prevent inflationary forces originating in the United States from being transmitted throughout the world.

Since the United States produces almost half of the total output of all industrialized market economies, whatever is done here to combat inflation will have a major impact on other countries. The external effects of policies adopted in the United States should be kept in mind as these policies are designed and implemented. For example, if the United States were to experience a serious recession as a consequence of policies introduced to fight inflation, American's demand for the products of other countries would decline substantially. Some of these nations are heavily dependent on U.S. markets for their exports. For example, 65 percent of Canadian exports and 60 percent of Mexican exports are sold in the United States. Similar percentages of exports to the United States as a fraction of total exports are as follows: 26 percent for Japan; 12 percent for the United Kingdom; 9 percent for Italy; and 8 percent for Germany. Similarly, the United States is influenced more by developments in other countries than is often realized. The 1972–73 expansion in this country was fueled in part by a 25 percent jump in the real volume of exports from mid-1972 to mid-1973. A drop in export demand caused by recession abroad would intensify the current downturn in the U.S. economy.

The United States and other industrialized countries should cooperate to avoid excessively restrictive policies that could produce a serious worldwide recession.

Consultations designed to promote such cooperation are conducted regularly under the auspices of the Organization for Economic Cooperation and Development. Such consultations are especially important at the present time.

An Integrated World Food Policy.—The United States has taken the lead in setting up the World Food Conference to be held in Rome this November. This conference will provide a much needed opportunity to develop international policies on food reserves and on food aid for developing countries.

An international system of food reserves offers the best hope for limiting the range of short-term fluctuation in food prices. Experience of the last few years indicates both the value of maintaining reserve food stocks and the difficulties which are encountered when reserves become depleted. In the past the availability of reserves has been largely an accident stemming from surplus U.S. production. A rational system for the future would consist of the deliberate creation of reserve stocks in all the major importing and exporting countries and the use of these reserves both to hold prices within some reasonable range of fluctuation and to ameliorate famine or acute food needs. In view of the present crop outlook, there is little prospect of actually setting aside significant reserve stocks this year, but it is important that negotiations and enabling legislation move forward so that, when crop conditions do permit the building of reserves, the opportunity will not be lost. Even in the absence of participation by other major nations, the United States should proceed to establish its own system of reserve management.

The Public Law 480 program of donations and concessional sales of surplus U.S. agricultural products was designed to serve the dual purposes of reducing the domestic surplus and meeting world food needs. Congress and the executive branch should cooperate in developing new legislation reflecting changes that have occurred in the world food situation in the past few years. A new U.S. food aid program should be accompanied by an international program to which all wealthy nations contribute. The World Food Conference presents an opportunity to discuss the design of such a program.

At best it will be some years before the developing nations can meet their basic food needs from their own production. Food aid will be necessary during this period, but equally urgent will be assistance in attaining agricultural self-sufficiency. The United States can readily afford to be generous with its technical assistance. More difficult over the next few years will be decisions on the allocation of fertilizer and other scarce productive inputs. These allocation questions should be decided internationally; both American farmers and developing nations need to know how much fertilizer can be made available and at what price.

The United States must take the lead in developing international policies to cope with food shortages. Congress and the Executive should jointly develop a position for the World Food Conference in November that includes the following:

(1) U.S. readiness to participate in a new international program of food and agricultural aid to developing countries. Commitments should include fertilizer and technical assistance as well as food.

(2) Establishment of food reserves in both importing and exporting countries.[7]

[7] Senators Javits and Pearson state: "A food reserve system to deal with acute food shortages is needed and the United States should vigorously pursue with food exporting and food importing nations the very complex means by which such a reserve might be established and administered. Beyond this, a food reserve system intended to stablilize prices would not only appear to be extremely difficult to administer (for both political and technical reasons), but might in the long run have a counter-productive effect. The existence of such a reserve, or the prospect of its establishment, might well create a false sense of security among the food deficient countries thereby dulling the efforts to increase their own production. On the other hand, farmers in food surplus countries like the United States might perceive such a reserve to be a price depressing mechanism and, therefore, hold back in their long term production plans."

(3) U.S. readiness in times of crop failure or temporary shortage, to utilize its reserves to sustain a reasonable level of exports to regular customers and to developing countries facing acute difficulties. The United States should not, however, undertake obligations to sustain exports to developed countries which are themselves unwilling to carry reasonable reserve stocks.

U.S. feed grain crops this year are now expected to be some 15 percent below last year. With carryover stocks already virtually exhausted, both domestic and export use of feed grains will have to be reduced substantially. U.S. exports of feed grains go chiefly to West Europe, Japan, and the Soviet Union. Discussions have been held with representatives of Western Europe and Japan and agreement has been reached that their purchases of U.S. feed grains will be held considerably below last year's levels. The Soviet Union is not presently expected to import significant quantities of feed grains this year, but this situation could change if their own harvest is less than expected. The feed grain situation should continue to be monitored closely. Since the United States exports only about 20 percent of its feed grain crop, international agreement to limit exports will by no means prevent a domestic price rise, but it will contribute to an orderly market and to the maintenance of good relations with our trading partners. Such cooperative efforts by the United States and its traditional foreign customers to share products in scarce supply are entirely in keeping with the following bipartisan recommendation of this Committee that was included in our last Annual Report:

The United States should initiate negotiations to reach multilateral understandings regarding the availability of basic commodities and raw materials. We should seek assured availability of essential materials imports. In exchange the United States should offer potential recipients of food aid and our regular export customers assured access—given prior satisfaction of minimum domestic needs—to supplies of U.S. agricultural products and raw materials.

The example the United States sets in combating inflation domestically, in attempting to increase production of scarce commodities and products, and in cooperatively curtailing demand and sharing temporarily scarce items will be critical in determining the degree of cooperation that can be achieved internationally in fighting inflation. If we adopt a selfish, narrowminded view, we can only expect to be treated in a similar fashion by other countries. The consequence of such behavior would probably be to intensify inflation and increase the risk of a serious global recession.

Appendix. ECONOMIC SITUATION AND OUTLOOK

The gravity of the present economic situation makes it especially important that the Administration, Congress and the public be fully informed as to recent economic developments and the probable economic outlook. Important policy decisions will be discussed at the upcoming economic Summit Conference. Congress may be asked to move rapidly on legislative questions relating to economic policy. Therefore, the Committee is making available the following assessment of the economic situation and outlook, which has been prepared by the Committee staff.

Summary.—Prices as measured by the Gross National Product (GNP) deflator rose at an annual rate of nearly 11 percent during the first half of this year. Real output fell at an annual rate of about 4 percent. The unemployment rate rose from an average of 4.7 percent in the fourth quarter of 1973 to 5.1 percent in the second quarter of 1974 and has since risen further to 5.4 percent in August.

Most forecasters expect real GNP to remain essentially flat in the second half and prices to continue to rise at a rapid rate of anywhere from 9 to 12 percent. Unemployment is expected to rise further, averaging between 5½ and 6 percent for the remainder of the year. For the year 1974 as a whole, real output is expected to be down 1 percent or more from the 1973 average, while prices may rise 10 percent or more from the 1973 average.

Economic developments in 1975 are, of course, much more difficult to predict, especially as policy decisions taken in the remainder of this year could have a significant impact on the course of events in 1975. Private forecasts available at the present time, which for the most part assume no major shift from current policies, suggest a change in real output within the range of −0.5 to +1.5 percent for the year as a whole and an increase in prices of anywhere from 7 to 10 percent. This forecast implies that unemployment would continue to increase steadily, with the unemployment rate well above 6½ percent by the fourth quarter of 1975.

Developments Over the Past 12 Months: Gross National Product.—GNP rose $109 billion, or 8.6 percent, in current dollars from the second quarter of 1973 to the second quarter of 1974. After adjustment for price increase, however, the real volume of goods and services fell about 1 percent. Table 1 summarizes the changes in real GNP by major sectors.

TABLE 1.—MAJOR COMPONENTS OF GROSS NATIONAL PRODUCT (PERCENT CHANGES, SEASONALLY ADJUSTED ANNUAL RATE, CONSTANT 1958 DOLLARS)

	1972:IV to 1973:II	1973:II to 1973:IV	1973:IV to 1974:II
Total GNP	+5.8	+2.0	−4.0
Final sales	6.1	−.9	−1.2
Personal consumption expenditure	+4.3	−2.7	−1.3
Business fixed investment	+16.9	+3.6	+1.0
Residential construction	−4.0	−23.6	−25.6
Federal purchases	−5.0	−4.5	−.4
State and local purchases	+5.8	+7.3	+.4
Gross domestic product	+5.8	+2.0	−3.9

Source: Department of Commerce.

As can be seen in Table 1, real output grew rapidly in the early part of 1973, but the rate of growth slowed abruptly in the second half of the year, with the real volume of final sales actually declining. This decline in final sales was masked by an unusually large accumulation of business inventories. Measured in 1958 dollars, the rate of inventory accumulation increased from $7.8 billion in the second quarter of 1973 to $20.0 billion in the fourth. In the first half of this year, final sales fell slightly more rapidly more than in the second half of last year, and an accompanying drop in the rate of inventory accumulation caused total GNP to fall rather sharply. The pattern of Gross Domestic Product, which measures output produced within the geographic boundaries of the United States, has conformed quite closely to that of GNP over the past 18 months.

The decline in real output in the past 12 months has been concentrated in the consumer, residential building, and Federal sectors. Some part of the weaknesses in the consumer sector is attributable to the sharp drop in automobile purchases following the Arab oil embargo last fall. Consumer spending on new domestically produced automobiles in the second quarter of 1974 was 25 percent less in real terms than it was a year earlier. However, other areas of consumer spending have also been weak in recent quarters. If gasoline, motor oil and auto purchases are excluded, other consumer purchases have dropped about 0.4 percent during the past four quarters.

The sector of the economy which has shown the sharpest decline, of course, is residential construction, where real output in the second quarter was 25 percent below year earlier levels. In real terms, Federal purchases in the second quarter were 2.4 percent below year earlier levels while State and local purchases were up about 3.8 percent. However, real State and local purchases are estimated to have fallen slightly from the first to the second quarters of this year, the only such decline since the first quarter of 1962.

Business fixed investment continued to increase in real terms during the past four quarters, but the rate of increase, especially in the first half of this year has been less than many observers had anticipated.

Wages, Prices and Productivity.—Prices as measured by the GNP deflator rose 9.7 percent from the second quarter of 1973 to the second quarter of 1974. Within this period, as shown in Table 2, the overall rate of increase was considerably sharper in the first half of 1974 than in the preceding 6 months.

TABLE 2.—WAGES, PRICES, AND PRODUCTIVITY (PERCENT CHANGES, SEASONALLY ADJUSTED ANNUAL RATE)

	1972:IV to 1973:II	1973:II to 1973:IV	1973:IV to 1974:II
GNP deflator	6.4	8.5	10.9
Deflator for gross private product	6.4	8.7	11.5
Consumer Price Index:[1]			
All items	8.0	9.7	12.6
Food	21.5	18.6	10.9
Nonfood commodities	4.7	5.6	15.9
Services	4.0	8.4	10.1
Wholesale Price Index:[1]			
All commodities	20.2	10.9	18.2
Industrials	10.6	10.9	34.0
Farm products, processed foods and feeds	45.8	10.4	−11.5
Output per man-hour[2]	1.6	−.3	−4.0
Compensation per man-hour[2]	8.2	7.7	9.5
Unit labor costs[2]	6.6	8.1	13.9

[1] Measured from last month of one period to last month of next period.
[2] Private nonfarm economy.

Sources: Department of Commerce, Bureau of Labor Statistics.

Food prices, however, have followed an opposite pattern. Thus, in contrast to 1973, inflation in the first half of 1974 was led by increases in the price of nonfood commodities.

The decline in farm prices which prevailed in the first half of this year was reversed in July and August, with the wholesale price index for farm products, processed foods and feeds rising about 14 percent in just those 2 months, thus essentially regaining the extraordinarily high level of August 1973. Wholesale industrial prices continued their sharp advance in July and August and have now been rising at an annual rate in excess of 30 percent ever since last March.

Table 2 also shows the accelerating trend in unit labor costs. This trend was caused by the decline in output per man-hour rather than by any marked acceleration in labor compensation. The rate of increase in compensation per man-hour fluctuated within a fairly narrow range during the 18-month period shown in the table. However, productivity, as measured by output per man-hour, has declined steadily for the past five quarters reflecting reductions in output unaccompanied by any reduction in man-hours. In the first half of 1974 this produced a situation in which unit labor costs rose at the extraordinary rate of 14 percent.

Worker compensation, whether measured by the quarterly figures shown in Table 2 or by any of several available monthly series, rose more slowly than consumer prices, meaning that real wages declined from mid-1973 to mid-1974. Table 3 summarizes recent wage changes both in current dollars and after adjustment for consumer price increases.

TABLE 3.—WAGES (PERCENT CHANGE, SEASONALLY ADJUSTED ANNUAL RATE, PRIVATE NONFARM ECONOMY

	December 1972 to June 1973	June 1973 to December 1973	Decembe 1973 to June 1974
Hourly Earnings Index:[1]			
Current dollars	5.9	7.4	8.9
1967 dollars	−2.0	−2.2	−3.1
Average weekly earnings:			
Current dollars	7.1	7.3	6.4
1967	−.8	−2.2	−5.5

[1] Adjusted for overtime (manufacturing only) and interindustry employment shifts.

Source: Bureau of Labor Statistics.

The data in Table 3 show a relatively moderate rise in hourly earnings measured in current dollars in the first half of this year. Data for the most recent 3 months available (May, June, July) show a more marked acceleration, with the hourly earnings index rising at an annual rate of 11 percent. This rise, however, has barely kept pace with the rate of price increase. Real hourly earnings have remained essentially unchanged since March and are still more than 3 percent below year earlier figures.

Employment and Unemployment.—As indicated above, the decline in man-hours worked in the first half of this year was less than the decline in output, leading to a drop in productivity as conventionally measured. A similar pattern is apparent in the data on employment and unemployment. Despite declining output, total employment rose slightly in the first half. As can be seen in Table 4, the rise was insufficient to keep pace with growth of the labor force, so that unemployment rose.

TABLE 4.—LABOR FORCE AND EMPLOYMENT (PERCENT CHANGES, SEASONALLY ADJUSTED ANNUAL RATES)

	1972 IV to 1973 II	1973 II to 1973 IV	1973 IV to 1974 II
Civilian labor force:			
Total	3.0	3.3	1.7
Adult men	1.2	2.5	.8
Adult women	5.1	3.3	4.0
Both sexes, 16 to 19 yr	6.9	8.1	−1.5
Employment:			
Total	3.8	3.7	.7
Adult men	1.8	3.1	−.2
Adult women	6.1	3.3	3.3
Both sexes, 16 to 19 yr	8.8	9.2	−3.2

Source: Bureau of Labor Statistics.

As can also be seen in Table 4, the labor force grew much more slowly in the first half of 1974 than it had in the previous 6 months. The slowing, however, was limited to adult males and teenagers. The adult female labor force continued to grow rapidly. Patterns in the growth of employment were similar, with employment of adult men and teenagers actually declining while employment of adult women continued to expand strongly. This differential pattern can probably be explained at least in part by the continued growth of employment opportunities in retail trade and in State and local government, sectors which employ a high proportion of women. Employment in the automobile industry, which employs a high proportion of men, declined.

For each of the three age and sex groups the data suggest that labor force participation is highly sensitive to employment opportunities. Since those who drop out of (or fail to enter) the labor force are not counted among the unemployed, changes in measured unemployment, as shown in Table 5, by no means reflect the full magnitude of the change in labor market conditions during the past year.

TABLE 5.—SELECTED UNEMPLOYMENT RATES

[Average during period]

	January–June 1973	July–December 1973	January–June 1974	July–August 1974
All civilian workers	5.0	4.7	5.2	5.4
Adult men	3.4	3.0	3.5	3.7
Adult women	4.9	4.8	5.1	5.2
Both sexes, 16 to 19 yr	14.7	14.3	15.2	15.8
White	4.5	4.2	4.7	4.8
Nonwhite	9.0	8.9	9.2	9.3

Source: Bureau of Labor Statistics.

Federal Budget.—On a national income account basis, the Federal budget was essentially in balance in the first half of 1974. As shown in Table 6, there has been no significant deficit since the first half of 1973.

TABLE 6.—FEDERAL RECEIPTS AND EXPENDITURES

[National income account basis, billions of dollars, seasonally adjusted annual rate]

	1973, 1st half	1973, 2d half	1974, 1st half
Receipts	252.1	265.1	285.5
Expenditures	261.3	267.0	286.3
Surplus or deficit (−)	−9.2	−1.9	−0.8

Source: Department of Commerce.

Had the unemployment rate been at the 4 percent conventionally used to estimate the full employment budget, there would have been a surplus of around $10 billion in fiscal 1974. In fiscal 1975 this surplus may rise to around $15 billion.

On a unified basis, receipts in fiscal 1974 were $264.8 billion and outlays $268.3 billion, for a deficit of $3.5 billion. The latest official outlay estimate for fiscal 1975 is $305.4 billion. Receipts are estimated at $294 billion, for a deficit of $11.4.

Agricultural Situation.—Tables 7, 8 and 9 below present information on important aspects of the current agricultural situation. Table 7 presents the recently revised data on income received from farming and illustrates the dramatic jump in net income from 1972 to 1973 and the subsequent partial decline toward more normal levels.

Table 8, based on the Department of Agriculture's August crop estimate, illustrates the very short supply of feed grains expected this year.

Table 9 presents estimates of world grain production and consumption. It can be seen that in 4 of the last 6 years, consumption has exceeded production, with the cumulative effect that carryover stocks have dropped from 24 to 11 percent of consumption. In 1974–75, with carryover stocks already too small to permit much further drawing down both production and consumption are expected to fall by between 2 and 3 percent.

TABLE 7.—INCOME RECEIVED FROM FARMING[1]

	Realized gross farm income		Farm production expenses		Net income to farm operators	
	Billions of dollars	Percent change	Billions of dollars	Percent change	Billions of dollars	Percent change
1971	60.6		47.6		14.4	
1972	69.9	+15.3	52.4	+10.1	18.4	+27.8
1973	97.0	+38.7	64.7	+23.5	36.2	+96.7
1974, 2d quarter[2]	98.4	+5.6	74.5	+18.4	26.9	−19.2

[1] Includes Government payments. Net income includes inventory change.
[2] Seasonally adjusted annual rate. Percent changes are from 2d quarter 1973.

Source: U.S. Department of Agriculture.

TABLE 8.—U.S. FEEDGRAIN SUPPLIES, USE, AND CARRYOVER STOCKS (INCLUDES CORN, SORGHUM, OATS AND BARLEY)

[Millions of short tons]

	Production	Domestic use	Exports	Ending stocks
1970–71	160	155	21	33
1971–72	208	166	27	48
1972–73	200	173	43	32
1973–74 estimated	205	173	44	21
1974–75 projected	175	[1] 155	[1] 27	14

[1] Midpoint of projected range.

Source: U.S. Department of Agriculture.

TABLE 9.—WORLD GRAIN PRODUCTION, CONSUMPTION, AND STOCKS[1]

[Millions of metric tons]

	Production	Consumption	Yearend stocks	Stocks as percent of consumption
Marketing year:				
1968–69	819	790	188	24
1969–70	821	840	169	20
1970–71	819	856	132	15
1971–72	908	889	151	17
1972–73	884	927	108	12
1973–74 projected	967	969	106	11
1974–75 estimated	942	943	105	11

[1] Includes wheat, rye, barley, oats, corn and sorghum.

Source: U.S. Department of Agriculture.

The Economic Outlook for the Second Half of 1974.—Recent forecasts are largely in agreement that real output will grow little if at all in the second half. Little if any diminution of the inflation rate is expected. Table 10 below summarizes three recent forecasts.

TABLE 10.—SELECTED GNP FORECASTS

[Seasonally adjusted annual rate]

	1973:IV to 1974, II actual	1974:II to 1974:IV, forecast		
		DRI [1]	Chase [2]	Wharton [3]
Percent change in major GNP components in constant 1958 dollars:				
Total GNP	−4.0	+0.6	−1.2	−1.4
Final sales	−1.2	+0.8	+0.1	−0.6
Personal consumption expenditures	−1.3	+1.9	+1.1	+0.6
Residential construction	−25.6	−25.0	−13.5	−9.9
Business fixed investment	+1.0	+1.9	+3.5	−2.7
Federal purchases	−0.4	−5.3	−4.3	+0.7
State and local purchases	+0.4	+2.0	+3.6	−0.5
Change in business inventories (billions of 1958 dollars)	9.4	7.7	3.7	−5.0
Percent change, GNP deflator	10.9	9.4	12.4	11.4
Unemployment rate (end of period)	5.1	5.9	5.5	5.9

[1] Data Resources, Inc. Forecast of Aug. 27, 1974.
[2] Chase Econometrics Forecast of Aug. 23, 1974.
[3] Wharton Econometric Forecasting Associates Forecast of Aug. 30, 1974.

All three forecasts shown above predict that final sales will remain essentially flat in the second half. A drop in the inventory accumulation rate will cause total GNP to be weaker than final sales and possibly to fall at a rate of 1 percent or more. The forecasts are in agreement that a further substantial drop in residential construction spending will be a major negative factor. Other sectors may either drop or rise slightly.

In an attempt to assess the possibilities for achieving some improvement in this outlook, the Joint Economic Committee staff has used an econometric model to assess the impact of the fiscal and monetary policies suggested in this report. This exercise suggests that if spending were held to the $300 billion recommended in this report and monetary policy were eased moderately real GNP at the end of 1975 would be about $6 billion higher than it would be in the absence of such action and the rate of inflation would be essentially unchanged. With a larger GNP, tax receipts would increase. Together with the lower spending level this would significantly reduce the Federal deficit. Substantial benefits would accrue to residential construction, with housing starts running at an annual rate about 400,000 above what would otherwise be expected.

Econometric models have many limitations and these results should be taken merely as suggestive of the general magnitude of the effect to be expected from the policies recommended in this report. Econometric models have no ready way of incorporating the results of a price-wage monitoring program or the beneficial psychological effects which might result from decisive government actions. It would be reasonable to conclude that the total positive effect of the combination of policies recommended in this report would be greater than the econometric simulations suggest.

SUPPLEMENTARY VIEWS OF CHAIRMAN PATMAN

I will confine my comments on this Interim Report to monetary and fiscal policy. Such comments as I may have on other aspects of the report will be submitted with the final report.

The current double digit inflation has several additive causes. Chief among them is monetary mismanagement. Fiscal excesses and special factors such as drought and the OPEC-imposed oil price rise may account for changes in the rate of inflation in the short run. But, over a period as long as the one in which the current inflation has been raging, the rate at which the price level rises depends strategically on Federal Reserve policy. Let me point out that from 1965 to mid year 1974 the rate of increase in the Consumers' Price Index was 3.6 percentage points faster per year than in the 1953–1964 period. And also, in the 1965–1974 period the Nation's money supply (publicly held currency and demand deposits) grew 3.7 percentage points per year faster than in 1953–1964 and the Treasury bill rate averaged 280 basis points higher. The connection between the Federal Reserve's money policies, interest rates and inflation should be apparent to all. We can achieve reasonable interest rates and stop inflation only if new money is created at about the same rate as the historic growth of our labor force and its productivity. The Joint Economic Committee has long recommended that the Federal Reserve be guided by this principle, and I see no reason to modify this recommendation. This principle gives adequate leeway for real economic growth but would prevent the Federal Reserve from accommodating and validating current and future inflation spirals through willy-nilly expansion of the money supply.

I am, however, equally concerned that the Federal Reserve will not again become a monetary tightwad, failing to create new money as fast as labor force and productivity grow and thereby causing recessions as in 1953–54, 1957–58, 1960–61, 1966–67 and 1969–70. We have had enough Federal Reserve roller-coaster rides. The proper monetary policy to follow now is one of steady, moderate money supply growth and a gradual easing of interest rates.

Under any monetary conditions, moreover, there are areas of public need which are starved for credit. It is essential that we adopt policies to allocate credit to areas of greatest need such as housing. Such a program of allocation, if properly carried out, will allow the monetary managers to maintain stable policies on money growth and at the same time to alleviate severe hardships.

It should come as no surprise now that I am against trying to check inflation by tinkering with the budget. We should of course continually strive for better economy and efficiency in the Government sector. Every penny of waste and fat in the budget should be cut as fast as it can be found. But we deceive the people when we report that fiscal deficits are to blame for inflation and recommend cutting the budget as the way to check it. The budget has become less and less expansionary since 1971 and is not now inflationary by any reasonable standard. The NIA Federal deficit fell from $22 billion in 1971, to $17.5 billion in 1972, and then to annual rates of $9.2 billion in the first half of 1973, $1.9 billion in the second half of 1973 and $0.8 billion in the first half of 1974.

There are many essential government programs that remain underfunded or unfunded. It would be a grave error for us to sacrifice housing programs, transit needs, health care, clean air and water, and necessary education and welfare programs to the false demonology of cutting the budget to achieve a balance which already virtually exists. We must make only those cuts in the budget which cut fat and waste, and must not defer meaningful funding of essential public services. The fight against inflation cannot be won by tilting with windmills, and such battling will only lead to unnecessary sacrifices.

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FOR RELEASE AFTER 6 P.M.
SATURDAY, SEPTEMBER 21, 1974
FOR SUNDAY A.M. PAPERS

CONGRESS OF THE UNITED STATES
JOINT ECONOMIC COMMITTEE

Joint Economic Committee Presents Recommendations
On Reducing Inflation and Restoring Economic Growth

This afternoon (Saturday, September 21) Members of the Congressional Joint Economic Committee presented President Ford with their recommendations for quick action to deal with the country's economic problems. Key recommendations include a reduction in Federal spending to $300 billion, a moderate easing of monetary policy, a strengthened role for the Council on Wage and Price Stability, a major program of public service employment, and the appointment of a commission to draft omnibus legislation to remove impediments to competition.

In releasing the recommendations, Senator William Proxmire (D-Wis.), Vice-Chairman of the Committee, stressed that "These recommendations represent the joint views of the Democratic and Republican members of the Joint Economic Committee. While individual members, including myself, have noted their reservations on some specific points, taken as a whole the degree of unanimity is remarkable. This action program for reducing inflation and restoring economic growth is a program which will command broad support in the Congress and among the public.

"Our report was prepared in response to the hope expressed by President Ford in his first address to Congress on August 12 that the Committee could present recommendations on economic policy within six weeks. We are very pleased that we were able to present these recommendations prior to the Economic Summit next weekend, and we hope they will be fully debated by other participants in these summit meetings. In our report we stress the urgent necessity that these summit meetings be followed by quick and decisive action to deal with a deteriorating economy.

"As our report brings out, it is essential to understand the anatomy of the current inflation. We do not face a typical excess demand inflation, nor a typical cost-push inflation. The inflation has had multiple causes -- many of them international in origin. Furthermore, this inflation increasingly appears also to be the result of administered price increases in

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non-competitive industries. No other factor can fully explain price increases ranging from 40 to 80 percent during the past year in industries such as steel, chemicals and petroleum. Monetary and fiscal policy alone cannot cope with the present inflation. Measures to restore competition -- antitrust action and reform of government regulations -- must be a key element in a program to reduce inflation and restore economic growth.

"This report contains many valuable recommendations. I personally feel that one of the most significant and most original is the recommendation that a Commission be appointed to prepare omnibus legislation to strengthen competition. If all the government impediments to competition -- the Interstate Commerce Commission regulations, the restraints on trade, the Buy America requirements -- and the private defenses against competition -- the monopolistic practices -- can be attacked together in a single anti-inflation bill, it may be possible to rally the political support to make real progress against inflation."

The report contains supplemental views by Committee Chairman Wright Patman. Copies of the report entitled "An Action Program to Reduce Inflation and Restore Economic Growth" are available in the Committee's office, Room G-133 Dirksen Senate Office Building.

# # # #

Members of the Committee:

JOINT ECONOMIC COMMITTEE

(CREATED PURSUANT TO SEC. 5(A) OF PUBLIC LAW 304, 79TH CONG.)

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SUMMARY OF MAJOR RECOMMENDATIONS

The Committee's recommendations are grouped under four hearings: Fiscal and Monetary Policy; Price and Incomes Policy; Help for Those Hurt Most by Inflation; and Restoring Greater Competition to the Economy.

With respect to fiscal and monetary policy, the Committee recommends that Federal spending in the current budget year be held to $300 billion, and that this reduction from present spending estimates be accompanied by a moderate shift toward less restrictive monetary policy.

Within the $300 billion spending total, defense and civilian spending should be cut sufficiently to make room for intial costs of a new public service employment program.

The Committee also expressed the view that a system for channeling credit into sectors such as housing, agriculture, public utilities, small business, and State and local government and into productive rather than speculative corporate investment is required.

With respect to price and incomes policy, the Committee recommends that part of the purchasing power workers have lost to inflation should be restored through tax relief for low and middle-income persons, rather than through larger wage increases. This tax relief should be accompanied by revenue-raising tax reforms so that the overall revenue-raising potential of the tax system is not reduced. Reductions in the social security tax or in the lower brackets of the income tax, coupled with the elimination of unjustified tax subsidies, an increase in the minimum tax on those in the highest income brackets, and the introduction of new taxes designed to encourage the conservation of energy would meet this objective.

The Committee feels that the Council on Wage and Price Stability has a vital role to play in reducing inflation. Its statutory powers are limited, but if it acts vigorously and skillfully and receives public support, it can accomplish a great deal. The Committee recommends a number of actions the Council should take, including industry-by-industry guidance on price and wage behavior and systematic review of government practices which contribute to inflation. The Council should be required to send formal public notice to Congress as well as the President of any serious threat to the anti-inflation program caused by failure to comply with the Council's guidance. The Chairman of the Federal Trade Commission and the Assistant Attorney General in charge of the Antitrust Division should be made members of the Council.

In order to help those hurt most by inflation, the Committee recommends a public service employment program which would be triggered when unemployment reaches 5.5 percent and which would be expanded to a total of 500,000 to 650,000 jobs if unemployment goes to 6 percent.

The Committee also recommends improvements in the unemployment insurance program and in other income support programs.

To restore greater competition to the economy, the Committee recommends that a Commission be appointed jointly by Congress and the President to recommend comprehensive legislation to eliminate both governmental and private barriers to an efficient market economy. The Commission should consider the elimination, retention, or modification of: Federal subsidies, production quotas and marketing orders, price supports, excess stockpiles, prevailing wage determinations, excessive or inept regulation of transportation and communication, import quotas and voluntary agreements to curtail imports, retail price maintenance, and other similar governmental impediments to economic efficiency.

The Commission should also consider the strengthening of private competition through actions such as divestiture and reorganization; improved antitrust laws and administration, including the transfer of enforcement responsibility to an independent agency; and removal of artificial barriers to employment.

The Commission should in addition consider the provision of adjustment assistance for groups of workers severely affected by the transition to a more competitive economy.

The Commission should report within six months of its establishment. In appointing the Commission the President and the congressional leadership should make an advance commitment to introduce the Commission's recommendations in Congress immediately in the form of omnibus legislation and to give it prompt consideration.

The report contains a number of additional recommendations with respect to energy, agriculture, better coordination of economic policy, and achievement of increased productivity throughout the economy. It stresses the importance of maintaining the price ceiling on "old" domestic oil, of revitalizing our energy conservation effort, and of intensifying our efforts to achieve lower world oil prices. It urges that the United States take the leadership in working for an international system of food reserves and an expanded international program of food and agricultural aid for developing countries.